

# "INCOME IN RESPECT OF A DECEDENT" AND SALES TRANSACTIONS

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So familiar is the notion that nothing in this world is certain but death and taxes that it is curious how much uncertainty attends the consequence of their juxtaposition in sales transactions. For a yet to be rationalized anomaly is the federal income tax result, where the death of a vendor takes place before the consummation of a sale the agreement for which was executed or negotiated by the vendor during his lifetime.

This anomaly involves the meaning and application of the phrase "income in respect of a decedent."<sup>1</sup> On a practical level this often involves questions of whether decedent-vendor's successor in interest<sup>2</sup> will or will not be obliged to pay income taxes on the sale and, if so, what rates<sup>3</sup> will be applicable.

The term "income in respect of a decedent" is not defined in the Internal Revenue Code.<sup>4</sup> Its meaning must be approached by reference to the problems of income tax administration that its use was intended to solve. Unfortunately, however, statutory history alone does not provide a suitable explanation of the operation of this phrase with respect to sales. Therefore, it is necessary to inquire further into

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1. Int. Rev. Code of 1954, § 691.

2. Such successor in interest may be an executor, administrator, legatee or devisee.

3. Int. Rev. Code of 1954, § 1 or § 1201 and § 1202.

4. The full text of § 691(a) (1) is as follows:

(a) INCLUSION IN GROSS INCOME.—

(1) GENERAL RULE—The amount of all items of gross income in respect of a decedent which are not properly includible in respect of the taxable period in which falls the date of his death or a prior period (including the amount of all items of gross income in respect of a prior decedent, if the right to receive such amount was acquired by reason of the death of the prior decedent or by bequest, devise, or inheritance from the prior decedent) shall be included in the gross income, for the taxable year when received, of:

(A) the estate of the decedent, if the right to receive the amount is acquired by the decedent's estate from the decedent;

(B) the person who, by reason of the death of the decedent, acquires the right to receive the amount, if the right to receive the amount is not acquired by the decedent's estate from the decedent; or

(C) the person who acquires from the decedent the right to receive the amount by bequest, devise, or inheritance, if the amount is received after a distribution by the decedent's estate of such right.

the several distinct tax policy judgments which converge in this area, in order to understand the difficulties with which the subject abounds.

Ultimately a resolution of the difficulties depends upon the adoption of a treatment which will result in a successful blend of these several judgments. This, as will be seen, is not easy since the mixture tends to curdle. However, certainly no omelet can be hoped for unless some eggs are broken.

### I.

Historically, the problem of a decedent's income was first regarded primarily as a matter of tax accounting.<sup>5</sup> Prior to 1934, when a cash method taxpayer died, the income accrued but not received at the date of his death escaped the income tax altogether. To prevent this revenue loss and to avoid the inequity in treatment between cash and accrual method taxpayers, the law was amended in 1934 to provide for the accrual of income items to the date of death in the final return of the cash method taxpayer.<sup>6</sup> Thus tax avoidance was eliminated and equity among taxpayers restored. The Supreme Court, however, construed the term "accruals" as used in the 1934 amendment quite broadly, departing from traditional accounting practice in order, as it said, to further "the intent of Congress to cover [sic] into income the assets of decedents, earned during their life and unreported as income. . . ."<sup>7</sup> This construction resulted in what was thought to be an excessive piling up of income in decedents' final returns.<sup>8</sup> Therefore, in 1942 the law was again amended to add what is now section 691.<sup>9</sup>

Section 691 was intended to resolve the dilemma presented by a broad construction of the term "accruals" on the one hand and by tax avoidance and inequity on the other.<sup>10</sup> This it did by requiring an inclusion of the income items in the return of the decedent's successor when the items were in fact received. The Senate Report stated that "This provision is designed to place the person described"<sup>11</sup> . . . in the same position with respect to the nature of this income as the position

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5. See Parlin, *Accruals to Date of Death for Income Tax Purposes*, 87 U. Pa. L. Rev. 295 (1939); Shelton, *Problems that Come with Filing the Income Tax Returns of Decedents, Minors and Incompetents*, N.Y.U. 8th Inst. on Fed. Tax 1176 (1950).

6. *Commissioner v. Linde*, 213 F.2d 1, 4-6 (9th Cir. 1954); S. Rep. No. 558, 73d Cong., 2d Sess. 28 (1934); 2 Mertens, *Federal Income Taxation* § 12.100 (Zimet & Stanley Rev. 1955).

7. *Helvering v. Enright*, 312 U.S. 636, 644 (1941).

8. *Hearings Before the Senate Committee on Finance on Revenue Revision Act of 1942*, 77th Cong., 2d Sess. (1942).

9. Note 4 *supra*.

10. Note, *Income in Respect of Decedents: The Scope of Section 126*, 65 Harv. L. Rev. 1024 (1952).

11. The "person described" is the decedent's successor in interest.

the decedent enjoyed."<sup>12</sup> Subsequently, however, the provision was read more expansively by the courts. It was intended, said the Court of Appeals for the Ninth Circuit, not only to prevent bunching of income in a decedent's final return, but also to "avoid the loss of income taxes which would have been received were it not for the death of the decedent."<sup>13</sup>

To appreciate the significance of this expansion and its relevance to sales transactions, it is necessary to consider the cases which initiated the recognition of the entire problem. They were, in the main, cases dealing with personal service income which had been earned but not received at the date of death.<sup>14</sup> In this area the function of section 691 has been to obviate the necessity of a referral to accounting terms. Thus, in *O'Daniel's Estate*,<sup>15</sup> although decedent employee had no enforceable right to a share in a bonus declared by his employer for the year prior to his death,<sup>16</sup> the court held its receipt by his estate "income in respect of a decedent" and, therefore, taxable to the fiduciary as ordinary income.<sup>17</sup>

The word "accrual" is an accounting term which describes one of several possible methods by which items of cost and receipt may reasonably be attributed to a particular period of time.<sup>18</sup> Such an allocation is of most significance in cases which involve a continuing business activity, for it is principally in this context that a choice among different time periods becomes important to a taxpayer.<sup>19</sup> Personal service is, of course, a major kind of continuing business activity. Accordingly, it is not difficult to see why accounting methods became relevant in the cases of deceased taxpayers who were engaged in this type of activity. It is understandable, as well, therefore, that any extension of the coverage of section 691 beyond the cases in the personal service area should take place in another familiar area of continuing business activity—the area of sales transactions. Whether

12. S. Rep. No. 1631, 77th Cong., 2d Sess. 100 (1942).

13. *Commissioner v. Linde*, 213 F.2d 1, 4 (9th Cir. 1954); cf. *Kreig & Buschman*, Section 126: Items of Gross Income in Respect of a Decedent, 32 *Taxes* 651 (1954).

14. *Estate of Edgar V. O'Daniel*, 10 T.C. 631 (1948), aff'd, 173 F.2d 966 (2d Cir. 1949); *Estate of Fred Basch*, 9 T.C. 627 (1947); *Loe M. R. Peyton*, 44 B.T.A. 1246 (1941); *Lillian O. Fehrman*, 38 B.T.A. 37 (1938); *Antoinette B. Held*, 3 B.T.A. 408 (1926); G.C.M. 21040, 1939-1 Cum. Bull. 242.

15. *Estate of Edgar V. O'Daniel*, supra note 14.

16. Ordinarily there would be no accrual of a contingent item in such a case.

17. Cf. *Treas. Reg. § 1.691(a)-1(b)(3)* (1960).

18. See *Holland*, *Accrual Problems in Tax Accounting*, 48 *Mich. L. Rev.* 149 (1949).

19. This significance is mitigated to some extent by the provisions of the Int. Rev. Code of 1954, § 172 relating to net operating loss carrybacks and carryovers and by the provisions of Int. Rev. Code of 1954, §§ 1301-03.

such an extension is, on this basis, to be made to sales which do not occur in the "continuing business activity" setting is another matter. An extension to sales outside this setting must be based on a view of section 691 which de-emphasizes its genesis in the problem of accounting methods and involves a broader concept of its utility. The extension of section 691 to income from sales<sup>20</sup> has, in any event, eliminated what might have been one limitation on the definition of "income in respect of a decedent," i.e., as "income arising from the personal efforts of the decedent."

The next possible limitation might have been looked for in the character of the income to which a transaction gives rise. Such a touchstone is suggested by *Estate of Sarah L. Narischkine*,<sup>21</sup> where the decedent's executors collected arrearages on alimony due her from her ex-husband. The court held the receipts "income in respect of a decedent" since if decedent had collected them they would have represented ordinary income in her hands.<sup>22</sup> If this were accepted as a limitation on the phrase, one could say "income in respect of a decedent" is income which, if collected by decedent, would have been ordinary income rather than capital gain. Although such a limitation would not have prevented the application of section 691 to sales which take place as part of a continuing business activity, it is clear that this limitation is not accepted by the Treasury.<sup>23</sup>

One further possibility for limiting the applicability of section 691 might be investigated. What relevance has the character of an asset which produces the income? Is it significant whether the asset is a capital asset<sup>24</sup> in decedent's hands? In *Lattendresse v. Commissioner*<sup>25</sup> certain contracts which were purchased by decedent were capital assets and yet their collection by his widow was held income

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20. Note 6 supra. But see *Drye*, *The Taxation of a Decedent's Income*, 8 *Tax L. Rev.* 201 (1953); cf. *Commissioner v. Alldis' Estate*, 140 F.2d 885 (6th Cir. 1944).

21. 14 T.C. 1128 (1950).

22. See also *Scott*, *A Critique of Section 126*, 26 *Taxes* 127, 131 (1948).

23. *Treas. Reg.* § 1.691(a)-3(b)(1) (1957). However, it should be noted that neither is it always true that if decedent would have realized ordinary income (had he lived), it therefore follows that his successor has ordinary income. See *Estate of Jacques Ferber*, 22 T.C. 261 (1954). Some cases, on the other hand, are to the contrary. *Dixon v. United States*, 96 F. Supp. 986 (E.D. Ky. 1950), *aff'd per curiam*, 192 F.2d 92 (6th Cir. 1951); *Estate of Thomas F. Reminton*, 9 T.C. 99 (1947). See also *Rev. Rul.* 162, 1959-1 *Cum. Bull.* 224. These latter cases involve personal service, however, and may fall within § 691 for this reason alone. But see *Latendresse v. Commissioner*, 243 F.2d 577 (7th Cir. 1957), where items of income involving both personal services and investment by the deceased resulted in § 691 treatment.

24. *Int. Rev. Code of 1954*, § 1221.

25. *Latendresse v. Commissioner*, 243 F.2d 577 (7th Cir. 1957).

in respect of a decedent.<sup>26</sup> On the other hand, crops in the hands of a farmer are not capital assets, yet they have been ruled not to be section 691 items when disposed of by a decedent farmer's estate.<sup>27</sup>

If, then, neither the nature of the income, nor the nature of the transaction which generated it, nor the character of the asset involved serves in present practice as a criterion for defining and delimiting "income in respect of a decedent," what guide posts exist for definition and prognosis?

## II.

Three major tax policy judgments in addition to those of section 691 itself and the tax accounting sections<sup>28</sup> converge in the phrase "income in respect of a decedent."

### *The Policy of Section 1014*

It has long been the general rule that assets held by a decedent at his death take on a basis equal to their fair market value at the date of death in the hands of his successor;<sup>29</sup> thus, there is no income tax assessed on their appreciation from cost during his lifetime.<sup>30</sup> The rule is easier to state than to justify, for it represents a complete divergence from the usual operation of the tax law.<sup>31</sup> Moreover, its economic consequence, an encouragement of the retention of appreciated assets, has been deplored.<sup>32</sup> Irrespective of the wisdom of such a policy, it is clear that it conflicts with the operation of section 691, for an asset whose sale involves income in respect of a decedent does not take a section 1014 basis, but rather retains the decedent's basis.<sup>33</sup> Since there is no evidence that the enactment of the predecessor of section 691 was initiated because of a general dissatisfaction with the policy of section 1014, the limitation which in fact resulted from section 691 arose as its consequence rather than as its purpose.<sup>34</sup> It is

26. Although a capital asset was involved, if decedent had collected the proceeds, ordinary income would have resulted because there would have been no sale or exchange as required by Int. Rev. Code of 1954, § 1222. See Galvin Hudson, 20 T.C. 734 (1953). On the other hand, if decedent had sold the contract before collection there would have been capital gain.

27. Rev. Rul. 436, 1958-2 Cum. Bull. 366; see also Estate of Jacques Ferber, 22 T.C. 261 (1954). Cf. Int. Rev. Code of 1954, § 1231(b) (4).

28. Int. Rev. Code of 1954, §§ 441-43, 446.

29. Int. Rev. Code of 1954, § 1014.

30. The appreciation is, of course, reached by the Federal Estate Tax. Int. Rev. Code of 1954, § 2031.

31. Usually appreciation is included in gross income on the disposition of the asset. Int. Rev. Code of 1954, § 61(a) (3).

32. See Groves, Taxation of Capital Gains, 2 Tax Revision Compendium 1193 (1959).

33. Int. Rev. Code of 1954, § 1014 (c).

34. Pp. 31-32 *supra*.

difficult to weigh conflicting policy judgments under such circumstances. However, one could hazard the suggestion that the background of section 691, as outlined in the first part of this article,<sup>35</sup> seems to exhibit greater rationality than does the general policy of section 1014. It should also be recalled that the rationality of section 691 really stems from its treatment of ordinary income items<sup>36</sup> and thus might not be considered as outweighing section 1014 in the area of capital gains.

### *The Policy of Subchapter P*

As every adult and many children know, income tax policy favors considerably the realization of income in the form of gains from the sale or exchange of capital assets held for more than 6 months.<sup>37</sup> About this favoritism has grown a cluster of distinctions related to the nature of the particular asset,<sup>38</sup> the means of its disposition,<sup>39</sup> the status of the disposing taxpayer<sup>40</sup> and many others. Although the plethora of artificiality and misuse which has typified the statutory development of this field tends to obscure and even to adulterate the basis of such favoritism, it is possible to defend the idea that a major rationale of the favoritism is based upon a desire to afford relief against taxing in one year, at steeply progressive rates, the accumulated appreciation of many.<sup>41</sup> Thus, since the sale of assets which have appreciated in value over the course of several years will be infrequent in the economic lives of most taxpayers, capital gain treatment might be expected to result with respect to intermittent transactions as opposed to those transactions which regularly recur.

Section 691 treats income in respect of a decedent "as having the same character it would have had if the decedent (or a prior decedent) had lived and received such amount."<sup>42</sup> But this does not tell us which sales transactions are to be treated as yielding income in respect of a decedent and which are not. Thus, although apparently the reference to decedent's treatment is preserved in section 691,<sup>43</sup> the section itself seems to be neutral with respect to the policy of

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35. *Ibid.*

36. *Ibid.*

37. Int. Rev. Code of 1954, § 1201.

38. Int. Rev. Code of 1954, § 1221.

39. Int. Rev. Code of 1954, § 1222.

40. The distinction between assets held in trade or business and those held for investment are of particular significance.

41. The distinction between investment property and inventory, and the importance of the holding period point to this. See generally, ALI Discussion Draft of a study of Definitional Problems in Capital Gains Taxation (Oct. 20, 1960).

42. Int. Rev. Code of 1954, § 691(a)(3); Treas. Reg. § 1.691(a)-3(a) (1957).

43. Note 23 *supra*.

subchapter P. The chief difficulty lies in determining which such transactions were sufficiently matured during decedent's lifetime as to result in such income upon their completion after his death. Thus, a third policy line becomes relevant.

#### *The Policy of Lucas v. Earl*<sup>44</sup>

Attempts by taxpayers through inter vivos donative assignments of their claims to income, in order to reduce the tax burden on their families, have spawned a progeny of cases, the holdings of which, in substance, are that the income is taxable to the assignor whose efforts created it.<sup>45</sup> But since this result does not follow in all cases of gift assignments, we must determine in which cases it does obtain. The line of cases under *Lucas v. Earl*<sup>46</sup> would apparently pick out only those situations where the product of the assignment is ordinary income.

Somewhat similar to the issue in *Lucas v. Earl* was the problem presented by certain cases in the field of corporate liquidations.<sup>47</sup> Here the question was whether the gain from a sale of corporate assets in a liquidation should be attributed to the liquidating shareholders or to the corporation. If the sale was attributed to the shareholders, only one tax was paid on it; but if to the liquidating corporation, then, in effect, the gain was taxed twice. Legislation has now resolved this difficulty of determining how a given case is to be treated in this regard.<sup>48</sup> But from the cases which arose under prior law, one could extract the notion that when the problem of which of two taxpayers should be regarded as having effected a sale is raised, "the transaction must be viewed as a whole, and each step, from the commencement of negotiations to the consummation of the sale, is relevant."<sup>49</sup> According to such a view, one would, in the section 691 cases, look to see to what extent decedent's activities constituted the principal moving force in the transaction or to what extent it was his successor whose actions constituted the prime cause of the ultimate consummation of the transaction.

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44. 281 U.S. 111 (1930).

45. *Helvering v. Horst*, 311 U.S. 112 (1940); *Helvering v. Eubank*, 311 U.S. 122 (1940); *Strauss v. Commissioner*, 168 F.2d 441 (2d Cir. 1948); *Hogle v. Commissioner*, 132 F.2d 66 (10th Cir. 1942). By analogy § 691 characterizes a transaction by reference to the decedent whose efforts brought it about. See Holland, Kennedy, Surrey & Warren, *A Proposed Revision of the Federal Income Tax Treatment of Trusts and Estates—American Law Institute Draft*, 53 Colum. L. Rev. 316, 372 (1953).

46. Note 44 *supra*.

47. *Commissioner v. Court Holding Co.*, 324 U.S. 331 (1945) and *United States v. Cumberland Pub. Serv. Co.*, 338 U.S. 451 (1950) are the best known.

48. Int. Rev. Code of 1954, § 337.

49. *Commissioner v. Court Holding Co.*, 324 U.S. 331, 334 (1945).

## III.

Turning to the language of section 691 itself, we find it requires the inclusion by the recipient in his gross income of "the amount of all items of gross income in respect of a decedent" where "the right to receive the amount" has been "acquired . . . from the decedent."<sup>50</sup> The problem of determining which sales transactions are included within this language and which are not, centers upon the question whether decedent's successor, in a given case, acquired a "right to receive" the proceeds of the disposition from the decedent or acquired an asset from the decedent the proceeds of whose disposition are not attributable to a "right" acquired from the decedent.

As an original matter one might have argued that the advantage of the acquisition of a stepped-up basis under section 1014 should not be lost if decedent in some way initiated a sale prior to his death, since whether he did or not his beneficiary certainly owns whatever he receives as an acquisition from the decedent, and, therefore, nothing should turn on whether he receives a "right" or any other kind of asset. Indeed, it is perhaps in this apparent hairsplitting that the strongest argument against the application of section 691 to sales (at least to those which would result in capital gain) is grounded.<sup>51</sup> Nevertheless, it is clear that this distinction is the crux of the matter.<sup>52</sup> Thus it is established that if decedent had, during his lifetime, entered into a contract of sale incomplete at his death only as to delivery of the res and receipt of the purchase price, when his executor receives the proceeds of the sale, section 691 applies. On the other hand, if the executor had himself initiated and carried out the sale, the section would not apply and gain would be measured by the value of the asset at date of death.<sup>53</sup>

There are, of course, intermediate situations as to which doubt may be justified. For example, suppose decedent had given a lease of property during his lifetime which granted the lessee an option to purchase. If the option is exercised after death does the estate have income in respect of a decedent? The answer is hard to come by because the rationale of section 691's application to sales is not clear. Certainly, as to all executory contracts, strong motivation is afforded by the present law for decedent's successor in interest to attempt to

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50. Int. Rev. Code of 1954, § 691(a)(1).

51. See p. 33 *supra*.

52. Treas. Reg. § 1.691(a)-2(b), Ex. 5(1) (1960).

53. Drye, *The Taxation of a Decedent's Income*, *supra* note 20, at 206; cf. Craven, *Taxation of Income of Decedents*, 102 U. Pa. L. Rev. 185, 212 (1953); Young, *Linde Decision Confuses Tax Treatment of Cash-basis Decedent's Inventory*, 4 J. Taxation 160, 162 (1956).



avoid the transaction. If he can do so and then arrange a new sale he will have the advantage of a stepped-up basis.<sup>54</sup>

Prior to *Commissioner v. Linde*,<sup>55</sup> the status of consignments or pooling agreements was doubtful. Now the dicta of the *Linde Case*<sup>56</sup> and the regulations<sup>57</sup> establish that they too are considered within the coverage of the section. The Internal Revenue Service has, of course, read *Linde* broadly, holding that whenever the decedent, even short of an actual contract of sale, has placed the asset "beyond his dominion and control" section 691 income may result.<sup>58</sup>

Substantial difficulties with this view have appeared in the area of shareholder contracts to sell stock in close corporations on death.<sup>59</sup> The danger has been lessened through a ruling<sup>60</sup> now incorporated in the regulations.<sup>61</sup> How this self-limitation by the Treasury can be squared with the broad view taken in other kinds of transactions<sup>62</sup> is hard to see, except as a matter of administrative self-restraint in a special area where the outcry of taxpayers might have been the cause of extensive litigation.

It has been suggested that a distinction should be made between contracts made by a decedent which the vendee may specifically enforce and those for breach of which only an action for damages would lie.<sup>63</sup> As to the former, section 691 would be applicable. The trouble with such a view is twofold. First, the law relating to specific performance has as its touchstone the adequacy of a legal remedy, a criterion having little to do with whatever may be considered the relevant criteria under section 691. Second, modern substantive development in the law of sales, when combined with procedural developments, tend to make the choice of remedy discretionary with the court.<sup>64</sup> Under these circumstances, little of value for tax administration might be expected from a reference to the law of equity.<sup>65</sup>

54. Note, *Income in Respect of Decedents, The Scope of Section 126*, 65 Harv. L. Rev. 1030 (1952).

55. 213 F.2d 1 (9th Cir. 1954).

56. *Id.* at 7.

57. Treas. Reg. § 1.691(a)-2(b), Ex. 5(2) (1957).

58. Rev. Rul. 436, 1958-2 Cum. Bull. 366.

59. Hilgedag, *Taxing Good Will Under Purchase Agreements*, 81 *Trusts & Estates* 285, 285-87 (1945).

60. T.D. 5459, 1945-1 Cum. Bull. 193.

61. Treas. Reg. § 1.691(a)-2(b), Ex. 4 (1957).

62. See notes 55-57 *supra*.

63. Guterman, *New Problems Under Section 126 in Income and Estate Tax*, 24 *Taxes* 633 (1946).

64. Uniform Sales Act § 68; Uniform Commercial Code § 2-716.

65. See Voegelin, *Income Taxation of Inherited Intangible Assets*, U. So. Cal. 1954 *Tax Inst.* 587, 596-97. See also Kennedy, *Federal Income Taxation of Trusts and Estates* 469 (1948).

## IV.

It would seem a fair appraisal, in view of the foregoing, that the present treatment of sales transactions under section 691 is unsatisfactory on several grounds. First, because the history of the section affords little justification for its application to them.<sup>66</sup> Second, because a limitation in the policy of section 1014 has not been justified by any reference to revenue avoidance situations which are peculiar to decedents who have, in some way, initiated a disposition of an asset prior to their death.<sup>67</sup> Third, because the treatment has not differentiated between transactions which would result in capital gains and those which would result in ordinary income<sup>68</sup>—a distinction which would seem quite relevant in terms of revenue loss and the accounting issues which gave rise to the entire problem. It remains, therefore, to consider the possible alternatives to current practice.

One view is oriented to the causal relationship between decedent's lifetime activity and the production of the income item.<sup>69</sup> Because, in all cases, there is some causal relationship, the problem raised by this view is one of line drawing. Presumably, the mere ownership by a decedent of an asset later sold by the executor or beneficiary does not involve a sufficient causal connection for section 691 to be made applicable. At the other extreme, a sales contract executed and substantially performed during the decedent's lifetime would involve a sufficient causal connection to the collection of the proceeds by the executor or beneficiary for application of section 691. But for the in-between cases<sup>70</sup> this view offers no rationale. Nor can the other relevant policy judgments which converge in this area be used to clarify the degree of causal connection which would act as the dividing line.<sup>71</sup>

A second rationalization proceeds from a distinction between recurring and sporadic items in the economic life of the particular taxpayer.<sup>72</sup> Here the notion is that as to recurring sales, the taxpayer has little choice in timing and therefore, his reliance in the policy of section 1014 is minimal, whereas in sporadic sale situations he may well decide to withhold because of the basis step-up advantage of that provision. Hence, section 691, if applied to the former situations, will

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66. P. 31 *supra*.

67. Pp. 34-35 *supra*.

68. Pp. 33-34 *supra*.

69. Fink, Recent Developments Under Section 126, N.Y.U. 7th Inst. on Fed. Tax 731, 732-33 (1949); Note, Income in Respect of Decedents: The Scope of Section 126, 65 Harv. L. Rev. 1024, 1027 (1952).

70. See pp. 32-34 *supra*.

71. See pp. 34-36 *supra*.

72. Note, Income in Respect of Decedents, *supra* note 69, at 1034. See also p. 35 *supra*.

involve practically no intrusion into the policy of section 1014. It is, however, possible to make the opposite argument: that a taxpayer's freedom of choice in timing ought not to result in tax benefit; that the taxpayer who must sell should be treated no less advantageously than the taxpayer who might sell or not as he chooses. The result of this argument would lead either to the treatment of both recurring and sporadic sales under section 691 or to the treatment of neither thereunder.<sup>73</sup>

A third approach is more drastic. It would revoke the current policy of section 1014 altogether and apply the income tax to all appreciated assets at the death of their owner.<sup>74</sup> The difficulty here, lies of course in the collection of income tax on unrealized gain. Its effect would be to force sales at death to raise tax money, a result as difficult to justify as the present effect of section 1014 in encouraging retention of assets until death. No matter to which kind of assets or transactions section 691 applies, it at least avoids this result, since the inclusion in gross income depends on receipt.<sup>75</sup>

A fourth view of the reasonable application of section 691 sees the problem as one of classification of assets.<sup>76</sup> Such a classification, it is anticipated, would be applicable in other areas as well.<sup>77</sup> It would treat amounts received from the sale of inventory as coming within section 691 on the notion that most taxpayers will be on the accrual or inventory accounting method and that differences in choice of accounting method should not result in discrimination.<sup>78</sup> On this point it should be noted that the result is consistent with the genesis of section 691.<sup>79</sup> Moreover, as to inventory, it is argued that just as in the case of personal service income,<sup>80</sup> the policy of section 1014 does not apply because ordinary income rates and not capital gain rates would be avoided.<sup>81</sup> On the other hand, this approach would exclude amounts received from the sale of capital assets from a definition of

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73. There is even a departure from the capital gain treatment rationale on this point in the case of inventors.

74. See Groves, *Taxation of Capital Gains*, 2 *Tax Revision Compendium* 1193-99 (1959).

75. See p. 31 *supra*, and Note, *Income in Respect of Decedents*, *supra* note 69, at 1032.

76. See Holland, *supra* note 45, at 372; ALI Fed. Income Tax Stat. (Tent. Draft No. 7, 1952).

77. Holland, *supra* note 45, at 372.

78. *Id.* at 370. See also ALI Fed. Income Tax Stat. § X890(a)4d (Tent. Draft No. 7, 1952).

79. Pp. 32-33 *supra*.

80. ALI Fed. Income Tax Stat. § 890(a)4 (Tent. Draft No. 7, 1952).

81. *Id.* at 464-67.

"income in respect of a decedent."<sup>82</sup> It has been pointed out,<sup>83</sup> moreover, that the exclusion of capital assets will not result in difficulty because usually the decedent will have received payment during his lifetime,<sup>84</sup> or have received a contract for payment which will itself have been includible in gross income at the time of the sale,<sup>85</sup> or will have received a contract subject to the rules respecting installment obligations.<sup>86</sup> As to assets which are neither stock in trade nor capital,<sup>87</sup> these are arbitrarily grouped with capital assets and, therefore, under this view not covered by section 691.<sup>88</sup>

This view de-emphasizes the significance of the point at which a transaction is to be considered sufficiently matured during decedent's lifetime for section 691 to be made applicable.

Last of all, the Final Report of the Advisory Group on Subchapter J to the Subcommittee on Internal Revenue Taxation, recommended the addition of a new subsection to section 691, the purpose of which was to define "income in respect of a decedent."<sup>89</sup> Among the items so defined therein is "an amount . . . which equals so much of the proceeds of a sale, exchange, or other disposition of property made prior to the death of the decedent, as would have been includible in the decedent's gross income if he had received such proceeds."<sup>90</sup> This would seem to leave open the question under what circumstances a sale shall be deemed to have been "made" during decedent's lifetime, and thus exhibits the same deficiency as the "causal relationship"<sup>91</sup> approach. Moreover, unlike the classification of assets test, the Advisory Committee proposal does not differentiate between those sales which would and those which would not produce capital gain or loss results.

In any event, except as to matters relating to partnerships, no amendments to section 691 found their way into the Trust and Partnership Revision Bill of 1960.<sup>92</sup> Thus it would appear that so far as Congress is concerned, the matter remains open.

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82. Holland, *supra* note 45, at 370.

83. ALI Fed. Income Tax Stat. § 890(a)4g (Tent. Draft No. 7, 1952).

84. In this event there is no problem.

85. See Surrey & Warren, *Cases on Federal Income Taxation* 604-08 (1st ed. 1954).

86. Int. Rev. Code of 1954, § 691(a)(4).

87. Int. Rev. Code of 1954, § 1221(2)-(5).

88. ALI Fed. Income Tax Stat. § X890(a) (May 1952 Draft).

89. Final Report of Subchapter J Advisory Group, Dec. 28, 1958.

90. *Id.* at 61.

91. P. 39 *supra*.

92. H.R. Rep. No. 1231, 86th Cong., 2d Sess. (1960).

### CONCLUSIONS

We have reviewed the origin and development of section 691,<sup>93</sup> the conflicting and analogous policy judgments which converge in its operation,<sup>94</sup> and the problems its language presents.<sup>95</sup> We have also examined several alternatives for a shift in its approach to the sales area.<sup>96</sup> From this analysis certain conclusions can be drawn to resolve the difficulties presented.

First, section 691 should apply to the proceeds of a disposition by decedent's successor in interest only if the gain from the disposition would have represented ordinary income to the decedent had he lived to complete the transaction.

Second, this result should obtain only (a) where the action taken by the decedent during his lifetime with respect to the transaction was sufficient to create an enforceable obligation upon his successor, whether in law or equity, or (b) where decedent held out the asset involved for sale to his customers in the ordinary course of his business.

These conclusions are based upon the assumption that a major shift away from the policy of section 1014 is both unwise and unlikely, and so impinge on it only to the extent necessary to eliminate substantial avoidance and inequity. At the same time they avoid the difficulty of a test based upon an asset classification approach, while conforming to the underlying basis for such an approach.

Thus, the omelet may be fashioned to satisfy the appetite for revenue without offending the taste for consistency and rationality.

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93. Pp. 31-32 *supra*.

94. Pp. 34-36 *supra*.

95. Pp. 37-38 *supra*.

96. Pp. 39-41 *supra*.