Michigan Law Review

Volume 40 | Issue 3

1942

TAXATION - INCOME TAX - INCLUSION OF UNPAID DIVIDENDS IN DECEDENT'S INCOME

Michigan Law Review

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Recommended Citation
Michigan Law Review, *TAXATION - INCOME TAX - INCLUSION OF UNPAID DIVIDENDS IN DECEDENT'S INCOME*, 40 MICH. L. REV. 481 (1942).
Available at: https://repository.law.umich.edu/mlr/vol40/iss3/21

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TAXATION — INCOME TAX — INCLUSION OF UNPAID DIVIDENDS IN DECEDENT'S INCOME — Decedent owned stock in a corporation whose board of directors declared a dividend on April 30, 1934, for the fiscal year ending January 31, 1935, payable to stockholders of record at such times and in such installments as the directors might determine. At the time of decedent's death, October 15, 1934, only one-half of the dividend had been paid to him, but the commissioner included in the gross income of the decedent for the taxable period prior to death the entire amount of the dividend declared. The Board of Tax Appeals reduced this amount to the portion of the dividend actually paid. On appeal by the commissioner, *held* that the entire amount of the dividend had "accrued" as income before the date of death, and hence must be included in gross income for the taxable period in which death occurred. *Commissioner of Internal Revenue v. Cohen,* (C. C. A. 5th, 1941) 121 F. (2d) 348.

The second sentence of section 42 of the Internal Revenue Code provides that in case of death there shall be included in a decedent's income "amounts accrued up to the date of his death." [1] This sentence was added to the act in

[1] "In the case of the death of a taxpayer there shall be included in computing net income for the taxable period in which falls the date of his death, amounts accrued up to the date of his death if not otherwise properly includible in respect of such period or a prior period." 48 Stat. L. 694, § 42 (1934), 26 U. S. C. (1934), § 42; Treas. Reg. 103, § 19.42-1 (1940).

1934 and is intended (1) to equalize the tax burden as between persons using a cash receipts accounting method and persons using an accrual accounting method,[2] and (2) to reach all income earned during the life of a taxpayer which would otherwise escape the income tax. Since 1934 the first purpose has been recognized by decisions holding that section 42 compels the personal representative of decedent to use an accrual accounting method for the taxable period in which decedent died,[3] whereas formerly income of decedents, accrued but unpaid at death, escaped taxation completely, because decedent made his return on a cash disbursements basis.[4] The second purpose seems to have escaped attention until this year, when *Helvering v. Estate of Enright*[5] was decided, this being the first of a series of cases reversing the Board of Tax Appeals in the construction of this sentence. Interpretation of the sentence centers in the word "accrued," which the Board of Tax Appeals construed to include as income all items which a living taxpayer, using the accrual accounting method, would normally insert in his return.[6] This interpretation has been displaced by one

[2] For the intent of Congress, see Estate of G. Percy McGlue, 41 B. T. A. 1186 (1940), reversed in Helvering v. McGlue's Estate, (C. C. A. 4th, 1941) 119 F. (2d) 167; Herder v. Helvering, (App. D. C. 1939) 106 F. (2d) 153; Bach v. Rothensies, (D. C. Pa. 1941) 37 F. Supp. 217; also H. REP. 704, 73d Cong., 2d sess. (1934), p. 24 (Ways and Means Committee); S. REP. 558, 73d Cong., 2d sess. (1934), p. 28 (Committee on Finance). For accounting methods, see Treas. Reg. 103, § 19.41 (1940).

[3] "It is obvious from the language of the act and the legislative intent as disclosed by the committee reports . . . that the purpose of Congress was to treat the income of a decedent as though he were on an accrual basis even though he was actually on a cash basis and kept his books on a cash basis, and that the phrase 'amounts accrued up to the date of his death' means those amounts which would be properly included in a decedent's income if he were on an accrual basis as distinguished from a cash basis." Fehrman v. Commissioner, 38 B. T. A. 37 at 42 (1938). See Treas. Reg. 103, § 19.142-6 (1940), regarding executors' returns.

[4] Before the accrual sentence was added to § 42, it was held that dividends declared but not yet paid were not to be included in the decedent's income. Sharp v. Commissioner of Internal Revenue, (C. C. A. 3d, 1937) 91 F. (2d) 802. This decision was followed by the Board of Tax Appeals even after the addition of the accrual sentence in Estate of G. Percy McGlue, 41 B. T. A. 1186 (1940), reversed in Helvering v. McGlue's Estate, (C. C. A. 4th, 1941) 119 F. (2d) 167 and in the principal case. Estate of Cohen, B. T. A. memorandum opinion, Dec. 11, 262-B, 3 C. C. H., FEDERAL TAX SERVICE, ¶ 7081-R (1941). In neither case did the board have the Supreme Court decision in Helvering v. Estate of Enright, 312 U. S. 636, 61 S. Ct. 777 (1941), before it.

[5] 312 U. S. 636, 61 S. Ct. 777 (1941). In still another case on facts like the principal case, the Enright decision was anticipated by a district court. First Nat. Bank & Trust Co. v. Glenn, (D. C. Ky. 1941) 36 F. Supp. 552. The district court rejected Sharp v. Commissioner of Internal Revenue, (C. C. A. 3d, 1937) 91 F. (2d) 802 and the B. T. A. decision in Estate of G. Percy McGlue, 41 B. T. A. 1186 (1940).

[6] Compare with the definition in note 3, supra, the following definition of "accrued," used by the courts to determine whether a taxpayer making returns on an accrual basis must return an item in a certain year: "The complete definition would therefore seem to be that income accrues to a taxpayer, when there arises to him a

more literal and presumably more in accord with the intent of Congress, that every income item of a decedent shall at some time have been subjected to the income tax.[7] As enunciated in the *Enright* case and clarified in succeeding decisions, the new construction holds that any claim of a decedent, even though contingent, which is capable of valuation and which he may reasonably expect to collect, at least in part, will be included in his gross income.[8] Thus, items which are too indefinite for inclusion as realized income, even by a living taxpayer on an accrual accounting basis, are to be returned as income earned by the decedent.[9] Where, as in the principal case, dividends have been declared but

fixed or unconditional right to receive it, if there is a reasonable expectancy that the right will be converted into money or its equivalent." H. Liebes & Co. v. Commissioner of Internal Revenue, (C. C. A. 9th, 1937) 90 F. (2d) 932 at 938.

[7] Reed, J., in Helvering v. Estate of Enright, 312 U. S. 636 at 644-645, 61 S. Ct. 777 (1941): "It has been frequently said, and correctly, that § 42 was aimed at putting the cash receipt taxpayer on the accrual basis. But that statement does not answer the meaning of accrual in this section. Accounts kept consistently on a basis other than cash receipts might treat accruals quite differently from a method designed to reflect the earned income of a cash receipts taxpayer. Accruals here are to be construed in furtherance of the intent of Congress to cover into income the assets of decedents, earned during their life and unreported as income, which on a cash return, would appear in the estate returns. Congress sought a fair reflection of income." Quaere: Does Justice Reed mean that the cash accounting taxpayer will be treated more strictly than an accrual taxpayer? What about an item unreported as income even by an accrual taxpayer which nevertheless appears in the estate returns?

[8] "Accrued income . . . includes the value of the services rendered by the decedent, capable of approximate valuation, whether based on the agreed compensation or on quantum meruit." Helvering v. Estate of Enright, 312 U. S. 636 at 645, 61 S. Ct. 777 (1941). The item here included was the value of unfinished work of partnership of which decedent was a member.

Items which the courts have found included in income are: executor's fees earned but not yet approved by the probate court, Helvering v. McGlue's Estate, (C. C. A. 4th, 1941) 119 F. (2d) 167; uncollected doctor bills in firm accounts where decedent was a member of a medical partnership, Pfaff v. Commissioner of Internal Revenue, 312 U. S. 646, 61 S. Ct. 783 (1941); uncollected lawyer's fees, Estate of Wilton J. Lambert, 40 B. T. A. 802 (1939); stocks belonging to decedent which have been sold by a bank and applied to decedent's debts, Kelleher v. Commissioner of Internal Revenue, (C. C. A. 9th, 1938) 94 F. (2d) 294.

Items which the courts have found not included in income: salesman's contractual right to a percentage of renewal premiums on insurance policies which the holders were not obliged to renew, Seattle First Nat. Bank v. Henricksen, (D. C. Wash. 1938) 24 F. Supp. 256, appeal dismissed, Henricksen v. Boyns, (C. C. A. 9th, 1939) 100 F. (2d) 1015; store manager's right to a percentage of profits, payment of which was delayed at option of the company until after death, Fehrman v. Commissioner, 38 B. T. A. 37 (1938). In view of the Enright case these decisions are are probably no longer authoritative.

[9] "Had respondent been alive, and had he kept his books on the 'accrual basis' . . . we should feel obliged to uphold the Board's findings that the executors' fees could not have accrued prior to the allowance and approval of these fees by the probate court. . . .

"However, our interpretation of section 42 . . . is directly controlled . . .

no date of payment has as yet been set, or where dividends have been declared but made payable to stockholders of record at a date subsequent to the date of death, the statute as now interpreted clearly seems to encompass such items as income earned during the tax period in which the taxpayer died. The statute, although in its terms equitable, may in practice operate harshly on the taxpayer using a cash receipts accounting method, since the "bulge" in his income for this last taxable period due to the inclusion of accrued items may subject it to higher surtaxes. In view of the progressively steeper rates, especially in the middle income brackets, taxpayers may well be advised to change from a cash receipts accounting method to an accrual method in order to minimize the tax burden at death.[10]

by the very recent holding of the United States Supreme Court in Helvering v. Estate of John M. Enright. . . .

"Hence, while a living taxpayer on the accrual basis might not record the instant fees as accrued income, yet under Helvering v. Estate of John M. Enright, we think the fees must here be treated as 'accrued' and, therefore, taxable." Helvering v. McGlue's Estate, (C. C. A. 4th, 1941) 119 F. (2d) 167 at 169, 170.

[10] The accrual method will spread this income over some few years before the date of death, thus minimizing the tax. For discussions of § 42 before the Enright case, see Parlin, "Accruals to Date of Death for Income Tax Purposes," 87 UNIV. PA. L. REV. 295 (1939), and Farrand and Farrand, "Treatment of Accrued Items in the Event of the Death of a Taxpayer," 13 So. CAL. L. REV. 431 (1940).