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TAXATION-COMPUTATION OF CAPITAL GAINS

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TAXATION — COMPUTATION OF CAPITAL GAINS — In 1915 petitioner and husband purchased property by the entirety for $13,000. Petitioner contributed 12 per cent of the purchase price and her husband the remaining 88 per cent. In 1924 the husband died, the property at that time having a market value of $40,000. In 1925 petitioner sold the property for this sum. Petitioner, in her income tax return for that year, computed the taxable profit by using the market value of the property at the time of her husband's death with respect to the 88 per cent representing the contribution of the husband to the purchase price. *Held*, that the 1915 value was to be taken as the basis for the whole of the property in computing the taxable profit. *Lang v. Commissioner of Internal Revenue*, 289 U. S. 109, 53 Sup. Ct. 534 (1933).

The federal income tax law provides for the taxation of capital gains realized on the sale of property.[1] Capital gains come within the term *income* as used in the Sixteenth Amendment, and therefore to tax them is constitutional.[2] If property is acquired by gift, the capital gain is the difference between the cost of the property to the donor and the amount it is sold for by the donee.[3] If property is acquired by bequest, devise, or inheritance, the gain is the difference between the fair market value of the property at the time of acquisition by the donee and the amount realized on a sale by him.[4] In *Tyler v. United States*,[5] a provision of the federal estate tax[6] providing for a transfer tax on the interest of a decedent in a joint estate was held constitutional. The contention of the petitioner in the principal case was that in the light of the *Tyler* case the interest of her husband passed to her on his death by bequest, devise, or inheritance. This contention the court properly rejects. The decision in the *Tyler* case rests on the ground that on the death of one of the tenants by entirety, such an accession of rights in respect of the control of the property results to the survivor that the automatic transfer of the interest of the deceased spouse to the survivor can be taxed as a testamentary disposition of property. However, the interest passes by virtue of old common law principles and not by a bequest, devise, or inheritance as these terms are normally understood. The purpose of Congress in distinguishing in the income tax law between gifts and disposition of property by testamentary acts is to prevent the evasion of the tax on capital gains by *inter vivos*

[1] 43 Stat. 256 (1924), 44 Stat. 12 (1926), U. S. C. tit. 26, sec. 934(a) (1926).

[2] Merchants' Loan and Trust Co. v. Smietanka, 255 U. S. 509, 41 Sup. Ct. 386 (1921).

[3] 43 Stat. 258 (1924), 44 Stat. 14 (1926), U. S. C. tit. 26, sec. 935(a) (2) (1926).

[4] 43 Stat. 258 (1924), 44 Stat. 14 (1926), U. S. C. tit. 26, sec. 935(a) (5) (1926).

[5] 281 U. S. 497, 50 Sup. Ct. 356 (1930).

[6] 43 Stat. 305 (1924), U. S. C. tit. 26, sec. 1094(e) (1926).

gifts. Since the death of a tenant by the entirety is necessary to bring about the transfer of his or her interest to the spouse, it is arguable that to define the capital gain on the portion of the property purchased with the funds of the deceased spouse as the difference between the original cost of that portion and the price realized on a sale by the spouse, instead of the difference between the fair market price on the date of death and the sale price, as is done in the case of bequests, devises, and inheritances, involves some unfairness. The remedy, however, as stated by Mr. Justice Sutherland is with Congress and not with the courts.

M. S.