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Federal Income Taxation: Relation of Tax Valuation to Income Tax Basis

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standard in the *Stan-Jay Auto Parts* case.[15] It rejected the union's disclaimer of responsibility for the disruption of deliveries, holding that there is no legislative history to justify so qualifying the word "effect." The union reasonably should have anticipated that the picket line would induce employees to refuse to cross it, said the Board, and the union took no steps to insure that the picket line would not have this normal effect. Therefore, the Board held that, whatever may have been the union's subjective intent, at least objectively the picketing was intended to disrupt services.

If the "normal effect" of the picket line is to deter outsiders from crossing it, then it appears that the "intent" factor will be disposed of as it was in the *Stan-Jay Auto Parts* case, and the primary question in the *Stork Club* case and in future cases will be whether the effect is "substantial," i.e., is the refusal of one, two, or three outside workmen to cross the picket line sufficient to proscribe all informational picketing? The answer to these and the myriad other questions involved in Section 8(b)(7) remain to be determined by the Board and the courts.[16]

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Federal Income Taxation: Relation of Estate Tax Valuation To Income Tax Basis—In 1939 plaintiffs, a brother and sister, inherited from their father 510 shares of stock in a closely held Brazilian corporation. At the time of this acquisition they were respectively 15 and 12 years of age. The stock was valued by local appraisers at par value which amounted to $11,857.50 when converted at the existing exchange rate. The executors of the estate used this valuation for estate tax purposes, but also submitted a consolidated balance sheet of the company, showing the book value of the stock to be $273,686.40.

A deficiency was assessed against the executors in 1943. However, the only upward valuation relating to the stock in question was an $11,857.50 increase based upon the use of an incorrect conversion rate in 1939. The stock was sold by the plaintiffs in 1947 for $258,948.20. The basis used for computing long-term capital gain was $27,618.04.[1] Subsequently a suit for refund was filed, wherein the plaintiffs contended that the fair market value of the shares in 1939 was $331,418.40, and thus in excess of the price realized at sale. They presented evidence indicating that their alleged basis[2] was, in fact, actual market value in

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[15] *Supra* note 11.

[16] For a discussion of some of the other problems under Section 8(b)(7), see McDermott, *Recognitional and Organizational Picketing under Amendments to the Taft-Hartley Act,* 44 Marq. L. Rev. 1 (1960).

[1] This figure is slightly higher than the amended estate tax valuation of $23,715, however, the court offered no explanation for the increase.

[2] Since the amount of $331,418.40 is considerably higher than the 1939 book value, apparently the plaintiffs' evidence embodied more than this. The opinion gives no indication as to what constituted the additional evidence.

1939. *Held:* The taxpayers were permitted to adjust the basis and were allowed recovery of the 1947 overpayment; the Government's defenses of estoppel and conclusiveness of the estate tax valuation were invalid. In addition the court interjected the possibility of allowing the Government to recoup the underpaid estate tax against plaintiffs' claims for a refund. This was ultimately rejected with two judges dissenting on the denial of recoupment and one on the estoppel decision. *Ford v. U.S.,* 276 F. 2d. 17 (Ct. Cl. 1960).

In attempting to confine the plaintiffs to their original basis valuation, the Government relied upon the Commissioner's interpretation of the applicable statutory provision,[3] as set forth in the Treasury Regulations: "The value of property as of the date of the death of decedent as appraised for the purpose of the Federal estate tax—shall be deemed to be its fair market value at the time of acquisition."[4]

The court followed the generally accepted interpretation of this Regulation, by affording the estate tax valuation prima facie weight as evidence of fair market value.[5] The conclusiveness of the valuation has frequently been rebutted both by taxpayers[6] and by the Government.[7] In light of the plaintiffs' uncontroverted evidence, the rejection of the Government's contention was virtually inevitable. Although an

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[3] Int. Rev. Code of 1939 Sec. 113 (a) (5) "The basis of property shall be the cost of such property except that . . . (5) Property transmitted at death. If the property was acquired by bequest, devise or inheritance . . . the basis shall be the fair market value of such property at the time of such acquisition." Int. Rev. Code of 1954 Sec. 1014 is applicable today. It specifies that the fair market value of the property at the date of death or the optional valuation date is controlling, as opposed to "the time of acquisition" under the 1939 provision. This constitutes a clarification rather than an alteration, since by judicial interpretation the time of acquisition was deemed date of decedent's death. See Elizabeth G. Augustus, 40 B.T.A. 1201 (1939).

[4] U.S. Treas. Reg. 111 Sec. 29.113 (a) (5) -1 (c) (1943); U.S. Treas. Reg. 118 Sec. 39.113 (a) (5) -1 (c) (1953); U.S. Treas. Reg. Sec. 1.1014-2 (a) (5) (1958).

[5] "Except where the taxpayer is estopped by his previous actions or statements, such value is not conclusive but is a presumptive value which may be rebutted by clear and convincing evidence". 3A Mertens, Law of Federal Income Taxation Sec. 21.95 at 248, 249 (1958).

[6] In Estate of Virginia Evans Devereux, P-H 1948 TC Mem. Dec. Par. 48,208 (1948), petitioner was allowed to change her estate tax valuation of real proprety. The testimony of two real estate experts was decisive in allowing the upward valuation. So also in McCahill v. Helvering, 75 F. 2d 725 (8th Cir. 1935) the appraisal of an expert was sufficient to overcome the presumption established by the estate tax valuation. But see McEwan v. Commissioner, 241 F. 2d 887 (2nd Cir. 1957) where the testimony of the taxpayer's stock experts was not given effect when it contradicted a detailed analysis of the corporate structure furnished the Commissioner by another valuator. Generally see Plaut v. Munford, 188 F. 2d 543 (2nd Cir. 1951), and Elizabeth G. Augustus, 40 B.T.A. 1201 (1939).

[7] Helen S. Delone, 6 T.C. 1188 (1946) furnishes a unique form of rebutting evidence. The original $125 per share valuation placed on securities by the Commissioner was successfully readjusted by him at the time of disposition to $100 per share. Since the taxpayer was required by the testator's will to sell for $100 per share, the court held that the income tax basis could not exceed the compulsory sale price, notwithstanding a different estate tax valuation.

attempt was made to strengthen the force of the Treasury Regulation,[8] by alligning with it the authoritativeness of the initial appraisal, even the court noted the Government's almost passive reliance on this point.[9]

Presumably aware of the weakness of his position, the Commissioner contended that the taxpayers should be estopped from changing the valuation. The essence of the argument proceeds from the requirement that a taxpayer furnish accurate statements of fact in any return filed. Since this was not done by the executors of the estate, should the plaintiffs now be rightfully estopped from altering a misstatement made by their fiduciaries? With little elaboration or definitive reasoning, the court concluded that the basis for an estoppel did not exist. A brief analysis of the elements of an estoppel illustrates that: (1) there must be conduct amounting to a representation or concealment of a material fact, which fact is known by the party estopped or should be known by him; (2) the party claiming estoppel must be unaware of the true facts or unable to ascertain them at the time they were acted upon; (3) the conduct must be relied upon to the extent that the claimant would suffer a loss if the other party be permitted to repudiate his conduct and assert rights inconsistent therewith.[10]

In applying these criteria to various fact situations, the courts have gone to considerable lengths to afford the taxpayer a means of escaping the conclusiveness of errors reported in tax returns. *May Rogers*[11] involved a situation quite similar to the *Ford* case. The co-executors, having evaluated stock for estate tax purposes, sought to place a higher valuation upon the shares when they were later disposed of by the executors in an individual capacity. An increase was allowed on the grounds that "the value of property as of a particular date is a matter of opinion and evidence. Mere expressions of opinion cannot be regarded as misrepresentations of fact to work estoppel."[12] The same distinction between opinion and fact has been drawn with regard to real property.[13] It appears that in the area of debatable valuations the party pleading the estoppel must proceed with the burden of proof along different lines. To deny that a dubious valuation is not a matter of

[8] *Supra* note 4.
[9] Ford v. United States, 276 F. 2d 17, 21 (Ct. Cl. 1960).
[10] 10 Mertens, The Law of Federal Income Taxation Sec. 60.02 (1958).
[11] 31 B.T.A. 994. (1935) aff'd 107 F. 2d 394 (2d Cir. 1939). Although this decision was non-acquiesced in by the Commissioner, XV-2 Cum. Bull. 45, (1936) it has never been overruled nor criticized by the courts and has been cited in numerous other tax cases.
[12] *Id.* at 1004.
[13] Northport Shores Inc., 31 B.T.A. 1013 (1935), Non-acq. XIV-1 Cum. Bull. 34 (1935). Here the estate tax valuation was determined by the Commissioner to be $125,000. The petitioner originally claimed it was $112,500. substantiating this figure by the opinion of a reputable appraiser. Later, upon disposition she was permitted to establish a $250,000 basis upon the testimony of *other* appraisers more familiar with the land.

opinion would not only contradict the obviousness of the situation but also impose a seemingly insurmountable burden of establishing a de facto value at the time of the estate tax computation. This latter task was unsuccessfully attempted in the *Ford* case. However, the Internal Revenue Service, as evidenced by its non-acquiescence in the preceeding cases, takes a dim view of allowing basis changes simply because the original valuation involved a high degree of opinion. A taxpayer seeking such a change in analagous situations may be forced to litigate.

Even in litigation an alternative proof of the actual falsity of the original valuation quite clearly would estop a taxpayer. The Government's base case in the *Ford* decision, *Alamo National Bank v. Commissioner,*[14] involved the omission of an asset as a liquidating dividend in the petitioner's 1921 tax return. Upon disposition of the acquired business the court estopped the taxpayer from attaching a value to the franchise. The tone of the opinion indicates that, in fact, there was a value in 1921, and to omit it entirely revealed an underlying bad faith in accounting methods and procedure. The contrast between a clear-cut omission and a mistaken valuation appears to be one criterion upon which the court reached an opposite result in the *Ford* case by denying estoppel.

The other basic difference between *Alamo National Bank* and *Ford* relates to the availability of the true facts.[15] The Commissioner cannot assert estoppel where he is in a position to know the true facts. By furnishing a consolidated balance sheet to the Government, which was referred to in the 1943 proceeding, there existed an excellent possibility that the gross discrepancy between the estate tax valuation and the book value of the stock would be detected. When contrasted with a complete omission, it is possible that the court partially distinguished the two cases on this basis. However, the volume of tax returns handled by Internal Revenue would make a distinction, solely on this point, seem rather inequitable.[16] Each particular case involves a balancing of the Commissioner's position to know the true facts, against the

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[14] 95 F. 2d 622 (5th Cir. 1938).

[15] 10 Mertens, The Law of Federal Income Taxation Sec. 60.03 (1958). See Hull v. Commissioner, 87 F. 2d 260 (4th Cir. 1937), Estate of William Steele, 34 B.T.A. 173 (1936); Ross v. Commissioner, 169 F. 2d 483 (1st Cir. 1948).

[16] Commissioner v. Liberty Bank and Trust Co., 59 F. 2d 320, 325 (6th Cir. 1932) affords an ideal example of the rationale behind the treatment of taxpayer claims for adjustment or inclusion, where there originally was an omission on the taxpayer's part. Alleged worthless debts were collected and the court estopped petitioner from attaching an original value upon them to avoid their inclusion as income in the year of collection. "The Commissioner of necessity does and must rely largely upon the representations of the taxpayer, and in order to estop the taxpayer from assuming a contrary position, he is not compelled to look with suspicion upon all such representations and himself examine or cause to be examined the financial condition of all the taxpayer's debtors. It is the duty of the taxpayer to deal fairly and truthfully with the government."

taxpayer's duty to report them as such. In considering this duty the court stated:

> The fact that it did not do so (discover the discrepancy) did not relieve the executors of the estate of the responsibility of taking notice of it, and correcting the valuation stated in the return which they had filed before time.[17]

Seemingly the court is denying the decisiveness of the Government's oversight. However, considerable weight was given to the age of the plaintiffs in 1939 and their inability to ascertain the true facts.[18]

In lieu of the mitigating circumstances of the *Ford* case i.e. (1) the lack of an established market value of the stock; (2) the failure by the Government to notice the gross inconsistency between the estate tax valuation and the book value of the stock; (3) the minor status of the plaintiffs and their dissociation with the executors; the necessary elements of an estoppel were not clearly proved. The fact that the statute of limitations expired and barred a later reassessment of the estate tax will not sustain a strict plea of estoppel. The element of detriment is present,[19] but per se it is insufficient to offset the equities in favor of the taxpayer.[20]

Upon its own volition the court considered the possibility of permitting the Government to recoup the barred estate tax against the overpayment in income taxes. The doctrine of recoupment has been frequently invoked in tax cases, notwithstanding its inherent inconsistency with the statute of limitations.[21]

The cornerstone of the pro-recoupment argument was set forth in *Bull v. U.S.*,[22] where the Supreme Court permitted an executor to recoup an estate tax payment against an income tax deficiency that arose when the money, previously considered a part of the estate corpus, was deemed income. The gist of the opinion constituted an attempt to superimpose an equitable alternative upon the rigid restrictions of the statute of limitations. The court in the *Ford* case rejected a broad application

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[17] *Supra* note 9, at 22.

[18] Judge Littleton in his dissenting opinion disagrees with the majority on this point. He feels that since the executors were acting for and on behalf of the plaintiffs, the latter should be bound by the executor's representations.

The ultimate result of the case might justify such a conclusion, but in light of the possibility of a recoupment, the equitable nature of estoppel would be violated by holding a party bound by statements of an executor not voluntarily selected by him.

[19] Tidewater Oil Co., 29 B.T.A. 1208 (1934) indicates that the detriment to the government may consist of allowing the statute of limitations to run.

[20] See: Northport Shores Inc., 31 B.T.A. 1013 (1935); and May Rogers, 31 B.T.A. 994 (1935); aff'd 107 F. 2d 394 (1939) for illustrations of the harshness in refusing to accept estoppel as a defense.

[21] See: Lyeth v. Hoey, 112 F. 2d 4 (2nd Cir. 1940); Rothensies v. Electric Storage Battery Co., 329 U.S. 296 (1946); McEachern v. Rose, 302 U.S. 56 (1937); Stone v. White, 301 U.S. 532 (1937).

[22] 295 U.S. 247 (1935).

of the doctrine and relied on *Rothensies v. Electric Storage Battery Co.*,[23] which limited recoupment to its present day status,[24] by making it a prerequisite that both claims arise out of the same transaction. It is also essential that the cross-claiming parties be identical, i.e. a taxpayer cannot recoup another's overpayment against his own deficiency.[25]

In analyzing the possibility of a recoupment against the plaintiffs, the court admitted that the facts present a strong argument in favor of allowing it. The determining factor, however, was the non-existence of a single taxable event. The receipt of the stock in 1939 and its later disposition in 1947 were deemed separate transactions. Both of the dissenters disagreed, contending that the original valuation was the sole event upon which the separate taxes were based. Their argument finds considerable support in cases allowing the taxpayer recoupment.[26]

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[23] 329 U.S. 296 (1946). Here a taxpayer was denied recoupment where he sought to offset erroneously paid excise taxes, recovery of which was barred by the statute of limitations, against an assessment for income taxes levied against a refund paid to him. The refund consisted of excise taxes paid in years other than those barred by the statute of limitations. The Court distinguished Bull v. U.S. on the grounds that only one transaction was involved in the Bull case, i.e. receipt of income by the estate, whereas here there was (1) the payment of the excise taxes and (2) the inclusion of a refund in taxable income for the year 1935.

[24] The evolution of recoupment in tax cases necessarily has involved consideration of Code provisions which deal with the problem of barred claims, refunds and set offs. Int. Rev. Code of 1954 Secs. 1311-1315, providing for corrections and adjustments of errors, are *inapplicable* where the prior error and the subsequent refund or deficiency claim do not *both* relate to an income tax item. Thus, where a barred estate tax is sought to be recouped against an income tax overpayment, it must be done on the basis of the recoupment established by judicial interpretation. See: U.S. Treas. Reg. Sec. 1.1311 (a) -2(b) (1956); Also see, Note 52 Harv. L. Rev. 300 (1938), construing 52 Stat. 581 (1938), the enactment upon which Sec. 1311-1315 are based. Int. Rev. Code of 1954 Secs. 6514 (b) and 6401 (a) prohibit the crediting of an overpayment against a barred tax liability. Seemingly these provisions would automatically eliminate recoupment as a defense for the Government. In fact, the earlier counterparts of these statutes were the basis for denying such a defense in McEachern v. Rose and Lyeth v. Hoey, *supra* note 21. However, the history of recoupment indicates that the equities of the particular fact situation are determinative rather than a strict adherence to such provisions. The Court in Rothensies v. Electric Storage Battery, *supra* note 23, did not even consider the applicability of the statutes, but reached its decision by distinguishing the facts of the case from the judicially developed recoupment. If Secs. 6514 (b) and 6401 (a) were controlling in this type of case it would seem incongruous for the courts to afford them anything less than the utmost importance. There was no mention of the provisions in the *Ford* case and there appears to be an obvious disregard for their applicability, at least, where equitable tangents and elements of estoppel run in favor of the Government.

[25] See 10 Mertens, The Law of Federal Income Taxation Secs. 58.42 and 60.05 (1958). However, where the *Government* sets up recoupment as in Stone v. White, 301 U.S. 532 (1937), a three party situation often arises. There the barred claim against a trust beneficiary was set off against the trustees who mistakenly paid the tax, on the theory that a refund would ultimately inure to the benefit of the beneficiary.

[26] Mills v. U.S., 35 F. Supp. 738, 739 (N.D. N.Y. 1940). "It is sufficient if it (the claim) arises out of the same subject matter, and that the claims are susceptible of adjustment in one action." In U.S. v. Herring. 240 F. 2d 225 (4th Cir. 1957) the plaintiff acting as administratrix paid an estate tax in 1949 based on the net estate. Subsequently the government levied a deficiency

The *Ford* case illustrates a fact situation offering strong possibilities of allowing the equitable principles of estoppel and recoupment to govern. Although the former was not sufficiently established, the court seems to have engaged in an independent analysis of recoupment, divorcing its equitable foundation from the consequences of their decision. By stringently enforcing the "single transaction" requirement, in effect the court permitted the plaintiffs to evade their estate tax liability under circumstances which place a greater degree of fault upon their executors than upon the Government. Chief Judge Jones in his dissenting opinion expressed a sounder solution to the dilemma:

> The correction is being made at the instance of plaintiffs. It seems fair that as a condition to the change in valuation they should be willing to surrender the advantage which had come to them by reason of the undervaluation they are seeking to change."[27]

This result would leave the parties in the financial position they would have assumed by a correct valuation of the stock.

MICHAEL WHERRY

Torts—Negligence: Recovery for Traumatic Neurosis—Plaintiff, the driver of an automobile struck by defendant's car, received a brain concussion during the collision and was thrown onto the pavement. Regaining consciousness and observing defendant lying on the pavement apparently dead, and bleeding, and his elderly wife standing there helpless and confused, plaintiff became hysterical, commenced crying, shaking, and complained of a headache. On appeal from an award to plaintiff for mental and physical injuries, the record indicated that plaintiff had experienced a traumatic neurosis—an anxiety reaction precipitated by a trauma. A psychiatrist testified that the brain concussion served as a "competent reducing cause" which weakened plaintiff's powers of repression. Plaintiff, having a repressed hatred for his father, associated

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against her for past due estate income taxes. Her claim of recoupment was granted on the grounds that the true net estate was greatly reduced by the liability for income taxes in 1949. With regard to the single taxable event theory, the court stated at 228 "The Government has received monies which in equity and good conscience belong to the taxpayer. . . . It is true that in the *Bull* case both claims grew out of the same transaction and were asserted against the same money in the hands of the executor; but that in practical effect, is the situation that prevails here. The Government has asserted two claims against the monies of the estate that came into the hands of the administratrix, one on account of past due income taxes, and the other on account of the estate tax due on the net estate, and it is impossible to determine the amount of the latter without making due allowance for the deduction caused by the former." Accord: Bowcutt v. U.S., 175 F. Supp. 218 (D. Mont., 1959).

[27] *Supra* note 9, at 23, 24.