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GROSS AND NET INHERITANCE TAX VALUES

THE states have the absolute right to declare what disposition shall be made of the property of deceased persons. A sovereign state may escheat all of the property of a decedent subject to his debts.

The privilege of taking property by will or inheritance is not a natural right. Wisconsin is the only state which has questioned this doctrine.¹

States granting succession privileges may tax the same. A legacy becomes the property of the beneficiary only after it has suffered a diminution to the amount of the tax.² The payment of the tax is a condition imposed. Upon complying with such condition, the state assents to the transfer.

While the state has the paramount right to regulate successions, the Federal government may, if it does not interfere with the exercised rights of the state, exact an inheritance tax from the beneficiaries.³

The tax is on the transfer and not upon the property but the full and true value in money of the property passing⁴ is the measure by which the tax is computed. In Minnesota, the taxes imposed take effect upon the death of the person from whom the transfer is made.⁵ The value as of the date of death governs and the same is not affected by subsequent appreciation or depreciation.⁶

The difficulty, if any, in ascertaining the full and true value in money is occasioned by the character of the property involved. As to real estate, the assessor's full and true value for ordinary taxation purposes is not controlling.⁷ The rules employed in courts of general jurisdiction to ascertain land values govern. If the land is encumbered, the amount of mortgage or other liens

¹ *Nunnemacher v. State*, (1906) 129 Wis. 190, 108 N. W. 627, 9 L. R. A. (N.S.) 121.

² *United States v. Perkins*, (1896) 163 U. S. 625, 41 L. Ed. 287, 16 S. C. R. 1073.

³ *Knowlton v. Moore*, (1900) 178 U. S. 41, 44 L. Ed. 969, 20 S. C. R. 747.

⁴ *Minn. G. S. 1913 Sec. 2272*.

⁵ *Minn. G. S. 1913 Sec. 2273*.

⁶ *Matter of Penfold*, (1915) 216 N. Y. 163, 110 N. E. 497, *Ann. Cas.* 1916A 783 and note.

⁷ *In re Estate of McGhee v. State*, (1898) 105 Iowa 9, 74 N. W. 695.

should be deducted in arriving at the value of the decedent's interest therein.

Bonds listed on exchanges fix their own value to be the quoted sale price plus accrued interest. If such securities are not listed, then the value of the security given, the term of the bond and the rate of interest, together with the prescribed time for payment thereof, furnish the data from which is calculated the value as of any given date. The value of listed stocks is ordinarily determined by the record of sales on the stock exchange. If, however, an estate holds large blocks of stock, which, if all offered for sale at once, might depress the market, then it is proper to take the average price for a reasonable period.

In *Walker v. People*,⁸ the court said:

"'Fair market value' has never been construed to mean the selling price of property at a forced or involuntary sale. In *Peoria Gaslight Co. v. Peoria Terminal Railway Co.* 146 Ill. 372, it was said (p. 377): 'The theory, upon which evidence of sales of other similar property in the neighborhood at about the same time is held to be admissible, is that it tends to show the fair market value of the property sought to be condemned. . . . But it seems very clear that, to have that tendency, they must have been made under circumstances where they are not compulsory, and where the vendor is not compelled to sell at all events, but is at liberty to invite competition among those desiring to become purchasers.'"

"The very fact, that the market would be depressed by forcing large blocks of stock upon it, and forcing such large blocks of stock to sale, indicates that such a sale is not a proper test of the fair cash value of the stock."

"The quotations of the stock exchange may be temporarily uncertain and untrustworthy, if the sales thereon are suddenly affected for speculative purposes, or by the forcing upon the market and to sale of large blocks of stock in an extraordinary manner with no explanation of such action, and where the purpose of it is left to the conjecture of those dealing in the stocks; but such quotations may be a fair and safe guide where they are taken for a reasonable period of sales made in the usual and ordinary course of business."

In the *Estate of Jay Gould, deceased*,⁹ the court said:

"It is claimed, however, that the rule should be so construed that, when the value of large blocks of stock is involved, only the

⁸ (1901) 192 Ill. 106 (110) (112), 61 N. E. 489.

⁹ (1897) 19 App. Div. 352, 46 N. Y. Supp. 506, modified 156 N. Y. 423, 51 N. E. 287.

purchase and sale in markets of correspondingly large blocks of stock should be considered, upon the theory that such large blocks would necessarily sell at lower rates than small quantities of stock sold separately, and that throwing large blocks of stock upon the market all at once would have a tendency to produce a break in the market, and perhaps a total inability to get more. . . . Under the construction contended for, the securities involved in this proceeding might have been shown to be of little or no value, by considering that forcing them upon the market in large blocks at one time would break the market, and make them practically unsalable at all."

In *People v. Coleman*,¹⁰ it was said:

"So the market value of the shares of capital stock may sometimes be above and sometimes below the actual value. Such value may be greatly enhanced or depressed for speculative purposes without any change in the actual value. But the market value of any stock which is listed at the stock exchange in New York, and largely dealt in from day to day for a series of months will usually furnish the best measure of value for all purposes. The competition of sellers and buyers, most of them careful and vigilant to take account of everything affecting value of stock in which they deal, and each mindful of his own interests, and seeking for some personal gain and advantage, will almost universally, if time sufficient be taken, furnish the true measure of the actual value of stock."

In appraising the value of unlisted stocks, great difficulty is often experienced. Such stocks may be in a corporation which owns a large amount of property and has numerous stockholders or it may be in a corporation, the stock of which is closely held, or it may be in a family holding company.

In *Re Chappell's Estate*¹¹ presents a case where the decedent owned 3,219 shares of stock in the National Casket Company. There were 4,350 shares of the par value of \$100 each issued and outstanding. The company paid a 5% dividend and the book value of the stock was \$140 per share. In this case the court said:

"The true rule for appraising property of this kind is its actual market value. The fact that there was not a ready market for a large amount of the stock has a direct bearing. The amount of the stock, the market for it, and whether a large block could be sold are elements to be considered in fixing its value."

In *State v. Pabst*,¹² Mr. Justice Siebecker said:

¹⁰ (1887) 107 N. Y. 541 (544), 14 N. E. 431.

¹¹ (1912) 136 N. Y. Supp. 271.

¹² (1909) 139 Wis. 561 (594), 121 N. W. 351.

"On the various occasions when he secured stock for the corporation or when there were dealings between members of the family, the decedent had dealt with this stock on the basis of its book value. The transfers shown were apparently made in reliance on the book value. The evidence adduced showed the dividends declared and paid for the years from 1896 to 1904, inclusive, and the value of the corporation's assets from 1896 to 1906, inclusive, exclusive of the good will of the business. . . . The facts and circumstances regarding the business of the corporation and its properties, the progress, growth, and general financial results, furnish a basis for valuation."

In *Re Brandreth's Estate*,¹³ the value of shares of stock in the Porous Plaster Company was brought before the court. The business of the company was that of compounding or manufacturing pills and plasters under three secret recipes. The corporation for more than 17 years earned and paid from 48 to 60 per cent. In this case, the court said:

"It goes without saying that property of this kind is not susceptible of a market value, and its value cannot be determined by ordinary expert testimony. . . . While the earning power of a corporation is not proof of the value of its property, nevertheless it is competent evidence of value, and is a feature to be considered in determining the valuation to be placed upon the stock for the purposes of taxation. . . . Where it is impossible to ascertain a market value of the stock of a corporation by reason of the fact that there is none, the state does not thereby lose the tax upon the transfer. Under such circumstances, the actual value will be presumed to be the market value until the contrary is shown. . . ."

In *Re Smith's Estate*,¹⁴ the decedent owned stock in a newly organized industrial corporation which had paid an 8% dividend in the first year of its operation. About the time of decedent's death, an officer of the company sold stock of the par value of \$100,000 for \$50,000, which amount he considered was a fair value. In this case, the court held that in the absence of evidence other than the amount of the first dividend paid, the sale price was controlling.

Often in arriving at the value of unlisted stocks good will is an important factor. It may be a very valuable asset but no hard and fast rule could be laid down whereby the value of the same may be ascertained. One of the most recent cases involving the value of good will is *In Re Moore's Estate*,¹⁵ wherein was con-

¹³ (1899) 28 Misc. Rep. 468, 59 N. Y. Supp. 1092 (1096), (reversed but upon different grounds 58 App. Div. 575, 69 N. Y. Supp. 142.)

¹⁴ (1902) 71 App. Div. 602, 76 N. Y. Supp. 185.

¹⁵ (1916) 97 Misc. Rep. 238 (240), 161 N. Y. Supp. 142.

sidered the value of good will in "Tiffany & Company." Judge Fowler, writing the opinion said:

"The appraiser ascertained the value of the good will by deducting interest at the rate of six per cent per annum on the capital employed by the company in its business from the average annual net profits in its business from the average annual net profits of the business and multiplying the difference by ten. This gave the value of the good will as \$1,507,922.40. No exception was taken to the amount which the appraiser adopted as the average annual net profits, but it is contended that the value of the good will should be ascertained by multiplying the average net profits by three or five instead of ten, the latter being the figure used by the appraiser.

"The cases in this country are not uniform in regard to the number of years' purchase by which the average annual net profits may be multiplied for the purpose of determining the value of the good will. Most of the American cases adopt a period ranging from two to six years, the number being dependent upon the nature of the business, the length of time during which it has been established at a particular place and the extent to which it is known to the public. Tiffany & Company has an enviable international reputation as a craftsman and tradesman; it has been established in New York city for more than sixty years. If six years' purchase of the average annual net profits was considered not an unreasonable value of the good will in a case where the question of good will related to the name under which a number of candy stores were conducted (*Von Au v. Magenheimer*, 126 App. Div. 257) it would seem that the good will of a company having the prominence, the permanency and the established reputation of Tiffany & Company should be worth at least ten years' purchase of the annual net profits."

In *Re Keahon's Estate*¹⁶ it was held that to determine the value of the good will of a business for the purpose of a transfer tax the net earnings of a single year should be multiplied by a certain number of years; the number depending upon the nature of the business.

Generally the rule is that the value of unlisted stocks is ascertained by consideration of the book value, earnings and good will. In some instances, it may be necessary to reduce the book value on account of the depreciation. Such usually occurs in connection with bills and accounts receivable, and merchandise which is of a character where the fashions are fickle.

The rule governing the valuation of closely held stock also determines the value of co-partnership interests. Often it is

¹⁶ (1908) 60 Misc. Rep. 508, 113 N. Y. Supp. 926.

provided by agreement that the surviving partner or partners may purchase the decedent's interest in the business for an amount much less than its full and true value. Such agreements do not, however, fix the value for inheritance tax purposes. The state is entitled to a tax upon the full and true value in money on the property passing.¹⁷ In such cases, a portion of the property may be taxable as a gift made to take effect in possession or enjoyment at death.¹⁸

The appraisal of countless other items forming a part of decedent's estate requires the adoption of such method as will best establish the full and true value. In many instances expert tax testimony alone controls. The value of diamonds, jewelry and paintings can be determined in no other way.

With the value of a decedent's estate established, the next inquiry is as to the amount of the net estate for distribution; or, in other words, what are the properly allowable deductions before computing the tax? The widow's maintenance, consisting of a reasonable amount paid during the time necessary to probate the estate, and her selection of personal property, as provided for by statute, are treated as deductions. They are not in fact such. They constitute no part of a decedent's estate but are an encumbrance thereon.¹⁹ They are not even subject to debts or administration expenses.

Claims filed and properly allowed by the probate court are deductible, but in this connection it should be kept in attention as to what constitute claims which may be allowed against an estate in the probate court. Under the Minnesota statute, the court has defined the same to be a demand of a pecuniary nature which could have been enforced against the decedent in his lifetime.²⁰

Expenses of last sickness and burial constitute deductible items, if reasonable in amount. A suitable monument or tombstone consonant with the value of decedent's estate is properly classed as a funeral expense. It matters not whether decedent died intestate or left a will in which no provision was made for a

¹⁷ *In re Cory's Estate*, (N. Y. 1917) 164 N. Y. Supp. 956.

¹⁸ *Comptroller of New York v. Orvis et al.*, (N. Y. 1917) 166 N. Y. Supp. 126.

¹⁹ *State ex rel. Pettit v. Probate Court of Hennepin County et al.*, (Minn. 1917) 163 N. W. 285.

²⁰ *Knutson v. Krook*, (1910) 111 Minn. 352, 127 N. W. 11.

monument.²¹ A note to the Lester case²² contains many interesting illustrations of the amounts allowed for tombstones. In *Taylor's Estate*,²³ the court held that it was unreasonable to erect to a deceased person a monument of such a character as to provoke comment on the contrast between the lavishness of the monument and the simplicity of the habits and antecedents of the deceased.

Taxes and assessments, if they became a lien or in effect a debt prior to the date of death, even if not payable, are allowable as deductions;²⁴ but inheritance taxes imposed by other states are not allowed as deductions.²⁵

New York State has refused to allow as a deduction the federal inheritance tax.²⁶ The Minnesota supreme court recently²⁷ held that such tax was a proper deduction, not upon the ground that the federal government has paramount right to regulate successions but because Minnesota under its statute has expressed an intention to allow such deduction.

Expenses of administration, including appraisers' fees, executor's or administrator's fees, attorneys' fees, and the ordinary miscellaneous items are, if reasonable in amount, allowable as deductions. In *State v. Probate Court*,²⁸ Mr. Justice Brown (now Chief Justice) said:

"The expenses of administration are imposed as a matter of law, and are caused by the use of the legal machinery provided by the state to wind up the affairs of deceased persons, and cannot ordinarily be avoided; hence it is just that they should be deducted from the valuation of the estate."

In this case it is also clearly pointed out that it is not proper to allow as a deduction compensation earned, not in the administration of the estate, but in the management thereof for the benefit of the legatees and devisees.

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²¹ *State ex rel. Smith, Atty. Gen., v. Probate Court of St. Louis County et al.*, (Minn. 1917) 164 N. W. 365.

²² (1915) 169 Iowa 15, 150 N. W. 1033, Ann. Cas. 1917B 255 (263).

²³ (1894) 3 Pa. Dist. 691.

²⁴ *In re Liss' Estate*, (1902) 39 Misc. Rep. 123, 78 N. Y. Supp. 969; *Matter of Babcock*, (1889) 115 N. Y. 450, 22 N. E. 263.

²⁵ *Matter of Penfold*, (1915) 216 N. Y. 163 (171), 110 N. E. 497, Ann. Cas. 1916A 783.

²⁶ *In re Bierstadt*, (N. Y. 1917) 166 N. Y. Supp. 168; *In re Sherman*, (N. Y. 1917) 166 N. Y. Supp. 19, affirmed in December, 1917, by Court of Appeals.

²⁷ *State ex rel. Smith v. Probate Court of Hennepin County et al.*, (Minn. 1918) 166 N. W. 125.

²⁸ (1907) 101 Minn. 485 (487), 112 N. W. 878.