

TAM-117623-02

INTERNAL REVENUE SERVICE  
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

SEPTEMBER 19, 2002

Number: **200303010**

Release Date: 01/17/2003

Index (UIL) No.: 2031.00-00, 691.03-00

CASE MIS No.: TAM-117623-02/CC:PSI:4

Taxpayer's Name:

Taxpayer-s Address:

Taxpayer's Identification No:

Date of Conference:

LEGEND:

Decedent	=
Date 1	=
<u>\$a</u>	=
<u>\$b</u>	=
<u>\$c</u>	=
<u>\$d</u>	=
D%	=
Year 1	=
Year 2	=

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ISSUE:

Whether, in determining the fair market value of Series E United States savings bonds for estate tax purposes, the estate should calculate a lack of marketability discount for the income taxes due on the interest that accrued on the bonds from the date of purchase to the date of maturity.

CONCLUSION:

In determining the fair market value of the bonds for estate tax purposes, the estate should not calculate a discount for lack of marketability for the income taxes due on the interest that accrued on the bonds from the date of purchase to the date of maturity.

FACTS:

During her lifetime, Decedent purchased Series E United States savings bonds (Bonds) for a total purchase price of \$b. The Bonds were registered in Decedent's name. Interest totaling \$c accrued on the Bonds to the last date of maturity in Year 1.

Decedent died on Date 1 in Year 2. The date of death value of the Bonds is \$a, representing \$b, the purchase price and \$c, the interest on the Bonds from the date of purchase to the date of maturity. The Bonds passed to Decedent-s revocable trust (Trust) under the terms of Decedent's will. On a supplemental estate tax return the Decedent's personal representative included \$d in Decedent-s gross estate, representing the date of death value of the bonds less a D% discount for lack of marketability.

Section 315.15 of The Department of the Treasury Circular No. 530, as revised and amended (as of July 1997), provides that savings bonds are not transferable and are generally payable only to the owners named on the bonds, except as provided in the regulations contained in the Circular. Section 315.70(a) provides that if the owner of a bond registered in single ownership form has died, the bond becomes the property of that decedent-s estate, and payment or reissue will be made under specified rules contained in Circular No. 530. Section 315.71 provides that the legal representative of an estate may request payment of bonds, including interest or redemption checks, belonging to the estate or may have the bonds reissued in the names of the persons entitled to share in the estate.

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LAW AND ANALYSIS:

Section 2031 provides that the value of the gross estate of the decedent shall be determined by including the value, at the time of the decedent's death, of all property, real or personal, tangible or intangible, wherever situated.

Section 20.2031-1(b) of the Estate Tax Regulations provides that the value of every item of property includible in a decedent's gross estate under sections 2031 through 2044 is its fair market value at the time of the decedent's death, except that if the executor elects the alternate valuation method under section 2032, it is the fair market value at the date, and with the adjustments, prescribed in that section. The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts.

In Rev. Rul. 55-278, 1955-1 C.B. 471, in 1948, A purchased entirely with his own funds Series E United States savings bonds and registered the bonds in the names of A and his son B. In 1953, the bonds were reissued in the name of B alone in order to effect a gift to him. The Service held that the redemption value of Series E United States savings bonds at the time reissued is the proper value to be used by A with respect to the gift for federal gift tax purposes. In the ruling, the Service stated that since Series E United States savings bonds are generally nonnegotiable and nontransferable, they are nonmarketable and, accordingly, have no particular market value. Although ownership therein is transferable by death and by reissue in certain cases, (citing Department Circular No. 530, *supra*) their only definitely indicated or ascertainable value is the amount at which they are redeemable by the United States Treasury.<sup>6</sup> In that ruling, the Service referred to an earlier memorandum issued by the Service in which the Service held that Series E United States savings bonds are includible in the gross estate at their redemption value. *Mim. 5109*, C.B. 1940-2, 283, and *Mim. 5002*, C.B. 1941-2, 241.

The estate asserts that the interpretation by the Service in Rev. Rul. 55-278 clearly contravenes the definition of willing buyer discussed in section 20.2031-1(b). The estate argues that "[t]he contractual limitation on U.S. Savings Bonds, that they are only redeemable by the United States Treasury, does not change the definition of a hypothetical willing buyer." According to the estate, "a hypothetical willing buyer of the bonds would consider the built-in income tax liability in determining the amount he would be willing to pay for those bonds." In support of this position, the estate relies on Eisenberg v. Commissioner, 155 F.3d 50 (2d Cir. 1998) and Estate of Davis v. Commissioner, 110 T.C. 530 (1998).

The Service's holding in the revenue ruling does not contravene the definition of the willing buyer-willing seller test. "The willing buyer-willing seller test of fair market value is nearly as old as the federal income, estate, and gift taxes themselves. . . ." United States v. Cartwright, 411 U.S. 546 (1973). The willing buyer-willing seller test of fair market value is set forth in the U.S. Treasury Regulations as early as 1921. See Treas. Reg. 63 Relating to Estate Tax Under the Revenue Act of 1921, Art. 13 (122 ed.). When the Service issued Rev. Rul. 55-278, the willing buyer-willing seller test was widely applied by both the courts and the Service.

Under consideration in this case and in the revenue ruling is an issue similar to the issue considered by the United States Supreme Court in United States v. Cartwright, 411 U.S. 546 (1973). In Cartwright, the Court granted certiorari to determine the value of shares of mutual funds to be included in a decedent's gross estate under section 2031. The mutual fund shares were not traded on exchanges or generally in the over-the-counter market, but were sold by the investment fund through a principal underwriter, and redeemed by the fund, at prices which were related to the net asset value. The Court stated that in implementing section 2031, the value of property is to be determined by its fair market value at the time of decedent's death and the fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts.

The Court recognized the fact that the fund was under an obligation to redeem its shares at the redemption price and stated "that shares so held are, in important respects, similar to ordinary corporate stock held subject to a restrictive agreement, . . . so long as the restriction is a bona fide one, the value of the shares in the hands of the restricted stockholder is determined in accordance with the terms of the restriction. Treas. Reg. § 20.2031-2(h). Outstanding mutual fund shares are likewise held subject to a restriction, as the Court of Appeals noted. . . . Those shares may not be "sold" at the public offering price. By statute, they may be "sold" back to the mutual fund only at the redemption price. We see no valid justification for disregarding this reality connected with the ownership of mutual fund shares." Accordingly, the Court concluded that the redemption price was the value to be used in reporting the funds in the gross estate of the decedent.

Similarly, in this case and the revenue ruling, the only willing seller is the decedent or decedent's estate and the only willing buyer is the United States government. By contractual arrangement, the Bonds will be redeemed by the United States Treasury at the redemption price.

Eisenberg and Davis are distinguishable from this case. In those cases, the taxpayers transferred stock in a closely held corporation to family members. In valuing the stock for gift tax purposes, the taxpayers discounted the value of the stock to take into account the potential capital gains tax liabilities that may be incurred by the corporation if the corporation were to liquidate or distribute and sell its appreciated assets. In each case, the court held that the taxpayer was entitled to a discount for the potential capital gains tax liabilities because the court determined that a hypothetical buyer would take the corporation's potential capital gains tax liabilities into account in determining the value of the stock.

Eisenberg and Davis involve situations in which the hypothetical willing buyer acquires stock in a corporation that owns appreciated assets with built-in capital gain. The fact that the buyer will pay tax on the sale of the appreciated assets may be a factor in determining the price the willing buyer would pay for the stock. This case involves a situation in which the hypothetical willing seller must include in his/her gross income the interest accrued on the Bonds prior to the date of the "sale" (the redemption). Under section 454(c), the accrued interest on the Bonds is includible in the gross income of the taxpayer in the taxable year in which the obligation is finally redeemed or in the taxable year of final maturity, whichever is earlier. The income tax on the accrued interest is paid by the seller in this case. The courts recognize that it is not appropriate to allow a discount for the hypothetical willing seller's costs in determining the fair market value of an asset for estate tax purposes. For example, in Estate of Robinson v. Commissioner, 69 T.C. 222 (1977), in determining the value of an installment obligation includible in decedent's gross estate, petitioner (decedent's estate) discounted the installment obligations for estimated income taxes. The court held that the value of the installment obligation may not be discounted and remarked that "under [petitioner's] approach, every determination of fair market value for estate tax purposes would require consideration of possible income tax consequences as well as a myriad of other factors that are peculiar to the individual decedent, his estate, or his beneficiaries." In this case, the hypothetical willing buyer would not take the seller's income tax liability into consideration in determining the purchase price of the Bonds and, accordingly, the estate is not entitled to discount the Bonds for the income tax due on the accrued interest.

#### CAVEAT(S)

A copy of this technical advice memorandum is to be given to the taxpayer(s). Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.