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Income Tax Determinations
Arms, George L. & Frances

Commissioners Murphy & Macduff

Selomon Slos, Hearing Officer

**GEORGE L. ARMOUR and
FRANCES ARMOUR, his wife**

1953 Assessment #B 289953

1954 Assessment #B 324162

1955 Assessment #B 577452

Article 16

A hearing with reference to the above matter was held before me at 80 Centre Street, New York City, on March 24, 1960. The appearances and the evidence produced were as shown in the stenographic minutes and exhibits submitted herewith.

The issues involved herein are (1) whether the deduction by the taxpayer, George L. Armour of \$39,312.70 paid in settlement of a claim for surcharge as a trustee of various inter vivos trusts was a proper deductible expense in accordance with the provisions of subdivision 1, Section 360 of the Tax Law; (2) whether the value of stock sold by the taxpayer on an installment basis which was purchased by him under an option granted to him under the will of his deceased brother should have been \$4,488,666.82, the cost of said stock upon purchase rather than \$4,966,950.00, the appraised value for federal estate tax purposes as claimed by the taxpayer in accordance with subdivision 6, Section 353 of the Tax Law or whether the gain should be computed on the actual cost basis pursuant to subdivision 1, Section 353; and (3) whether the taxpayer, is entitled to a deduction of legal fees in the sums of \$25,000.00 and \$21,000.00 respectively for the years 1954 and 1955 as an expense incurred in the acquisition of the stock deductible from capital gains on Schedule E for said years.

On November 26, 1934, the taxpayer, George L. Armour, was named sole trustee of four separate (irrevocable) inter vivos trusts, which had been created by his late brother, Bernard L. Armour, under the Laws of the State of New York for the benefit of his infant children and sister. It appears that Bernard was divorced from his wife, and desired to create these trusts primarily for their education. The settlor of the trust transferred to each trust certain shares of stock of certain corporations. Under the terms of the trust agreement, the trustee was required to retain the principal in the form in which he had received the same and was empowered in his discretion to sell said property and reinvest the proceeds in such securities as he deemed proper and pay a portion of the income for the education of the minor children as he deemed necessary and to accumulate the balance for their benefit until they reached their majority.

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The taxpayer submitted an agreement dated September 2, 1937, entered into between himself, as trustee and the settler of the trusts, (his brother, Bernard E. Armour) whereby taxpayer, agreed to purchase for each trust 5,000 shares of common stock in the Aspinock Corporation at 10 cents per share and \$25,000.00 first mortgage 6% bonds maturing February 14, 1948. Pursuant to the agreement the taxpayer granted his brother the exclusive right and option for a period of ten years from the date of the agreement to repurchase the aforementioned common stock of Aspinock Corporation at ten cents per share in consideration of the settler agreeing to indemnify the taxpayer from any liability as a result thereof. On August 22, 1945, Bernard E. Armour exercised the option given him under the agreement and did purchase the stock at the original cost thereof. Bernard E. Armour died on December 1, 1949, a resident of New Jersey and the stock of Aspinock Corporation had become part of the assets in his estate. His will was admitted to probate in Superior Court, New Jersey on December 19, 1949 and George L. Armour (taxpayer), Chase Manhattan Bank and George F. Lewis, Esq. were duly appointed as executors and trustees under said will.

The taxpayer, as trustee of the inter vivos trusts commenced an action in the Supreme Court, New York County in 1949 for judgment permitting him to render an intermediate account of his proceedings as trustee for the period from November 26, 1934 to December 19, 1948 or until such date prior to entry of judgment as to the Court may seem proper. A guardian ad litem had been appointed by the Court to protect the interest of the minor beneficiaries of the trust who filed an answer containing counter-claims. It was contended that the Aspinock Corporation's stock which had greatly appreciated in value at the time of the resale to the settler should not have been sold by the taxpayer trustee to his brother, Bernard L. Armour since the agreement was invalid; that the agreement had been pre-dated to avoid possible surcharge; that the proceeds of the stock should revert to the various trusts and that the taxpayer as trustee should be surcharged for improper administration of the trusts. While the action was pending Bernard Armour died in 1949 leaving a will which was admitted to probate in State of New Jersey. The complaint in the action was amended and the executors of the estate (the taxpayer was one of the co-executors named in the will) and the testamentary guardians were brought in as additional parties.

In 1953, the executors of the estate of Bernard L. Armour and the taxpayer entered into an agreement with the testamentary guardian and the guardian ad litem representing the beneficiaries of the trust to settle the matter in controversy. The taxpayer submitted an intermediate account of his proceedings on trustee for period

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November 26, 1934 to March 31, 1950 and waived his commissions for said period pursuant to the agreement of settlement. The taxpayer was also required to file a supplemental account of his proceedings for period subsequent to March 31, 1950. The executors of the estate of Bernard L. Armour agreed to and did transfer to each of the trusts the sum of \$492,500.00 and the taxpayer, agreed to and did pay a total of \$33,312.70 into the aforementioned trusts in settlement of all pending litigation pertaining to him directly as trustee of the inter vivos trusts and indirectly as one of the executors and trustees of the estate. Releases were exchanged between the parties. An order was entered by the Court approving the aforementioned settlement.

The taxpayer on his return deducted "expenses incurred as professional fiduciary - surcharge as trustee of various trusts upon an accounting" the aforementioned \$33,312.70 from normal income. This deduction was originally disallowed by Internal Revenue Service. Thereafter the case came on for hearing before the Tax Court but was settled on a 50% basis.

Under the terms of the will of Bernard Armour, the taxpayer was given the right within one year from the date of the death of the testator to purchase all the shares of stock of American Aniline Products, Inc. (a closely held corporation controlled by decedent) which the decedent owned at the time of his death at a purchase price equal to the book value of said shares of stock without including any valuation for good will upon such terms as the executors and trustees may in their sole discretion determine. The taxpayer elected to exercise his option to purchase the aforementioned stock on February 2, 1950. An agreement was entered into between the taxpayer and the executors of the Estate on June 17, 1953 whereby the latter sold to the taxpayer 99,339 shares of the common stock of American Aniline Products Inc. for the sum of \$4,400,664.82 with a down payment of cash in the sum of \$8,664.82 and the balance of \$4,400,000.00 by a series of twelve promissory notes payable on the 15th day of January, 1955 and annually thereafter. On December 21, 1953, the taxpayer entered into an agreement with Columbia Dye Stuffs, Inc., a corporation organized under the laws of the State of New York for the sale of the shares of common stock of American Aniline Products, Inc. on an installment basis for the sum of \$6,457,035.00, with a cash down payment of \$50,000.00. In 1955 Columbia Dye Stuffs, Inc. sold the aforementioned stock to another corporation which was in no way connected with the estate of Bernard L. Armour or the taxpayer. Columbia Dye Stuffs, Inc. paid the balance of its obligation in full to the taxpayer who in turn repaid the executors of the estate of Bernard L. Armour in full for the purchase of said stock.

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The stock of American Aniline Products, Inc. was fixed for federal estate tax purposes at \$50.00 per share. In computing the basis of the capital gain reported by the taxpayer for the years in issue, he used the value of the stock as appraised for federal estate tax purposes. The Income Tax Bureau, however, in issuing its assessments computed the basis of the stock on the actual cost to the taxpayer relying upon the decisions of Helvering v. San Joaquin Investment Co., 279 U.S. 496 and Magv. Commr., 148 F. 2d 62.

Although the taxpayer acquired the American Aniline Products, Inc. stock from the estate in 1953, certain heirs of the estate commenced litigation against the taxpayer in the New Jersey Courts. He retained the services of attorneys in said state to represent him individually and was successful in such litigation. The Income Tax Bureau disallowed the legal expenses as a capital charge added to the cost of the property because of failure to substantiate the same. The Superior Court of New Jersey decided that the privilege given to the taxpayer under the will was in the nature of a legacy or bequest and overruled the contentions of the heirs. The taxpayer at the hearing submitted receipts from the law firm of Tener, Crowley, Woolper & Vanderbilt, Esqs., attorneys licensed in the State of New Jersey acknowledging receipt of payment from the taxpayer of \$25,000.00, on account, on April 27, 1954 and the sum of \$21,000.00 on March 29, 1955 for legal services rendered to him individually in connection with the acquisition of stock of the American Aniline Products, Inc. from the estate of Bernard L. Armour. I am of the opinion that the same should have been allowed. (Bowers v. Lumpkin, 140 F. 2d 927, cert. den. 322 U.S. 755.

With respect to the payment by taxpayer in compromise of the surcharge as trustee of the inter vivos trusts, the instant case is analogous to the case of Carl F. Fayen, 34 T.C. 630. In 1953 Carl F. Fayen, the sole trustee and life-income beneficiary of the Carl F. Fayen Trust, paid \$4,664.37 into the principal of said trust in compromise of surcharge proceedings filed by the guardian ad litem for the remaindermen of the trust. Held, that petitioner is not engaged in carrying on a trade or business as trustee. His claim for deduction under section 23(a)(1)(A), I.R.C. 1939, is accordingly denied. Held, further, that said payment in settlement of the surcharge suit is not an expense incurred in the collection or production of income and hence not deductible under section 23(a)(2).

The provisions of subdivision 1, Section 360 of the Tax Law are similar to those contained in section 23(a)(1)(A) and (a)(2) of I.R.C. 1939. Section 360 (1), provides, in part, as follows: