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Tax Problems Involved in Administration

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TAX PROBLEMS INVOLVED IN ADMINISTRATION†

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MR. TESTATOR IS DEAD. Soon his family will express their fears over how much of his estate will be left after the death taxes have been paid and their fears will not be without foundation. But long before the estate and inheritance taxes must be determined, the executor and the attorney will have other tax schedules to be filed and other taxes to be paid. The death of Mr. Testator has created not only a new order of living for his family; it has also automatically changed the requirements for filing income tax returns; it has brought about a different treatment to be accorded income, deductions, exemptions; it has given to the executor opportunity to invoke different rules with respect to the running of statutes of limitations; it has also imposed upon the executor liabilities and responsibilities of which he must be aware and against which he must guard lest he incur loss to himself as well as to the estate which he is administering. Months before the federal estate tax becomes payable, the executor and the attorney must consider their plan of action, including the effect upon the income, estate, and inheritance taxes to be paid if they do not ascertain and weigh carefully all the available facts having a bearing upon the estate's tax liabilities.

FILING OF NOTICES

After the appointment of the executor, one of the first documents which he should prepare and file is one which often goes unnoticed. It is the notice of the assumption of the office of the executor, and when it is properly served upon the Commissioner of Internal Revenue, it places the executor in the fiduciary relationship insofar as the Commissioner is con-

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cerned and continues him in that position until he is properly discharged. While no particular form of notice is required, the Regulations state that it must be in writing, signed by the fiduciary, giving the names and addresses of the beneficiaries, filed with the Commissioner, and be accompanied by certified copies of letters testamentary issued to the executor.[1] It must also state whether there is a liability for tax, and, if so, the year or years involved; whether there is a liability at law or in equity of a transferee of the property of a taxpayer; or whether there is a liability of a fiduciary under Section 3467 of the Revised Statutes, as amended, in respect of the payment of any tax from the estate of the taxpayer.

Irrespective of a discharge by the probate court, failure to give the notice of appointment in the prescribed form, it is generally held, does not relieve the executor of his responsibility to the Federal Government. While ordinarily the possibility of a penalty for failure to file such notice would seem to be remote, it is important to remember that before an assessment is valid, the Commissioner must issue a properly addressed deficiency notice to the taxpayer. This deficiency notice is properly addressed if sent to the taxpayer's last known address[2] unless the executor has given a notice of fiduciary relationship.[3] If the executor fails to give the proper notice, he risks surcharge if a deficiency notice is not duly received by him.

The same section of the Regulations provides that another notice must be filed upon termination of the executor's tenure if the executor is to be relieved of further responsibility to the Federal Government. It would appear that the second notice is entirely effective even though the first notice is never given. Once the executor has given notice of his discharge, he has no further authority to represent the estate as to federal tax matters.[4] The fiduciary capacity, however, must have terminated under the state law or the notice is not effective.[5]

The Regulations define "executor" to include any person in actual or constructive possession of the estate's property in the event a legal representative of the deceased does not qualify within two months after the date of death of the deceased. If the executor does qualify as such, the persons in possession of the deceased's property are excluded from such term.[6]

With respect to the federal estate tax, the executor is required to file a Preliminary Notice, Form 704, within two months after the death of the deceased or two months after the date the executor qualified as such, whichever date is later.[7] Such preliminary notice must be filed if the gross estate

[1] INT. REV. CODE § 312; U.S. Treas. Reg. 111, § 29.312-1 (1943).
[2] INT. REV. CODE § 272(k).
[3] *Id.* §§ 312, 901, 1026.
[4] Estate of Joseph B. Dabney, 40 B.T.A. 276 (1939).
[5] Hulburd v. Commissioner, 296 U.S. 300 (1935.)
[6] U.S Treas. Reg. 105, § 81.59 (1942); *cf.* U.S. Treas. Reg. 105, § 81.85 (1942).
[7] INT. REV. CODE § 820; U.S. Treas. Reg. 105, §§ 81.57, 81.58 (1942).

exceeds $60,000 in value at the date of death. Such value is determined under the Federal Estate Tax Statute and has no relevance to the extent of the probate estate. Therefore, the executor must examine the affairs of the deceased to ascertain whether there are any assets such as life insurance, gifts in contemplation of death, or property held in joint tenancy which might raise the gross taxable estate to more than $60,000. This notice must be filed regardless of the amount of deductions claimed by the estate or of any contention with respect to the exclusion of any of the property from the estate. The Regulations provide that such notice should be prepared and filed if an examination indicates any doubt as to the $60,000 requirement being met and that the filing of such notice is mandatory. Note, however, that if the decedent was a non-resident and not a citizen of the United States, a preliminary notice must be filed if the gross estate exceeds $2,000 in value.[8] Form 704 indicates that an approximation must be given with respect to the various types of property in the estate, but it is common practice in many cases to ignore this requirement and instead insert a lump sum.

Failure to file the preliminary notice does not result in ad valorem penalties being asserted because there is no tax by which the penalty may be measured. However, a mandatory penalty not exceeding $500 from the person failing to comply with the filing of such notice, together with the cost of the suit, to be recovered in a civil action in the name of the United States, is apparently imposed.[9] The general practice seems to be that such penalties are not asserted except in case of a refusal to file such notice after demand has been made. The penalty necessarily would be imposed directly upon the executor and would not be a charge against the estate. The preliminary notice is not a "return" within the scope of the criminal penalty provided by Internal Revenue Code Section 894(b)(2)(B) for failure to file a return. This section does not provide a penalty for willful failure of the executor to keep records and supply any information which may be pertinent to the collection of the estate tax. Personal penalties are exacted for failure to supply supplemental data.[10] The law requires an information return to be filed where distributions have been made to the beneficiaries.[11]

PERSONAL LIABILITY OF THE EXECUTOR

In reporting the income of the decedent it is becoming increasingly obvious that it is the duty of an executor to examine the returns of the decedent which had been filed prior to the date of death and to make some reasonable check between the assets in the estate and the prior income tax returns. A correlation of the two may make it obvious on the usual "net

[8] U.S. Treas. Reg. 105, § 81.60 (1942).
[9] INT. REV. CODE § 894.
[10] *Id.* § 821(a)(1).
[11] *Id.* § 147; U.S. Treas. Reg. 111, § 29.147-1 (1943).

worth" basis that the decedent had failed to report part or all of the income from his assets. An executor owes an obligation both to the government and to the estate to disclose the facts through the preparation and filing of amended returns, insofar as it may be possible to prepare such returns, if an examination of the facts leads the executor to feel reasonably sure that false returns were filed by the decedent. A failure to do so might result in a criminal charge against the executor for the concealment of a material fact in a dealing with an agency of the United States. It is also possible that a violation of Section 145 of the Internal Revenue Code might be involved. There is no way in which the executor may terminate his responsibilities for the penalties that might be imposed with respect to false returns.

If an executor finds himself saddled with personal liability, it may be the result of unpaid income tax assessments issued against the decedent or the estate. Such a liability arises as a matter of substantive law under Sections 3466 and 3467 of the Revised Statutes.[12] Section 3466 creates a priority of payment in favor of debts due to the United States whenever the estate of any deceased debtor in the hands of the executors or administrators is insufficient to pay all the debts due from the deceased. Section 3467 makes the executor personally liable if he pays in whole or in part any debt due by the person or estate for whom or for which he acts before he satisfies and pays the debts due to the United States. If he is liable it shall be to the extent of such payments for debts so due to the United States or for so much thereof as remain due and unpaid. The priority granted by Section 3466 must exist before the personal liability of the executor will arise under Section 3467. The act, therefore, which causes the personal liability to arise is the payment or distribution of assets which results in insolvency. However, if the executor distributes a clearly solvent estate while the debt is still owing to the United States, he may find himself personally liable for the debt.[13]

Estate Tax Regulations 105, Section 81.99, provide that, if the executor before paying all the estate tax pays in whole or in part any debt due by the decedent or the decedent's estate, or distributes any portion of the estate, he is personally liable to the extent of such payment or distribution for so much of the estate tax as remains due and unpaid. The all inclusive language of this regulation would seem to preclude the distribution of any part of the estate by a cautious executor, in spite of the fact that a partial distribution may well effect substantial income tax savings.

However, opinion is not uniform that the statutes should be interpreted so rigorously. In *Jessie Smith, Executrix,*[14] the Board of Tax Appeals stated:

[12] 31 U.S.C.A. § § 191, 192, as amended by Rev. Act of 1934.

[13] United States v. Munroe, 46-1 U.S.T.C. ¶ 9219, 65 F. Supp. 213 (W.D. Penn. 1946).

[14] 24 B.T.A. 807, 811 (1931).

> "The funds in her hands as executrix, after the payment of only a portion of the widow's allowance and the expenses of protecting the estate, amounted to nothing. We do not think, therefore, that she is liable in her own person for the Government taxes under section 3467 of the Revised Statutes."

This seems to be the sole exception in the avoidance of personal liability, and if the tax is collected from the personal representative, his only recoupment must be from the distributees. The personal liability arises at the time the statute is violated and the extent of the liability is the amount of the distribution [15] other than to the United States, which includes the amounts distributed to the beneficiaries of the estate.

The situation with respect to the personal liability of the executor for unpaid assessments on returns of the taxpayer during his lifetime seems to indicate that personal liability will not be imposed upon the executor in the absence of his knowledge of the unpaid assessment. But the courts are not uniform in the application of their respective tests. In *Livingston v. Becker,* [16] the court concluded that the statute relied on and which created a personal liability in favor of the United States and against the trustee was highly penal and that notice of the existence of a tax due the United States must be given to the trustee, at least to the extent of bringing home to him such facts as to put a reasonable and prudent person on inquiry.

However, in *Irving Trust Co.* [17] the court stated:

> "But the courts have held, in interpreting section 3467, that in order to render a trustee personally liable, it must appear that the trustee is chargeable with knowledge of the debt due to the United States. . . . If the trustee has knowledge of the debt, it matters not how that knowledge was obtained. . . . It is enough if the trustee be in possession of such facts as that a faithful and fair discharge of his duty would put him on inquiry."

In contrast, Income Tax Regulations 111, Section 29.162-1, state, with respect to returns filed by the executor, that the liability for the payment of the tax attaches to the person of the executor or administrator up to and after his discharge if prior to distribution and discharge he had notice of his tax obligation or failed to exercise due diligence in ascertaining whether or not such obligation existed.

In *Giovaninni Terranova,* [18] the Commissioner in asserting personal liability argued that, as the executors paid outside debts and distributed the remaining assets without discharging the deficiencies involved, there was no escape from their liability by reason of the fact that they were unaware of the tax, even though no determination of tax liability had been made until

[15] U.S. v. Munroe, *supra* note 13.
[16] 40 F.2d 673 (E.D. Mo. 1929).
[17] 36 B.T.A. 146, 148 (1937).
[18] P-H 1943 TC Mem. Dec. ¶ 43,380.

long after the executors had been discharged. The *Terranova* case involved a transferee liability and the facts were that the decedent had not filed a return for several years prior to his death nor had he kept adequate records of his income. Even though the executors may not have had any knowledge of the decedent's business affairs, under these conditions it would seem that, acting prudently, they would not have distributed the assets of the estate until they had satisfied themselves with respect to the income tax liabilities of the decedent.

What of the danger where the executor has a faint amount of knowledge that might indicate fraud and, being able to find nothing further, is ready to close the estate? Should be bring this situation to the attention of the Bureau and force a case? This question cannot be lightly or quickly answered. Every executor and attorney with the problem before them will have to answer it in the light of the circumstances applicable to their particular case. The courts specifically provide that such personal liability may be enforced against an executor by the same procedure as with respect to the enforcement of a tax deficiency. [19]

Section 311(b)(3) of the Internal Revenue Code provides, as to the personal liability of a fiduciary, that assessment may be made against a fiduciary ". . . not later than one year after the liability arises or not later than the expiration of the period for collection of the tax in respect to which such liability arises, whichever is later." Inasmuch as the period for collection of a duly assessed tax is six years, theoretically it is possible for the Commissioner to assess personal liability of the fiduciary just short of seven years from the original assessment. [20]

The ordinary period for assessment against a taxpayer is three years from the due date of the return. [21] By proper notice under the provisions of Section 275(b) of the Internal Revenue Code an executor may shorten this period to eighteen months from the notice in the case of his decedent's returns and in the case of his own returns during the period of administration of the estate. There are, however, certain exceptions to this short period of assessment which are set forth in the Code. The more important of these exceptions are:

1. Where 25% or more of the gross income has been omitted from the return. [22]
2. Where mathematical error has been made in the return. [23]
3. Where the return is false or fraudulent. [24]
4. Where no return was filed. [25]

[19] INT. REV. CODE § 311(a)(2).
[20] *Id.* § 276(c).
[21] *Id.* § 275(a).
[22] *Id.* § 275(c).
[23] *Id.* § 272(f).
[24] *Id.* § 276(a).
[25] *Ibid.*

5. Where transferee liability of the decedent or the estate was involved and was not adequately described in the notice.[26]

The question has also been raised as to whether or not Code Section 311(c) may be a further exception in view of the fact that this section seems at least in part in direct conflict with Code Section 275(b), *i.e.*, there seems to be no way for a living taxpayer to shorten the statute. As an example, suppose the executor from an examination of a decedent's return learns that an error of law was committed on such return.

In addition to requesting under Section 275(b) of the Internal Revenue Code an early determination with respect to income taxes, the executor under Section 825(a) of the Code has the right to request the determination of the federal estate tax within one year from the filing of the return. The executor is thereupon released from personal liability for any deficiency in estate tax found due after that date. A common misconception exists with respect to the extent of such request, for many do not realize that such discharge is limited to the personal liability of the executor for unpaid federal estate tax. Such request does not discharge the liability of the estate, nor does it release the executor from liability for any other charges asserted under Sections 3466 and 3467 of the Revised Statutes.[27] The section has no applicability to the liability of any person as a transferee of estate assets.[28]

INCOME TAX RETURNS

Generally two or more income tax returns are required to be prepared and filed by the executor. Even though the estate of a deceased person is considered for most legal purposes to be merely the representative of the deceased for the purpose of settling his affairs and distributing his assets, the tax law is unique in regarding the estate as a separate and distinct entity. The reason for treating estates thus for tax purposes is in order to subject to taxation income earned during the interim between the decedent's death and the time when the income from his property becomes taxable to his beneficiaries. The estate reports during this period all income received by it and is allowed a deduction for income which is distributed or distributable to beneficiaries. All income received during the period of administration is thereby taxed either to the estate or to the beneficiaries.

The first income tax return to be filed by the executor is the last return of the deceased covering the period between the end of the last taxable period of the decedent and the date of death. The Regulations place the duty of filing this return on the executor.[29] Form 1040, or 1040A, is filed

[26] DeForest Hulburd et al., Executors and Trustees, 21 B.T.A. 23 (1930).
[27] Rodenbough v. United States, 25 F.2d 13 (3d Cir. 1928).
[28] Bessie M. Brainard, 47 B.T.A. 947 (1942).
[29] U.S. Treas. Reg. 111, § 29.142-6 (1943).

for the decedent and must be accompanied by a copy of letters testamentary, or letters of administration, to show the authority of the personal representative to sign the return.

In order for fiduciaries to have more time within which to complete the work required for filing their income tax returns, the Revenue Act of 1950 has moved the due date for filing the returns of estates and trusts from the fifteenth day of the third month to the fifteenth day of the fourth month following the close of the tax year.[30] The failure to file this return by the executor may subject the executor to personal penalties as well as to the penalties inflicted upon the estate.[31] The period of administration begins, of course, at the death of the decedent even though the fiduciary is not appointed until some time later.[32] The normal period of administration is the time required to collect the assets and pay the debts of the estate. An administration which runs beyond this point is subject to close scrutiny. The courts have sometimes upheld the Commissioner's determination that the actual administration of the estate had been concluded and that net income received thereafter by the estate was taxable during such subsequent years to the legatees.[33]

Computing the Income

The income of an estate is computed for tax purposes in much the same manner as the income of an individual. There are, however, some problems which have arisen from the estate's function as representative of the decedent which are peculiar to the tax treatment of income and deductions of an estate. If a legacy is one of a specified sum of cash and the beneficiary agrees to accept property in satisfaction of the bequest, there may be taxable consequences. Such a transfer constitutes a sale or other disposition of the property within the contemplation of Section 111(a) of the Code.[34] The estate, therefore, realizes taxable gain or loss measured by the difference between the basis of the assets in its hands and their value at the time of distribution in satisfaction of the legacy.

However, where distributions in kind are made to residuary legatees, the same factors are not present. Such distributions are, for all practical purposes, a division of whatever remains in the residuary estate and such division does not have the effect of substituting the transfer of property with a lower basis for the payment of a liability to pay a fixed sum of money. The estate realizes no benefit since its obligation to transfer all its remaining assets to the residuary legatee is in no wise affected.

[30] Int. Rev. Code § 53(a)(1).
[31] *Id.* § 142(c).
[32] U.S. Treas. Reg. 111, § 29.162-1(c) (1943).
[33] Alma Williams, 16 T.C. 893 (April, 1951).
[34] Suisman v. Eaton, 15 F. Supp. 113 (D.C. Conn. 1935), *aff'd* 83 F.2d. 1019 (2d Cir. 1936), *cert. denied*, 299 U.S. 573, *rehearing denied*, 299 U.S. 621 (1936).

A problem which frequently arises in connection with the last return of the decedent is that with respect to income which has been reported on an installment basis. The executor must decide whether or not savings could be effected by filing a bond to prevent the accrual in the last return of the decedent of all uncollected installment items.[35] For example, the maturing of the installment obligations would increase the debt for income tax deduction on the estate tax return. Sometimes it is impossible to determine which course is the most expedient in the long run, but the imposition of the tax before all of the installment payments have been received may require the bond to be filed.

Filing a Joint Return

Sections 51(b)(3) and (4) of the Internal Revenue Code provide for the filing of a joint return by the surviving spouse and the executor. Such a joint return in most cases will reduce the combined income taxes of the estate and the spouse and generally will be beneficial to all concerned. There is, however, the danger to the executor of ascertaining whether the income of the spouse is being correctly reported and whether there might be subsequent developments that would render the joint return injurious to the estate.

Section 340a has recently been added to the Probate Act of Illinois by a law effective August 2, 1951.[36] This new section authorizes an executor, on his verified petition, with the approval of the probate court, to join with the spouse in making a joint federal income or other tax return for the decedent and his spouse, and to consent for gift tax purposes to gifts made by the spouse of the decedent as having been made one-half by the decedent and one-half by the spouse. Notice of time and place of the hearing may be ordered by the court, and the court further, in its discretion, may require the spouse to give adequate indemnity to the executor to protect the estate.

Occasionally a joint return is filed by a surviving spouse, and the executor, when appointed later, need not abide by the joint filing. He may disaffirm within one year after the last day prescribed by law for filing the return of the surviving spouse. The separate return thereafter made by the executor will constitute the return of the deceased spouse for the taxable year.[37]

Types of Returns

The return to the date of death, filed on Form 1040 or 1040A, must be filed by the fifteenth day of the third month following the close of what would otherwise have been the annual accounting period of the decedent. This is to be distinguished from the filing date of the fiduciary's return,

[35] U.S. Treas. Reg. 111, § 29.44-5 (1943).
[36] ILL. REV. STAT., c. 3, § 495a (1951).
[37] U.S. Treas. Reg. 111, § 29.51-1(b)(2) (1943).

Form 1041, as stated previously. Not only must a return be filed by the executor for the fractional part of the taxable year ending with the date of death, but a separate return must also be filed for any other period which may have been neglected by the decedent.[38] In determining the returnable income for the period ending with the date of death, reference should be made to Sections 480-482, inclusive, of the Internal Revenue Code with respect to any tax liability on self-employment income. Even though the taxable income for this period should not otherwise require the executor to file a return as provided under Section 51(a) of the Code, if the net earnings from self-employment income amount to $400, a return must be filed "and such return shall be considered a return required under Section 51(a)."[38a] The full $600 exemption is allowed the decedent even if the surviving spouse remarries during the regular taxable year, provided such spouse had no gross income and is not a "dependent" of another.[39]

In additon to filing the return to the date of death, if the gross income of the estate is $5,000 or more, there must be filed with the Collector of Internal Revenue, when the first return is filed, a copy of the will along with an "affidavit of correctness."[40]

For information returns which the executor may be required to file, reference should be made to Section 1604 of the Internal Revenue Code and Regulations 116, Section 405.601 with respect to withholding income tax; Sections 1400 to 1432 of the Internal Revenue Code with respect to old age and survivors insurance tax; and Sections 1600 to 1611 of the Internal Revenue Code with respect to unemployment compensation tax.

The executor may be required to file two additional forms. One is Form 1116, a statement in support of credit claimed by individuals for taxes paid or accrued to a foreign country or possession of the United States as provided in Section 131 of the Internal Revenue Code, Regulations 111, Section 29.131-3. The other is Form 1310, a statement of claimant to refund due on behalf of a deceased taxpayer.

Before filing an income tax return for the period beginning with the date of death of the decedent, the executor will wish to consider whether or not to place the estate on a fiscal year commencing with the date of death and ending on the last day of any month selected, so long as the period does not exceed twelve months. If a fiscal year basis is chosen, this procedure will require the keeping of formal books and records. The advantage of a fiscal year is that such procedure may result in the taxable income being prorated over smaller periods at the commencement of the estate, thus reducing the tax bracket applicable. However, this advantage may be lost

[38] U.S. Treas. Reg. 111, § 29.53-1(6) (1943). U.S. REV. STAT., § 3466, but such return however need not be annualized under INT. REV. CODE § 47(c).

[38a] INT. REV. CODE § 482a.

[39] I.T. 3888, 1948-1 Cum. Bull. 43.

[40] U.S. Treas. Reg. 111, § 29.142-1(d) (1943).

in the final distribution and may be further jeopardized by the question of the meaning of Section 164 of the Internal Revenue Code in its reference to Section 162(b) with respect to distribution currently of income by the fiduciary. Consequently, a fiscal year would not ordinarily be desirable for an estate. A similar problem is whether to place the estate on a cash or an accrual basis. In the writer's experience relatively few estates have been placed upon a fiscal year basis and almost none upon an accrual basis.

"INCOME IN RESPECT OF A DECEDENT"

The phrase "income in respect of a decedent" has particular significance for the executor in the filing of his returns for taxable periods subsequent to the date of death. The treatment by both the Bureau of Internal Revenue and Congress of income of a decedent has varied over the years. For a time prior to 1942 the rule laid down in Section 42(a) of the Internal Revenue Code, as it then stood, often resulted in the reporting in one period of income which was received over a period of years. The inequity of this situation was recognized and remedied by the Revenue Act of 1942 which amended Sections 42 and 43 and added Section 126 to the Internal Revenue Code.

Section 126(a) provides that all the income "in respect of a decedent," which is not properly included in his final return prepared on his regular basis, is to be included, when received, in the income of the estate or other persons having the right to receive such income. If such right to receive income is sold or otherwise disposed of by the estate or other persons possessing it, the vendor is to include in income the value of the right at the time of the transfer plus the excess, if any, by which the sales price exceeds the value at that time. Items of income postponed under Section 126(a) are to be reported by the estate or legatee when received regardless of whether they report on the cash or accrual basis. Since these items are income to the recipients, the basis provisions of Section 113(a)(5) of the Internal Revenue Code for property transmitted at death do not apply.[41]

Deductions

A deduction is allowed to the estate, or to the person acquiring property subject to obligation from the decedent, for amounts paid for expenses (as defined in Section 23(a) of the Internal Revenue Code), interest and taxes, as well as for depletion of the property of the decedent. A further deduction is allowed for the estate tax attributable to the inclusion in the gross estate of the net value of items required to be taken into consideration under Sections 126(a) and (b) of the Internal Revenue Code.

In the computation of the deduction for the amount of federal estate tax attributable to the inclusion of accrued income in the estate tax return,

[41] U.S. Treas. Reg. 111, § 29.126-1 added by T.D. 5233.

it is necessary to break down the entire deduction allowable, proportionately for the various years in which the income is received and taxed. In the usual simple situation the income is received by the executor in its first or second tax year. However, where the estate includes a holding of "Series E" bonds and these are not immediately redeemed, an additional problem is presented because it is not known in what year the income will be taxed. This is due to the fact that the bonds might not be held to maturity. Thus, where "Series E" bonds are retained over the period of probate, the best that can be done is to compute the amount of the deduction attributable to the income on such bonds in one lump sum. Ordinarily the amount of the deduction is computed by deducting the net accrued income from the net taxable estate and computing the federal estate tax on the difference. However, it appears that, where there is a marital deduction against which is charged some share of the federal estate tax, it will be necessary to use the formula again for the computation of the estate tax. The reason for this is, if the federal estate tax is reduced by the removal of the net accrued income from the taxable estate, the charge against the marital deduction for federal estate tax is likewise reduced, which may increase the amount of the marital deduction. This, in turn, will further reduce the amount of the federal estate tax. Other variations of the same problem arise where the residuary estate has been left in trust with the remainder over to a charitable organization and where there is a renunciation by the surviving spouse.

Accrued Income

Section 126(a) is applicable only to items of gross income in respect of a decedent. It is those items of income which would have been formerly accrued on the decedent's final return that are considered as income in respect of a decedent. The most frequently encountered form of this type of income is the accrued income of a cash basis taxpayer. Prior to the 1942 amendments, the earned, but unpaid, salary of a cash basis decedent would have been accrued on his last return, *i.e.*, the return to the date of death. The present law does not require such an accrual but rather taxes the salary to the estate when received. In order for income to fall within the scope of Section 126, it must be earned before the taxpayer's death. If it is earned after the death of the taxpayer, it is not "income in respect of a decedent" within the meaning of Section 126. A bonus for services rendered was earned by the decedent but was not awarded and paid until after death. Such bonus was considered as income to the estate under Section 126.[42] Where, however, a dividend was declared before death but was payable to stockholders of record on a date after death, it was held that Section 126 was inapplicable since the mere declaration of a dividend did not result in an accruable right being vested in the stockholder.[43]

[42] O'Daniel's Estate v. Commissioner of Internal Revenue, 10 T.C. 631 (1948), *aff'd* 173 F.2d 966 (2d Cir. 1949).

[43] Estate of Putnam v. Comm'r, 45 B.T.A. 517 (1941), *rev'd*, 324 U.S. 393 (1945).

The right to income falling under Section 126(a) of the Internal Revenue Code is considered to have the same character for tax purposes in the hands of the estate or person entitled to it as it would have had in the hands of the decedent if he had lived and received the income. Insurance renewal commissions, an amount received by the estate on a claim owned by the decedent, have been held to be ordinary income and taxable under Section 126.

Partnership Income

It is a rather common practice among partnerships to agree that upon the death of a partner his interest shall pass to the survivors in consideration of payments to be made to the estate. To the extent that these payments represent the decedent's share of previous income in connection with the partnership's unfinished business and to the extent that they have not been previously reported as income by the decedent, they constitute income to the estate. Regulations 111, Section 126-1 provide that the portion of the payments representing the increase in value of the partnership assets is not to be considered recognizable gain. In *Estate of Thomas F. Remington,* [44] the court held that where the decedent entered into an agreement for a share of future brokerage commissions to be continued for a period after his death, the commissions, when received by the estate, were ordinary income to it and that the transaction may not be treated as a "sale" of capital owned by the decedent at the time of his death.

Farm Income

The farmer decedent and Section 126 invariably give rise to problems of a somewhat baffling nature. If unsold livestock and harvested crops, raised by the farmer, are on hand at the date of his death, but not as crop rent, they are not includible in the decedent's final return but are returnable by the executor to the extent of the excess of their proceeds over the fair market value at the date of death. Thus a basis of fair market value at date of death is acquired. The foregoing represents the present treatment by the Bureau of Internal Revenue in the case of a cash basis farmer. However, if the decedent were on an accrual basis, his last return would necessarily reflect the value of the inventory of livestock and produce on hand at the date of his death. [45] The foregoing rule is limited, however, to the situation where the decedent is directly engaged in farming. It is deemed inapplicable if the deceased farmer were a landlord who leased his farm on a crop share basis. Then, if crops are harvested and on hand as crop rent, though not sold nor reduced to possession, they are treated as a right to income under Section 126 and taxable to the estate when sold.

Section 23(a)(2) of the Internal Revenue Code has been interpreted to permit an estate to deduct reasonable amounts paid or incurred on account

[44] 9 T.C. 99 (1947).
[45] U.S. Treas. Reg. 111, § 29.22(a)-7 (1943).

of administration expenses including fiduciary's fees and expenses of litigation.[46] As mentioned previously, since these expenses are also allowed as deductions in computing the federal estate tax, provision has been made to prevent a double deduction.

Business Income

An estate that is carrying on a business is entitled, of course, to deduct all ordinary and necessary business expenses. The estate may deduct also any part of its gross income without limitation which, pursuant to the terms of the will, is paid or permanently set aside for charitable, scientific, religious, educational, or other similar organizations regardless of whether they are domestic or foreign, incorporated, or unincorporated.[47] Such deductions are not subject to the fifteen per cent limitation applicable to individuals.

Where the estate is engaged in business, Section 170 of the Internal Revenue Code grants it the benefits of the deduction for net operating losses permitted by Section 122 of the Code. However, because of the estate's separate entity, it cannot claim the net operating loss of the decedent nor can the beneficiaries use the carry-over or carry-back of the estate.

The estate includes in its gross income all amounts received by it and deducts distributions made to beneficiaries. The fiduciary reports these amounts as the income of the beneficiaries. The rules applicable to distributions of income to beneficiaries are set forth in Sections 162(b), (c) and (d) of the Internal Revenue Code and the accompanying Regulations 111, Section 29.162-2.

Income Subject to Distribution

Income which is subject to distribution must be distinct from "net taxable income." The two terms are by no means identical. This is recognized by the Regulations in the discussion of Section 162(d)(1) of the Internal Revenue Code relating to the allocation of income among annuitants. Usually income in the hands of the executor is accumulated and is not in fact distributed until the final distribution is made of the estate. However, where distribution of income is made to the beneficiary during the period of administration, the question will sometimes arise as to whether or not such income is distributable currently.

Section 162(b) of the Internal Revenue Code authorizes a deduction in computing the taxable income of the amount of such income which within the taxable year becomes payable to the legatee, heir, or beneficiary. Income is not considered to become taxable within a taxable year where during the entire taxable year there is only a future right to such income.

[46] *Id.* § 29.23(a)-15.
[47] Int. Rev. Code § 162(a).

A widow's allowance in Illinois is not taxable to her even though the estate has income from which it might be paid.

An election is given with reference to the deductions described in Section 162(e) of the Internal Revenue Code between taking such items on the income tax return of the estate or on the estate tax return. Obviously such deduction should be taken upon the return where it will yield the most tax benefit. If such deductions are claimed on the income tax return, it is mandatory that a statement be filed therewith, waiving the right to claim the same deduction on the estate tax return. The Bureau has ruled that the failure to file such statement loses the income tax deduction even though no estate tax return was required because the gross estate was less than $60,000.[48] The election is an annual one for the expenses of the year concerned.[49] On the other hand, deductions for expenses, interest, taxes, and depletion in respect of a decedent allowable under Section 126 of the Internal Revenue Code may be taken on both the income tax return of the estate, if it is otherwise a deductible item by the estate, and as an estate tax deduction if otherwise allowable on the estate tax return.

THE FEDERAL ESTATE TAX RETURN

The federal estate tax return (Treasury Department Form 706) must be filed in duplicate within fifteen months from the date of death.[50] Thirty day extensions of time can be obtained from the local Collector of Internal Revenue in cases of sickness or absence,[51] and if the filing of the return is "impossible or impracticable," the Commissioner of Internal Revenue may grant an extension of not to exceed six months upon written application showing "good cause."[52] Aside from the usual penalties for failing to file an estate tax return on time, the Regulations specifically provide that the failure to file the return on time loses to the estate the privilege of using the optional valuation date.[53]

The Valuation Date

In preparing the estate tax return one of the most important problems is the choosing of the appropriate valuation date and sustaining the valuation that is most advantageous to the estate. Naturally all assets must be valued on the same date, except that if the optional valuation date is chosen, all assets distributed or disposed of during the first year after the date of death must be valued at the date of disposition;[54] and value which is affected by mere lapse of time must be determined as of the date of death with

[48] Bureau letter, Feb. 11, 1947, ¶ 76, 136 P-H FED. TAX SERV. (1947).
[49] I.T. 4048, 1951-9-13579 (p6), I.R.B. 1951-1.
[50] U.S. Treas. Reg. 105, § 81.63 (1942).
[51] *Id.* § 81.69.
[52] *Id.* § 81.70.
[53] *Id.* § 81.11.
[54] INT. REV. CODE § 811(j); U.S. Treas. Reg. 105, § 81.11 (1942).

adjustments for it in value due to factors other than lapse of time. Therefore, research must reveal the over all effect of possible increase in value of some assets and the decrease in the value of others. It is the opinion of many that the failure to select the proper date is justification for surcharging an executor with the loss unless it can be shown that the executor acted with due diligence.

Even more obviously the selection of the optional valuation date has income tax consequences to the estate. On one hand, if the value a year after the date of death is selected, there may be no income tax, but if the value at the date of death is selected, a sale might result in a loss which is an allowable deduction. It is frequently overlooked that a low valuation is not desirable in many cases, as, for example, in estates where little or no estate tax is to be paid. The executor, however, must reckon with the possibility that the revenue agent will use hindsight and contend that the value at the date of disposition was the value at the date of death.

In valuing property, consideration must be given to the immediate possibilities of sale, *e.g.*, the difference in tax rates between the estate tax rate and the income tax rate especially if any profit on the sale will be taxed as ordinary income. Another frequent problem is the valuation of notes—the balancing of the probability of payment against receiving some ordinary income if payment is received. The selection of the appropriate valuation date is particularly burdensome upon an executor in those cases in which the estate has oil and gas properties. As is well known, the value of these can change overnight. The drilling of an offsetting dry hole may completely change the entire outlook of the estate. Consequently, in such situations the executor has an exhaustive duty of completely reviewing the valuation data as of both dates.

The Revenue Act of 1948 necessarily imposed considerable additional duties upon the executor in connection with the estate tax return. The Regulations provide that the executor must prove that the deceased was survived by his spouse, that a property interest passed to the spouse, that the interest is deductible, the value of that interest, and the value of the adjusted gross estate.

The Marital Deduction

The provisions with respect to interest passing to the surviving spouse, otherwise known as the marital deduction, are set forth in Regulations 105, Section 81.47a. An example that is frequently used with respect to problems surrounding the determination of the marital deduction is that of the death of both spouses under such circumstances that there is no proof as to the order of their death. The Regulations state that a marital deduction will be allowed under such circumstances only if the executor can establish that the property has been finally determined to be includible in the estate of the surviving spouse.[55] Consequently, an executor under such circumstances could protect the estate only by the filing of a claim for refund in the event that the inclusion of such item in the surviving spouse's estate is being contested. This problem may be complicated by the added burden of property suits and tax controversies.

Another aspect of the marital deduction is that relating to the value to be reported in the estate tax return where one-half of the additional value will pass to the wife and increase the amount of the marital deduction. This, in turn, will provide a higher basis for income tax of property acquired by death and may in the long run result in savings in long term capital gains tax.

Where, by the terms of the will or by application of law, property subject to the marital deduction must bear its share of the federal estate tax, the problem of computing the marital deduction involves the determination of two unknowns. This problem is further complicated where there is insurance or some other type of property which does not qualify for the marital deduction and which likewise must bear its share of the federal estate tax. In such an instance there are in effect three unknowns which are interrelated. They are the amount of the federal estate tax, the share of the tax to be borne by the marital deduction, and the share of the tax to be borne by the insurance. If one wishes to make the problem still more complex, it may be further compounded where there is previously taxed property or a credit for foreign death duties also to be considered. No particular formula for resolving these problems has been devised. In the absence of a good working knowledge in algebraic equations the executor will probably resort to the trial and error method of determining the respective amounts and shares that are represented by the unknowns.

A somewhat different example of the foregoing is that of a will which has been renounced by the surviving spouse, the spouse electing to take her statutory share. In Illinois her share will thereby be charged with a portion of the federal estate tax in order to arrive at the marital deduction. There can be little question but what the statuory share qualifies for the marital deduction inasmuch as it passes outright. Assuming that there is no property outside of the probate estate which must bear a portion of the tax, the marital deduction is reduced by one-third or one-half, depending upon whether or not there may be children, of the federal estate tax. This is based on the theory that the widow's statutory share is computed after deducting claims, expenses, and the federal estate tax from the gross probate estate.

What of the requirement that certain lifetime gifts be declared in the return even though the executor contends that such transfers are not in-

[55] U.S. Treas. Reg. 105, § 81.47a(a) (1942).

cludible in the taxable estate? Regulations 105, Section 81.16 requires that a sworn statement should be filed giving all material facts and a copy of the death certificate furnished. In many instances it is believed this requirement is virtually ignored until examination of the return, and it is the belief of many that only experienced preparation protects an estate from "over-disclosure" in the preparation of the return. A question to be resolved is the conflict between the executor's duty to the estate and his duty to the Federal Government.

Valuing Crops on the Land

A problem present in many estates is that of valuing for estate tax purposes the decedent's interest in crops on land at the time of death. In *W. S. Peebles et al., Administrators*[56] the common law rule was restated that growing crops which are the product of annual sowing or planting form a part of the real estate to which they are attached and that the value of the decedent's interest in the growing crops was included in the value of the real estate and not valued separately and in addition thereto.

Time of Filing and Payment

A frequently misunderstood point is that an extension of time for filing the estate tax return is entirely separate and distinct from an extension of time for the payment of the tax. Regardless of filing the return, the tax must be paid at the end of fifteen months after the date of death unless the Commissioner of Internal Revenue grants an extension of time on a showing that the payment at the regular time would work an undue hardship upon the estate.[57] An illustration of this hardship is the disposition of property at a sacrifice in order to raise the money for the payment of the tax.[58] Experience has shown that the Commissioner is reluctant to make such extensions and usually imposes rigorous conditions before granting the extensions, which are passed on only by the Washington office of the Bureau of Internal Revenue.

In this connection it is important to note that if a timely extension of payment is obtained, the unpaid tax shall draw interest at the rate of four per cent during the period of extension, commencing eighteen months after the date of death.[59] On the other hand, if the extension is not obtained before the due date (either fifteen months after the date of death or a subsequent due date) the same tax draws interest at six per cent from the due date.[60]

In view of the usual delay for any proceeding in Washington, it is necessary to allow for a considerable lapse of time before the due date

[56] 5 B.T.A. 386 (1926).
[57] INT. REV. CODE § 822(a)(2).
[58] U.S. Treas. Reg. 105, § 81.79(a) (1942).
[59] INT. REV. CODE § 890(a).
[60] *Id.* § 893(a)(1).

occurs. As has been pointed out, the Regulations state only that such application will not be considered if filed with the Collector after the due date of the tax,[61] but it is inadvisable to allow the due date to pass without having received favorable action. A subsequent denial would probably produce penalties to the estate for which the executor could be held responsible.

The statute provides for an extension of time for the payment of any estate tax on a reversionary or remainder interest (belonging to the decedent) for six months after the date such interest vests in possession. However, a bond of double the amount of tax attributable to such interest, plus interest at four per cent for the estimated duration of the extended period commencing eighteen months after the date of death, must be filed. The Commissioner must be advised annually in September of the status of the matter.[62]

Recoupment from Life Insurance Beneficiary

Section 826(c) of the Internal Revenue Code provides that an executor "shall be entitled" to recoup from the beneficiary of any life insurance included in the gross estate such portion of the total estate tax payable as the proceeds of the policies bear to the sum of the net estate and the statutory exemption allowed in computing such net estate under Section 935(c) of the Code. Section 826(d) of the Code extends a similar authority to recoup proportionately from the object of the power of appointment over which the decedent–donee–had a power of appointment. This duty to obtain reimbursement does not extend under either section to property qualifying for the marital deduction except to the extent that the amount of insurance or property received exceeds the allowable marital deduction.[63] Each section is subject to contrary instructions in the decedent's will.[64]

It is obvious that the expression "shall be entitled" to recoupment is ambiguous. Illinois has no specific provision in her statutes with respect thereto. In the absence of an agreement among all parties in interest that the estate itself shall discharge the entire tax burden, it seems that a prudent executor would file suit, if necessary, against any such person to discharge the duty of the executor to conserve the estate. Otherwise there would be grounds for objection by the beneficiaries of the estate with the possibility of surcharging the executor.

GIFT TAX RETURN

Section 1026 of the Internal Revenue Code enjoins the executor to file gift tax returns–either donor or donee–for the decedent. Assuming that

[61] U.S. Treas. Reg. 105, § 81.79(a) (1942).
[62] INT. REV. CODE § 925; U.S. Treas. Reg. 105, § 81.79(b) (1942).
[63] INT. REV. CODE § 826(b).
[64] *Id.* §§ 826(b), 826(d).

research reveals no delinquent returns for the past, there arises a problem similar to the one discussed heretofore as to a joint income tax return with the surviving spouse. The 1948 Revenue Act authorizes the executor to consent to gifts of the surviving spouse and vice versa.[65] If the executor consents, the benefit to the estate apparently is non-existent and the executor must seek adequate protection. If the decedent made the gift, an obvious duty falls on the executor to seek immediately the consent of the surviving spouse. In this regard it should be noted that Sections 3466 and 3467, Revised Statutes, are also applicable to gift taxes.

PROCEDURE ON DEFICIENCIES

After income, estate, and gift tax returns have been filed, the pattern of examination and audit and of procedure with respect to deficiencies and protest is much the same as to all three taxes. As an example, Bureau procedure begins with the examination of the income tax return, which examination may be made by the Collector of Internal Revenue who examines the smaller returns or by the Internal Revenue Agent in Charge who examines the other returns. If the taxpayer does not agree with the examining agent's proposals, he will be sent a preliminary (thirty day) letter allowing him to file a protest and, if he so desires, he will be given a hearing. The protest may be filed with the Internal Revenue Agent in Charge at Springfield or Chicago, depending upon where the estate is being administered. A conference or hearing in the office of the Internal Revenue Agent in Charge will be granted if one is requested. Such hearings are informal.

Administrative Appeal

If no agreement is reached in the Agent's office, the taxpayer may, upon request, have his case considered by the Appellate Staff, Chicago District, known until recently as the Technical Staff, with headquarters in Chicago. The Appellate Staff is a special settlement group. Since the hearing before the Appellate Staff delays the issuance of the ninety day letter from which the taxpayer may appeal to the Tax Court, the hearing before the Appellate Staff is, in income tax parlance, commonly referred to as a pre-ninety day hearing.

Following the hearing in the Appellate Staff, if no settlement of the issues is reached, the ninety day letter will be issued from which an appeal may be taken to the Tax Court. Even though the taxpayer has not gone before the Appellate Staff prior to the issuance of the ninety day letter, he will still have an opportunity to do so after the appeal is taken to the Tax Court. This is commonly referred to as a settlement conference.

[65] *Id.* § 1000(f); U.S. Treas. Reg. 108, §§ 86.3(b), 86.20(a) (1943).

While the case is before the Agent in Charge, he may wish advice upon some question in the case and refer it to Washington for consideration. If the advice from Washington is adverse to the taxpayer, the taxpayer may then have a hearing if he requests one. In the possible review of the action of the Internal Revenue Agent in Charge, which review is made in Washington, the findings of the Agent may be disturbed because of failure to observe some Bureau rule or policy. If the Washington office upon possible review proposes to overrule the Agent in Charge before final action is taken, the taxpayer is allowed a hearing before a representative from the Washington office. Sometimes in an examination questions arise which are insolvable in the Agent's office but which can be solved by or at the direction of the Washington office. Perhaps several taxpayers are involved in a transaction and all of them do not come within the jurisdiction of any one Agent in Charge. It may be necessary to centralize their cases in one field office or in Washington.

Since it is the policy of the Bureau of Internal Revenue to keep the taxpayer informed as to necessary actions and remedies available to him, counsel for the estate may well wish to request that communications regarding the estate's case be sent to him in addition to the executor.

In all tax controversies before the Bureau it is important that all of the pertinent facts be submitted at the first opportunity and, if possible, in writing.

In preparing his tax case the attorney will wish in his investigation of the facts to know how the item in controversy was treated in the taxpayer's return, whether or not there has been any correspondence with the Bureau concerning this item, and if any disputes in prior years with the Bureau may affect this item. He will wish also to consider carefully all possible theories of law that may be applicable to the facts both from the standpoint of the government and that of his own side of the case.

Judicial Appeal

If the case is not disposed of within the Bureau and resort is to be had to the courts, there are several factors to be considered in selecting the trial court, whether it shall be the Tax Court, the district court or the Court of Claims.

With respect to the payment of the tax, the taxpayer who elects to take his case to the Tax Court need not pay the tax until the Court hands down its decision. It is necessary to pay the tax and file a claim for refund before the case can be litigated in the Court of Claims or in the district court. If the taxpayer ultimately loses his case in the Tax Court, the interest payment may be substantial. On the other hand, interest does not accrue while the case is before the Court of Claims or the district court because the tax has been paid; and if the taxpayer wins he will receive interest from the date he paid the tax. However, the taxpayer may stop the running of interest while he litigates in the Tax Court by paying the bulk of the deficiency to the Collector after he files his petition. It should be remembered that there is a greater risk of an increased deficiency in the Tax Court. If the refund claim is not filed until the statute of limitations on assessment of a deficiency has run, issues which might otherwise lead to an increased deficiency can only be used in the Court of Claims and the district court to defeat the refund claim.

The advantage of taking the case to the trial court with the most favorable prior decisions on the issues involved in the case is not to be overlooked. The taxpayer may appeal as a matter of right to the courts of appeal from an adverse decision of the Tax Court or the district court, and thereafter the decision of the court of appeals may be reviewed on certiorari from the United States Supreme Court. Decisions of the Court of Claims are reviewable only by the Supreme Court on certiorari. A trial by jury can only be had in the district court in a suit against the Collector of Internal Revenue. Some tax practitioners believe that it is more difficult to recover a tax previously paid to the Collector than to defeat a proposed tax deficiency. Since procedure is different in each of the three trial courts, many attorneys are of the opinion that less difficulty is to be encountered in this respect in the Tax Court. The legal theory of a suit on a refund claim in the Court of Claims or the district court is different from the legal theory of a case in the Tax Court, and this may have a bearing on the result if the case in any way involves set off, recoupment, or estoppel. While a refund claim cannot be commenced in the Court of Claims or the district court until six months after the claim is filed, a decision may nevertheless be obtained there more quickly than in the Tax Court depending upon the speed with which the courts are deciding their cases.

Mechanics of Protest

A protest under Bureau procedure must contain the name and address of the taxpayer; the designation by date and symbol of the letter advising of the proposed adjustments in tax liabilities with respect to which the protest is made; the designation of the year or years involved and a statement of the amount of tax in dispute for each year; an itemized schedule of the findings to which the taxpayer takes exception; a statement of the grounds upon which the taxpayer relies in connection with each exception; in case the taxpayer desires a hearing, a statement to that effect; and if the protest is prepared or filed by an attorney or agent of the taxpayer, it shall have thereon a statement signed by such attorney or agent showing whether or not he prepared it and whether or not the attorney or agent knows of his own knowledge that the facts therein are true.

While it is possible to obtain a final and effective closing agreement under Section 3760 of the Internal Revenue Code in the settlement of a tax controversy, this method is used somewhat infrequently. A settlement obtained, however, without such a closing agreement may be for practical purposes final in most instances, but the fiduciary may wish to consider the risks which he will incur before deciding to accept the settlement.

If settlement within the Bureau procedure is not to be had, the taxpayer may choose one of several judicial remedies. Payment of tax under protest or under duress is not a prerequisite to the maintenance of a suit for its recovery.[66]

Claims for Refund

Claim for refund, with certain minor exceptions, should be made on Form 843 and should be filed with the Collector of Internal Revenue for the district in which the tax was paid. "The claim must set forth in detail and under oath each ground upon which a refund is claimed, and facts sufficient to apprise the Commissioner of the exact basis thereof."[67] The claim for refund should actually be in the office of the Collector of Internal Revenue to whom the tax was paid before the end of the day on which the statute of limitations expires. If a claim is being filed for more than one year, a separate claim must be prepared for each taxable year. If the claim has been timely filed, it can be amended only if the amended claim is filed within the period of the statute of limitations and if the claim has not been formally rejected. The claim for refund must set forth clearly all grounds upon which the taxpayer might base his contention that he is entitled to a refund.

If the Revenue Agent's report results in a review of the claim, the taxpayer may file a protest and have a conference on the question in the office of the Internal Revenue Agent in Charge. The Commissioner is entitled to six months in which to take action on a claim, and after such action by him, suit may then be brought. The taxpayer must bring his suit within two years after receipt by registered mail of notice of rejection by the Commissioner.

Section 272(a) of the Internal Revenue Code sets forth the procedure when petition is to be made to the Tax Court. Section 272(d) of the Internal Revenue Code provides that the taxpayer shall have at any time, by a signed notice in writing filed with the Commissioner, the right to waive the restrictions provided in Sub-Section (a) of Section 272 on the assessment and collection of the whole or any part of the deficiency.

Waivers

Waiver Form 870 is a taxpayer's consent to assessment and collection of the tax agreed upon. It authorizes the Commissioner to assess and collect the

[66] 26 U.S.C.A. § 3772(b) (1940).

[67] U.S. Treas. Reg. 111, § 29.322-3 (1943); U.S. Treas. Reg. 105, § 81.96 (1942); U.S. Treas. Reg. 108, § 86.63 (1943).

deficiency immediately. Interest stops running on this amount thirty days after the waiver is filed. Waiver Form 874 is similar except that it includes the acceptance of an overassessment. Neither of these waivers is a closing agreement under Code Section 3760. They do not preclude the assertion of a further deficiency if subsequently determined. If signed after the statutory notice of deficiency has been issued, either waiver stops the running of interest but does not affect the right of appeal to the Tax Court. However, where such a waiver is executed before the notice of deficiency has been issued, no such notice will be issued and, consequently, no appeal to the Tax Court from the deficiency is possible.

Where a deficiency is being settled in the Appellate Staff, a waiver is filed on Form 870-TS. This form evidences a finality of settlement not accomplished by the use of Form 870. By it the taxpayer waives his right to petition the Tax Court because in executing the form the taxpayer executes the equivalent of a closing agreement. And when the waiver on Form 870-TS is accepted by or on behalf of the Commissioner, the case may not be reopened nor may a claim for refund be filed or prosecuted respecting taxes for the years covered by the waiver in the absence of fraud, malfeasance, concealment, or misrepresentation of material fact or of an important mistake in mathematical calculations. Interest on a deficiency ceases to run following the filing of Waiver Form 870-TS thirty days after the Commissioner accepts the "offer" of waiver and not thirty days after it is filed.

THE ILLINOIS INHERITANCE TAX

The Illinois Inheritance Tax Act[68] provides not only for the assessment and collection of an inheritance tax, but in addition in Sections 30a and 30b the Act provides for the determination and collection of an Illinois estate tax designed to pick-up the unused portion of the eighty per cent credit allowed against estate taxes imposed by the Federal Government. Thus, while the Illinois inheritance tax is primarily a tax upon the right to succeed to property and assessable only on the beneficial interest passing to an heir, devisee, or legatee, the addition in 1949 of the "pick-up" tax gives to Illinois an additional tax which is based upon the transfer of property at death. Therefore, we have combined in the Illinois Inheritance Tax Act a tax on the right to receive property by descent or devise and a tax against the estate. The combination of these two opposite approaches to the taxation of property at death results in some differences of practice with respect to the taxability of specific types of transfers; it results also in other differences in both practice and procedure because of differences either in the substance of or the operation under the Illinois Inheritance Tax Act and the Federal Estate Tax Sections of the Internal Revenue Code.

[68] ILL. REV. STAT., c. 120, §§ 375-405 (1951).

Section 1 of the Inheritance Tax Act provides for the taxation of all real and tangible personal property within the State of Illinois and all intangible personalty wherever located in the case of a resident decedent and all property having a taxable situs in Illinois which is not subject to inheritance, succession, or estate tax in the state of the decedent's residence if the decedent were a non-resident.

Section 1 provides also that gifts made within two years before death shall be deemed to have been made in contemplation of death. The Illinois law differs from the federal statute in that under the latter transfers made within three years before death shall be presumed to have been made in contemplation of death and those made before three years before death shall be taxable only if they can be reached under Sections 811(c) and (d) of the Internal Revenue Code.

Section 1 of the Inheritance Tax Act further provides for the taxation of transfers intended to take effect in possession or enjoyment at or after death, transfers in trust with retention of powers to revoke, alter or amend, exercisible alone or in conjunction with parties not having a substantial adverse interest (without regard to whether or not the power is actually exercised), the exercise of a power of appointment either general or special, and the succession to property held in joint tenancy. The failure to exercise a power of appointment does not result in liability for inheritance tax. Life insurance payable to third party beneficiaries is not taxable under the Inheritance Tax Act. The Illinois estate tax, commonly referred to as the "pick-up" tax, is based upon the eighty per cent credit allowed under the federal basic estate tax. Consequently, the taxable estate under Section 30a is identical to that determined for purposes of the federal estate tax and includes life insurance and other items not subject to the inheritance tax provisions.

A minor change has been made in Paragraph 4, Sub-section 5, Section 1 of the Inheritance Tax Act, effective July 11, 1951, pertaining to the exemptions and rates of tax applicable to persons legally adopted. The law now provides that, in determining whether any person stood in any of the relationships for a decedent set forth in said Sub-section 5, whether lineal or collateral, legal adoption, single, or successive, shall be the equivalent of blood relationship for the purposes of taxation.

Among the deductions claimed in determining the net taxable estate, the estimated federal estate tax in its entirety has been treated as a deduction whether all of the decedent's taxable property was in Illinois or part of it was taxable elsewhere. Some question has now been raised about continuation of this treatment in view of a recent decision involving a substantial amount of property taxable in Illinois but belonging to the estate of a non-resident.[69] The court held that, the federal estate tax being a claim or

[69] The People v. Luehrs, 408 Ill. 383, 97 N.E.2d 307 (1951).

charge against the estate, it and all other debts and claims wherever located were subject to proration upon the basis of the ratio of property taxable in Illinois to the gross taxable estate.

The tax upon an estate for life or for years (Section 2 of the Inheritance Tax Act) is often confused in its determination with that on contingent or conditional estates (Section 25 of the Act). If *A* is given an estate for a term of ten years at the expiration of which if living he will receive the corpus, but if he dies before the expiration of said ten year period his interest will be extinguished and the property will pass to others, his interest should be taxed as a life estate under Section 2. Only the remainder interest should be subjected to the Section 25 tax.

Section 4 of the Act provides that property passing to the beneficiary is subject to the amount of tax assessed thereon and the personal representative need not deliver such property until he shall have collected the tax on it unless otherwise provided by the testator or transferor. But the tax on a life estate is a charge upon the corpus of the property in which it exists unless otherwise provided in the will.[70] The executor and the beneficiary are each personally liable for the payment of taxes and interest, and the statute of limitations does not run against the state nor is suit to enforce the executor's liability ever barred.[71]

The inheritance tax return (Form 500) must be filed on or before sixteen months after the date of death, and the tax must be paid within eighteen months from the date of death. This allows for the filing of a verified copy of the federal estate tax return with the Attorney General if there is an Illinois estate tax due under Section 30a. The "pick-up" estate tax is computed on Schedule F of the inheritance tax return.

While Section 25 of the Act provides for the deposit of securities in lieu of the payment of the full amount of the Section 25 tax on conditional and contingent interests, the practice of making such deposits is fraught with dangers to the executor and to the trustee. No satisfactory device has been created, either under the statutory provision or the Attorney General's procedure, for protecting the trustee, when the remainder ultimately falls in, from an interest charge on the inheritance tax as finally determined unless he shall have withheld an adequate amount of income from the life tenant during the period of the trust.

GENERAL PROPERTY TAXES

Chapter 120 of the Illinois Revised Statutes (the Revenue Chapter) in Section 534 requires the executor or administrator to list the property inventoried in the estate for the assessment of a personal property tax. The Act further provides that personal property, except such as is required to be listed

[70] Ill. Rev. Stat., c. 120, § 378 (1951).
[71] *Id.* § 379.

and assessed otherwise, shall be listed and assessed in the tax district where the owner resides. Where an executor was not appointed until after April 1 of the year for which personal property was to be assessed, the executor stands in the shoes of his testator with respect to the personal property and his ownership of the property is but a continuation of the ownership of the decedent. Until the property has been distributed the executor is regarded by the statute as the legal owner and possessor of the property of his decedent and is personally responsible for the taxes.[72]

CONCLUSION

Even though, generally speaking, the exact measure of the liability of the executor for the failure to discharge the duties discussed herein has not been clarified by the courts, it is difficult to conceive of a court being sympathetic toward an executor who failed to avail himself of every opportunity to minimize the tax burden of the estate and, therefore, of the beneficiaries who receive it. The courts have in fact very early held that an executor is presumed to know the duties imposed upon him under certain applicable tax laws.

[72] People v. Continental Illinois National Bank & Trust Co., 360 Ill. 454, 196 N.E. 515 (1935).