

TAXATION

ESTATE OF PETERSON *v.* COMMISSIONER: "INCOME IN RESPECT OF A DECEDENT" AS APPLIED TO A LIVESTOCK SALES CONTRACT

INTRODUCTION

A difficult tax question arises when income is received by a decedent's successor in interest¹ as a result of a sales transaction executed during the decedent's lifetime, which was not completed until some point after death. This question revolves around whether these sales proceeds constitute "income in respect of a decedent" within the terms of section 691 of the Internal Revenue Code (Code).² If so, the successor in interest would be required to include the proceeds in gross income.³ If not, the property which was subject to the sale, as an asset of the decedent's gross estate, would be entitled to a step-up in basis equal to its fair market value on the date of the decedent's death.⁴ Any taxable gain on the

1. I.R.C. § 691(a)(1) (1954). That section provides that a successor in interest could be the decedent's estate, any person who acquired the right to receive an amount passing outside of his estate, or any person acquiring a right by bequest, devise, or inheritance after a distribution of the estate. *Id.*

2. *Id.* The text provides:

(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.

Id.

3. *Id.* at § 691(a)(3). That section provides that the income retains the same character in the hands of the successor in interest as it would have had in the hands of the decedent had he lived to complete the contract and receive the proceeds into his income. *Id.*

4. *Id.* at § 1014(a). That section provides that the basis of property in the hands of a person acquiring the property from a decedent shall be the fair market

transaction would be minimal.⁵

One of the key reasons for the extensive conflicts that have arisen over the application of this provision of the Code stems from the failure of Congress to adequately define the term "income in respect of a decedent."⁶ The definition offered by the Treasury Department Regulations⁷ provides little help in determining whether this section should apply to a given transaction.⁸ The task of providing a workable definition for this term has fallen on the courts.⁹ The results have caused both confusion and criticism of the judicial application of this provision.¹⁰

It was against this background that the case of *Estate of Peterson v. Commissioner*¹¹ arose. In *Peterson*, the Eighth Circuit held that the proceeds from a livestock sales contract did not constitute income in respect of a decedent where the estate's administrator performed substantive acts required as preconditions to the sale.¹² A historical analysis of section 691 follows. This analysis will facilitate an understanding of the problems confronting the judiciary when it applies the vague language of this section to executory sales transactions.

value of the property at the date of the decedent's death or on the alternate valuation date provided for by § 2032. *Id.* However, § 1014(c) provides that § 1014(a) does not apply to property "which constitutes a right to receive an item of income in respect of a decedent under section 691."

5. Note, *Sales Transactions and Income in Respect of a Decedent*, 3 GA. L. REV. 606, 607 (1969).

6. M. FERGUSON, J. FREELAND & R. STEPHENS, *FEDERAL INCOME TAXATION OF ESTATES AND BENEFICIARIES* 144 (1970) [hereinafter cited as M. FERGUSON]. An attempt to add a statutory definition to the Code failed in 1959. See also *Estate of Peterson v. Commissioner*, 74 T.C. 630, 638 n.7 (1980).

7. 26 C.F.R. § 1.691(a)-1(b). That section provides in part:

(b) *General Definition.* In general, the term "income in respect of a decedent" refers to those amounts to which a decedent was entitled as gross income but which were not properly includible in computing his taxable income for the taxable year ending with the date of his death or for a previous taxable year under the method of accounting employed by the decedent Thus, the term includes—

- (1) All accrued income of a decedent who reported his income by use of the cash receipts and disbursements method;
- (2) Income accrued solely by reason of the decedent's death in case of a decedent who reports his income by use of an actual method of accounting; and
- (3) Income to which the decedent had a contingent claim at the time of his death.

Id.

8. 3 B. BITTKER, *FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS* ¶ 83.1.2 (1981).

9. M. FERGUSON, *supra* note 6, at 144.

10. See, e.g., Gordon, *Income in Respect of a Decedent and Sales Transactions*, 1961 WASH. U.L.Q., 30, 30 (1961); See also Note, *supra* note 5, at 607.

11. 74 T.C. 630 (1980), *aff'd*, 667 F.2d 675 (8th Cir. 1981).

12. 667 F.2d at 678.

Historical Background of Section 691

Prior to 1934, the tax treatment of a decedent's right to income was dependent solely upon the accounting methods employed.¹³ If the decedent used an accrual method of accounting, all income properly accrued on the decedent's books up to the date of death was includible in the final income tax return.¹⁴ If a cash-basis method had been adopted, income "accrued" prior to death but received after death escaped income taxation.¹⁵ If a sales transaction was involved, the property which was subject to the sale would be entitled to a step-up in basis equal to its fair market value at the date of the decedent's death, and any taxable gain upon its disposition would be minimal.¹⁶

In part to prevent this revenue loss and in part to relieve the inequitable treatment between cash-basis and accrual-basis taxpayers,¹⁷ Congress enacted section 42 of the Revenue Act of 1934.¹⁸ This section provided that the final return of a decedent was to include "amounts accrued up to the date of his death if not otherwise properly includible in respect of such period or a prior period."¹⁹ In effect, this provision required all taxpayers to file their final returns as if they employed an accrual method of accounting.

In 1941, however, the United States Supreme Court, in *Helvering v. Enright*,²⁰ construed the term "accrual," as used in the 1934 Act, much broader than was the case under traditional accounting principles.²¹ In *Enright*, the decedent was a member of a law partnership.²² Both the partnership and the decedent used a cash-basis method of reporting income.²³ The Court concluded that the term required that the decedent include in his gross income his share of the estimated gross receipts for work commenced but un-

13. See Parlin, *Accruals to the Date of Death for Income Tax Purposes*, 87 U. PA. L. REV. 295, 296-97 (1939).

14. *E.g.*, 3 B. BITTKER, *supra* note 8, at ¶ 83.1.1; M. FERGUSON, *supra* note 6, at 140.

15. See, *e.g.*, *Nichols v. United States*, 64 Ct. Cl. 241, 246 (1927), *cert. denied*, 277 U.S. 584 (1928); *Kemper v. Commissioner*, 14 B.T.A. 931, 932 (1928); *Frank v. Commissioner*, 6 B.T.A. 1071 (1927).

16. See 3 B. BITTKER, *supra* note 8, at ¶ 83.1.1; M. FERGUSON, *supra* note 6 at 140.

17. See H.R. REP. NO. 704, 73d Cong., 2d Sess. — (1934), *reprinted in* 1939-1 C.B. 554, 572; S. REP. NO. 558, 73d Cong., 2d Sess. — (1934), *reprinted in* 1939-1 C.B. 586, 608.

18. Pub. L. No. 216 § 42, 48 Stat. 680, 694 (1934).

19. *Id.*

20. 312 U.S. 636 (1941).

21. See Note, *supra* note 5, at 608. For a definition of accrual, see Parlin, *supra* note 13, at 301-03.

22. 312 U.S. at 637.

23. *Id.*

finished at the date of his death.²⁴ This interpretation required the decedent to include in his final return amounts that would not have been accruable at death even by an accrual-basis taxpayer.²⁵ The Court reasoned that this interpretation met with "the intent of Congress to cover into income the assets of decedents, earned during their life and unreported as income . . ."²⁶

This construction resulted in what was considered an excessive "bunching"²⁷ of income into the decedent's final return and the imposition of a much higher tax, due to the surtax rates in effect.²⁸ To rectify this situation, Congress added section 126 to the 1939 Revenue Code.²⁹ This section provided for the taxation of income to the successor in interest of the decedent in the year it was received.³⁰ Congress intended to place the successor "in the same position with respect to the nature of this income as the position the decedent enjoyed."³¹ This provision exists today as section 691 of the 1954 Code.³²

Before the decision of *Commissioner v. Linde*,³³ it was generally thought that a sales transaction had to be consummated completely during the lifetime of the decedent before section 691 would apply.³⁴ In *Linde*, the decedent had marketed his wine grapes by delivering them to a cooperative marketing association.³⁵ The association commingled his grapes with those of other association members and assigned each member a percentage interest in the wine pools for that year.³⁶ The net proceeds received by the association upon the sale of these wine pools were returned to the members in proportion to their percentage interest.³⁷ The Tax Court held that a trust arrangement and not a sale had taken

24. *Id.* at 640-41.

25. M. FERGUSON, *supra* note 6, at 164.

26. 312 U.S. at 644-45.

27. B. BITTKER, *supra* note 8, at ¶ 83.1.1. See also M. FERGUSON, *supra* note 6, at 140-41.

28. M. FERGUSON, *supra* note 6, at 140-41. See also 3 B. BITTKER, *supra* note 8, at ¶ 83.1.1.

29. I.R.C. of 1942, ch. 619, § 126, 56 Stat. 798, 831 (1942).

30. *Id.* at § 126(a)(1).

31. S. REP. NO. 1631, 77th Cong., 2d Sess. — (1942), reprinted in 1942-2 C.B. 504, 581.

32. The only change in the statute in 1954 was an expansion to include items of income in respect of a prior decedent. I.R.C. § 691(a)(1) (1954).

33. 17 T.C. 584 (1951), *rev'd*, 213 F.2d 1 (9th Cir. 1954), *cert. denied*, 348 U.S. 871 (1954).

34. Drye, *Taxation of a Decedent's Income*, 8 TAX L. REV. 201, 207 (1953); Tomlinson, *How to Handle Income in Respect of a Decedent Under Section 691*, 6 J. TAX'N 250, 252 (1957).

35. 213 F.2d at 3.

36. *Id.*

37. *Id.*

place between the decedent and the association, and held that the proceeds received by the decedent's widow on sales made in the year following his death did not constitute income in respect of a decedent.³⁸

On appeal, the Ninth Circuit reversed, holding that it was not necessary for the decedent to have had an enforceable right to the proceeds during his lifetime in order for them to be covered by section 691.³⁹ The court noted that:

The payments which the taxpayer [widow] received in 1945 were realized under and in consequence of contracts and deals made by the decedent in his lifetime. No act or thing taken or performed by the taxpayer operated to procure or to give rise to this payment. Such payments had their source exclusively in the decedent's contract and arrangement with the cooperative associations.⁴⁰

The court in *Linde* relied heavily on the theory espoused in the case of *O'Daniel's Estate v. Commissioner*.⁴¹ In *O'Daniel*, the Second Circuit established the principle that, in the area of personal service income, it was not necessary for decedents to have had an enforceable right to an amount during their lifetimes for it to be considered income in respect of a decedent.⁴² The decedent in *O'Daniel* was an officer of a corporation and participated in a company bonus plan for several years prior to his death.⁴³ No enforceable right to any of the bonuses arose until they were declared by the proper official.⁴⁴ Several months after *O'Daniel's* death, a bonus was declared and paid to his estate.⁴⁵ In holding this payment to be income in respect of a decedent, the Second Circuit noted that "the right . . . acquired by the decedent's estate from the decedent' which is referred to in [the statute] is not necessarily a legally enforceable right but merely any right derived through his services rendered while living."⁴⁶

The broadening of the *O'Daniel* theory to sales transactions by the *Linde* court did not pass without criticism.⁴⁷ It is a well estab-

38. 17 T.C. at 593-94.

39. 213 F.2d at 8.

40. *Id.* at 4.

41. *Commissioner v. Linde*, 213 F.2d 1, 3 (9th Cir. 1954) (citing *O'Daniel's Estate v. Commissioner*, 173 F.2d 966 (2d Cir. 1949)).

42. 173 F.2d at 968.

43. *Id.* at 967.

44. *Id.*

45. *Id.*

46. *Id.* at 968.

47. See Krieg & Buschmann, *Section 126: "Items of Gross Income in Respect of a Decedent . . ."* 32 TAXES 651 (1954); Scott, *The Strange Case of Commissioner v. Linde*, 33 TAXES 675 (1955).

lished principle of income tax law that a taxable transaction or event occur as a prerequisite to taxation.⁴⁸ It is argued that this decision led to the taxation of rights to property rather than rights to income.⁴⁹

The next major case which applied section 691 to the proceeds of a sales transaction was *Trust Company of Georgia v. Ross*.⁵⁰ *Trust Company* involved a contract for the sale of assets in a hotel chain valued at over \$3.5 million.⁵¹ Prior to his death, the decedent entered into an executory contract for the sale of his stock and placed the stock in the hands of an escrow agent.⁵² At the time of the decedent's death, the purchasers lacked sufficient funds to close the deal. The decedent's estate negotiated a modified agreement as to the manner of payment and effected the formal closing.⁵³ The Commissioner sought to treat these proceeds as section 691 income.⁵⁴

The trial court held that the proceeds constituted income in respect of a decedent within the purview of section 691.⁵⁵ Despite the considerable post-death negotiations carried out between the purchasers and the decedent's executor, the trial court reasoned that it was the "economic activity" of the decedent that gave rise to the right to receive the sales proceeds.⁵⁶ The court held that the executor's activities "were merely perfunctory and of no material significance."⁵⁷ The court stated that "on the date of his death, [the decedent] had only to await the date of the closing to receive the sums due under the contract of sale which he had negotiated prior to his death."⁵⁸

On appeal, the Fifth Circuit affirmed the lower court decision but refused to adopt the "economic activity" test as the basis for its decision, finding it too open-ended and inadequate as precedent given the scope of the statute.⁵⁹ The court agreed that an inquiry into the decedent's level of activities in relation to the transaction

48. Scott, *supra* note 47 at 677.

49. *Id.* at 679-80.

50. 262 F. Supp. 900 (N.D. Ga. 1966), *aff'd on other grounds*, 392 F.2d 694 (5th Cir. 1967), *cert. denied*, 393 U.S. 830 (1968).

51. *Id.* at 901.

52. *Id.* at 902.

53. *Id.* at 904.

54. *Id.*

55. *Id.* at 910.

56. *Id.* at 908-09. For a critique of the "economic activity" test, see Note, *supra* note 5, at 613-21.

57. 262 F. Supp. at 909.

58. *Id.*

59. 392 F.2d at 695.

was pertinent.⁶⁰ However, these efforts must give rise to a *right* to the income before section 691 would apply.⁶¹ This right should be distinguished from the activities which gave rise to the right.⁶² The court noted that “[a]bsent such a right, no matter how great the activities or efforts, there would be no taxable income under § 691.”⁶³ This test has commonly been referred to as the “entitlement” test.⁶⁴ The court found the right existed at the time of the execution of the contract and affirmed the decision.⁶⁵

*Keck v. Commissioner*⁶⁶ set forth the requirement that there could not exist at the time of the decedent's death any material contingencies that could disrupt the sale.⁶⁷ In *Keck*, the decedent was in the process of selling his minority interest in three corporations involved in the transportation business.⁶⁸ The sales contracts were conditioned upon a favorable ruling from the Internal Revenue Service that any gain realized on the sale would be exempt from taxation under section 337 of the Code⁶⁹ and that the Interstate Commerce Commission (ICC) would approve the sale.⁷⁰ The ICC approval was not granted until eighteen months after the decedent's death.⁷¹ The Tax Court, in a divided opinion, held that the proceeds were income in respect of a decedent, relying on the “economic activity” test set out by the trial court in *Trust Company*.⁷²

The dissenting judges in *Keck* argued that “[t]he proper test for determining whether gain from the sale of property is to be treated as income in respect of a decedent is the status of the transaction at decedent's death, not who carried on the ‘economic activity’ which brought it to that status.”⁷³ The dissent noted that

60. *Id.*

61. *Id.*

62. *Id.*

63. *Id.*

64. *Id.* at 696. *See also* Estate of Peterson v. Commissioner, 667 F.2d 675, 679 (8th Cir. 1981).

65. 392 F.2d at 696-97.

66. 49 T.C. 313 (1968), *rev'd*, 415 F.2d 531 (6th Cir. 1969).

67. 415 F.2d at 534-35.

68. 49 T.C. at 314-16.

69. *Id.* at 320. I.R.C. § 337(a) (1954) provides that if a corporation adopts a plan of complete liquidation, and distributes all of its assets in complete liquidation within the 12-month period beginning on the date of the adoption of the plan, it shall not recognize any gain or loss from the sale or exchange of property within that 12-month period.

70. 49 T.C. at 320.

71. *Id.* at 316.

72. *Id.* at 320-21. *See* notes 54-65 and accompanying text *supra*. The Tax Court in *Keck* did not have the benefit of the appellate court's decision five days earlier in *Trust Company* which had rejected the “economic activity” test.

73. 49 T.C. at 323. (Featherston, J., dissenting).

the majority shareholder in these corporations could have decided not to liquidate.⁷⁴ Furthermore, they noted that ICC approval, which was not obtained until eighteen months after death, was neither routine nor perfunctory.⁷⁵ Since these contingencies existed at the date of the decedent's death, the dissent argued that section 691 was inapplicable.⁷⁶

On appeal, the Sixth Circuit reversed.⁷⁷ In its decision, the court adopted the approach taken by the dissent in the Tax Court.⁷⁸ The Sixth Circuit found this approach consistent with the Fifth Circuit's decision in *Trust Company*.⁷⁹

The Eighth Circuit, in *Estate of Sidles v. Commissioner*,⁸⁰ dealt with the application of section 691 to the proceeds of a complete liquidation and dissolution of a corporation.⁸¹ Before his death, the decedent, as sole shareholder and member of the board of directors of the Bi-State Distribution Corporation, approved a plan of liquidation.⁸² After his death, the board distributed the assets of the corporation, declared the liquidating dividend and filed the articles of dissolution with the State of Nebraska.⁸³ The estate sought to exclude these proceeds from the operation of section 691, contending that neither the adoption of the plan of liquidation nor the decedent's activities created the requisite right to income necessary at the time of death to bring the proceeds within the scope of the statute.⁸⁴ The Tax Court disagreed, holding that the acts of the board were ministerial in nature⁸⁵ and that "the decedent had performed enough substantive acts within his control to perfect his right to receive the liquidating distribution for purposes of section 691."⁸⁶ Finding that no material contingencies existed at the time of death, the court held the sales proceeds to be income in respect of a decedent.⁸⁷ The Eighth Circuit affirmed in an unpublished opinion.⁸⁸

74. *Id.* at 323-24.

75. *Id.* at 323.

76. *Id.*

77. 415 F.2d at 535.

78. *Id.* at 534-35.

79. *Id.*

80. 65 T.C. 873 (1976), *aff'd mem.*, 553 F.2d 102 (8th Cir. 1977).

81. 65 T.C. at 873.

82. *Id.* at 880-81.

83. *Id.* at 881.

84. *Id.* at 877-78.

85. *Id.* at 881.

86. *Id.*

87. *Id.* at 882-83.

88. 553 F.2d 109 (8th Cir. 1977).

FACTS AND HOLDING

In *Estate of Peterson v. Commissioner*,⁸⁹ the decedent was in the business of raising and selling cattle for over forty years prior to his death.⁹⁰ In July of 1972, he entered into a "livestock sales contract" with the Max Rosenstock Company (Rosenstock), through its agent, R. E. Brickley.⁹¹ The agreement provided that the decedent was to raise and deliver to the Rosenstock Company approximately 3,300 head of calves at \$0.49 per pound, with the decedent designating delivery upon five days notice.⁹² The calves located on the decedent's Brown County ranch were to be delivered no later than November 1, 1972, and those on his Holt County ranch were to be tendered by December 15, 1972,⁹³ with the decedent bearing all risk of loss until delivery.⁹⁴

From the past dealings of the parties, it was evident that the decedent would deliver calves between three and eleven months old and that the decedent would allow Brickley to reject any calves he considered unmerchantable, diseased, too old or too young.⁹⁵ The decedent generally culled those calves from the herds prior to delivery.⁹⁶

The decedent had not designated any delivery dates nor tendered any of the calves as required by the contract prior to his death on November 9, 1972.⁹⁷ His estate, which was co-administered by one of his sons, took over care of the cattle and delivered them between December 8 and December 15, 1972.⁹⁸ Of those eventually delivered, two-thirds would have met the minimum contract requirements on the date of the decedent's death.⁹⁹

The estate filed a fiduciary tax return on which it reported the sale of the calves, computing the gain on the sale as the difference between the sales proceeds and the fair market value of the cattle on the date of the decedent's death.¹⁰⁰ The Commissioner deter-

89. 74 T.C. 630 (1980), *aff'd*, 667 F.2d 675 (8th Cir. 1981).

90. *Id.* at 631.

91. *Id.* at 631, 633.

92. *Id.* at 632-33.

93. *Id.* at 632.

94. *Id.* at 634.

95. *Id.* at 633. The parties to the contract had done business together for over 40 years. *Id.*

96. *Id.*

97. *Id.* at 634.

98. *Id.*

99. *Id.* at 635.

100. *Id.* The estate initially reported the sale of only 1,479 head of calves, but later conceded that an additional 919 should have been reported in this return. *Id.* It appears that there was still a conflict over the amount of gain to be recognized as to these additional calves.

mined that the proceeds realized from the sale constituted income in respect of a decedent and recomputed the gain by subtracting the decedent's adjusted basis in the calves from the sales proceeds.¹⁰¹

The Tax Court rejected the Commissioner's position.¹⁰² After reviewing the relevant statutory and case law history, the court set forth a four-pronged test to be utilized when section 691 is applied to sales transactions.¹⁰³ The first factor required that the decedent have entered into a legally significant arrangement regarding the subject matter of the sale.¹⁰⁴ Second, the decedent had to perform all the substantive, *i.e.*, non-ministerial, acts required as preconditions to the sale.¹⁰⁵ Third, there could not exist at the time of death any materially economic contingencies which might have disrupted the sale.¹⁰⁶ Finally, the decedent must have been able to receive the sales proceeds had he lived, *i.e.*, contracts that would only be effective upon death were excluded.¹⁰⁷

The Tax Court determined that the second factor of the test was not met in *Peterson*.¹⁰⁸ The majority of the court appeared to adopt the position that, at the time of his death, the decedent had not sufficiently perfected his right to receive the sales proceeds in order to warrant application of section 691.¹⁰⁹

Several judges in the Tax Court concurred only in the majority's result.¹¹⁰ These concurring judges would have supported the Commissioner's position had he sought to apply section 691 only to that portion of the sales proceeds attributable to the calves which were in a deliverable state on the date of the decedent's death.¹¹¹ As to the remaining one-third of the herd, the concurring judges agreed that section 691 would be inapplicable.¹¹² Since the Commissioner failed to argue for allocation of the sales proceeds, the judge concurred in the majority's result.¹¹³

On appeal, the Commissioner was unsuccessful in arguing for the allocation¹¹⁴ of the sales proceeds as recommended by the

101. 74 T.C. at 635. *See* note 4 *supra*.

102. *Id.* at 641.

103. *Id.* at 639.

104. *Id.* at 639-40.

105. *Id.* at 640-41.

106. *Id.* at 641.

107. *Id.*

108. *Id.* at 644-46.

109. *Id.* at 644-45.

110. *Id.* at 646 (Simpson, J., concurring).

111. *Id.*

112. *Id.* at 647.

113. *Id.* at 646.

114. 667 F.2d at 678-79.

concurring judges' opinion in the Tax Court. The Eighth Circuit affirmed the majority opinion of the Tax Court,¹¹⁵ finding additional support for its position in the works of noted scholars.¹¹⁶ The court noted that the Tax Court's position emphasized delivery or disposal of the subject matter of the sale over the significance of the sales contract, but found such an interpretation was not inconsistent with the prior case law.¹¹⁷

ANALYSIS

The facts of *Peterson* presented the Eighth Circuit with an interesting situation which it had not previously confronted. The record contained no reason as to why the decedent had not designated a delivery date or delivered the Brown County calves by the November deadline specified in the contract.¹¹⁸ The Tax Court¹¹⁹ found that Brickley's acceptance of the calves during December operated as a waiver of the November 1 delivery date and resulted in an implied modification of the contract.¹²⁰ The Tax Court based its decision in part on the fact that a "significant" number of the calves were not in a deliverable condition on the date of the decedent's death.¹²¹ This finding, coupled with the fact that each calf gained from one-half to three pounds per day¹²² between the date of the decedent's death and the date of delivery, apparently led the Tax Court to hold that the decedent had not sufficiently perfected a right¹²³ to receive the sales proceeds by the date of his death. The Eighth Circuit stated:

Here, the task remaining to be performed by the estate was performance of the contract. We agree with the conclusion of the Tax Court that performance of the contract, which, under the circumstances, involved care and feeding of livestock and delivery, cannot be characterized as a ministerial or minor act.¹²⁴

115. *Id.* at 676.

116. *Id.* at 677-80. Those works include 3 B. BITTKER, *supra* note 8 and M. FERGUSON, *supra* note 6.

117. 667 F.2d at 681.

118. 74 T.C. at 635.

119. All references in this analysis to the majority approach in the Tax Court are also applicable to the Eighth Circuit's decision in this case. It appears that the Eighth Circuit adopted the Tax Court's majority opinion in toto, adding relevant support where it deemed necessary. Any differences are noted.

120. 74 T.C. at 635.

121. *Id.* at 644.

122. *Id.*

123. *Id.* The court stated: "In sum, the estate's right to the sale proceeds derived from its own efforts as well as those of the decedent." *Id.*

124. 667 F.2d at 681.

In the absence of the majority's finding that the contract had been modified, both the Tax Court and the Eighth Circuit's decisions would not appear to have been justified under the prior case law.¹²⁵ The Eighth Circuit found that there existed at the time of death a "legally significant agreement to sell the calves on the basis of the livestock sales contract,"¹²⁶ which met with the first requirement of the adopted test. Second, the court found that there were no material economic contingencies that could have disrupted the sale.¹²⁷ Third, the court found that the decedent would have received the sales proceeds had he lived to complete the sale.¹²⁸ These findings, coupled with the fact that the *original* agreement would have been considered an "installment contract" within the terms of section 2-612 of the Nebraska Uniform Commercial Code,¹²⁹ would appear to support the concurring judges' position in the Tax Court that a portion of the sales proceeds constituted income in respect of a decedent. In the words of Judge Simpson:

As to the two-thirds of the calves which were deliverable at the date of the decedent's death, his efforts had earned a right to the income from their sale As to those calves, actual delivery of the calves to the purchaser was all that was required to complete the sale. We do not know why none of the calves were delivered before the death of the decedent, but whether those calves were delivered *was wholly within the control of the decedent and those managing his affairs*. It was their decision not to deliver the calves before his death, and their decision not to perform that ministerial act of delivery should not result in the income from the sale of such calves being exempt from income tax. . . . The effect of the opinion of the majority is to exempt from income tax the proceeds of the sale of all of the calves simply because some of them were not deliverable at the time of the decedent's death [S]uch a result clearly frustrates the purpose of section 691.¹³⁰

125. See notes 50-65, 80-87 and accompanying text *supra*.

126. 667 F.2d at 678.

127. *Id.* Cf. Keck v. Commissioner, 415 F.2d 531, 534 (6th Cir. 1969) (ICC approval necessary as precondition to sale of decedent's interest).

128. 677 F.2d at 678.

129. NEB. REV. STAT. (U.C.C.) § 90-2-612 (Reissue 1980) provides in pertinent part: (1) An "installment contract" is one which requires or authorizes the delivery of goods in separate lots to be separately accepted, even though the contract contains a clause "each delivery is a separate contract" or its equivalent Section 2-607 provides that once a buyer has accepted a conforming lot of goods, the seller is entitled to payment for that portion of the goods so tendered.

130. 74 T.C. at 649-50 (emphasis added).

Thus, the question of whether section 691 applied to the sales proceeds in *Peterson* was dependent on the majority's finding in the Tax Court that the actions of the decedent, the administrator of his estate, and the buyer constituted a modification of the contractual provisions.¹³¹ The concurring opinion's position appears to bring back the "economic activities" test which was set out in the trial court's opinions in *Trust Company*¹³² and *Keck*.¹³³ This test was rejected on appeal in *Trust Company*,¹³⁴ *Keck*¹³⁵ and *Peterson*.¹³⁶

The problem the court addressed was the standard to be employed when confronted with contracts of sale that have been modified in such a way as to preclude application of section 691. If modifications of sales transactions are not carefully reviewed, astute taxpayers or executors of their estates could vitiate the application of section 691.¹³⁷ If the judiciary refuses to consider the effects of modification of sales contracts, then it is foreseeable that section 691 could be applied where the modification is the result of good faith bargaining between the parties, thereby nullifying any "right" the decedent may have had in the sales proceeds at the time of the execution of the contract.¹³⁸ Some clear, ascertainable standard is necessary to balance the competing values of freedom to contract and the prevention of tax avoidance.

Little has been written on the applicability of section 691 with regard to modified sales contracts.¹³⁹ The theory of a bonafide "business purpose," which has been useful in analyzing other tax avoidance problems within the Code, also appears to have value with respect to modified sales contracts.¹⁴⁰ If there exists a valid reason, other than the avoidance of tax liability, to explain the modifications, then there appears to be good reason to allow a con-

131. *Id.* at 635.

132. See notes 58-65 and accompanying text *supra*.

133. See notes 72-77 and accompanying text *supra*.

134. See notes 59-65 and accompanying text *supra*.

135. See notes 73-77 and accompanying text *supra*.

136. 667 F.2d at 679. The court stated: "Whether income is considered income in respect of a decedent under § 691 depends upon whether the decedent had a right to receive income at the time of his or her death. The focus is upon the decedent's right or entitlement to income at the time of death." *Id.* (emphasis in original).

137. See generally Rice, *Judicial Techniques in Combating Tax Avoidance*, 51 MICH. L. REV. 1021, 1021-24 (1963).

138. See M. FERGUSON, *supra* note 6 at 185-86.

139. For a brief discussion, see M. FERGUSON, *supra* note 6, at 184-87. See also Note, *Tax Effect of Executor's Rescission and Renegotiation of Decedent's Contracts*, 51 MINN. L. REV. 251 (1966).

140. See Note, *supra* note 139, at 256-58. For an exhaustive review of the "business purpose" test as it applies to the tax avoidance problems, see generally Lesser, *Business Purpose Revisited*, 14 U. S. CAL. 1962 TAX INST. 513; Rice, *supra* note 137.

tract for sale to avoid application of section 691. Such a modification would have to be sufficient to take away the decedent's "right" to receive the sales proceeds at the date of death or should be sufficient to effectuate a rescission of the contract if a post-death modification is involved.¹⁴¹

As applied to the facts of Peterson, the Tax Court and the Eighth Circuit appeared to adopt some sort of a "business purpose" test in their analyses inasmuch as they excused the application of section 691. The Tax Court went to great lengths to point out the deficiencies that existed with the tender at the time of the decedent's death.¹⁴² The amount of the sales proceeds was enhanced as to those cattle that were in a deliverable state at the date of death due to the care offered by the decedent during the nine days between the November 1 delivery deadline and the date of his death, and which was continued by his estate until the eventual delivery.¹⁴³ The Eighth Circuit declared that the estate had the burden of performing the contract.¹⁴⁴

Another interesting portion of this case relates to the Eighth Circuit's apparent adoption of Ferguson, Freeland and Stephens' approach to the application of section 691 to sales proceeds.¹⁴⁵ The court first laid out Ferguson, Freeland and Stephens' working definition of income in respect of a decedent:

Items of income in respect of a decedent . . . are payments received toward satisfaction of a right or expectancy created almost entirely through the efforts or status of the decedent and which, except for his death and without further action on his part, the decedent would have realized as gross income. Two observations should be made. First, the concept is manifestly broader than the mere accrued earnings of a cash basis decedent. Second, despite the breadth of this tentative definition, § 691 does not reach the income potential in a decedent's appreciated property, even if the appreciation is due to the decedent's own efforts. Further action on the decedent's part (*e.g.*, a sale) would have been required for such appreciation to be realized as income. Within this definition farm produce inventories grown, harvested, and processed for market,

141. For a discussion on the reasons why rescission, rather than renegotiation, between the same contracting parties is more apt to gain a favorable judicial interpretation, see M. FERGUSON, *supra* note 6, at 185. See also Note, *supra* note 139, at 257-61.

142. 74 T.C. 630, 644 (1980) (one-third of the cattle were not in deliverable condition on the date of the decedent's death).

143. See notes 119-123 and accompanying text *supra*.

144. See note 124 and accompanying text *supra*.

145. 667 F.2d at 677-81.

but not delivered by the decedent before his death, even though they come very close to representing ordinary income actually realized, are 'property' rather than a bare right to income until they are sold. Not being income in respect of a decedent, they qualify for a new basis at death under the fair market value provision of § 1014(a).¹⁴⁶

The more troublesome aspect of the court's opinion was its apparent adoption of the Ferguson, Freeland and Stephens' approach to the application of section 691 to sales proceeds from executory sales transactions. That approach states in part:

[W]here there is a contract of sale which would have been completed during the decedent's life but for his death, the proceeds received upon culmination of the sale by the decedent's transferee will be taxed as income in respect of a decedent if no substantial conditions remained to be performed by the decedent at his death. Thus, if the executor had only a passive or ministerial role to play in completing the sale, the proceeds should be taxed as income in respect of a decedent Whenever the decedent negotiates a contract enforceable by his executor after death, the profit may properly be attributed to the decedent's bargaining and other efforts, which would seem to suggest income treatment for a part of the post-death receipts. On the other hand, the basis rule of § 1014(a) suggest that, wherever the risks inherent in ownership remain with the decedent until death, adjustments to the property's basis (and hence variations in the amount of gain or loss under the contract) remain possible until actual disposition by the decedent's successor.¹⁴⁷

Depending upon how the above statement is interpreted, this approach may appear to be inconsistent with prior case law.¹⁴⁸ From these cases, it is clear that the judiciary does not require delivery of the subject matter of the sale before death in order for section 691 to apply.¹⁴⁹ If this statement is interpreted to mean that the decedent must substantially perform all the *substantive* acts required as preconditions to the sale before section 691 would apply, and that mere delivery was a ministerial act, it is consistent with prior case law.¹⁵⁰

146. *Id.* at 679-80 (quoting M. FERGUSON, *supra* note 6, at 146).

147. *Id.* at 681 (quoting M. FERGUSON, *supra* note 6, at 183-84).

148. See notes 33-88 and accompanying text *supra*.

149. See notes 50-65, 80-87 and accompanying text *supra*.

150. *Id.* See note 149 *supra*.

CONCLUSION

The *Peterson* decision illustrates the extreme difficulty a court confronts when faced with the task of applying the vague and confusing language of section 691 to practical situations where tax implications emerge when settling a decedent's estate. While the courts have done a fairly good job of grappling with the problems caused by section 691, there is a definite need for Congress to codify a clearer definition of "income in respect of a decedent." Until this is done, all that can be foreseen is further confusion and conflict between the tax professional and the Internal Revenue Service. The *Peterson* decision, insofar as it adopted the majority position of the Tax Court, offers a workable test to apply to the area of proceeds from executory sales contracts. It is also advisable that the judiciary adopt a "business judgment" test when evaluating modifications to executory sales contracts. The application of such a test fairly treats the competing interests present when confronting this type of problem.

Terrence P. Maher—'84