Vanderbilt Law Review

Volume 15
Issue 2 *Issue 2 - March 1962*

Article 4

3-1962

Tax Planning of the Administration of an Estate

Sherwin P. Simmons

Follow this and additional works at: https://scholarship.law.vanderbilt.edu/vlr

Part of the Estates and Trusts Commons, and the Tax Law Commons

Recommended Citation
Sherwin P. Simmons, Tax Planning of the Administration of an Estate, 15 *Vanderbilt Law Review* 437 (1962)
Available at: https://scholarship.law.vanderbilt.edu/vlr/vol15/iss2/4

This Article is brought to you for free and open access by Scholarship@Vanderbilt Law. It has been accepted for inclusion in Vanderbilt Law Review by an authorized editor of Scholarship@Vanderbilt Law. For more information, please contact mark.j.williams@vanderbilt.edu.

Tax Planning of the Administration of an Estate

*Sherwin P. Simmons**

In this article the author points out that the tax hazards and tax saving opportunities presented in the administration of an estate cannot be disregarded. With this in mind, he discusses in detail the filing of a decedent's final income tax return, the various elections and alternatives available to the executor in the tax planning of the estate, the tax consequences flowing from the executor's management of the estate, and the problems encountered in terminating the estate and paying the tax.

I. Introduction

Lifetime planning for the preservation and descent of an estate has long been an important area for tax counseling. Emphasis on this type of planning, "estate planning" as it is popularly known, has obscured the importance of adequate tax planning in the equally vital and fertile field of estate administration.

Like the aging actor still waiting to be discovered, the value of tax planning of the administration of estates is yet to be appreciated by the great majority of estate lawyers. Many members of the Bar share the view that no federal tax pitfall or tax saving opportunity is presented in the administration of an estate unless a federal estate tax return is to be filed.

Every estate, be it large or small, subject to federal estate tax or not, presents some tax question of concern either to the estate or to its beneficiaries, or both. The problem raised may be minor or the economy offered insignificant. On the other hand, the danger may be great or the tax-saving possibility substantial. Uuless the tax pitfalls and benefits are considered, the attorney will not completely discharge his duties to the estate or its beneficiaries.

No longer is the competent handling of the probate features of an estate sufficient. The modern day estate lawyer must be "tax conscious."

The purpose of this article is to summarize the common federal tax problems and tax-saving opportunities encountered in the administration of estates.[1] Many of the points treated herein require detailed study. The

---

*Member, Fowler, White, Gillen, Humkey & Trenam, Tampa, Florida.

1. See also Wormser, The Planning and Administration of Estates (1961); Price, *Post-Mortem Estate Planning*, N.Y.U. 15th Inst. on Fed. Tax 1029 (1957); Miller, *Tax Problems in Administration of Estates*, N.Y.U. 14th Inst. on Fed. Tax 331 (1956); Greenbaum, *Tax Responsibilities of the Executor, the Administrator, the Trustee*, 2 Lasser's Estate Tax Techniques 2003 (1961); Page, Wills 1 (2 Bowe-Parker ed. 1960).

reader is therefore admonished to consider this as a checklist and nothing more.

II. The Need for a Plan

An appreciation of the tax aspects of the administration of a particular estate is valueless unless the attorney brings them together in a coordinated blueprint for action by the executor.[2]

The administration must be planned with a view to the estate and income tax problems of the estate, the income tax problems of estate beneficiaries, and to a minor extent, the gift tax consequences to the beneficiaries. The plan must be framed as a checklist rather than a chronological listing of the pitfalls to be avoided and the benefits to be garnered. This is because many of the tax considerations are continuing and only a few occur at the same point in the administration of every estate.

If costly errors are to be avoided and savings effected, the planning must begin at the earliest possible moment, that is, at the very inception of the estate proceedings. Accordingly, the attorney should consider the tax contingencies at the outset of the administration and work out the best course of action based on the information then available. Inasmuch as not all of the facts will be available at the start of the administration, the tax plan must be sufficiently flexible to allow for later discovered assets, increased or decreased values, unexpected calls on cash reserves, claims of dower or its substitute, the appearance of unknown beneficiaries, and the like.

III. First Steps

A. Determination of Domicile

In the great majority of estates, there is no necessity to labor long over the question of the domicile of the decedent. The facts are usually clear and do not admit of dispute.

However, in an increasing number of estates, the question of domicile is not readily determinable.[3] With the greater mobility of man and the substantial shift of wealth from realty and tangibles to securities, bank accounts and other intangibles, the common law concept of one domicile is becoming less certain.[4] It has long been agreed that there can be more

2. Although reference throughout the text is to the executor of the estate, the discussion is applicable to representatives of all types.

3. See Lentz, *Problems in Determining Domicile*, N.Y.U. 15th Inst. on Fed. Tax 945 (1957); Chrystie, *Where Is or Was or Will Be Your Client's Domicile?*, 1 Prac. Law. 13 (1955); Reese, *Does Domicile Bear a Single Meaning?*, 55 Colum. L. Rev. 589 (1955); Knapp, *Solutions of the Double Domicile Problem—History and Prospects*, 15 Conn. B.J. 251 (1941); Gnterman, *Avoidance of Double Death Taxation of Estates and Trusts*, N.Y.U. 5th Inst. on Fed. Tax 102 (1947).

4. Mr. Justice Frankfurter has opined that "in the setting of modern circumstances, the inflexible doctrine of domicile—one man, one home—is in danger of becoming a social anachronism." Texas v. Florida, 306 U.S. 398, 429 (1939) (separate opinion).

than one domicile for state tax law purposes.[5] Indeed, it is in connection with liability for state inheritance and estate taxes that the question of domicile most often arises.

The solution of a domiciliary dispute carries with it not only the determination of the liability of the estate for local inheritance and estate taxes, but also the answers to important questions of federal estate, gift and income tax law which turn on what state rules govern the validity of a will, intestate succession, the availability of dower, and the like. For example, the existence and size of the marital deduction and the validity of charitable bequests require reference to the law of the domicile. Apportionment of taxes, equalization of benefits resulting from the deduction of administration expenses against income, and the gift tax effects of the renunciation of bequests depend on local law. State law also determines the power of the executor to file a joint income tax return with a surviving spouse, to elect to offset administration expenses against income, to set up testamentary trusts, to distribute income and corpus and to accumulate income.

The importance of the domicile of the decedent cannot be ignored. It is suggested that in a doubtful case the administration of the estate be deferred as long as possible pending a thorough investigation of the facts. Later discovered information may prove that a too hasty rush to administration caused the wrong state to be selected as the domicile with the result that the maximum state tax liability was incurred and the federal tax picture clouded.

B. Filing of the Preliminary Notice

The first formal contact any executor has with the federal tax laws is the determination whether to file Form 704, Estate Tax Preliminary Notice.

This form must be filed for every citizen or resident of the United States whose gross estate exceeds $60,000 in value at the date of death.[6] Its purpose is to advise the Internal Revenue Service of the existence of taxable estates.

The value of the gross estate at the date of death as determined for federal estate tax purposes governs the filing of the notice.[7] The value of

5. Texas v. Florida, *supra* note 4; *In re* Dorrance's Estate, 309 Pa. 151, 163 Atl. 303 (1932), *cert. denied*, 287 U.S. 660 (1932), 288 U.S. 617 (1933); *In re* Dorrance, 113 N.J. Eq. 266, 166 Atl. 177 (1933); *In re* Dorrance, 115 N.J. Eq. 268, 170 Atl. 601 (1934), *aff'd sub nom.* Dorrance v. Thayer-Martin, 116 N.J. Eq. 362, 184 Atl. 743 (1936), *cert. denied*, 298 U.S. 678 (1936); Hill v. Martin, 296 U.S. 393 (1935).

6. INT. REV. CODE OF 1954, § 6036; Treas. Reg. § 20.6036-1 (1958). A similar notice is required on Form 705 with respect to every nonresident who is not a citizen if that part of his gross estate which was situated in the United States (see Treas. Reg. § 20.2104-1 (1955)) exceeds $2,000 in value at the date of death.

7. Treas. Reg. § 20.6036-1(a) (1958).

the probate estate is unimportant. Similarly, it matters not whether any estate tax will ultimately be due or that the executor later elects to value the estate as of the alternate valuation date provided by section 2032 of the Internal Revenue Code of 1954.[8]

Thus, where the probate estate is $10,000 and the decedent owned insurance of $60,000, the preliminary notice must be filed.

The form itself requires a summary listing of the values of the various assets composing the gross estate. As a matter of practice, conservative estimates are usually given for these values. Apparently, the Internal Revenue Service does not pay too much attention to the figures used; nonetheless, it might be embarrassing to file a preliminary notice showing a gross estate of $300,000 and then come up with an estate tax return reflecting ouly $90,000 in assets.

The executor is required to file the notice within two months after his qualification; or, if no executor qualifies within two months after the decedent's death, notices must be filed by every person in actual or constructive possession of any property of the decedent.[9] This notice must be filed with the district director of internal revenue in whose district the decedent had his domicile at the time of his death.[10]

The preliminary notice itself states that the penalty for failure to file is a sum not to exceed $500. The Regulations suggest the imposition of criminal sanctions for failure to file or for knowlingly making a false return.[11] However, the Internal Revenue Service does not press for the imposition of criminal penalties or for prosecution; and the practice with respect to the civil penalty varies from district to district.

Where the notice is filed late, it is advisable to attach to it an affidavit explaining the delay. In some areas, it is customary to include a modest check as a voluntary penalty with the affidavit.[12]

C. *Notice of Fiduciary Relationship*

An often ignored provision of the Internal Revenue Code is the requirement that every person acting for another in a fiduciary capacity give notice of such relationship to the appropriate district director of internal revenue.[13] In the case of an estate, notice is given to the direetor in whose district the decedent was domiciled. The purpose of this notice is to give

8. All statutory references in the text and in the footnotes unless otherwise indicated hereafter are to the Internal Revenue Code of 1954 and all references to Treasury Regulations are to the Regulations under the Internal Revenue Code of 1954.

9. Treas. Reg. § 20.6036-1(b) (1958).

10. Treas. Reg. § 20.6091-1 (1958).

11. Treas. Reg. § 20.6036-1(a) (1958); see INT. REV. CODE OF 1954, §§ 7203, 7207, 7269.

12. WORMSER, *op. cit. supra* note 1, at 203.

13. INT. REV. CODE OF 1954, § 6903; Treas. Reg. § 301.6903-1 (1957), as amended, T.D. 6498 (1960).

the Service someone to whom it can look for the collection of the income, estate and gift taxes of the decedent until the fiduciary relationship is terminated.

There is no specific form of notice. The Regulations require only that it include the name and address of the executor and the name and former address of the decedent. Satisfactory evidence of the authority of the executor to act must accompany the notice.[14]

The filing of the notice is beneficial to the estate in at least one respect. After notice, the Service must send all notices of deficiency in tax of the decedent to the executor. If no notice of fidueiary capacity is filed, it is sufficient to send the notice of deficiency to the last known address of such decedent. With the mailing of the notice to the last address of the decedent,[15] the ninety day period for filing a petition with the Tax Court of the United States commences to run. There is apparently little likelihood that a penalty will be imposed for failure to file a notice of fiduciary capacity.

IV. Decedent's Last Return

A. Separate or Joint Return

An early problem in the administration of any estate is the preparation and filing of the final income tax return of the decedent.

The executor has the option of filing a separate return for the decedent or a joint return with the decedent's surviving spouse for the taxable year in which death occurs.[16] The option is not available where the surviving spouse remarries before the close of the taxable year or if the taxable years of both spouses do not begin on the same day.[17]

A separate return includes only the income of the decedent from the beginning of his normal taxable year through the date of death. A joint return includes not only the decedent's income through the date of death but also the spouse's income for the entire taxable year.

The determination of whether to file a separate or joint return depends on the savings to the estate. If the decedent had substantially more income than his surviving spouse, then a joint return would probably benefit the estate. On the other hand, if the survivor's income was greater, the estate would probably be benefited if a separate return is filed for the decedent.

14. Treas. Reg. § 301.6903-1(b) (1957), as amended, T.D. 6498 (1960).
15. Treas. Reg. § 301.6903-1(c) (1957), as amended, T.D. 6498 (1960).
16. Int. Rev. Code of 1954, §§ 2, 6013(a). Provision is also made for the surviving spouse to file a joint return in the event an executor is not appointed before the last day for filing the return; however, any executor subsequently appointed has the right to disaffirm the joint return by making a separate return for the decedent at any time within one year after the last day for filing the return of the surviving spouse plus any extension therefor. Int. Rev. Code of 1954, § 6013(a)(3); Treas. Reg. §§ 1.6013-1(d)(3), (4), (5), (6) (1959).
17. Treas. Reg. § 1.6013-1(d) (2) (1959).

Some executors are hesitant to take advantage of the option to file a joint return without a court order, specific statutory authority, or specific authority in the will. This approach is probably wise inasmuch as the tax liability resulting from the filing of a joint return is joint and several.[18] The executor must assure himself of the spouse's ability to pay her share of any tax deficiency or any negligence or fraud penalties. The executor might be subject to criticism by the probate court or the beneficiaries if, as the result of filing a joint return without prior approval or authority, the estate is saddled with tax liabilities which result from the transactions of the surviving spouse.

B. Income and Deductions

The income and deductions to be reported in the decedent's final return are those ordinarily includable under the decedent's usual method of accounting. There are, however, certain items which deserve brief mention.

1. Trust Income

If the decedent was the beneficiary of a trust, it is necessary to determine the extent to which trust income is includable in the final return.

Unless the date of death happens to coincide with the close of the taxable year of the trust, the beneficiary and the trust will have different taxable years. In the usual case where a beneficiary has a taxable year different from that of the trust, the amount the beneficiary is required to include in gross income is his share of trust income for the taxable year of the trust which ends within his own taxable year.[19] However, the usual rules do not apply in the case of the death of a trust beneficiary.[20] In such case, the gross income for the last taxable year of the deceased beneficiary includes the income actually distributed to him before death.[21] Income required to be distributed before death, but in fact later distributed to the estate, is included in the gross income of the estate as income in respect of a decedent under section 691.

2. Partnership Income

On the other hand, the last return of a deceased partner includes only his share of partnership income for the partnership taxable year or years ending within or with the last taxable year of such deceased partner—that is, the year ending with the date of his death.[22] The decedent's distributive share of partnership income for a partnership taxable year ending after the decedent's last taxable year is includable in the return of

18. Int. Rev. Code of 1954, § 6013(d)(3).
19. Int. Rev. Code of 1954, § 662(c); Treas. Reg. § 1.662(c)-1 (1956).
20. Treas. Reg. § 1.662(c)-2 (1956).
21. *Ibid.*
22. Treas. Reg. § 1.706-1(c)(3)(ii) (1956).

the estate or other successor in interest as income in respect of a decedent under section 691.[23]

However, if the death of a partner results in the termination of the partnership, or if, under the terms of an agreement existing as of the date of death, a sale or exchange of the decedent's partnership interest occurs, the taxable year of the partnership closes with respect to the decedent.[24] In such event, the last return of the decedent includes his share of all partnership income for the partnership taxable year which ends with his death.

3. Bond Income

If the tax bracket of the decedent's last return is low, the executor may wish to take advantage of the election available to cash basis holders of United States Savings Bonds; that is, the increase in value of the bonds may be treated as income received and therefore taxed at the low rate.[25]

A cash basis bondholder may elect for any taxable year to treat the increase in value of the bond as income for the year. However, in the return for the year of the election, he must also report as income the increase in value of the bond which occurred between the date of its acquisition and the beginning of the taxable year of the election.[26] The election applies to all similar obligations owned at the time of the election or thereafter acquired by the taxpayer and is binding for all subsequent taxable years.[27] No election can be made on an amended or delinquent return.[28]

The election is available with respect to all other noninterest bearing obligations issued at discount[29] as well as growth savings certificates issued by banks.[30]

If the election is made by the decedent prior to his death, his last return includes the income which would normally be reportable had he lived. The estate or beneficiary will report the balance of the income as it accrues or as the bond increases in value.

If the executor does not elect to report the increment in value as income, the entire increment from the date of the acquisition through maturity or other disposition is includable in the income of the estate or other recipient at the time of maturity or disposition as income in respect of a decedent under section 691.

---

23. Treas. Reg. § 1.706-1(c) (3) (v) (1956).
24. Treas. Reg. §§ 1.706-1(c)(3)(i), (iv) (1956). A partnership is terminated if it ceases to operate or there is a change of 50% or more in partnership capital and profits within a twelve month period. Int. Rev. Code of 1954, § 708(b).
25. Int. Rev. Code of 1954, § 454(a).
26. Treas. Reg. § 1.454-1(a) (1957).
27. *Ibid.*
28. Rev. Rul. 655, 1955-2 Cum. Bull. 253.
29. Int. Rev. Code of 1954, § 454(a).
30. Rev. Rul. 452, 1957-2 Cum. Bull. 302.

4. Equalizing Brackets

If a joint return is to be filed with the decedent's surviving spouse and the spouse is entitled to current distributions of estate income, the executor should consider the advisability of distributing sufficient income to the spouse so as to equalize the income tax brackets of the estate with that of the joint return. This will produce the lowest aggregate income tax to the estate and the joint return.

5. Medical Expenses

The executor may also be able to take advantage of a special rule relating to medical expenses of a decedent. Expenses for the medical care of a decedent which are paid out of his estate within the one year period following his death may be treated as a deduction in the decedent's income tax return for the year in which the expenses were incurred,[31] or, they may be claimed as a debt of the estate and deducted on the estate tax return.[32] This election applies only to the decedent's medical expenses and not to those incurred for a dependent.

The election to throw the expenses against income is available only in the return for the year in which the expenses were incurred. That year may not necessarily be the year in which the decedent died. Therefore, the estate may be in a position of filing a claim for refund covering a prior year in which the expenses were incurred rather than deducting them in the decedent's last return. Of course, any portion of the expenses incurred in the year of death may be deducted at the election of the executor in the final return.

In order to claim the expenses on the decedent's income tax return, the estate must file in duplicate a statement that the expenses have not been allowed as a deduction on the estate tax return and waive the right to have such expenses allowed as a deduction at any time on the estate tax return.[33]

Careful consideration should be given to all factors before an election is made. For example, the income tax bracket of the final return may be greater than the estate tax bracket and therefore it would probably be beneficial to claim the expenses as a deduction on the income tax return. On the other hand, the limitations on the deduction of medical expenses on income tax returns may make it more attractive in some instances to apply them against estate tax.[34]

Some thought should also be given to splitting the expenses between the income and estate tax returns. Although the Internal Revenue Code and the Regulations are silent with respect to the splitting, the Service

31. Int. Rev. Code of 1954, § 213(d).
32. Int. Rev. Code of 1954, § 2053(a)(3).
33. Int. Rev. Code of 1954, § 213(d)(2); Treas. Reg. § 1.213-1(d) (1957), as amended, T.D. 6451 (1960.).
34. Int. Rev. Code of 1954, §§ 213(a), (b), (c).

will apparently raise no objection to such an approach inasmuch as it is consistent with the treatment of administration expenses accorded under section 642(g).[35]

C. Request for Prompt Assessment

The Internal Revenue Code permits the executor of an estate to make application to have the decedent's income tax returns audited.[36] The effect of such a request is to limit the time in which an assessment of tax may be made, or a proceeding in court without assessment for collection of tax may be begun, to a period of eighteen months from the date the request is filed with the proper district director.[37]

In order for the request to be effective, it must be transmitted separately from any other document, must set forth the classes of tax and the taxable periods for which the prompt assessment is requested, and must clearly indicate that it is a request for prompt assessment under the provisions of section 6501(d).[38]

The eighteen months limitation does not apply if the decedent committed fraud or omitted more than 25% of the gross income in the return for which the application is filed.[39]

As discussed below, the executor may be held personally liable for the decedent's back taxes. Therefore, because the tax returns of the decedent, including the final return, involve transactions about which the executor ordinarily has limited knowledge, it is advisable to request a prompt assessment of the returns for any open years so as to secure a release from personal liability.

The Internal Revenue Service attempts to comply with every request for prompt assessment; however, there are times when the audit cannot be completed within the eighteen month period. In such event, the Service usually requests additional time within which to complete the audit. It is prudent to grant the request. Otherwise, the audit will be rushed to conclusion within the eighteen month period and all doubts will be resolved against the taxpayer. In such event, a deficiency notice usually issues.

D. Estate Tax Deduction

The tax due on income earned by the decedent prior to his death is deductible for estate tax purposes as a claim against his estate.[40]

When the decedent's final return is separate, the amount of income tax deductible against estate tax is readily ascertainable. However, when a

35. See Treas. Reg. § 1.642(g)-1 (1956).
36. Int. Rev. Code of 1954, § 6501(d).
37. Treas. Reg. § 301.6501(d)-1(b) (1956), as amended, T.D. 6498 (1960).
38. *Ibid.*
39. Int. Rev. Code of 1954, § 6501(d).
40. Int. Rev. Code of 1954, § 2053; Treas. Reg. § 20.2053-6(f) (1958).

joint return is filed, the decedent's share of the total tax and thus the amount deductible as a claim against the estate is the amount for which the decedent's estate would be liable under local law as between the decedent and his spouse after enforcement of an effective right of reimbursement or contribution.[41]

The Regulations state that the deduction shall not exceed the decedent's liability for the period reduced by the amounts already contributed by the decedent toward payment of the joint liability.[42] The burden is on the executor to determine either in the probate proceedings or otherwise the portion of the joint tax for which the decedent's estate would be liable under local law. The failure to sustain this burden will result in the disallowance of any elaim against the estate for any portion of the joint tax.

The Tax Court is apparently going to require an express determination as to the amount of tax due from the estate. In the recent case of *Estate of Minnie S. Pridmore*,[43] the Tax Court refused to find in the general approval of the estate's disbursements for income tax by the probate court a determination of the liability of the estate for such tax. Therefore, if the executor is to rely on the actions of the probate court to determine the liability of the estate for the tax, it must be shown, at least to the Tax Court, that the probate court specifically considered and passed on the question.

V. ELECTIONS

A. Selection of Taxable Year

The estate is a new taxpayer. As such, it is entitled to a $600 annual exemption.[44] If its income is in excess of $600, it must file an income tax return on Form 1041, Fiduciary Income Tax Return.

For this purpose, it is necessary to establish a taxable year for the estate. With the possible exception of the treatment of administration expenses, an intelligent selection of the taxable year for an estate offers the greatest opportunity for tax savings available to an executor. Too often the significance of the estate's accounting period for tax purposes is overlooked, with the result that valuable tax economies are lost.

As a new taxpayer, an estate may choose any annual accounting period ending on the last day of any month without obtaining the approval of the Internal Revenue Service.[45] The accounting period may be either the

---

41. *Ibid.*
42. Treas. Reg. § 20.2053-6(f) (1958); Rev. Rul. 290, 1956-1 CUM. BULL. 445; Rev. Rul. 78, 1957-1 CUM. BULL. 300; See also McClure v. United States, 288 F.2d 190 (Ct. Cl. 1961).
43. 20 CCH Tax Ct. Mem. 47 (1961).
44. INT. REV. CODE OF 1954, § 6012(a)(3).
45. Treas. Reg. § 1.441-1(b)(3) (1957).

calendar year (*i.e.*, a period of twelve months ending on December 31),[46] or a fiscal year (*i.e.*, a period of twelve months ending on the last day of any month other than December).[47] If a fiscal year is selected, the estate must maintain books of account in accordance with such fiscal year.[48] If the estate fails to keep books, or fails to establish the fiscal year as its accounting period, or simply fails to establish any accounting period, the calendar year is required to be the taxable year of the estate.[49]

The Regulations state that the bookkeeping prerequisite to the adoption of a fiscal year is satisfied if the records are sufficient to reflect the income clearly.[50] There is no requirement that the books and records be bound. However, informal records, consisting of check stubs, rent receipts and dividend statements do not meet the recordkeeping requirement.[51]

Although it is easy for an estate to meet the record keeping requirement, its satisfaction is frequently overlooked. The result is that the estate is forced to operate on a calendar year basis.

A prerequisite to any tax saving resulting from the selection of the taxable year of the estate is that the estate and its distributees have different taxable years. As most taxpayers are calendar year taxpayers, comments in this area are frequently confined to a discussion of the election of a fiscal year. However, it should not be overlooked that in some instances, where the beneficiaries (whether individuals or trusts) are fiscal year taxpayers, the calendar year may be the best choice for the estate's taxable year.

The advantages of a careful selection of the taxable year of the estate flow primarily from the following factors:

(1) The first and probably the last taxable year of the estate will be short years, that is, for periods of less than twelve months. The tax on the income reported in such returns is computed as though the return was for a full taxable year, that is, there is no requirement that the income of the estate for the short period be annualized and the full $600 exemption is available in each return.[52]

(2) It results in a greater number of taxable years for the estate and therefore in a greater number of $600 exemptions.

(3) It permits the spreading of income among a greater number

46. INT. REV. CODE OF 1954, § 441(d); Treas. Reg. § 1.441-(d) (1957).
47. INT. REV. CODE OF 1954, § 441(e); Treas. Reg. § 1.441-1(e) (1957).
48. Treas. Reg. § 1.441-1(e)(2) (1957).
49. Treas. Reg. § 1.441-1(g) (1957).
50. *Ibid.*
51. Max H. Stryker, 36 B.T.A. 326 (1937); Louis M. Brooks, 6 T.C. 504 (1946); Klempner v. Glenn, 82 F. Supp. 626 (W.D. Ky. 1949).
52. Treas. Reg. § 1.443-1(a)(2) (1957). For an excellent discussion of the advantages of the proper selection of taxable years, see Price, *Post-Mortem Estate Planning*, N.Y.U. 15TH INST. ON FED. TAX 1029 (1957).

of taxpaying entities with the result that the income is taxed in the lower brackets.

(4) It permits the realization of income to be delayed.[53]

These points may be illustrated by a simple example. Assume that a decedent died on March 1, 1959 and that the estate income is $1,000 per month. If the estate files its tax returns on the calendar year basis, its first return for the ten month period ending December 31, 1959 would show $10,000 income and the returns for the years 1960 and 1961 would show $12,000 each. On the other hand, if the estate had chosen a fiscal year ending September 30, 1959, instead of the calendar year, its first return for the period March 1, 1959 through September 30, 1959 would reflect $7,000 in income and the returns for the periods ending September 30, 1960 and 1961 would show $12,000 each. If the estate terminates after October 1, 1961 and before December 31, 1961 the beneficiary would be taxed on $3,000, that is the income for the period from October 1 through December 31, 1961.[54]

In each instance, $34,000 of income was taxed; but, on a calendar year basis, it was reported in three returns and on a fiscal year basis it was reported in four returns. A comparison of the two methods shows the following:

Calendar Year		*Fiscal Year*	
Estate 3/1/59–12/31/59	$10,000	Estate 3/1/59–9/30/59	$ 7,000
Estate 1/1/60–12/31/60	12,000	Estate 10/1/59–9/30/60	12,000
		Estate 10/1/60–9/30/61	12,000
Estate or Beneficiary: 1/1/61–12/31/61	12,000	Estate or Beneficiary: 10/1/61–12/31/61	3,000
Total	$34,000	Total	$34,000

The use of a fiscal year for an estate is not without its dangers. A beneficiary of the estate is taxed on his share of estate income which is required to be distributed, whether or not it is actually distributed during the taxable year of the estate, plus any other amounts properly paid, credited or required to be distributed to such beneficiary for that year.[55] However, the amount includable in a beneficiary's return is determined by reference to the taxable year of the estate which ends within or with the beneficiary's taxable year.[56]

Therefore, in the example above, if the estate were terminated after October 1, 1961, the beneficiary would include in his income $3,000. If, however, the estate were terminated prior to September 30, 1961, the

53. INT. REV. CODE OF 1954, § 662(c).
54. *Ibid.*
55. INT. REV. CODE OF 1954, § 662(a).
56. INT. REV. CODE OF 1954, § 662(c).

beneficiary would not only have to pay tax in his 1961 return on the $3,000 earned from October 1, 1961 through the end of the year but also on the $12,000 earned during the period October 1, 1960 through September 30, 1961—a total of $15,000 would be taxable to the beneficiary for that year. The estate, of course, would pay no tax on the $12,000 earned during its fiscal year ended September 30, 1961, but the bunching of fifteen months income in the beneficiary's return would ordinarily result in a hardship to the beneficiary. This possibility must be watched.

Delaying the realization of income by the beneficiaries will also assist them in effecting personal income tax savings. Thus, in the foregoing example, the income earned in October, November and December, 1960 could be immediately distributed to the beneficiaries without such income being taxed to them in their personal returns for 1960. This is because such income was earned in the estate's taxable year ending September 30, 1961 and the beneficiaries are not required to report their share of income for such year until they file their 1961 returns. In other words, the beneficiaries have the use of the money for more than a twelve month period before they pay tax on it.

Additional deferral of taxes can be effected through a combination of fiscal years established for the estate and the testamentary trusts. For example, assume in the foregoing illustration that a testamentary trust is established by the will and that the trustee selects the fiscal year ending June 30. The income earned in October, November and December, 1960 can be distributed to the trust in September, 1961. The estate will pay no tax on the income since it is distributed prior to the close of its year on September 30, 1961. The trust will report the income in its fiscal year ending June 30, 1962. However, if the trust distributes the income to a beneficiary in June, 1962, the trust will pay no tax on the income and the beneficiary will not have to pick up the income until he files his 1962 return. Thus, by combining fiscal years of the estate and trust, the income earned in October, November and December, 1960 by the estate is not taxed until the trust beneficiary files his return for the year 1962, a postponement of tax for more than two years.[57]

B. Method of Accounting

As a new taxpayer, the estate also has a choice as to the method of accounting for tax purposes.

The two basic methods of accounting are, of course, the cash method and the accrual method. However, any method of accounting is permissible if it clearly reflects income.[58]

57. See Price, *supra* note 52; WORMSER, THE PLANNING AND ADMINISTRATION OF ESTATES (1961).
58. Treas. Reg. § 1.446-1 (1957).

Most individuals are on the cash method of accounting and most estates follow along and adopt such method without any thought being given to the matter. In the ordinary case, the selection of the accounting method may not be too significant. However, there may be some estates in which one method would more clearly reflect the flow of income and expenses than the other. The presence of a business in the estate certainly requires attention to the matter.

In any case, whether the estate is ordinary or unique, the accounting basis on which the estate will file its tax returns is sufficiently important that a positive decision should be made with respect to it rather than having it adopted by default.

C. Disclaimers

1. Waiver of Executor's Fee

It may be to the personal advantage of the executor of the estate to waive his commission for serving in such capacity. This is particularly true where the executor is also a primary beneficiary of the estate.

A bequest or devise to the executor is not subject to income tax, whereas the commissions would be. On the other hand, the commissions are deductible for estate tax purposes, or, if the executor so elects, against the estate's income. Therefore, the cash cost to the estate in paying the commissions and taking them as a deduction against tax must be compared with the cost to the executor in including such commissions in his personal income.

If the decision is made to waive the commissions, when must the waiver be made? The Internal Revenue Service has indicated that in order for a waiver to be effective, it must be clear and irrevocable and made prior to the commission of any action which would indicate prior acceptance or exercise of ownership, dominion, or control of the amounts so waived.[59] The Service also states that where an executor enters into an agreement to take a stipulated amount which is less than the amount allowed by state law, the excess is not taxable to him as compensation for services, providing the relinquishment of the right to a portion of the commissions allowable under state law is binding and the executor has done nothing to indicate prior acceptance or control of the amount waived.[60] According to the Internal Revenue Service, any commissions renounced by the executor which meet the foregoing conditions do not constitute income to him or a gift for gift tax purposes.

Implicit in this ruling is the conclusion by the Service that if the waiver occurs after commencement of his duties as executor, the amount waived

59. Rev. Rul. 472, 1956-2 CUM. BULL. 21.
60. *Ibid.*

constitutes compensation for income tax purposes and a gift for gift tax purposes.

To avoid such a result, the waiver would presumably have to be filed at the beginning of the administration. If this is the intent of the Service's ruling, it is completely unworkable because it disregards local law.

An executor is customarily entitled to a fee for ordinary services and a fee for extraordinary services. The right to compensation for ordinary services is vested.[61] However, according to the great weight of authority, the right of the executor to a defined rate or standard of compensation for ordinary services is not vested as of the date of the decedent's death, nor even as of the date when he first qualifies as executor, but such right first accrues at the time when by appropriate order of the probate court the amount of compensation payable to him is determined and allowed.[62] Similarly, neither the right to nor the rate of compensation for extraordinary services is vested. Such right and rate vest only when allowed by the probate court in the exercise of its discretion.[63]

Therefore, if under local law the executor has no right to a standard of pay in advance of its determination by the probate court, is it not possible for the executor to waive his fees at any time up to the order of the court without adverse tax consequences to himself? A contrary result would be squarely opposed to the basic theories of constructive receipt[64] and the accrual of income.[65]

2. Election of Dower

Technically, the decision whether the widow should claim dower or its statutory substitute is a question for the widow's attorney and not the estate's attorney. All too often, however, the attorney for the estate and the attorney for the widow are the same person. In such an event, there is an obvious conflict of interest.

The estate's attorney represents the executor who stands in the shoes of the decedent. In the usual case of claiming dower, the widow is contesting her husband's expressed desires. The same attorney cannot serve two masters and the widow should be advised to obtain independent counsel in connection with the dower question.

However, this conflict of interest complicates the handling of the estate

---

61. *In re* Johnston's Estate, 303 P.2d 1 (Cal. 1956).
62. Brown's Estate v. Hoge, 198 Iowa 373, 199 N.W. 320 (1924); Leigh's Estate, 196 Iowa 1102, 195 N.W. 1005 (1923); *In re* Donovan's Estate, 266 Mich. 362, 253 N.W. 552 (1934); *In re* Dewar's Estate, 10 Mont. 426, 25 Pac. 1026 (1891); *In re* Hildebrand's Estate, 57 N.M. 778, 264 P.2d 674 (1953); *In re* Kings' Will, 121 Misc. 530, 201 N.Y. Supp. 239 (1923); *In re* Barker, 230 N.Y. 364, 130 N.E. 579 (1921); *In re* Daly's Estate, 99 Misc. 203, 165 N.Y. Supp. 792 (1917).
63. *Ibid.*
64. Treas. Reg. § 1.451-2(a) (1957).
65. See, *e.g.*, Emery Kinkead, Iuc., 35 T.C. 152 (1960).

tax aspect of the administration. In many instances, a claim of dower or its statutory substitute will provide the only marital deduction available to the estate. For example, where the estate is large and no marital deduction is available, a claim of dower followed by gifts by the widow to the children can result in an immediate tax saving so that the family members actually receive more from the decedent than they would have had dower not been claimed. The interests of the estate and the widow while theoretically antagonistic may as a practical matter be identical.

3. Renunciation of Bequests and Intestate Shares

For one reason or another, beneficiaries of estates occasionally refuse to accept a bequest under a will or a statutory share under the intestate succession laws. Such a disclaimer involves more than local law problems. It carries with it important tax consequences.

It must be determined in connection with any disclaimer whether the disclaming party has made a taxable gift as the result of the disclaimer. Where the law governing the administration of the decedent's estate gives a beneficiary, heir or next of kin a right to completely and unqualifyingly refuse to accept ownership of property transferred from the decedent (whether the transfer is by will or by operation of the laws of intestate succession) a refusal to accept ownership does not constitute the making of a gift if the refusal is made within a reasonable time after knowledge of the existence of the transfer. The refusal must be unequivocal and effective under the local law.[66] There can be no refusal of ownership of property after its acceptance. Where the local law does not permit such a refusal, any disposition by the beneficiary, heir or next of kin whereby ownership is transferred gratuitously to another constitutes a gift by such beneficiary, heir or next of kin.[67] In the absence of facts to the contrary, if a person fails to refuse to accept a transfer to him of ownership of a decedent's property within a reasonable time after learning of the existence of the transfer, he will be presumed to have accepted the property.[68]

A disclaimer also affects the estate tax. If a decedent's surviving spouse makes a disclaimer of any property interest which would otherwise be considered as having passed from the decedent to her, the disclaimed interest is considered as having passed from the decedent to the person or persons entitled to receive the interest as a result of the disclaimer.[69] The effect of such a disclaimer is to remove the value of the disclaimed property from

66. Treas. Reg. § 25.2511-1(c) (1958); *see* Kathryn S. Fuller, 37 P-H Tax Ct. Mem. 109 (1961); Hardenbergh v. Commissioner, 198 F.2d 63 (8th Cir. 1952); Brown v. Routzahn, 63 F.2d 914 (6th Cir. 1933).
67. Hardenbergh v. Commissioner, 198 F.2d 63 (8th Cir. 1952).
68. Treas. Reg. § 25.2511-1(c) (1958), as amended, T.D. 6542 (1961).
69. Treas. Reg. § 20.2056(d)-1(a) (1958).

the computation of the marital deduction which results in a decrease in the amount of the marital deduction.

On the other hand, if a person other than the surviving spouse disclaims an interest in property of the decedent in favor of the surviving spouse, such interest will still be considered as passing to the person who made the disclaimer, in the same manner as if the disclaimer had not been made.[70] In short, the amount of the marital deduction cannot be increased by disclainers in favor of the surviving spouse.

A question has also arisen as to whether the marital deduction itself may be waived. The Service has ruled[71] that it cannot be waived by the estate of the first of two spouses to die in order to give the survivor a smaller estate and to make available to the survivor's estate the credit on prior transfers. The position thus announced by the Service made no reference to the disclaimer provisions of the Regulations. It simply relied upon the mandatory language of the marital deduction section.

D. Administration Expenses

1. The Election

Expenses of estate administration and losses incurred during administration enjoy a unique tax status. This arises from the right of the executor to select the tax against which such items will be used as deductions. The executor is given the option to take such expenses and losses in the estate tax return as a deduction in computing the taxable estate of the decedent,[72] or in an estate income tax return in computing the taxable income of the estate.[73]

This election presents the greatest opportunity for tax saving in the administration of most estates. It is designed to preclude a double deduction of items of a character which would properly be deductible for both estate and income tax purposes.[74]

The expenses to which the option relates are those actually and necessarily incurred in the administration of the decedent's estate; that is, in the collection of assets, payment of debts and distribution of property to the persons entitled to it.[75] These items include (1) executor's commissions, (2) attorneys' fees, (3) court costs, (4) surrogates' fees, (5) accountants' fees, (6) appraisers' fees, (7) clerk hire, (8) cost of storing or maintaining property, and (9) brokerage fees for selling estate property. For these purposes, "administration expenses" do not include taxes, interest, business

70. Treas. Reg. § 20.2056(d)-1(b) (1958).
71. Rev. Rul. 123, 1959-1 Cum. Bull. 248.
72. Int. Rev. Code of 1954, §§ 2053(a)(2), 2054.
73. Int. Rev. Code of 1954, § 212.
74. O. F. Yetter, 35 T.C. 737 (1961).
75. Treas. Reg. § 20.2053-3 (1958).

expenses and other items accrued at the date of a decedent's death and which are allowable for estate tax purposes as claims against the estate and are also allowable for income tax purposes as deductions in respect of a decedent.[76]

The option is also available with respect to losses incurred during the settlement of an estate arising from fires, storms, shipwrecks or other casualties, or from theft (if not compensated by insurance or otherwise).[77]

The same expense may not be deducted in both the estate tax return and an estate income tax return. The executor must select the return in which a particular item is to be deducted.

The administration expenses and losses incurred in each taxable year of the estate are treated separately. Such items may be deducted in one year on the income tax return and in another year on the estate tax return.[78] In the same pattern, all or any portion of a particular expense or loss of a single year may be allocated between the income tax return and the estate tax return.

The mechanics of making the election are simple. If expenses and losses are to be used against estate tax, they are merely claimed as deductions on the estate tax return and nothing more is required. If they are to be used against income tax, the executor must file a statement in duplicate to the effect that the specified items of expense and loss have not been allowed as deductions against the estate tax of the decedent and that all rights to have such items allowed against estate tax are waived.[79] The waiver must be filed with the income tax return to which it relates or separately for association with the return at any time prior to the expiration of the statute of limitations applicable to the taxable year for which the deduction is sought.

Allowance of the deduction in the income tax return is not precluded by claiming the same deduction on the estate tax return so long as the deduction on the estate tax return is not finally allowed before the waiver is filed. An estate tax deduction is not "finally allowed" unless the statute of limitations has expired or unless, for any other reason, such as the execution of a closing agreement, the assessment of a deficiency resulting from the disallowance of the deduction is prohibited.[80]

As a matter of practice, when the facts are not clear, it is advisable to claim the same expenses as deductions on both the income and estate tax returns. By so doing, no rights are waived and the executor has a

76. Treas. Reg. § 1.642(g)-2 (1956). See also INT. REV. CODE OF 1954, §§ 2053(a)(3), 691(b).

77. Treas. Reg. § 1.642(g)-1 (1956); INT. REV. CODE OF 1954, § 2054; Treas. Reg. § 20.2054-1 (1958).

78. I.T. 4048, 1951-1 CUM. BULL. 39.

79. Treas. Reg. § 1.642(g)(1) (1956).

80. Rev. Rul. 484, 1958-2 CUM. BULL. 363.

longer period in which to determine the relative advantages of taking the expenses as a deduction on one return over the other.

After a waiver is filed with respect to a particular item of expense or loss, the item cannot thereafter be allowed as a deduction for estate tax purposes because the waiver operates as a relinquishment of the right to have the deduction allowed at any time against estate tax.[81]

If part of a particular expense is attributable to the earning of tax exempt income and therefore not deductible for income tax purposes, the executor may still deduct the allowable portion on the income tax return and the balance on the estate tax return.[82]

2. Economics of the Election

It is fundamental that the election is useful only if there is sufficient income or gross estate against which the expenses may be applied.

The exemptions offered by the taxes may make the election valueless. If the income does not exceed the $600 income tax exemption allowed to the estate, an offsetting deduction is useless, except perhaps in the year in which the estate is terminated. On the other hand, if the gross estate does not exceed the $60,000 specific exemption or $120,000 where the maximum marital deduction is available, there is no point in claiming the expenses as deductions against estate tax.

In the usual case, the economics of the election inure to the benefit of the estate. However, where there are interim distributions to the beneficiaries, estate income is taxed to the beneficiaries rather than to the estate;[83] and, therefore, the effective income tax brackets of the beneficiaries must be compared with the income and estate tax rates of the estate.

Consideration must also be given to the option available in the final year of the estate to pass the excess of deductions over estate income on to the beneficiaries for use in their personal income tax returns.[84]

Complicating the whole inquiry into the dollar effect of the election is the existence of a formula type marital deduction or a residuary charitable bequest.

The existence of a formula type marital deduction causes the deduction of an administration expense on the estate tax return to be only partially effective. This is because the marital deduction itself is reduced by a percentage of the amount of the administration expense. For example, where the surviving spouse is entitled to the maximum marital deduction, the marital deduction is reduced by one-half of any administration expense claimed on the estate tax return. In such a situation, the administration

81. Rev. Rul. 240, 1953-2 Cum. Bull. 79.
82. Rev. Rul. 32, 1959-1 Cum. Bull. 245.
83. Int. Rev. Code of 1954, §§ 661(a), 662(a)(2).
84. Int. Rev. Code of 1954, § 642(h); Treas. Reg. § 1.642(h)-3 (1956).

expense is only 50% effective as an offset against estate tax because of the resulting decrease in the amount of the marital deduction.

If the administration expense is claimed against income tax, the value of a formula marital deduction is increased because the adjusted gross estate is not reduced by the amount of the expense. A surviving spouse will therefore receive a greater portion of the estate.[85]

The election should be carefully weighed where there is a residuary bequest to a charity. If the residuary estate, or a portion of it is bequeathed to a charity, and by local law the estate tax is payable out of the residuary estate, the charitable deduction against estate tax[86] is limited to the amount of the charitable bequest reduced by its share of the estate tax.[87] Thus, if an administration expense is claimed against income tax, the consequent increase in estate tax is borne to some extent by the charitable bequest with the result that the charitable deduction available against estate tax is less because the value of the bequest to the charity is reduced.

Vital considerations in the intelligent selection of the treatment of administration expenses are the timely payment of the expenses and a wise choice of the taxable year of the estate.

Obviously, an income tax deduction of $1,000 is worth less to the estate in a $5,000 income year than the same deduction in a year in which the income is $20,000. It may be advisable therefore to spread the payment of expenses, such as executor's commissions and attorneys' fees out over the period of the administration so as to make them available as deductions in years most beneficial to the estate. An expense may be claimed as a deduction in the estate tax return without actually being paid, so long as the executor gives the Service at the time of audit an affidavit as to the date of future payment of such item. However, the executor cannot deduct an expense in the income tax return unless it is actually paid.

There are no ironclad rules which dictate in every case when and where to deduct the administration expenses. The circumstances of each estate are different. The size of the gross estate and the amount of income are only two of the factors to be considered. Nor is the decision dependent on a comparison of the top estate tax bracket with the top income bracket.

A proper decision can be made only after compiling all relevant data and making many projections and computations.

3. Effect on Beneficiaries

The consequences of the election on the marital deduction and charitable bequest have already been noted. It is important also to record the effect of the election on the other beneficiaries of the estate.

---

85. Rev. Rul. 643, 1955-2 Cum. Bull. 386.
86. Int. Rev. Code of 1954, § 2055.
87. Treas. Reg. § 20.2055-3(a) (1958).

The Internal Revenue Code gives the executor no guide to use in exercising his right of selection. All too frequently, the decedent's will is silent as to the option, and state law on the subject is almost nonexistent.

The problem simply put is this—by electing to claim an administration expense on the estate's income tax return and thereby reduce taxable income, the executor necessarily increases estate tax by the diversion of a deduction which would have reduced the taxable estate. While the net overall effect may be beneficial to the estate as a whole, the effect of the election is to benefit the income account of the estate while penalizing the principal of the estate which actually bore the expense. Thus, the income beneficiaries are benefited to the detriment of the remaindermen.

The injustice to the ultimate takers of principal occurring from the election has been the subject of recent judicial review. In the first reported decision, *Estate of Warms*,[88] the decedent's will directed that all estate taxes be charged against and paid out of the residuary estate. The decedent bequeathed two-fifths of his residuary estate outright to two nieces and the balance in trust with the income payable to his widow for life with remainder to others. The trust established for the benefit of the widow did not qualify for the marital deduction. The executors paid certain administration expenses out of the principal of the residuary estate and claimed such expenses as deductions on the estate's income tax return rather than on the estate tax return. The result of the election was to increase the federal estate tax. The court ruled that the principal of the estate should be reimbursed from the income account in an amount equivalent to the detriment suffered by the principal as the result of the executors' failure to claim the deductions on the estate tax return. The court added, however, that if the income tax benefit exceeded the estate tax detriment, the income accomt was entitled to retain the excess benefit.

The *Warms'* decision was followed shortly thereafter in the California case of *In the Matter of Estate of Bixby*.[89] Pennsylvania in *Estate of Bell*[90] followed suit and required that an amount equal to the increase in federal estate tax caused by the election be transferred to principal from income.

The adjustments required where there is a formula marital deduction were considered in *In re Levy's Estate*.[91] The court there held that the election had different results for tax and accounting purposes, and that the election cannot vary the interests of the legatees under state law. Because the marital deduction passed free from tax under the state law, the court directed that all reimbursement to estate principal be allocated to the residuary estate.

88. 140 N.Y.S.2d 169 (Surr. Ct. 1955).
89. 140 Cal. App. 2d 326, 295 P.2d 68 (1956).
90. 7 Pa. Fiduc. Rep. 1, *aff'd*, 393 Pa. 623 (1958); See also Estate of Rice, 8 Pa. D. & C. 2d 379, 6 Pa. Fiduc. Rep. 225 (1956).
91. 9 Misc. 2d 361, 167 N.Y.S.2d 16 (Surr. Ct. 1957).

It is sufficient to observe that until local law is clarified as to the duties and liabilities of the executor in exercising his right of election, the wary executor will either secure court approval or the agreement of the beneficiaries as to any proposed treatment of administration expenses and losses.

E. Valuation—Election of Valuation Date

The Internal Revenue Code provides that the value of the decedent's gross estate for estate tax purposes may be determined as of the date of the decedent's death,[92] or, if the executor so elects, as of the date one year after the decedent's death.[93]

The election applies to all properties in the gross estate. The executor cannot value some as of one date and the balance as of another.

The selection of the valuation date involves more than a simple factual determination of value as of the appropriate dates. The fact that the value is greater on one date than on another is only one point to consider. In some instances, it may be to the advantage of the estate and its beneficiaries if the larger value is used; in others, the lower figure may produce the greatest benefits.

The value determined for estate tax purposes fixes the basis of the decedent's properties in the hands of the estate and the beneficiaries.[94] A higher valuation will yield a larger basis; lower values will save estate taxes.

Thus, if depreciable property composes part of the gross estate, consideration should be given to selecting the higher value in order to yield a larger basis for future depreciation deductions. The projected savings in income tax from the increased depreciation deduction may well offset the increased estate tax.

Regard must also be given to the income tax cost of a subsequent sale or exchange of property. The savings in estate tax resulting from a lower valuation may be at the price of increased income taxes to the holder of the property upon its later disposition.

The value also affects the size of the interests passing to the beneficiaries from the decedent. When there is a formula marital deduction, the selection of a higher value increases the amount the surviving spouse receives to the detriment of the other beneficiaries. Election of the higher values will increase the size of the charitable bequests with a concurrent increase in the estate tax charitable deduction. Specific legatees may benefit from increased estate values to the detriment of the residuary legatees where the taxes are paid out of the residuary estate.

If the value of the decedent's gross estate is less than $60,000 so that no

92. INT. REV. CODE OF 1954, § 2031(a).
93. INT. REV. CODE OF 1954, § 2032.
94. INT. REV. CODE OF 1954, § 1014(a).

estate tax return need be filed, no election as to value is available to the executor. In such cases, the bases of the estate assets are their values as of the decedent's death.

Frequently, executors for such nontaxable estates obtain an order from the probate court dispensing with the formal appraisal of estate assets. Their theory is that under the circumstances there is no need to put the estate to the expense of an appraisal. However, failure to obtain a formal appraisal denies to the ultimate distributees of the property a valuable element of proof if the basis of the asset later becomes a matter of concern either for depreciation purposes or at the time of a sale or exchange. The beneficiary who is faced with the burden of proving the value of the property as of the date of the decedent's death may not then appreciate the saving of the appraisal expense. This is not to say that the values obtained through formal appraisal may not be disputed by the Internal Revenue Service; but a formal appraisal is at least based on the opinions of qualified persons made at the time when the facts as to value were best obtained, not several years later when the question of basis is first raised.

As with the election of the treatment of administration expenses as deductions, the executor's choice of a valuation date for estate tax purposes carries with it the risk of criticism from the beneficiaries. It is advisable, therefore, in the absence of appropriate direction in the will, to obtain court approval of the valuation date or (better still) the agreement of all interested parties.

F. Insurance

In the usual case, the executor has no obligation to assist the beneficiaries of life insurance in the collection of the proceeds. However, Internal Revenue Form 712, Life Insurance Statement, must be filed with the estate tax return in connection with every insurance policy included in the estate. This form is completed by the insurance company and contains a description of the insurance policy on the decedent's life. If the request for such form is made to the insurance company at the time the claim is made, considerable time and trouble are saved. It is advisable, therefore, for the executor to assist in the collection of the insurance proceeds.

The executor may also be called upon to assist the surviving spouse in the selection of the method of settlement of the insurance proceeds. In this connection, he will want to consider the installment payment settlement option. The Code permits the spouse to exclude from income each year up to $1,000 of interest increment included in the installment payments.[95]

95. INT. REV. CODE OF 1954, § 101(d).

VI. ESTATE OPERATION AND TERMINATION

A. Continuance of Decedent's Business

The operation by the estate of the business of the decedent involves the same tax problems encountered in any business. The fact that an estate is involved raises no unique problems. However, the executor should be mindful that the business employees and perhaps the other employees of the estate are subject to withholding tax, social security taxes, and the various state and federal unemployment compensation taxes.

It is also advisable to remember in connection with payments to nonresident aliens the statutory requirement that the estate deduct and withhold a percentage of the amount to be paid.[96] The Internal Revenue Code requires that a flat 30% be withheld from the payment of covered items to a nonresident alien.[97] These provisions, including the percentage to be withheld, are varied in some instances by treaty. Care should be taken that the correct amount is withheld and paid to the United States. The executor is personally liable for any deficit.[98]

B. Liquidity

A primary concern in the administration of every estate is the availability of sufficient cash to pay debts, administration expenses and taxes. This need may have been anticipated and adequate provision made prior to death. On the other hand, conditions may have changed since the planning, or, as so often is the case, there was no planning at all.

Obvious solutions to the problem such as sales of estate assets and loans are available to the executor. Some relief may be obtained through a judicious enforcement of the tax apportionment provisions of the will or state statutes. In that connection, a fair share of the tax may be sought from the beneficiaries of a decedent's life insurance, which is included as an asset for estate tax purposes.[99]

A special Code provision, section 303, is available to minimize the liquidity problems faced by an estate composed in large part of stock in closely held corporations. This section permits the redemption at capital gain rates of stock, including section 306 stock, included in the decedent's gross estate. A redemption which does not come within section 303 carries with it a risk of dividend income.

The distribution permitted by section 303 may not exceed the sum of estate, inheritance, legacy and succession taxes (plus interest), and the amount of funeral and administration expenses allowable as deductions to

96. INT. REV. CODE OF 1954, § 1441.
97. INT. REV. CODE OF 1954, § 1441(b).
98. INT. REV. CODE OF 1954, § 1446.
99. INT. REV. CODE OF 1954, § 2206.

the estate for federal estate tax purposes.[100] There is no requirement, however, that the proceeds of the redemption be used for the payment of taxes, funeral expenses, or administration expenses. It is sufficient that such taxes and expenses are incurred. In this respect, the official caption of the section, "Distribution in Redemption of Stock To Pay Death Taxes," is misleading.

The redemption permitted by section 303 must be effected during (1) the three year period of limitations for assessment of estate tax and ninety days thereafter, or (2) if a petition for redetermination of estate tax deficiency is filed with the Tax Court, within the sixty day period after the decision of the Tax Court becomes final.[101]

The relief offered by section 303 is available only if the value of the stock in the redeeming corporation included in the gross estate for estate tax purposes is either more than 35% of the value of the gross estate or more than 50% of the value of the taxable estate. For purposes of the percentage tests, stock of two or more corporations is treated as the stock of a single corporation if more than 75% in value of the outstanding stock of each such corporation is included in the decedent's gross estate.[102]

Section 303 is not without its problems. If there are a series of redemptions, there is a problem of identifying which redemptions are pursuant to section 303 and which come within the general redemption provisions of sections 301 and 302. This problem is aggravated because the application of section 303 is not limited to redemptions from estates. It also applies to distributions in redemption of stock included in the decedent's gross estate and held at the time of the redemption by an heir, legatee, or donee of the decedent, surviving joint tenant, surviving spouse, appointee or taker in default of appointment, or trustee of a trust created by the decedent.[103] In order to safeguard against the risk of dividend income on the redemption, the executor must determine whether redemptions to other stockholders have exceeded the permissible limit.

Another pitfall of the redemption is loss of control of the corporation by the estate. The executor may be powerless to avoid this disadvantage if the press for cash is great.

A substantial risk is an error in the original valuation of the stock or an increase in value upon audit of the estate tax return. A change in value of the stock may cause a substantial shift in the percentage relationship of the stock to the estate with the result that the redemption does not qualify under section 303.

A redemption which does not come within section 303 is governed by

100. Treas. Reg. § 1.303-2(g) (1955).
101. Treas. Reg. § 1.303-2(c) (1955).
102. Treas. Reg. § 1.303-2(a) (1955).
103. Treas. Reg. § 1.303-2(f) (1955).

the general redemption provisions of sections 301 and 302. These provisions provide that a distribution in redemption of stock is subject to capital gain treatment *unless* the distribution is essentially equivalent to a dividend. Whether a distribution is essentially equivalent to a dividend is a factual determination.

The benefits and risks of these provisions are familiar.[104] However, the executor should be mindful of the risks resulting from the application of the family attribution rules to a section 302 redemption.[105]

Stock owned directly or indirectly by an estate is considered as being owned proportionately by the beneficiaries and stock owned by a beneficiary is considered as being owned by the estate.[106] In order to comply with the requirements of section 302, it may be necessary for the executor to first terminate a beneficiary's interest in the estate by making a distribution to him of his bequest or devise.

However, a residuary legatee does not cease to have an interest as a beneficiary of an estate until the estate is finally closed, even though the estate has assets sufficient only to pay its existing liabilities.[107] In such case, a redemption of estate stock may be considered as a distribution essentially equivalent to a dividend inasmuch as the residuary beneficiary of the estate owns, actually or constructively, stock of the corporation.

The dividend risks incident to a redemption are not eliminated by the existence of a buy-sell agreement or any other business purchase agreement.

Even though a redemption is subject to dividend treatment under section 302, it will receive capital gain treatment to the extent that the distribution in redemption comes within the scope of section 303.

C. Distribution of Income and Corpus

1. Minimizing Income Tax

Where the estate income tax bracket is greater than those of some or all of its beneficiaries, the careful scheduling of income and principal distributions to the beneficiaries can produce a lower aggregate income tax to the estate and the beneficiaries.

This result is based on the fact that an estate is entitled to a deduction for, and the beneficiaries are taxed on, the amount of income for the taxable year which is required to be distributed currently to the beneficiaries and any other amounts properly paid or credited or required to be distributed to the beneficiaries, which includes current income dis-

104. See Young, *Extreme Care Needed Today To Avoid Dividend Treatment of Stock Redemptions*, 7 J. TAXATION 66 (1957); Winton, *Stock Redemptions in Closed Corporations*, 37 TAXES 397 (1959).

105. INT. REV. CODE OF 1954, § 318.

106. INT. REV. CODE OF 1954, § 318(a)(2).

107. Rev. Rul. 18, 1960-1 CUM. BULL. 145.

tributable at the executor's discretion, distributions of corpus and accumulated income.[108] However, the deduction and the consequent income to the beneficiaries are limited to the estate's distributable net income for the taxable year.[109]

Thus, under these rules a distribution of corpus would be income to the beneficiaries to the extent of the estate's distributable net income unless it is a bequest of a specific sum of money or property which is paid in not more than three installments.[110]

The application of the foregoing principles permits an equalization of income between the estate and beneficiaries with a correlative saving to the group in income taxes.

As is so often the case, the maximum tax saving to the group can be effected only through disproportionate distributions to the beneficiaries with the result that some beneficiaries bear a substantially larger part of the tax than others. However, the increased tax to such beneficiaries may still be less than their share of the estate income tax had the distributions not been made. They, therefore, benefit as a result of the distributions but perhaps not to the same extent as other beneficiaries.

The executor must consider that an overall saving in income tax to the estate and the beneficiaries may be at the cost of a disproportionately higher income tax payable by one or more of the beneficiaries. The inequities of planned distributions should be carefully considered with the interested parties to forestall any charge against the executor of favoritism of one beneficiary over others.

2. Distribution in Kind

As noted, corpus distributions result in taxable income to the beneficiaries to the extent of the estate's distributable net income.[111] However, the distribution of an amount which qualifies as a bequest of a specific sum of money or of specific property and which is paid or credited all at once or in not more than three installments is not treated as a distribution of estate income.[112]

In order to qualify as a gift or bequest of a specific sum of money or specific property, the amount of money or the identity of the property must be ascertainable under the terms of the will as of the date of death.[113] It is not sufficient that the value of the bequest is determinable after the decedent's death but before it is satisfied. The marital deduction be-

108. INT. REV. CODE OF 1954, §§ 661-62; Treas. Reg. §§ 1.661(a)-2, 1.662(a)-1 (1956).
109. INT. REV. CODE OF 1954, §§ 643(a), 661(c), 662; Treas. Reg. §§ 1.661(c)-1, 1.662(a)-2 (1956).
110. INT. REV. CODE OF 1954, § 663(a)(1).
111. *Ibid.*
112. Treas. Reg. § 1.663(a)-1 (1956).
113. Treas. Reg. § 1.663(a)-1(b) (1956).

quest to the decedent's spouse of money or property, to be selected by the decedent's executor, equal in value to a fraction of the decedent's adjusted gross estate does not come within the terms of the statute. Similarly, a residuary bequest is not a bequest of a specific sum of money or of specific property.

The inherent income tax danger of any interim distribution of estate corpus to the beneficiaries is apparent. For example, under the terms of the will the decedent's estate is to be divided equally between *A* and *B*. The will makes no provision for the disposition of income of the estate during the administration. The estate has income of $40,000 for the taxable year 1960. In accordance with an agreement of the beneficiaries that part of the assets of the estate would be distributed in kind to the beneficiaries, stock was distributed to *A* during 1960. On the date of distribution, the stock had a fair market value of $30,000. No other distributions were made during 1960. The distribution to *A* is not excludable from income because it is not a specific gift to *A* required by the terms of the will. Accordingly, the fair market value of the stock ($30,000) represents ordinary income to *A*.

On the other hand, if the will provided a legacy of $5,000 to *A* and the balance of the estate to *B*, a payment of the bequest to *A* in a lump sum would not be taxable income to him even though the estate had income during the taxable year which was accumulated and added to corpus.

It should also be noted that a specific bequest otherwise qualifying as an exclusion from income becomes taxable if it is paid in more than three installments.[114] Therefore, when *A* receives a specific bequest of $20,000 payable in four equal annual installments, the sums paid to *A* do not come within the definition of a specific bequest and are therefore taxable to the extent of the distributable net income.

D. Allocation of Income

Related to the question of income distributions is the problem raised by allocating estate income among the beneficiaries. For example, *A* and *B* are equal income beneficiaries of an estate. *A* is a high bracket taxpayer and *B* is in the low brackets. The estate earns income of $20,000, half of which is tax exempt interest and the remainder taxable income. It is obviously to the advantage of *A* for the executor to allocate the $10,000 tax exempt income to him; but, what about *B*? Is not the executor leaving himself open to a charge of failure to discharge his duties impartially if he allocates the exempt income to *A*? In the absence of an express direction in the will or an agreement between the beneficiaries, it appears that any allocation of income which favors one beneficiary over another may

114. Treas. Reg. § 1.663(a)-1(c) (1956).

result in criticism of the executor. However, there may be limited occasions in which the executor can act with impunity, as for example, when one of the beneficiaries is a charity.

E. Accumulation of Income

The antithesis to scheduled distributions of income is the accumulation of income. In some estates where the beneficiaries are in high income tax brackets, it is to the advantage of all concerned to have the estate income accumulated for as long as possible in order to have it taxed in the lower brackets of the estate.

The throwback rules applicable to trusts do not apply to estate accumulations.[115] However, there is always the danger that the Service will claim that the accumulated income is "required to be distributed currently,"[116] and is therefore taxable to the estate beneficiaries. Neither the Code nor the Regulations offer any assistance to the determination of when income is required to be distributed currently. Presumably, this determination must be made by reference to local law.

F. Establishment of Testamentary Trusts

The value of the early establishment of testamentary trusts has already been touched upon in connection with the discussion regarding the use of taxable years to defer the realization of income. The earlier a testamentary trust can be established the better it is from an overall income tax savings standpoint because there is another taxable entity available to which estate income can be funneled. When testamentary trusts may be properly established is a question of state law. If the executor jumps the gun, the income allegedly belonging to the trust will still be taxed to the estate.[117]

G. Prolonging Estate Administration

The longer an estate is in administration, the longer an additional taxable entity in the form of the estate is available for use in minimizing income taxes. The Internal Revenue Service is not unmindful of this advantage. The Regulations speak where the Internal Revenue Code is silent. According to the Regulations, the period of administration or settlement of an estate is the period actually required by the executor to perform the ordinary duties of administration, such as the collection of assets and the payment of debts, taxes, legacies, and bequests, whether the period required is longer or shorter than the period specified under the

---

115. See INT. REV. CODE OF 1954, §§ 665-68.
116. INT. REV. CODE OF 1954, § 662(a)(1).
117. United States v. Britten, 161 F.2d 921 (3d Cir. 1947).

applicable local law for the settlement of estates.[118]

The period of administration cannot be unduly prolonged. If the administration is unreasonably prolonged, the estate is considered terminated for income tax purposes after the expiration of a reasonable period for the performance by the executor of all the duties of administration.[119] An estate is also considered as terminated for income tax purposes when all the assets have been distributed except for a reasonable amount which is set aside in good faith for the payment of unascertained or contingent liabilities and expenses (not including a claim by a beneficiary in the capacity of a beneficiary).[120]

Whether the administration of an estate has terminated is a factual determination.[121] The question to be answered is whether the administration has been "unduly prolonged." Many legitimate reasons are available for prolonging estates; however, the one which has received the most favorable reception is the necessity to prosecute or defend a tax claim.[122]

H. Concluding Estate Administration

There are two principal points to keep in mind in connection with the termination of any administration. First, care should be taken that the settlement does not result in a bunching of more than twelve months of estate income in one taxable year of the beneficiary. This possibility arises where the beneficiary and the estate have different taxable years. In such case, the beneficiary is required to include in income for his current taxable year his share of distributable net income of the estate plus any amounts paid, credited, or required to be distributed to him for any taxable year or years of the estate ending with or within his taxable year.[123] If more than one taxable year of the estate ends with or within the taxable year of the beneficiary, the beneficiary will be taxed on more than twelve months income.

Second, the allocation of administration expenses and losses against income in the estate's final taxable period will result in any excess of such deductions over income being carried over to the beneficiaries for use in their personal income tax returns.[124] However, such excess is available as a deduction only to those beneficiaries who have a right to receive

118. Treas. Reg. § 1.641(b)-3 (1956), as amended, T.D. 6353 (1959) and T.D. 6462 (1960).

119. *Ibid.*

120. *Ibid.*

121. McCauley v. United States, 193 F. Supp 938 (E.D. Ark. 1961); Caro Du Bignon Alston, 8 T.C. 525 (1947); Estate of Robert W. Harwood, 46 B.T.A. 750 (1942).

122. McCauley v. United States, *supra* note 121; Alma Williams, 16 T.C. 893 (1951).

123. INT. REV. CODE OF 1954, § 662(c).

124. INT. REV. CODE OF 1954, § 642(h). Within limits capital losses and net operating losses are also carried over to the beneficiaries.

"property," that is corpus from the estate, as distinguished from other beneficiaries who only have a right to receive income from such property.[125] The Regulations prescribe the method of allocating the excess deductions between the beneficiaries.[126]

The deduction of the excess is allowable only in computing the taxable income of a beneficiary, not his adjusted gross income. The deduction to the beneficiary is allowable only in the taxable year of the beneficiary within which the estate terminates whether the year of termination is of normal duration or is a short year.[127]

VII. Filing of Returns

A. Declaration of Estimated Tax

An estate, though generally taxed as an individual, is not required to file a declaration of estimated tax.[128]

B. Fiduciary Income Tax Return

The executor must file Form 1041, Fiduciary Income Tax Return, for any taxable year in which the gross income of the estate is in excess of $600, or, regardless of the amount of income for the taxable year, if any beneficiary of the estate is a nonresident alien.[129]

In cases where the gross income of the estate is $5,000 or over for any taxable year, a copy of the will, accompanied by a written declaration of the executor under penalties of perjury that it is a true and correct copy, must be filed with the fiduciary return of the estate, together with the statement by the executor indicating the provisions of the will, which, in his opinion, determine the extent to which the income of the estate is taxable to the estate or the beneficiaries.[130] If, however, a copy of the will and the statement relating to the provisions of the will have once been filed, they need not again be filed if the fiduciary return contains a statement showing when and where they were filed.

Where an estate has both domiciliary and ancillary administrations, the domiciliary and ancillary executors must each file a fiduciary income tax return. The domiciliary executor is required to include in the return rendered by him the entire income of the estate. The return for the ancillary executor is filed with the district director for his internal revenue district and shows the name and address of the domiciliary executor, the amount of the gross income received by the ancillary executor, and the

125. Rev. Rul. 134, 1960-1 Cum. Bull. 259.
126. Treas. Reg. § 1.642(h)-4 (1956).
127. Treas. Reg. § 1.642(h)-2(a) (1956).
128. Treas. Reg. § 1.6015(h)-1 (1957).
129. Treas. Reg. § 1.6012-3 (1959).
130. Treas. Reg. § 1.6012-3(a)(2) (1959).

deductions to be claimed against such income, including any amount of income properly paid or credited by the ancillary executor to any heir, legatee, or other beneficiary.[131]

The due date of the fiduciary income tax return is the same as for individuals, that is, the fifteenth day of the fourth month following the close of the estate's taxable year.[132]

C. Gift Tax Return

The executor is required to file a gift tax return for any gift in excess of $3,000 made by a donor who dies before filing his return.[133]

D. Estate Tax Return

The estate tax return is due within fifteen months after the date of death.[134] In case it is impossible or impracticable for the executor to file a reasonably complete return by the due date, the district director may, upon the showing of good and sufficient cause, grant a reasonable extension of time for filing the return.[135] However, unless the executor is abroad, extension may not be for more than six months.

The estate tax return must be filed with the district director in whose district the decedent is domiciled at the time of death.[136]

E. Omissions From Estate Tax Return

There is no provision in either the Code or the Regulations for the amendment of an estate tax return. Errors and omissions in the return are called to the attention of the Service at the time of audit. However, it is better practice to notify the Service in writing immediately upon the discovery of an error or omission in the return.

If there is an omission of more than 25% of the gross estate from the return, the usual three year statute of limitations[137] on assessments is extended to six years.[138] There is, of course, no limitation on assessments in the case of a fraudulent return.

VIII. Payment of Taxes

A. General Rule

The payment of the tax due on the decedent's last return and the

131. Treas. Reg. § 1.6012-3(a)(3) (1959).
132. Treas. Reg. § 1.6072-1(a) (1959).
133. Treas. Reg. § 25.6019-1(b) (1958).
134. Int. Rev. Code of 1954, § 6075(a).
135. Treas. Reg. § 20.6081-1(a) (1958).
136. Treas. Reg. § 20.6091-1 (1958).
137. Int. Rev. Code of 1954, § 6501(a).
138. Int. Rev. Code of 1954, § 6501(e)(2).

fiduciary income tax return follows the usual rules and presents no unique problems.

Generally, the estate tax is due and payable at the time the estate tax return is filed.[139] However, if the district director finds that the payment of the estate tax would result in undue hardship to the estate, he may extend the time for payment for a period or periods not to exceed one year for any one period and for all periods not in excess of ten years.[140] The extension will not be granted upon a general statement of hardship. The term "undue hardship" means more than an inconvenience to the estate.[141] It must appear that substantial financial loss, for example, due to the sale of property at a sacrifice price, will result to the estate for making payment of the tax at the due date. If a market exists, a sale of the property at the current market price is not ordinarily considered as resulting in an undue hardship. The mechanics for applying for an extension of time are detailed in the Regulations.[142]

If an extension of time for payment of the estate tax is granted, the district director may, if he deems it necessary, require the executor to furnish a bond for the payment of the amount in respect of which the extension is granted in accordance with the terms of the extension. As a practical matter, most surety companies will not write such a bond without full cash collateral. Accordingly, if the executor cannot pay the tax on time, he probably cannot put up the cash collateral in order to obtain the bond. Therefore, his quest for an extension will prove fruitless.

B. Use of Treasury Bonds To Pay Tax

Treasury bonds of certain issues which were owned by the decedent at the time of his death or which were treated as part of his gross estate under the rules contained in paragraph 306.28 of Treasury Department Circular 300, revised,[143] may be redeemed at par plus accrued interest for the purpose of payment of the estate tax.[144]

Whether bonds of particular issues may be redeemed for this purpose will depend on the terms of the offering circulars cited on the face of the bonds. A current list of eligible issues may be obtained from any Federal Reserve bank or from the Bureau of Public Debt. It is immaterial for this purpose whether the bonds are in registered or coupon form or what their actual market values are. However, for estate tax purposes these bonds must be valued in the gross estate at least at par.[145]

139. INT. REV. CODE OF 1954, § 6151(a).
140. INT. REV. CODE OF 1954, § 6161(a)(2).
141. Treas. Reg. § 20.6161-1(b) (1958), as amended, T.D. 6522 (1960).
142. Treas. Reg. § 20.6161-1(c) (1958), as amended, T.D. 6522 (1960).
143. 31 C.F.R. § 306.
144. Treas. Reg. § 20.6151-1(c) (1958).
145. Bankers Trust Co. v. United States, 284 F.2d 537 (2d Cir. 1960).

C. Installment Payment of Estate Tax

The Small Business Tax Revision Act of 1958 added a new provision to the Code designed to relieve the estate tax burden of estates composed in large part of an interest in a closely held business.[146]

If the value of the closely held business exceeds either 35% of the value of the gross estate or 50% of the value of the taxable estate, the executor may elect to pay the estate tax attributable to such business interest in at least two but not more than ten equal annual installments. As with section 303, the percentage requirement may be satisfied by the aggregate of two or more closely held businesses if more than 50% of the total value of each is included in the decedent's gross estate.[147]

A "closely held business" means (1) an interest in a sole proprietorship; (2) a 20% interest in the capital of a partnership, or an interest in a partnership composed of ten or less partners; or (3) a 20% interest in the voting stock of a corporation or an interest in a corporation having ten or fewer stockholders.[148]

Installment payments of tax are subject to interest at the rate of 4% per annum.

There is a constant danger that the privilege of paying tax in installments will terminate with the consequent acceleration of the installments.[149] Such acceleration will occur upon the happening of any one of the following:

(1) Withdrawals of money or property from the business, the aggregate of which equals or exceeds 50% of the value of the business;[150]

(2) Failure to pay any installment on or before the due date;[151]

(3) Failure to apply undistributed income after the fourth taxable year of the estate against the unpaid balance of the tax;[152]

(4) The distribution, sale, exchange, or other disposition by the estate of 50% or more of the business.[153]

If the requirements are met, the installment payment privilege is available even though a redemption of the stock from the estate can be effected pursuant to section 303. Indeed, there is no reason why an estate cannot use a section 303 redemption to drain cash out of the business and still pay the tax on the business in installments. A section 303 redemption is

146. Int. Rev. Code of 1954, § 6166.
147. Int. Rev. Code of 1954, § 6166(d).
148. Int. Rev. Code of 1954, § 6166(c).
149. Int. Rev. Code of 1954, § 6166(h); Treas. Reg. § 20.6166-3 (1960).
150. Int. Rev. Code of 1954, § 6166(h)(1).
151. Int. Rev. Code of 1954, § 6166(h)(3).
152. Int. Rev. Code of 1954, § 6166(h)(2).
153. Treas. Reg. § 20.6166-3(e) (1960).

not considered to result in the withdrawal of more than 50% of the value of the business and thereby accelerate the payment of the balance of tax.[154]

IX. Liability of Executors and Heirs for Tax

A. Executor

In his *representative* capacity, the executor has no obligation for the payment of taxes, interest, and penalties, except to the extent of the assets of the estate.[155] However, an executor who pays, in whole or in part, any debt of the estate before satisfying and paying debts, including taxes, due the United States is personally liable to the extent of such payments.[156] The liability of the executor is assessed as a transferee liability.[157]

In order to make the executor *personally* liable, he must have knowledge of the tax due.[158] However, the burden is on the executor to establish a lack of knowledge when the government establishes a prima facie case.[159]

In the case of the liability of the executor, the period for collection of the tax is limited to one year after the liability arises or not later than the expiration of the period for collection of the tax (within six years after assessment) in which such liability arises, whichever is the later.[160]

In order to minimize the risks of personal liability, the executor should consider doing the following:

(1) Upon discharge by the probate court, filing a notice of termination of fiduciary relationship with the appropriate district director of internal revenue together with a copy of the order of discharge;[161]

(2) Filing requests for prompt assessment of income and gift taxes. These requests reduce the time for assessment of the taxes to eighteen months unless there is fraud, or unless more than 25% of the gross income, or gross gift, as the case may be, is omitted from the returns;[162]

(3) Filing a request for prompt determination of the estate tax and discharge from personal liability.[163] Such request will reduce the time for assessment to one year unless more than 25% of the value of the gross estate was omitted from the estate tax return.[164]

---

154. Int. Rev. Code of 1954, § 6166(h)(1)(B).
155. Int. Rev. Code of 1954, § 6903(a); Treas. Reg. § 301.6903-1(a) (1957), as amended, T.D. 6498 (1960).
156. Rev. Stat. § 3467 (1875), as amended, 31 U.S.C. § 192 (1958).
157. Int. Rev. Code of 1954, § 6901(a)(1)(B).
158. Irving Trust Co., 36 B.T.A. 146 (1937).
159. L. T. McCourt, 15 T.C. 734 (1950).
160. Int. Rev. Code of 1954, §§ 6901(c)(3), 6502(c)(3).
161. Int. Rev. Code of 1954, § 6903.
162. Int. Rev. Code of 1954, § 6501(d), (e)(1).
163. Int. Rev. Code of 1954, § 2204.
164. Int. Rev. Code of 1954, § 6501(e)(2).

The discharge of the executor from personal liability does not relieve the estate or its distributees from liability for any deficiency in tax.[165]

B. Heirs

The heirs, legatees, devisees and distributees of an estate are liable as transferees for all unpaid income and gift taxes of a decedent and all unpaid income and estate taxes of the estate.[166]

However, to hold an heir liable as a transferee, it must be shown that (1) the transferee received assets of the estate, and (2) that the transferor was insolvent at the time of the transfer, or was rendered insolvent by the transfer of assets or a related series of transfers.[167]

Transferee liability is joint and several;[168] however, a transferee who pays the entire tax is entitled to contribution from the other transferees.[169]

X. Conclusion

A whole new phase of probate law will soon emerge. The liability of the executor to the heirs and beneficiaries for failure to avoid tax pitfalls or secure tax advantages will become the subject of many future court decisions. The modern estate lawyer must recognize his duties to the executor. Both professional ethics and the fiduciary principles of probate administration demand that the tax hazards and tax saving opportunities presented in the administration of an estate be given careful and detailed consideration.

165. Bessie M. Brainard, 47 B.T.A. 947 (1942).
166. Int. Rev. Code of 1954, § 6901; Treas. Reg. § 301.6901-1(b) (1957), as amended, T.D. 6498 (1960).
167. Marva T. B. Spaulding, 27 T.C. 479 (1956); George M. Newcomb, 23 T.C. 954 (1955).
168. Phillips v. Commissioner, 283 U.S. 589 (1931).
169. Int. Rev. Code of 1954, § 2205.