CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 294

April 23, 1965

BONDS: BASIS FOR COMPUTING GAIN OR LOSS

Syllabus:

Decedent owned U.S. Treasury Bonds on the date of his death November 18, 1958. For State income tax purposes the basis used in computing the gain resulting from a subsequent redemption of the bonds in payment of Federal estate taxes was the "quoted market price" of the bonds at the date of decedent's death. For Federal income tax purposes the basis used was the "par value" of the bonds at the date of the decedent's death. The basis used for State income tax purposes was less than the basis shown for Federal income tax purposes.

The executrix of the decedent's estate subsequently filed a claim for refund claiming that the basis previously reflected on the State income tax return was in error and that since the bonds were redeemed at par in payment of Federal estate taxes their value should be increased for basis purposes to reflect the par value on the State income tax return. It was noted on the claim that the California inheritance tax appraiser had increased the value for inheritance tax purposes to the "par value" of the bonds at the date of decedent's death.

Should the basis for the computation of gain or loss upon the redemption of U. S. Treasury Bonds in payment of Federal estate tax be the "quoted market price" or the "par value" of such bonds at the date of the decedent's death?

Section 18044 provides as follows:

> "Except as otherwise provided in this article, the basis of property in the hands of a person acquiring the property from a decedent or to whom the property passed from a decedent shall, if not sold, exchanged, or otherwise disposed of before the decedent's death by such person, be the fair market value of the property at the time of its acquisition."

The purpose of this section has been interpreted by Regulation 18044-18047(a) to be "to provide a basis for property acquired from a decedent which is equal to the value placed upon such property for purposes of the California inheritance tax . . ." The California Inheritance Tax Division has ruled that the fair market value of the U. S. Treasury Bonds used in partial payment of the Federal estate tax is their par value at the date of death rather than their quoted market price at that date. Under such circumstances, Regulation 18044-18047(c)(1) is even more definite. That regulation states:

> "For purposes of this regulation and Reg. 18044-18047(a) the value of property as of the date of the decedent's death as appraised for the purpose of the State inheritance tax, shall be deemed to be its fair market value."

Here the bonds were redeemed at par in payment of Federal estate taxes. Thus, for Federal income tax and estate tax purposes and for State inheritance tax purposes, the par value rather than the quoted market price has been deemed to be the "fair market value" of the bonds at the date of decedent's death. Bankers Trust Company v. United States, 284 F. 2d 537 decided that where U. S. Treasury Bonds could be used as a credit against estate tax, such bonds had to be valued at par rather than the lower market price in determining their value for estate tax purposes. Although such a bond might be quoted in the market at less than par, in the hands of the decedent's executor it is clearly worth par if it can be applied in payment of the estate tax. The fair market value is thus determined by the use to which the bond may be put, not by the price at which the bonds would change hands between a willing buyer and a willing seller. Since the bonds in question could be and were redeemed at par, for basis purposes, their redemption value was their "fair market value." The presumption created by Reg. 18044-18047(c)(1) has not been rebutted.

Under the circumstances, only by the allowance of the claim for refund will the purpose of the statute as interpreted by Reg. 18044-18047(a) be fulfilled.