JURISDICTION: OKLAHOMA TAX COMMISSION
CITE: 2004-08-31-08
ID: P-01-255-H
DATE: AUGUST 31, 2004
DISPOSITION: DENIED
TAX TYPE: ESTATE TAX
APPEAL: NONE TAKEN

FINDINGS OF FACT AND CONCLUSIONS OF LAW

At the request of the parties this matter was submitted for decision on briefs.[1] On July 14, 2004, the undersigned Administrative Law Judge advised the parties of "Evidence By Official Notice" regarding materials from internet web-sites on Series E Bonds, in order to complete the factual background of the assets, which are the subject matter of this case.[2] The parties were given fifteen (15) days in which to contest the materials or submit materials on the Series E Bonds. On July 19, 2004, the Protestant's counsel filed a letter and addition to Exhibit I-1, which reflects the marketability discount of 33% on Gross Value, and a copy of I.R.C. § 1(e) (1999).

FINDINGS OF FACT

Upon review of the file and records, the exhibits received into evidence and the position letters, briefs and supplemental arguments of the parties, the undersigned finds:

1. DECEDENT ("Decedent") died on September 11, 1999.[3]

2. After requesting and being granted an extension of time to file by the Division, the Estate timely filed a State of Oklahoma Estate Tax Return ("Original Return").

3. On January 26, 2001, the Division informed the Estate that its audit revealed no additional liability.[4] On January 26, 2001, the Division issued the Order Releasing Taxable Estate reflecting the full payment of $220,744.00 in estate taxes.[5]

4. On October 25, 2001, the Division received a First Amended State of Oklahoma Estate Tax Return ("First Amended Return").[6] The First Amended Return reported a balance due of $9,017.00.[7] The Estate reported assets omitted from the Original Return, resulting in additional estate tax to absorb the allowable federal credit. The balance due of $9,017.00 was remitted in full with the First Amended Return.

5. The omitted assets reported on Schedule B of the First Amended Return were 24 Series E Bonds ("E Bonds") with a total value of $113,868.84.[8] The Estate applied a "lack of marketability discount" of thirty-three percent (33%) or $37,576.72, resulting in a total adjusted value of $76,292.12.[9]

6. On November 9, 2001, the Division issued an assessment letter,[10] which disallowed the "lack of marketability discount", and assessed additional estate tax and interest due in the amount of $4,406.00.[11]

7. By letter dated November 14, 2001, the Estate timely filed a protest to the proposed assessment on the basis, that in determining the "fair cash market value" of the Series E Bonds, it is appropriate for the Division to include a "lack of marketability discount" on the Series E Bonds. The Estate argued that if a willing buyer was required to pay income taxes on a portion of the asset he acquires, he would reduce the amount he is willing to pay for that asset by the built-in income tax liability. Otherwise, the buyer would have a build-in loss.[12]

8. The Estate filed a Second Amended Oklahoma Estate Tax Return ("Second Amended Return") dated September 9, 2002.[13] The Second Amended Return reflected the Division's computations made in the assessment of November 9, 2001. The net estate was increased by $37,577.00, the amount of the "lack of marketability discount" on the Series E Bonds. The Estate remitted payment in full of $4,826.00 with the Second Amended Return.

9. On December 18, 2003, the Estate filed a Third Amended Oklahoma Estate Tax Return ("Third Amended Return").[14] The Third Amended Return *reclaimed* the "lack of marketability discount" on the E Bonds in the amount of $37,577.00, as it had claimed on the Original Return, and requested a refund of $3,608.00.[15]

10. The IRS disallowed the "lack of marketability discount" claimed by the Estate on the E Bonds on the federal return.

ADDITIONAL FINDINGS OF FACT

11. E Bonds were issued May 1941 to June 1980. The E Bonds were purchased for 75% of face value. E Bonds issued May 1941 through November 1965 earned interest for 40 years. E Bonds issued December 1965 to June 1980 earned interest for 30 years.[16]

12. E Bonds were issued only in registered, physical form and are not transferable.[17]

13. E Bonds can be redeemed at a financial institution or Federal Reserve Bank at any time at the most recent semiannual accrual value.[18]

14. E Bond interest is reportable for Federal income tax purposes for the year in which the E Bonds are redeemed, reach final maturity, or are otherwise disposed of, whichever occurs earliest.[19]

15. Savings Bonds are Treasury securities that are payable only to the person to whom they are registered.[20]

16. Unlike savings bonds, Treasury bills, notes, and bonds are transferable, so you can buy or sell them in the securities market.[21]

17. At the Decedent's date of death (September 11, 1999) all of the E Bonds had stopped earning interest, except the E Bond purchased May 1971.[22]

18. The E Bonds, which are the subject matter of this action, were cashed in or redeemed by the Estate sometime in 2002, per counsel for the Estate.

19. The Estate has not claimed that the federal income taxes paid on the E Bonds is a deduction under 68 O.S. § 808, or that the "lack of marketability discount" on the E Bonds is a deduction under 68 O.S. § 808.

20. The Estate is claiming a "lack of marketability discount" on the E Bonds under the provisions of 68 O.S. § 816(A), in determining the "fair cash market value" of the E Bonds as of the date of death of the Decedent.

CONCLUSIONS OF LAW

1. The Tax Commission is vested with jurisdiction over the parties and subject matter of this proceeding.[23.]

2. A tax is levied upon the transfer of the net estate of every decedent.[24]

3. A tax is levied upon any transfer of the net estate of every decedent.[25] The tax shall accrue at the time of death of the decedent and shall be payable nine months after the date of death of the decedent.[26]

4. The value of the gross estate, used as a basis for the determination of the value for the net estate, shall be determined by including the value of all property that the decedent had an interest in at the time of death or by including the alternate valuation of said property as authorized by statute.[27]

5. Appraisements of property shall be made at the fair cash market value of the property transferred as of the date of death of the decedent.[28] Fair cash market value means the value and price at which the property transferred would change hands between a willing buyer and a willing seller.[29]

6. In calculating the net estate, an estate may apply certain deductions, and no others.[30] The Estate may deduct from the gross estate, the state and federal income taxes on the income of the decedent to the date of death.[31]

7. In the event that the tax levied on the value of the estate in Oklahoma is less than the credit allowed by the federal government on estate tax imposed upon the value of the property of the estate in Oklahoma, pursuant to 26 U.S.C. § 2011,[32] there shall be an additional tax levied on the estate in Oklahoma as of the date of the determination of the

Federal Estate Tax equal to the difference between the allowed Federal credit and the Oklahoma Estate Tax.[33]

8. Any adjustments by the IRS affecting the State Death Tax Credit shall be submitted to the [Division] within thirty (30) days of agreed settlement along with a copy of the revenue agent's report ("RAR").[34]

9. In all proceedings before the Oklahoma Tax Commission, the taxpayer has the burden of proof[35] to show the action of the Commission is incorrect, and in what respect.[36]

10. The Estate has failed to meet its burden of proof in this matter. The Estate has not presented any evidence that the sum claimed by the Division is incorrect. No adjustment to the Third Amended Estate Tax Return should be made resulting in a refund of estate tax and interest paid, due to the disallowance by the Division, of a "lack of marketability discount" on the E Bonds.

The Division contends that the "lack of marketability discount" should not be applied to the E Bonds when calculating the net estate because a "lack of marketability discount" is not one of the deductions allowed by Section 804 of Title 68.[37] However, a "lack of marketability discount" does not act as a deduction. Rather, the issue in contention is whether in determining the "fair cash market value" of the E Bonds, the Estate can claim a "lack of marketability discount", pursuant to the provisions of 68 O.S. § 816(A).

The Estate's argument is that on the date of death, the accrued interest on the E Bonds could not pass in possession or enjoyment to the heirs, without the payment of federal income tax on the accrued interest, so the value of the bonds and accrued interest must be reduced by the statutorily mandated federal income tax on the interest. The Estate identifies this reduction as a "lack of marketability discount".

In support of its argument, the Estate cites numerous federal estate tax cases where the taxpayer argues that where there is a built-in tax burden or imbedded tax on the asset (usually the stock of a closely held corporation), a "lack of marketability discount" is appropriate in determining the fair market value of the asset.[38]

The definition of fair market value is as universally recognized as its determination is elusive:

> "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."[39]

The Estate's attempt to analogize the allowance of a "lack of marketability discount" and "built-in capital gains", etc., usually applied to determine the "fair market value" of stock in a closely held corporation is misplaced.

The E Bonds were registered in the name of the Decedent and redeemable only by the Decedent during her lifetime, or by the Estate, after her death, because the E Bonds were not transferable. The U.S. Treasury guaranteed a minimum investment yield in effect at the start of the original or extended maturity period. The Estate redeemed the E Bonds, plus all of the accrued interest.

The hypothetical model of what a willing buyer would pay a willing seller is simply not applicable to the Estate's claim for a "lack of marketability discount" on the E Bonds. There was only one scenario possible for the sale of the E Bonds after the death of the Decedent. Only the Estate could redeem the bonds after the Decedent's death and the U.S. Treasury was the only possible buyer. The payment of federal income tax did not affect the value of the E Bonds when the Estate redeemed them sometime in 2002.

There is no authority whatsoever on the state or federal levels allowing a "lack of marketability discount" for the E Bonds, which are the subject of this matter.

The Estate's final argument is that the Division may not assess additional estate tax until after the date the IRS determination is final. The Estate cites no authority to support its position. This argument must also fail.

The Division correctly recites that the Oklahoma Supreme Court addressed this specific issue in *Estate of Kasishke v. Oklahoma Tax Commission*, 1975 OK 133, 541 P.2d 848. In *Estate of Kasishke*, the Court noted "that to prohibit [the] Commission from assessing tax until after federal tax became final would create … unnecessary delay in the initial computation of State taxes … ."

The IRS has not allowed the "lack of marketability discount", nor has the Division received an agreed settlement and RAR from the IRS of any adjustments affecting the State Death Credit.

The additional estate tax liability and interest reported in the Third Amended Return filed by the Estate, and paid under protest, should not be adjusted to allow a "lack of marketability discount" on the E Bonds. No refund of the additional estate tax and interest is due the Estate.

DISPOSITION

It is the ORDER of the OKLAHOMA TAX COMMISSION, based on the above and foregoing findings and conclusions, that the protest of the Estate of DECEDANT be denied.

OKLAHOMA TAX COMMISSION

CAVEAT: This decision was NOT deemed precedential by the Commission. This means that the legal conclusions are not generally applicable or are limited in time and/or

effect. Non-precedential decisions are not considered binding upon the Commission. [1]Thus, similar issues may be determined on a case-by-case basis.

---

1 *OAC 710:1-5-38*, which states in pertinent part:
"When … the parties agree that an oral hearing is not needed the Administrative Law Judge will base the Findings, Conclusions, and Recommendations on the position letters and briefs submitted by the parties."

2 *OAC 710:11-5-36*.

3 Division's Exhibit A.

4 Division's Exhibit B.

5 Division's Exhibit C.

6 Division's Exhibit D. The Amended return (Statement 4) reflected changes to the following schedules:

Schedule B:	Addition of Series E Bonds	$76,292.00
Schedule C-2:	Addition of Cash	$ 3,481.00
Schedule C-2:	Addition of 19 Kruggerand Coins	$ 4,997.00
Schedule H-1:	Additional Accounting Fees	$ 6,500.00

7 Division's Exhibit D. The balance due on the Amended Return was $7,514.00 in additional estate tax, plus interest of $1,503.00 for the total due of $9,017.00.

8 Division's Exhibit D, Statement 3. The bonds are in denominations of $500.00 and $1,000.00, with issue dates ranging from June 1947, March 1948, January and December 1949, June and September 1951, March 1952, and May 1971.

9 See Note 8. The Estate describes the discount as follows:

> In determining the fair market value of the Series E bonds reported on this amended Estate Tax Return, we calculated a lack of marketability discount based on the fact that a willing buyer of the bonds would not pay the full face value for the bonds since income taxes would be due on the accrued interest.

10 Division's Exhibit E.

11 Division's Exhibit F. The Division assessed additional estate tax of $2,105.00 and interest of $2,301.00, through December 17, 2001, for the total due of $4,406.00.

12 Division's Exhibit G.

13 Division's Exhibit H.

14 Division's Exhibit I.

15 Division's Exhibit I and Division's Exhibit I-1. In an attachment to the Third Amended Return, the Estate asserts that since the Internal Revenue Service ("IRS") has acquiesced in the allowability of a discount for lack of marketability in the build-in capital gains scenario, we believe a similar position is appropriate for the built-in ordinary income tax on U.S. Savings Bonds. The attachment is reflected as being an attachment from the U.S. Estate Tax Return.

---

16 E Bonds, *http://www.savingsbonds.com/bond_basics/ebond1.cfm* (Visited July 9, 2004). See also U.S. Savings Bonds, http://www.publicdebt.treas.gov/sav/savstop.htm (Visited July 9, 2004).

17 See Note 16.

18 See Note 16.

19 See Note 16. See Protestant's letter of July 19, 2004, which reflects that the total income tax on the accrued interest, calculated to the date of death, was $38,574.00, pursuant to I.R.C.§ 1(e). See Exhibit "A" to counsel's letter of July 19, 2004.

20 See Note 16. See also The Basics of Treasury Securities, http://www.publicdebt.treas.gov/of/ofbasics.htm.

21 See Note 20.

22 See Note 20 and Note 3. The bond purchased May 1971 continued to earn interest through May 2001.

23 68 O.S. § 207.

24 68 O.S. § 802 in pertinent part provides:

> A tax, at the rates prescribed in the following section is hereby levied upon the transfer of the net estate of every decedent, whether in trust or otherwise, to persons, associations, corporations, or bodies politic, of property, real, personal, or mixed, whether tangible or intangible, or any interest therein or income therefrom, by will or the intestate laws of this state, by any order setting apart property and/or granting family allowances pursuant to the probate code, by deed, grant, bargain, sale, or gift made in contemplation of death of the grantor, vendor or donor or intended to take effect in possession or enjoyment at or after such death. Provided, however, that nothing in this article shall be construed as subjecting to payment of such tax the escheat of property to the state for the benefit of its common schools. Such tax shall be imposed upon the value of the net estate and transfers at the rates, under the conditions, and subject to the exemptions and limitations hereinafter prescribed.

25 68 O.S. § 806(a):

> The tax levied by this article shall accrue at the time of the transfer by the death of decedent or otherwise and shall be due and payable nine (9) months after the date of the death of the decedent. All taxes shall bear interest at the rate of one and one-quarter percent (1¼%) per month from the date when the same are delinquent. No interest or penalty shall be collected on any tax levied by this article except as provided in this section.

26 See Note 25.

27 68 O.S. § 807(A)(1), states in pertinent part:

> A. The value of the gross estate, used as a basis for a determination of the value of the net estate, shall be determined by including:
>
> 1. The value, at the time of the death of the decedent, or the alternate valuation as herein authorized, of all property, real, personal, or mixed, whether tangible or intangible, in which the decedent had an interest, whether vested or

> contingent, within the jurisdiction of this state, and any interest therein, or income therefrom, which shall pass in possession or enjoyment, present or future, by distribution, by statute, descent, devise, bequest, grant, deed, bargain, sale, gift or contract, to any person or persons, associations or corporations, in trust or otherwise, by testamentary disposition or by the laws of inheritance or succession of this or any other state or country, and including the value of the homestead.

28 68 O.S. § 816(A)

> A. Any and all appraisements of property provided by this article shall be made at the fair cash market value of the property transferred as of the date of the death of the decedent, and the term "fair cash market value," as used herein, is hereby declared to mean the value and price at which the property transferred would change hands between a willing buyer and a willing seller, both being free of any compulsion to buy or sell, and the locally assessed value of such property shall not be the criterion of the fair cash market value of such property, but all appraisements for estate, inheritance, gift or transfer tax purposes under the provisions of this article shall be made independently of the locally assessed value for ad valorem tax, at the full one hundred percent (100%) fair cash market value of such property as the measures of applying the provisions of this article.

29 See Note 28.

30 68 O.S. § 808.

31 68 O.S. § 808(b)

> For the purpose of determining the net estate and transfers there shall be deducted from the value of the gross estate, as provided in Section 807 of this title, the following amounts and no others:
>
> (b) State and federal income taxes on the income of the decedent to the date of death and unpaid federal gift taxes on gifts made by the decedent.

32 See Note 11.

33 68 O.S. § 804 provides:

> In case the tax levied upon the value of the property of the estate in Oklahoma and transfers by Section 801 et seq. of this title is less than the credit allowed by the federal government on estate tax imposed upon the value of the property of the estate in Oklahoma, for state estate and inheritance taxes imposed upon the value of the property of the estate in Oklahoma, pursuant to 26 U.S.C. § 2011, then, in that event, there shall be levied an additional tax which shall be imposed upon the value of the property of the estate in Oklahoma, as of the date of the determination of the Federal Estate Tax, equal to the difference between such credit and the Oklahoma Estate Tax levied upon the value of the property of the estate in Oklahoma and transfers by this Article. Such credit allowed by the federal government shall be the percentage of such credit which is the percentage which the value of the property of the estate in Oklahoma bears to the total value of the estate of the decedent. Such additional tax to absorb the credit shall be determined, assessed, collected and paid pursuant to the provisions of Section 801 et seq. of this title.

34 *OAC 710:35-5-73*. See also 68 O.S. § 804.

35 The standard of review in an administrative proceeding is preponderance of the evidence. *Oklahoma Tax Commission Order No. 1999-04-08-003* (citing *Oklahoma Tax Commission Order No. 1991-10-17-061). OAC 710:1-5-77(b)* provides in pertinent part that "preponderance of the evidence" means the evidence which is of greater weight or more convincing than the evidence which is offered in opposition to it; evidence which as a whole shows that the fact sought to be proved is more probable than not.

36 *OAC 710:1-5-47*. See *Enterprise Management Consultants, Inc. v. Oklahoma Tax Commission*, 1988 OK 91, 768 P.2d 359.

37 68 O.S. § 808.

38 *Estate of Davis v. Commissioner*, 11 TC 35 (1998); *Eisenberg v. Commissioners*, 98-2 USTC par 60.322 (2nd Cir 1998); *Estate of Jameson v. Commissioner*, 267 F.3d 366 (5th Cir 2001); *Estate of Dunn v. Commissioner*, 301 F.3d 339 5th Cir 2002, and *The Estate of Algerine Allen Smith*, 198 F.3d 515 (5th Cir. 1999).

39 See *Dunn v. C.I.R.*