

CERTAIN DEFICIENCIES UNDER ESTATE TAX PROVISIONS OF INTERNAL REVENUE CODE OF 1939

FEBRUARY 9 (legislative day, JANUARY 26), 1965.—Ordered to be printed

Mr. LONG of Louisiana, from the Committee on Finance, submitted the following

REPORT

[To accompany H.R. 10185]

The Committee on Finance, to which was referred the bill (H.R. 10185) amending certain estate tax provisions of the Internal Revenue Code of 1939, having considered the same, reports favorably thereon without amendment and recommends that the bill do pass.

I. SUMMARY OF BILL

H.R. 10185 amends the Internal Revenue Code of 1939 to provide that if any part of a deficiency with respect to estate tax liability is due to fraud with intent to evade tax, the penalty to be imposed is 50 percent of the total amount of the deficiency, rather than 50 percent of the total tax liability. This conforms the rule under the Internal Revenue Code of 1939 to the rule now applicable in the case of estate tax deficiencies under the 1954 code.

The Treasury Department has indicated that it does not object to this bill.

II. REASONS FOR THE BILL

The attention of your committee has been called to the recent case of *Commissioner of Internal Revenue v. Estate of H. S. Leyman* ((Mar. 29, 1965) 344 F. 2d 763), in which a circuit court of appeals, reversing a decision of the Tax Court, held that under the Internal Revenue Code of 1939 the penalty, in the case of a fraudulent estate tax return, is 50 percent of the entire estate tax. The Tax Court had held that the penalty was the same as under the Internal Revenue Code of 1954—50 percent of the deficiency (the underpayment) in the estate tax.

In the *Leyman* case, the decedent died on May 24, 1954. If he had died on or after August 17, 1954, the Internal Revenue Code of 1954

would have been applicable to his estate and it would have been clear that the penalty, in the case of a false or fraudulent return, is 50 percent of the deficiency and not 50 percent of the tax. The decedent's son was the executor of the estate, and he filed an estate tax return which showed a tax due in an amount slightly in excess of \$2,056,000, and that tax was paid in full. Thereafter, the Commissioner of Internal Revenue asserted a large deficiency in the estate tax and claimed that part of the deficiency was due to fraud. The Tax Court held that there was a deficiency in the estate tax of \$1,240,242, most of which was attributable to a change in the valuation of an unlisted stock owned by the decedent and no fraud was involved on this issue. However, the Tax Court also held that part of the deficiency was attributable to fraud; that the executor had fraudulently omitted from the estate tax return the sum of \$613,000 in cash owned by the decedent at the time of his death. Since part of the deficiency was attributable to fraud, the Tax Court added a penalty of \$620,121 (50 percent of the deficiency of \$1,240,242).

The Commissioner contended that the fraud penalty should include, in addition to the \$620,121, 50 percent of the \$2,056,000 in tax paid when the original estate tax return was filed. The U.S. Court of Appeals for the Sixth Circuit agreed with the Commissioner and held that under the 1939 code the penalty for a fraudulent estate tax return was 50 percent of the entire tax and not just 50 percent of the underpayment.

In its decision the court of appeals stated that it was presented with a case of first impression for which it could find "no guiding casebook authority." Although the issue had not been previously litigated, it can be noted that the decision is contrary to the understanding your committee had of the 1939 code provision at the time of the enactment of the Internal Revenue Code of 1954. At that time the 1939 code provided a fraud penalty, in the case of excise taxes, of 50 percent of the entire tax. Your committee then believed that the fraud penalty should be limited in all cases to only 50 percent of the deficiency or underpayment, which was clearly the rule under the 1939 code in the case of the income and gift taxes and also, so your committee thought, in the case of the estate tax.

In reporting the bill which became the Internal Revenue Code of 1954 and which provided that the fraud penalty in all cases should be only 50 percent of the deficiency or underpayment, your committee reported to the Senate language identical to that which had been reported to the House:

Existing law imposes a 50-percent addition in the case of fraud applicable to all taxes, but in the case of taxes other than income, estate, and gift, that addition is based on the total amount of tax imposed. (S. Rept. 1622, p. 591, 83d Cong.)

Your committee, like the Committee on Ways and Means of the House, believes that the type of decision reached in the *Leyman* case produces a harsh result which cannot be justified, particularly in view of the fact that the burden of the penalty may fall in part on innocent beneficiaries of an estate who had nothing at all to do with the filing of the false estate tax return.

III. GENERAL EXPLANATION

The bill amends the Internal Revenue Code of 1939 to provide that if any part of a deficiency in the estate tax is due to fraud with intent to evade tax, then 50 percent of the total amount of the deficiency (in addition to the deficiency) is to be assessed and collected—in lieu of 50 percent of the entire tax.

The amendment is applicable with respect to any estate of a decedent subject to the estate tax provisions of the Internal Revenue Code of 1939, but the bill does not open up the statute of limitations if a refund is barred by the statute of limitations. Your committee is informed that there are only a few cases in which the Service has collected a fraud penalty based upon 50 percent of the entire tax. In those cases (if refunds are not barred by the statute of limitations or by any other law or rule of law, such as *res adjudicata*) the bill provides that no interest is to be paid or allowed on any refund resulting from the bill.

CHANGES IN EXISTING LAW

In compliance with subsection 4 of rule XXIX of the Standing Rules of the Senate, changes in existing law made by the bill are shown as follows (existing law proposed to be omitted is enclosed in black brackets; new matter is printed in italics; existing law in which no change is proposed is shown in roman):

INTERNAL REVENUE CODE OF 1939

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SEC. 871. PROCEDURE IN GENERAL.

(i) 50 PER CENT ADDITION TREATED AS DEFICIENCY.—The 50 per centum addition to the tax provided by section [3612(d)(2)] 894(a) shall, when assessed in connection with an estate tax, be assessed, collected, and paid in the same manner as if it were a deficiency, except that the provisions of section 891 shall not be applicable.

SEC. 894. PENALTIES.

(a) AD VALOREM.—

FAILURE TO FILE RETURN.—For addition to the tax for failure to file return, see section 3612(d)(1).

FALSE OR FRAUDULENT RETURN.—[For 50 per centum addition to the tax in case of a false or fraudulent return, see section 3612(d)(2).] *If any part of any deficiency is due to fraud with intent to evade tax, then 50 per centum of the total amount of the deficiency (in addition to such deficiency) shall be assessed, collected, and paid, in lieu of the 50 per centum addition to the tax provided in section 3612(d)(2).*