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Ronald D. Fairchild

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SECTION 642 (g) OF THE INTERNAL REVENUE CODE: THE EXECUTOR'S QUANDARY

What is the difference between a taxidermist and a tax collector? The taxidermist takes only your skin.

—Attributed to Mark Twain

The executor[1] is faced with myriad obligations during the administration of his fiduciary estate. He is forced by federal tax demands to become a post mortem estate planner. While filing the decedent's final income tax return, paying estate taxes, and reporting the estate's income the executor must decide many tax-related questions in a relatively short period. His most important decision is perhaps the election provided by section 642 (g) of the Internal Revenue Code.[2] Section 642 (g) permits the executor to deduct certain expenses from either estate income or the decedent's gross estate, but not both. If he chooses to use the deductions on the estate tax return no special action is required. However, if the expenses are used as income tax deductions, section 642 (g) requires the executor to apprise the Service of his intentions.[3] The section 642 (g) election may affect the estate's income and estate tax liabilities, the size of charitable and marital deductions, the size of estate tax credits, estate liquidity, the relative rights of beneficiaries, and the executor's fiduciary duties to preserve the estate and remain impartial. The extensive impact of the election, therefore, demands that the executor know the consequences of his choice under section 642 (g).

Until 1942 the Code did not proscribe the double deduction of estate administration expenses and casualty losses.[4] However, the double deduction opportunity that existed was not extensive since only adminstration expenses attributable to a business conducted by the estate were deductible from income.[5] With the enactment of Code section 212 allowing nonbusiness expense deductions, however, the opportunity for the double deduction

1. The term "executor" as used in CODE §642 (g) and in this note is not restricted to a technical meaning. It connotes all persons who may administer a decedent's estate. *See* INT. REV. CODE of 1954, §2203 [hereinafter cited as CODE].

2. CODE §642 (g) states: "Amounts allowable under section 2053 or 2054 as a deduction in computing the taxable estate of a decedent shall not be allowed as a deduction in computing the taxable income of the estate or of any other person, unless there is filed, within the time and in the manner and form prescribed by the Secretary or his delegate, a statement that the amounts have not been allowed as deductions under section 2053 or 2054 and a waiver of the right to have such amounts allowed at any time as deductions under section 2053 or 2054. This subsection shall not apply with respect to deductions allowed under part II (relating to income in respect of decedents)."

3. Hereinafter cited as a "642 (g) election."

4. Judicial sanction of double tax benefits was based on the rationale that the estate tax and income tax are different in theory and incidence — the former imposed upon the privilege of transferring wealth and the latter upon the privilege of amassing wealth. *E.g.*, Robert J. Kleberg, 31 B.T.A. 95 (1934).

5. United States v. Pyne, 313 U. S. 127 (1941).

of estate administration expenses was greatly expanded, leading Congress to enact section 642 (g).[6] While the policy behind section 642 (g) is probably a concern for revenue,[7] Congress merely stated the desirability of preventing double deductions.[8] Nevertheless, the opportunity for double deductions remains despite section 642 (g).

Section 642 (g) does not create additional deductions. It applies only to expenses deductible by estates *and* individuals. Items such as funeral expenses, deductible from the gross estate under Code section 2053, are not allowable as an income tax deduction if an election is made, since they are never deductible from income.[9]

This note will consider the deductions subject to the 642 (g) election; taxpayers eligible for the election; the double deduction available despite section 642 (g); considerations to be utilized by the executor in making the 642 (g) election; the impact of the election upon the testator's various donees; and procedural aspects of the 642 (g) election. As necessary, the interrelationship of section 642 (g) with other code sections will be discussed, and the rationale behind section 642 (g) will be evaluated.

DEDUCTIONS SUBJECT TO A 642 (g) ELECTION

Casualty Losses

In *Estate of M. M. Stark*,[10] decided one year prior to enactment of the predecessor to 642 (g), estate losses were held deductible from both estate income in the year of occurrence and the gross estate. Congress was apparently aware of the *Stark* decision when section 642 (g) was enacted because it specifically proscribed the double deduction of uninsured casualty losses. Other than concern over allowing double deductions, the committee reports[11] accompanying section 642 (g) offer no basis for subjecting estate casualty losses to the election. A slight federal revenue loss is thus prevented.

Inconsistently, Congress prevented the casualty loss deduction from being used twice, while others, such as charitable deductions, were allowed.[12] The current treatment of casualty losses also defies economic reality.[13] A casualty loss occuring during decedent's lifetime reduces his estate and he is com-

6. The House enacted a proviso that prevented only the double deduction of business expense. H.R. REP. No. 2333, 77th Cong., 2d Sess. 75 (1942). However, the Senate modified the bill to deny double deductions of both business and nonbusiness expenses. S. REP. No. 1631, 77th Cong., 2d Sess. 136 (1942).

7. M. FERGUSON, J. FREELAND & R. STEPHENS, FEDERAL INCOME TAXATION OF ESTATES AND BENEFICIARIES 321 (1970) [hereinafter cited as FERGUSON].

8. S. REP. No. 1631, 77th Cong., 2d Sess. 136 (1942).

9. Estate of Orville F. Yetter, 35 T.C. 737 (1961).

10. 45 B.T.A. 882 (1941).

11. S. REP. No. 1631, *supra* note 8.

12. CODE §§642 (c), 2055. Charitable bequests are encouraged because they help relieve the government of the cost of supporting charitable institutions. *See In re* Sage's Estate, 122 F.2d 480 (3d Cir. 1941).

13. FERGUSON, *supra* note 7, at 320.

pensated by a corresponding income tax deduction.[14] If, however, death occurs immediately after the loss, the deduction can be utilized on decedent's final income tax return and his estate does not include the loss property. This difference in treatment is difficult to reconcile when the taxpayer is an estate. If the deduction is used to reduce the taxable estate, an income tax deduction available to other taxpayers is denied the estate. Moreover, economic reality and tax theory are further abused when the deduction is used to reduce estate income taxes and the estate is still taxed on property that does not exist for distribution.[15]

If the executor uses the casualty loss deduction to reduce estate income tax liability, an equitable adjustment between estate accounts may be required. The taxpayer enjoying the benefit of the deduction should restore an amount equal to the increased estate tax to the person paying the increase.[16] Where estate taxes are payable from the residuum, that account should be increased from the income account. In jurisdictions that charge each beneficiary with the estate tax attributable to the property he receives,[17] the adjustment should be made to the intended beneficiary of destroyed property. Such equitable considerations emphasize the difficult situation in which a 642 (g) election places the executor. Regulations providing a formula to protect beneficiaries with divergent interests arising from the effect of section 642 (g) would greatly aid the practitioner. Alternatively, state legislatures could act to remedy the inequities created by section 642 (g).[18]

Administration Expenses

Section 642 (g) precludes double deduction of administration expenses allowable by Code section 2053, but it is directed only at administration expenses deductible under subsection 2053 (a) (2).[19] Executor's commissions,[20] attorney's fees,[21] and miscellaneous expenses[22] necessarily incurred in col-

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14. CODE §165.

15. To avoid the action of §642 (g) on casualty losses, the alternate valuation date under CODE §2032 cannot be used because of the basis limitation on losses contained in CODE §1014 (a).

16. *See In re* Warms' Estate, 140 N.Y.S.2d 169 (Sur. Ct. 1955).

17. *E.g.*, FLA. STAT. §734.05 (1969).

18. *Cf.* FLA. STAT. §734.041 (1969). *See also* N.Y. EST., POWERS & TRUST LAW §11-1.2 (A) (McKinney 1967).

19. Treas. Reg. §1.642 (g)-2 (1956).

20. Treas. Reg. §20.2053-3 (b) (1965).

21. Treas. Reg. §20.2053-3 (c) (1965).

22. Treas. Reg. §20.2053-3 (d) (1965). Miscellaneous expenses include court costs, surrogates' fees, accountants' fees, appraisers' fees, and clerk hire. Treas. Reg. §20.2053-3 (d) (1965). Expenses incurred in preserving and distributing the estate are also deductible. *E.g.*, Estate of Martha A. Allison, 5 CCH Tax Ct. Mem. 992 (1946) (allowing expenses on the sale of an asset sold to avoid making needed repairs on the property); Treas. Reg. §20.2053-3 (d) (1) (1965). Likewise, expenses of selling estate property and excise taxes incurred upon such sales may be deducted. Treas. Reg. §20.2053-3 (d) (2) (1965) (the sale must be necessary to pay administration expenses, estate taxes, or to preserve or distribute estate property); Treas. Reg. §20.2053-6 (e) (1958). *See also* Rev. Rul. 68-335, 1968-1 CUM.

lecting assets, paying debts,[23] and distributing estate property[24] are the expenses primarily contemplated by subsection 2053 (a) (2).

Fiduciary fees and litigation expenses are specifically deductible from estate income under Code section 212. Estate and income provisions, however, overlap more than the Regulations indicate.[25] A ruling issued in 1954 listed eight items subject to the 642 (g) election:[26] (1) executor's commissions, (2) attorney's and accountant's fees, (3) compensation paid to a custodian of estate property, (4) premiums on fidelity bonds, (5) probate fees, (6) appraiser's fees, (7) court costs, and (8) traveling expenses incurred in administering the estate. The ruling suggests that attorney's fees in a suit to quiet an estate asset's title are not a proper income tax deduction, but are allowable as an estate tax deduction. This exception is, however, questionable.[27] All expenses allowable by the Regulations under subsection 2053 (a) (2) should be subject to a 642 (g) election because they are also within the purview of section 212.[28] On the other hand, expenses arising solely from income, such as executor's commissions, may not be deductible from the estate tax.[29]

A reasonableness test is used to determine the deductibility of attorney's fees and executor's commission.[30] A state court determination of reasonable attorney's fees is ordinarily accepted, and executor's commissions are deductible only to the extent of state statutory rates.[31] Attorney's fees for heirs and distributees may be allowed as administration expenses in a case involving the construction of a will.[32] Expenses in a stockholder's suit have been held nondeductible,[33] but expenses incurred for settling with a decedent's recalcitrant brother-partner have been allowed as administration expenses.[34]

Miscellaneous administration expenses, in order to be deductible, must serve a purpose stated in the Regulations.[35] Expenses incurred pursuant to

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BULL. 406 (treating real property tax liens as administration expenses rather than as claims against the estate).

23. *E.g.*, Huntington v. Commissioner, 36 B.T.A. 698 (1937) (allowing expenses attributable to notes issued to pay estate taxes as a deductible miscellaneous administration expense).

24. Treas. Reg. §20.2053-3 (a) (1965).

25. Treas. Reg. §1.212-1 (i) (1957).

26. P-H 1954 FED. TAXES ¶76,782.

27. *Cf.* Dulles v. Johnson, 273 F.2d 362 (2d Cir. 1959).

28. An examination of §§2053 (a) (2), 212, and the regulations thereunder suggests this conclusion. If the estate is conducting a business, the expenses allowable under §2053 (a) (2) should also be within the purview of CODE §162.

29. *Compare* Lewis v. Bowers, 19 F. Supp. 745 (S.D.N.Y. 1937), *with* Estate of Debe W. Hubbard, 26 T.C. 183 (1956).

30. Treas. Reg. §§20.2053-3 (b), (c) (1956).

31. *Id.*

32. Dulles v. Johnson, 273 F.2d 362 (2d Cir. 1959). However, such expenses may be disallowed as unreasonable expenses for the personal benefit of beneficiaries. Treas. Reg. §20.2053-3 (c) (3) (1965).

33. Estate of Marjorie G. Brush, 22 CCH Tax Ct. Mem. 900 (1963).

34. Estate of Isaac W. Baldwin, 18 CCH Tax Ct. Mem. 902 (1959).

35. Treas. Reg. §20.2053-3 (d) (1965).

a transaction primarily benefiting individual beneficiaries are not considered necessary.[36] In determining the deductibility of an expense, each new case must be considered in light of the appropriate Regulations. However, they will be determined in light of the "reasonable" and "necessary" tests.

When section 642 (g) is applied to administration expenses, the theoretical fallacy underlying the provision again becomes apparent. In reality, administration expenses do not give rise to double deductions that may be prohibited by a Code section. Administration expenses are charges reducing the gross estate and should realistically result in a corresponding deduction. Furthermore, estate income should obtain the benefit of expressly authorized Code deductions to reduce gross income. There are two different taxes being imposed. Thus, when either tax utilizes realistic deductions the other should not be increased by a corresponding denial of deductions. Coupled with the tenuous methods by which some "double deductions" continue to exist, these facts illustrate the superfluous nature of section 642 (g).

Tax-Exempt Income Expenses

Administration expenses attributable to collection of tax-exempt income present an unusual problem. Since tax-exempt income expenses are not deductible from the estate income,[37] they are not subject to the 642 (g) election. Difficulty arises when administration expenses are deducted from estate income, but expenses attributable to tax-exempt income must be deducted only from the gross estate. The expenses will ordinarily be prorated on the ratio of tax-exempt income to total estate income.[38] As this method will rarely distribute expenses fairly, the taxpayer may avoid a prorata division by demonstrating a more accurate method.[39] When tax-exempt income earned by the estate is a large percentage of total estate income, the executor should maintain accurate records of the charges actually attributable to the tax-exempt portion. He can thus effect a larger deduction available from estate income, since it is unlikely that the expenses actually chargeable to tax-exempt income will equal the prorated amount.

TAXPAYERS ELIGIBLE FOR THE 642 (g) ELECTION

Section 642 (g) was amended in 1966 to close a sizeable loophole. Immediately after the phrase: "Amounts allowable under section 2053 or 2054 as a deduction in computing the taxable estate of a decedent shall not be allowed as a deduction in computing the taxable income of the estate" the words "or any other person"[40] were added. The amendment was a direct

36. T.D. 6296, 1958-2 CUM. BULL. 432; *e.g.*, Moreell v. United States, 221 F. Supp. 864 (W.D. Pa. 1963) (disallowing miscellaneous administration expenses for maintaining a palatial country estate for the widow's benefit).

37. CODE §§265 (1), 641 (b).

38. Rev. Rul. 59-32, 1959-1 CUM. BULL. 245.

39. Rev. Rul. 63-27, 1963-1 CUM. BULL. 57. *See* Mallinckrodt v. Commissioner, 2 T.C. 1128 (1944), *acquiesced in*, 1944-1 CUM. BULL. 18.

40. Act of Oct. 4, 1966, Pub. L. No. 89-621, §2, 80 Stat. 872.

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result of *Commissioner v. Burrow*,[41] holding that administration expenses attributable to a trust included in the gross estate could be deducted on both the estate tax return and from trust income.[42] Until the 1966 amendment, section 642 (g) contained no precise proscription of double deductions for testamentary trusts, and *Burrow* illustrates a strict statutory interpretation.[43] The broadening of section 642 (g)'s applicability by the 1966 amendment may indicate a trend to be continued if other double deductions are subsequently allowed by the courts.

The double tax benefits manifested in *Burrow* led Congress to erase an area of uncertainty from the Code, but no guidance was given executors who must face the additional problems the 1966 amendment created. Although administration expenses attributable to testamentary trusts are now subject to the 642 (g) election, and the trust is entitled to an income deduction if an election is made, the executor has priority over the trustee in making the election.[44] The executor may elect to use the expenses chargeable to the trust to reduce estate income tax liability and the trust is then precluded from using the deductions.[45] If trust expenses are deducted on the estate's income tax return, trust beneficiaries and remaindermen may demand an equitable adjustment. The adjustment would flow from the estate's income. It would restore the trust corpus or income account by the amount the trust's income tax liability was increased because the trust expenses could not be deducted from the trust taxes. Moreover, if expenses of administering the trust are deducted from trust income, but paid from trust corpus, the trust remainderman may demand an adjustment from the income beneficiary. The prudent executor will consider these inequities in light of the relative tax brackets of all taxpayers concerned.[46] To preserve his impartiality and to avoid any possible litigation, he might obtain stipulations from the concerned taxpayers directing his actions.[47]

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41. 39 T.C. 1080 (1963), *aff'd*, 333 F.2d 66 (10th Cir. 1964), *acquiesced in*, 1965-2 CUM. BULL. 4.

42. *See* Cohn v. United States, 249 F. Supp. 763 (S.D.N.Y. 1966), *aff'd on other grounds*, 371 F.2d 642 (2d Cir. 1967), where the Government adhered to the *Burrow* decision by a stipulation.

43. Subsequently, in Levy Trust v. Commissioner, 341 F.2d 93 (5th Cir. 1965), an estate with a stipulated tax liability sought a reconsideration to take advantage of *Burrow*. The attempt was denied on a discretionary procedural point. This sequence of events illustrates the reluctance of some courts to grant double deductions.

44. S. REP. No. 1599, 89th Cong., 2d Sess. 3133 (1966).

45. *Id.*

46. Guidelines to consider are offered in Report, *Current Tax Problems of Decedents' Estates*, 3 REAL PROPERTY PROBATE & TRUST J. 361, 376 (1968).

47. The court in *In re* Kent's Estate, 23 Fla. Supp. 133 (County J. Ct. 1964), suggests that the executor is under no duty to obtain such stipulations and should avoid legislative action before attempting to do so. However, such action would appear particularly advisable in estates having both substantial income and substantial sums going into testamentary trusts.

Double Deductions Available to an Estate

Express Statutory Recognition of Double Deductions

Despite section 642(g), instances remain when items may be deducted from both the estate's income and on the estate tax return. Section 642(g) is specifically inapplicable to deductions in respect of a decedent.[48] Furthermore, it applies only to deductions allowable to the gross estate under sections 2053(a)(2) or 2054, and double deductions may result from the proper employment of other estate tax deductions. For example, a testamentary gift of principal and interest in trust to charity results in a double deduction.[49] Also, payments from estate income in satisfaction of the marital deduction are deductible from both estate income and the gross estate.[50] This apparent congressional largess is tempered by the limited availability of the double deductions; the post mortem estate planner has little or no effect on their availability.

Obligations to an Ex-Spouse

An estate's contractual obligation to decedent's ex-spouse may also result in double deductions. *Laughlin v. Commissioner*[51] held that the commuted value of alimony payments payable by the estate under a contractual obligation results in a double deduction. The total commuted value was deductible from the gross estate as a claim against the estate, which is not a deduction contemplated by section 642(g).[52] In addition, the annual payments made during administration were deductible from estate income as a distribution deduction.[53]

The approval of this double tax benefit may also lead to other estate tax deductions allowable under section 2053, but not specifically under subsection 2053(a)(2) to be deducted from estate income.[54] If this transpires,

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48. CODE §642(g); Treas. Reg. §1.642(g)-2 (1957).

49. Gilfillan v. Kelm, 128 F. Supp. 291 (D.C. Minn. 1955); CODE §642(c).

50. *E.g.*, Estate of M. R. Gale, 35 T.C. 215 (1960).

51. 167 F.2d 828 (9th Cir. 1948); *accord*, Estate of Daniel G. Reid, 15 T.C. 573 (1950), *aff'd*, 193 F.2d 625 (2d Cir. 1952).

52. Claims against the estate are deductible under CODE §2053(a)(3), and §642(g) contemplates only deductions available under §2053(a)(2).

53. CODE §661. After enactment of the 1954 Code several authorities believed this double tax benefit would be precluded, since §642(g) now referred only broadly to §2053. Bard, *The Disallowance to Estates of Double Deductions*, 42 TAXES 455, 456 n.11 (1964); Glassmoyer, *Double Deductions in Estate Taxation: When and How They May Be Taken*, N.Y.U. 24TH INST. ON FED. TAX. 425, 429 (1966). However, as enacted in 1954, §642(g) is substantially identical in form and effect to its antecedent. S. REP. No. 1622, 83d Cong., 2d Sess. 340 (1954). Courts have continued to uphold the double deduction of alimony and support payments. Commissioner v. Estate of Shively, 276 F.2d 372 (2d Cir. 1960); Gowetz v. Commissioner, 320 F.2d 874 (1st Cir. 1963). The Service affirmed the court holdings in Rev. Rul. 67-304, 1967-2 CUM. BULL. 224.

54. *See* Estate of Debe W. Hubbard, 26 T.C. 183 (1956), allowing some expenses attributable to property not subject to claims as both estate and income tax deductions.

the theory of section 642 (g) will remain effective.[55] Nevertheless, the road to any double tax benefit in the estate tax area will be difficult.[56]

Selling Expenses

Traditionally, selling expenses have not been treated as expressly authorized statutory deductions, but rather as "setoffs" used to reduce the selling price of an item.[57] This treatment of selling expenses has created the most significant pre-taxpayer development under section 642 (g) since its enactment. In the leading case, *Estate of Viola E. Bray*,[58] the issue was whether selling expenses attributable to stock held in the decedent's estate could be used as an administration expense deduction from the gross estate and as a setoff against the sale price in computing the capital gain subject to income tax. In a taxpayer victory, the court held that setoffs were not "deductions" subject to a 642 (g) election, but "reductions" of income.[59] The setoffs could thus be used to reduce income taxes and as a deduction from the gross estate. The *Bray* decision was based on a strict reading of section 642 (g) and the historical treatment of selling expenses by the Service.[60]

Double tax benefits have long been allowed to an estate for selling expenses, both before[61] and after[62] enactment of section 642 (g). However, in 1956 an unpopular[63] Revenue Ruling[64] held that setoffs would thereafter be considered subject to the 642 (g) election. By overruling the government's position, the courts have reverted to uniform treatment of selling expenses and restored a useful tax-savings device to estates that sell their assets. The double deductibility of selling expenses has been extended to the expenses

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55. FERGUSON, *supra* note 7, at 598 n.1120.

56. *See* Estate of Charles E. Godd, 208 F. Supp. 521 (E.D. Mich. 1962), holding §642 (g) inapplicable to a tax credit from estate income under CODE §1341. The principal amount was restored to decedent's employer and deducted from estate income and from the gross estate as a claim against the estate. The credit was held not to be a *deduction* within the meaning of §642 (g). The court declined to comment on whether §642 (g) would apply if the alternate deduction method under CODE §1341 (a) (4) had been employed by the estate.

57. Treas. Reg. §§1.212-1 (n) (1957), 1.263 (e) (1958). The Government has successfully argued this position when it was advantageous to the Treasury. *E.g.*, Munsen v. McGinnis, 283 F.2d 333 (3d Cir. 1960).

58. 46 T.C. 577 (1966), *aff'd*, 396 F.2d 66 (6th Cir. 1968), *nonacquiesced*, 1970 INT. REV. BULL. No. 30, at 7. *Accord*, Commerce Trust Co. v. United States, 309 F. Supp. 1317 (W.D. Mo. 1969); Kreher v. United States, 1970-1 U.S. Tax Cas. ¶9331 (M.D. Fla. 1970); Mercantile Safe-Deposit & Trust Co. v. United States, 1970-1 U.S. Tax Cas. ¶12,674 (D. Md. 1970); Wilson v. United States, 1970-2 U.S. Tax Cas. ¶12,714 (C.D. Cal. 1970); Clapp v. United States, 1970-2 U.S. Tax Cas. ¶9672 (C.D. Cal. 1970); Smith v. United States, 1970-2 U.S. Tax Cas. ¶12,721 (E.D. Mo. 1970).

59. Estate of Viola E. Bray, 46 T.C. 577, 581 (1966).

60. *Id.* at 582.

61. Estate of Dudley S. Blossom, 45 B.T.A. 691 (1941).

62. Don A. Davis, 4 T.C. 329 (1944), *aff'd*, 151 F.2d 441 (8th Cir. 1945).

63. *See* Bard, *supra* note 53, at 460.

64. Rev. Rul. 56-43, 1956-1 CUM. BULL. 210.

of selling a decedent's residence[65] and underwriter's fees on the sale of stock.[66] However, when the sale is necessary for estate administration the asset's nature should not affect the application of the *Bray* principle.[67]

In all reported cases where selling expenses were used to reduce both income and estate tax liabilities, a capital gain attended the sale.[68] If a capital loss occurs, however, different considerations exist. A capital loss on the sale of an estate asset is deductible from the gross estate as a miscellaneous selling expense.[69] However, since capital losses are a specific statutory deduction under Code section 165, they are subject to the 642(g) election. Nevertheless, the miscellaneous administration expenses attributable to the sale should remain within the *Bray* principle.[70] On the estate tax return the selling expenses are separate from the loss that is determined via gross proceeds of the sale.[71] When deducted on the income tax return, the loss is determined by adding the expenses to the asset's basis, rather than by deducting the expenses from the sale proceeds, as the Commissioner argued in *Bray*.[72] Thus, the loss results when the basis plus the selling expenses exceed the selling price, and the expenses attributable to the sale are separate from the statutory loss provided under section 165. Therefore, in a loss situation, the loss deduction is subject to the 642(g) election without regard to the attendant selling expenses. The selling expenses, however, will still reduce tax liability on both returns.[73]

At first glance it appears that the executor can sell as much estate property as possible, reducing both estate and income tax liability substantially. However, deductible selling expenses are subject to limitations. The Code allows selling expenses as estate tax deductions only when allowable by the laws of the jurisdiction under which the estate is administered.[74] The Regulations impose further restrictions by providing that selling expenses are de-

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65. Wilson v. United States, 1970-2 U.S. Tax Cas. ¶12,714 (C.D. Cal. 1970).

66. Clapp v. United States, 1970-2 U.S. Tax Cas. ¶9672 (C.D. Cal. 1970).

67. Congress may amend §642(g) to include selling expenses. See Fager, *Administration Expenses Deductible by Estates and Beneficiaries*, N.Y.U. 25TH INST. ON FED. TAX. 1167, 1177 (1967). This assumption is based on the experience of the 1966 amendment that closed the loophole manifested in Burrow v. Commissioner, 39 T.C. 1080 (1963), *aff'd*, 333 F.2d 66 (10th Cir. 1964), *acquiesced in*, 1965-2 CUM. BULL. 4. However, such an amendment is unlikely because the current treatment of selling expenses in the estate tax area is consistent with long established policy and practice in the income tax area. *E.g.*, Spreckles v. Commissioner, 119 F.2d 667 (9th Cir. 1941), *aff'd*, 315 U.S. 626 (1942). Furthermore, §642(g) referred solely to express statutory deductions when it was first under consideration. H.R. REP. No. 2333, 77th Cong., 2d Sess. 75, 76 (1942).

68. *E.g.*, Commerce Trust Co. v. United States, 309 F. Supp. 1317 (W.D. Mo. 1969).

69. Treas. Reg. §20.2053-3(d)(2) (1965). The loss is determined by subtracting the proceeds from the fair market value on the valuation date used or the date of sale, whichever is less.

70. Warren, *The Federal Estate Tax Return — Some Problems in Valuations, Deductions, and Elections*, N.Y.U. 26TH INST. ON FED. TAX. 1193, 1207 (1968).

71. *Id.* at 1207 n.38.

72. Comment, *"Disallowance of Double Deductions" in I.R.C. Section 642(g) Applies Only to Statutory Deductions*, 65 MICH. L. REV. 571, 576 (1967).

73. *See* Wilson v. United States, 1970-2 U.S. Tax Cas. ¶12,714 (C.D. Cal. 1970).

74. CODE §2053(a).

ductible only if incurred incident to a sale necessary to pay decedent's debts, cost of administration, estate taxes, preserve the estate, or effect its distribution.[75] Clearly, if assets are sold to pay taxes, administration expenses, or debts the expenses are deductible. However, when assets are sold to preserve or distribute the estate, the necessity of the sale may be questioned. It is the executor's duty to preserve the estate in the face of adverse economic conditions,[76] and expenses attendant to sales for such preservation should be deductible.[77] However, when a beneficiary wants cash instead of estate property in satisfaction of a bequest, a sale to effect his wishes causes problems. If the sale is made merely for the beneficiary's convenience, it is unlikely that the expenses are deductible on the estate tax return.[78] Additionally, state law may complicate this conclusion when there is no power to distribute in kind without the testator's consent. Courts are prone to rely on local law[79] when deductibility of a selling expense is contested. When the will gives the executor a general power to sell estate assets, selling expenses are ordinarily allowed if based on state law.[80]

Considerations of an Election

After determining which estate expenses are subject to a 642 (g) election, an estimated estate income tax bracket and approximate estate tax liability should be projected and kept in mind when deciding which tax liability to reduce. In addition, the executor must realize the effect of the election on the charitable and marital deductions, estate tax credits, liquidity, and the estate beneficiaries.

Tax Rates

The first consideration when deciding whether to make a 642 (g) election is the relative estate tax and estate income tax brackets. In two situations no question arises over administration expense and casualty loss deductions.

75. Treas. Reg. §20.2053-3 (d) (1965).

76. *Cf.* 2 A. Scott, Trusts 209 (3d ed. 1967).

77. *E.g.*, Estate of Martha A. Allison, 5 CCH Tax Ct. Mem. 992 (1946).

78. *Cf.* Treas. Reg. §20.2053-3 (c) (3) (1965).

79. Estate of Sternberger v. Commissioner, 18 T.C. 836 (1952), *aff'd*, 207 F.2d 600 (2d Cir. 1953), *rev'd on other grounds*, 348 U.S. 187 (1955), which allowed expenses on selling decedent's residence when the widow decided to discontinue living there. The sale was allowable under local law, but was not for any purpose stated in the Regulations. *Compare* Estate of Swayne v. Commissioner, 43 T.C. 190 (1964), disallowing the deductibility of selling expenses on a residence when there was no evidence for the purpose of the sale or reason for the state probate court's authorization of it. *See* Treas. Reg. §20.2053-1 (a) (2) (1958).

80. *E.g.*, Estate of Bartlett v. Smith, 153 F. Supp. 674 (E.D. Pa. 1957). However, when state law is examined in this respect, federal courts are bound only by the highest state court's authority. Commissioner v. Estate of Bosch, 387 U.S. 456 (1967). The Service and the courts thus have wide latitude when considering the deductibility of selling expenses, but presumably the Regulations or lower state court decisions will be used as guides. *See* Rev. Rul. 68-335, 1968-1 Cum. Bull. 406.

First, if the estate's taxable income is $600 or less, the expenses should be deducted from the gross estate since an estate is granted a $600 income tax exemption.[81] Because an estate is granted a $60,000 exemption when computing the taxable estate,[82] a deduction from the gross estate would be wasted if the gross estate is less than $60,000.

When the deductions are utilized on one return the tax liability will be reduced on that return; however, the tax liability on the remaining return will accordingly increase.[83] Simple calculations enable the executor to determine the deduction that results in the greatest tax savings to his trust estate. For example, assuming no other deductions, a gross estate of $500,000 having administration expenses of $40,000 will save $12,800 if the expenses are deducted entirely on the estate tax return.[84] Alternatively, if the same estate realizes income of $50,000 each of two consecutive years of administration, the executor will save $22,796 in income taxes by deducting the expenses entirely on the income tax return.[85] Considering tax rates alone, therefore, almost all estates will benefit by utilizing the deductions on the estate's income tax return.

Various tentative methods have been offered to determine whether the estate tax or the income tax return would benefit most from the deduction.[86] There is one particularly helpful rule concerning small estates.[87] Estate tax rates do not reach 14 per cent until the taxable estate exceeds $20,000. Thus, when the taxable estate is $20,000 or less, disregarding the deductions subject to the election, the deductions should be used to reduce income tax liability because the base income tax rate is 14 per cent.[88] However, determining the maximum gross estate value that continues to enjoy the lower tax rate when the expenses are deducted on the income tax return is not so definite. A figure of $2 million appears to be the most plausible, assuming the maximum marital deduction is employed.[89] A gross estate figure of $3

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81. CODE §642(b). If estate income is less than $600 no form 1041 need be filed. CODE §6012(a)(3).

82. CODE §2052. Estates need not file a form 706 unless their gross value exceeds $60,000. CODE §6018(a)(1).

83. Fleming, *"From Peter to Paul"—Income and Principal Adjustments when Administration Expenses Used as Income Tax Deductions*, 96 TRUSTS & ESTATES 1089 (1957).

84. CODE §2001.

85. CODE §1(a). This example assumes that one-half of the administration expenses were deducted in each of the two years.

86. Boehm, *Comparing the Relative Tax Costs of Alternative Treatment of Estate and Income Deductions and Valuation Adjustments*, 31 ROCKY MT. L. REV. 172, 173 (1958-1959); Browne, *Effect of Elections by an Executor Upon the Estate and Upon the Beneficiaries*, N.Y.U. 23D INST. ON FED. TAX. 1239, 1247-48 (1965); Metzer, *The Deduction of an Estate's Administration Expenses: Section 642(g) of the Internal Revenue Code and Its Impact*, 21 TAX L. REV. 459, 466 (1966).

87. *See* Boehm, *supra* note 86, at 173.

88. CODE §1(a).

89. Metzer, *supra* note 86, at 466. One-half the gross estate ($1 million after the marital deduction) reduced by the §2052 exemption equals $940,000. The effective estate tax rate on $940,000 is 28%. This is determined by dividing the tax of $303,500 imposed by §2001, less the credit under §2011 of $33,200, by the taxable estate of $940,000. Thus, the rate on the gross estate is 14% – the base income tax rate.

million has also been proposed,[90] resulting in a taxable rate on the gross estate of 15.5 per cent, also assuming the maximum marital deduction. Thus, if the estate has taxable income exceeding $1,000,[91] as would ordinarily occur, the executor could still obtain a tax savings by deducting the expenses on the income tax return.

Since income tax rates are higher than estate tax rates, the executor can usually reduce taxes by taking the deductions on the income tax return. The rate structures may dictate which return should use the deductions subject to the 642(g) election; however, other important election factors may cause the simple calculations to have little value.[92]

The Charitable Deduction

Charitable bequests are deductible without limitation from decedent's gross estate under Code section 2055. Litigation over the 642(g) election's effect on the size of the charitable deduction has arisen when the residuary or a portion thereof has been bequeathed to charity. In *Luehrman's Estate*[93] the executors elected to deduct administration expenses from estate income. They contended the election raised the presumption that the expenses were actually paid from the income account and not from the residuum. If paid from the income account the residuum would not be reduced by the amount of the expenses, and thus the residuary's charitable deduction would not be reduced. The court, however, accepted the Commissioner's argument that the value of the charitable deduction under section 2055 must be the amount that the charitable institution does in fact receive.[94] Upon a finding that the expenses were paid from the residuum, it was held that the charitable deduction was reduced. The court indicated in dictum that if the taxpayer demonstrated that expenses were not in fact paid from the residuum, the charitable deduction would not be reduced.[95]

Subsequently, in *Alston v. United States*[96] administration expenses were paid from post mortem income. Nevertheless, the court held that the amount of the expenses must be subtracted from the residuum to determine the charitable deduction attributable to that account, because the increase in the residuum was acquired by purchase rather than by bequest. The court

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90. Browne, *supra* note 86, at 1247.

91. *Compare* CODE §2001, *with* CODE §1 (a).

92. Most authors suggest that rates alone dictate the election, but such a statement is clearly misleading. *E.g.*, Stopperan, *After-Death Income Tax Planning*, 54 IOWA L. REV. 685, 704 (1969).

93. 33 T.C. 277 (1959), *aff'd*, 287 F.2d 10 (8th Cir. 1961). *Accord*, Republic Nat'l Bank v. Commissioner, 334 F.2d 348 (5th Cir. 1964), *aff'g* 39 T.C. 85 (1963).

94. *See* Harrison v. Northern Trust Co., 317 U.S. 476 (1943), holding that for an item to be deductible under §2055 evidence must be presented that it was in fact received by the charity and that estate taxes payable from the residuary reduced the amount going to charity. *See* CODE §2055 (c).

95. Estate of Luehrmann v. Commissioner, 287 F.2d 10, 16 (8th Cir. 1961).

96. 228 F. Supp. 216 (N.D. Ga. 1964), *aff'd*, 349 F.2d 87 (5th Cir. 1965).

applied this principle[97] after determining that the administration expenses constituted charges against the residuum rather than specific bequests. Presumably, in jurisdictions where administration expenses are not a charge against the residuum it will not be reduced by the amount of the expenses paid from estate income when determining the amount of the charitable deduction attributable to it. The 642(g) election would then have no effect on the amount of the charitable deduction.

Although the Fifth Circuit Court of Appeals affirmed *Alston,* it recognized that the holding conflicts with the policy of encouraging charitable contributions. The court suggested, therefore, that the problem be circumvented by a specific clause in the will directing administration expenses to be paid from estate income. The charitable deduction would not be reduced because the residuum's increase would be acquired by bequest when the expenses were no longer required to be subtracted from it in computing the charitable deduction. In this instance, however, the decedent, not the executor, would be making the 642(g) election.

The net effect of these decisions is to charge the residuary with an increased estate tax burden, since administration expenses are not available to reduce the gross estate. Under local law an adjustment from the income account may be necessary to reimburse the residuary in the amount of the increased estate tax.[98] The Tax Court in *Estate of Harry Britenstool*[99] held that the amount of the adjustment also constituted part of the charitable bequest of the residuary, thereby increasing the charitable deduction. The increase was held not acquired by purchase, since it was required by state law and was not a voluntary payment of administration expenses from another account.[100] Thus, the increased deduction decreases estate taxes while the income tax liability retains the benefit of the 642(g) election.[101]

The Marital Deduction

Several questions have arisen over the 642(g) election's effect on the estate's marital deduction allowed under Code section 2056. The effect on the marital deduction depends upon the type of bequest that has been made to the surviving spouse.

The marital deduction equals the lesser of one-half of the adjusted gross estate or the net value of interests in property passing to a widow.[102] Administration expenses do not constitute property passing to a widow,[103] and when the estate residue is bequeathed to the widow, the marital deduction

97. *See* Ballantine v. Tomlinson, 293 F.2d 311, 312 (5th Cir. 1961) (applying Florida law to a similar problem with the bequest of a residuary to decedent's spouse).

98. *E.g.*, N.Y. Est., Powers & Trusts Law §11-1.2(A) (McKinney 1967).

99. 46 T.C. 711 (1966).

100. Upon this point the Tax Court distinguished its result from that reached in Luehrmann's Estate, 33 T.C. 277 (1959), *aff'd*, 287 F.2d 10 (8th Cir. 1961).

101. By enacting statutes similar to New York's, other states can secure this double tax benefit of a 642(g) election for their residents. *See* note 98 *supra.*

102. Code §§2056(a), (c).

103. Rev. Rul. 55-225, 1955-1 Cum. Bull. 460.

will equal the residue's value less the administration expenses, whether deducted from the gross estate or estate income.[104] When the testator bequeaths the residue to his spouse, the amount of the marital deduction arising from the bequest could be increased if the expenses are deducted from estate income and the expenses are actually paid from the income.[105] However, by state law, administration expenses are ordinarily payable out of the residuum.[106] If this is not done and the expenses are paid from estate income, the increase in the residue passing to the widow is acquired by purchase rather than by bequest.[107] Thus, although the amount passing to the widow may be increased by the 642 (g) election, the amount of the marital deduction will not be increased.

When the decedent employs the maximum marital deduction of one-half the adjusted gross estate[108] by way of a formula bequest to his spouse, the executor may increase the marital deduction by deducting administration expenses on the estate's income tax return.[109] However, the increased marital deduction helps reduce the increased tax burden to what it would have been had the expenses been deducted from the gross estate.[110] Additionally, since the will directs that the widow receive an amount equal to the maximum marital deduction, no reduction in the amount passing to her occurs when administration expenses are paid from principal rather than income.[111]

In *Empire Trust Co. v. United States*[112] a variation of a formula bequest giving the widow the maximum deductible amount was inserted in the will. The clause stated:[113]

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104. Rev. Rul. 55-643, 1955-2 CUM. BULL. 386; Ballantine v. Tomlinson, 293 F.2d 311 (5th Cir. 1961); Estate of Newton B. T. Reney v. Commissioner, 33 T. C. 801 (1960), *aff'd*, 294 F.2d 774 (5th Cir. 1961). The testator may provide for the payment of administration expenses from estate income and thereby increase the deduction. However, the decedent, not the executor, is making the §642 (g) election.

105. Bernstein, *An Executor May Increase the Marital Deduction*, 42 A.B.A.J. 577, 578 (1956).

106. *Id.*

107. S. REP. No. 1013, pt. 2, 80th Cong., 2d Sess. 6 (1948).

108. CODE §2056 (c).

109. Rev. Rul. 55-643, 1955-2 CUM. BULL. 386.

110. Thus, a situation arises where it may be cheaper to take the deduction on the income tax return even if the top income tax bracket is slightly lower than the top estate tax bracket. For example, if a $3,000 legal expense is deducted on the estate tax return, the marital deduction is reduced by $1,500, in effect cutting the deduction in half. If the top estate tax bracket is 40%, the tax savings will be $600. On the other hand, deducting the $3,000 fee on the income tax return in a 30% bracket results in a tax savings of $900. D. NEWMAN, BASIC INCOME TAX PLANNING FOR FIDUCIARIES 94 (1969).

111. *See In re* Estate of Inman, 22 Misc. 2d 573, 196 N.Y.S.2d 369 (Sur. Ct. 1959). It has been suggested that the increase in the marital deduction should be disallowed because a terminable interest is created when the executor has power to vary the amount through the use of §642 (g). Stopperan, *After-Death Income Tax Planning*, 54 IOWA L. REV. 685, 705 (1969). However, this seems tenuous because the power is created by a specific CODE section and not by decedent's will. *Cf.* Jackson v. United States, 376 U.S. 503, 509-11 (1964).

112. 226 F. Supp. 623 (S.D.N.Y. 1963).

113. *Id.* at 624. *See* 4 J. MERTENS, LAW OF FEDERAL GIFT AND ESTATE TAXATION §29.57D (Supp. 1969).

> I give, devise and bequeath unto my said wife absolutely an amount equal to one-half of the value of my adjusted gross taxable estate, as determined for Federal Estate tax purposes, after deducting all debts and funeral and administration expenses . . . .

The court held that the 642 (g) election would not affect the size of the marital deduction when such a clause is employed because it was decedent's intent that the widow's bequest would be calculated only after subtracting administration expenses, regardless of where they were used as deductions. Consequently, if this clause is used, it avoids 642 (g) problems in the marital deduction area, but the widow's share is reduced.

Liquidity

The availability of liquid assets to discharge an estate's obligations is a problem confronting many executors. When an estate's assets consist substantially of shares in a close corporation, the problem is even more acute. Code section 303 enables an executor to redeem close corporation stock for cash without adversely affecting the control of the family business or having corporate distributions taxed at ordinary rates.[114] If the stock has been included in the gross estate, it may be redeemed to the extent of estate taxes, administration expenses, and funeral expenses allowable under Code section 2053. However, the privilege may be employed by the executor only if the distribution is with respect to corporate stock with a value for federal estate tax purposes that exceeds: (1) 35 per cent of the gross estate or (2) 50 per cent of the taxable estate.[115]

Because of these percentage limitations the executor may affect the estate's ability to meet the section 303 formula throughout the 642 (g) election. By not making the election and reducing the taxable estate, the 50 per cent requirement may be more readily satisfied. Thus, if the value of the stock in the close corporation does not exceed 35 per cent of the gross estate, reducing the gross estate by the administration expenses might enable the estate to meet the 50 per cent of the taxable estate limitation.[116] If this is possible, it might be desirable to forego an income tax deduction despite a disparity in income and estate tax rates.[117]

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114. *See* Bowe, *Estate Liquidity and the Family-Owned Business—A Tax Plan Under the Recent Amendments to Section 115* (g), 5 VAND. L. REV. 68, 70 (1951-1952), for a discussion of the uncertainty that accompanied such redemptions prior to the enactment of §303. Presently, gain on the redemption will be taxed at capital gain rates, but that gain should be minimal due to the estate's stepped-up basis. CODE §§303 (a), 1014 (a).

115. CODE §303 (b). As used in §303 (b) the term "gross estate" is that as computed under §2031, and the term "taxable estate" is that as computed under §2051. Treas. Reg. §1.303-2 (b) (1964).

116. *See* Lanahan, *Redemption To Pay Death Taxes: Redemptions Through the Use of Related Corporations (Sections 303, 304)*, N.Y.U. 15TH INST. ON FED. TAX. 493, 506 (1957), for an example of when the 50% rule may be met when the 35% limitation cannot be.

117. In D. NEWMAN, *supra* note 110, at 94, it is stated that the executor may want the highest possible value for the taxable estate in order to meet the 50% limitation, and he would thus deduct administration expenses on the estate's income tax return. This

By electing to deduct administration expenses from estate income, the executor may also affect the amount of the tax free redemption available, because section 303 (a) limits the redemption to the sum of federal estate taxes payable plus administration expenses and funeral expenses. However, this is an indirect relationship. The amount of the redemption is equal to administration expenses *allowable,* rather than those actually *allowed,* under section 2053 (a) (2) to be deducted from the gross estate.[118] By deducting the expenses on the estate income tax return, if their use is not required to meet the percentage limitations of section 303 (b), an increased estate tax results. An increased redemption is therefore available. This course should be followed when an estate has substantial funds in a close corporation and is unable to distribute them other than at ordinary rates.[119]

Code section 6166 also permits payment of the estate tax in installments when an estate has substantial assets in a close corporation. The same percentage requirements are contained in section 6166 as in section 303.[120] Thus, the 642 (g) election will have the same effect on the estate's ability to pay taxes in installments as it did on the availability of a tax free redemption.[121]

Effect on Estate Tax Credits

Both the taxable estate and estate tax liability are increased when administration expenses or casualty losses are deducted on the estate's income tax return. Thus, the estate tax credits allowed under the Code become more significant in reducing the increased estate tax burden.

Under Code section 2011 the estate tax shall be credited with the amount of any estate, inheritance, legacy, or succession taxes actually paid to any state in respect of any property included in the gross estate. After the taxable estate exceeds $40,000 the credit allowable is a fixed dollar amount plus a percentage applied to the amount the estate exceeds a given base.[122] Thus, the maximum credit available may be increased if the executor does not reduce the size of the taxable estate by deducting administration expenses or casualty losses. This increase in the available credit would be advantageous if state death tax liability exceeds the maximum credit that would be available if the gross estate were reduced by the 2053 (a) (2) and 2054 deductions.[123] When the estate tax rates and the rates on the estate's income ap-

statement is clearly misleading.

118. Rev. Rul. 56-449, 1965-2 CUM. BULL. 180.

119. Evall, *"Hidden" Estate Tax-Saving Techniques Can Be Found in Interplay of Tax Laws,* 19 J. TAXATION 280, 284 (1963). However, §303 may also be employed by any beneficiary receiving such stock from the decedent to the extent the executor did not exercise the redemption. Treas. Reg. §1.303-2 (f) (1964).

120. CODE §§6166 (a), 303 (b).

121. It should be noted that only that part of the estate tax attributable to the value of the interest in the close corporation can be paid in installments. CODE §6166 (b).

122. CODE §2011 (b).

123. In states such as Florida where state death taxes cannot exceed the federal credit allowable under §2011, this aspect will not be important. *Compare* FLA. STAT. §198.02 (1969), *with* FLA. STAT. §198.03 (1969).

proach an equal value in large estates, the latitude given the executor to deduct all or part of a 642 (g) item on the two different returns may be particularly helpful.[124]

Under Code section 2012 an estate tax credit is allowed if a gift tax has been paid on property included in the decedent's gross estate. The credit allowed is limited to the lesser of: (1) the amount of the estate tax attributable to the inclusion of the property or (2) the gift tax paid.[125] Like the section 2011 credit, the amount of the first limitation will be affected by the size of the taxable estate, which the executor may increase by deducting administration expenses from estate income. However, as gift tax rates are lower than estate tax rates[126] the second limitation will ordinarily impose the maximum section 2012 credit available. Thus, a 642 (g) election becomes significant only by increasing the value of the taxable estate in respect to the section 2012 credit when the value of the gift property declines between the time of donation and death.[127]

IMPACT UPON BENEFICIARIES

Once a 642 (g) election is made there may be repercussions from disgruntled beneficiaries who have been adversely affected. Ordinarily administration expenses and casualty losses will be deducted on the income tax return since that will result in the estate's greatest tax savings. However, this course leads to conflicts between (1) income beneficiaries and remaindermen and (2) between a widow and a residuary legatee.

Income Beneficiary Versus Remaindermen

The executor has a duty to act impartially toward all beneficiaries, but he is also obligated to make a 642 (g) election which realizes the greatest tax savings to the estate.[128] When tax savings result by a deduction of administration expenses on the income tax return, the income beneficiary is benefited by a reduction in income taxes. Consequently, the remaindermen take a principal amount reduced disproportionately by the increased estate taxes. The conflict may be remedied by a "*Warms* adjustment,"[129] which directs

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124. Treas. Reg. §1.642 (g)-2 (1956).

125. Treas. Reg. §20.2012-1 (b) (1958).

126. *Compare* CODE §2501, *with* CODE §2001.

127. Metzer, *supra* note 86, at 474. The estate tax credit allowed under CODE §2013 for the estate tax paid on property bequeathed to decedent within 10 years of his death will affect decedent's estate tax only in rare circumstances. The election effect of §642 (g) on the size of the taxable estate may affect the size of the §2013 credit, but a two-layer approach is necessary. Ordinarily, only the first executor's election will have any impact on the §2013 credit to the immediate tax liability.

128. Estate of Bixby, 140 Cal. App. 2d 326, 337, 295 P.2d 68, 74 (1956). This duty is not absolute in the face of competing considerations such as §§303 and 6166. Browne, *supra* note 86, at 1251.

129. *See In re* Warms, 140 N.Y.S.2d 169 (Sur. Ct. 1955). For a collection of alternative theories proposed to remedy this inequity, see Metzer, *supra* note 86, at 488-89. *Accord,*

principal to be restored from the income account in the amount of the savings in estate taxes, which would have resulted had the expenses been deducted from the gross estate rather than the estate income. In *In re Kent's Estate*[130] the court stated that the adjustment is only proper where a 642 (g) election has been made, and that the fiduciary is not required by state law to correct inequites created by uncorrelated interaction of tax laws with estate accounting.[131] The policy is that the fund charged with the payment of the expenses should be entitled to the primary benefit of the deduction.[132]

Widow Versus Residuary Legatee

A conflict between the widow and the residuary legatee may occur when the widow has been bequeathed the maximum marital deduction.[133] The conflict results from the increase in the marital deduction and the amount passing to the widow when the expenses are deducted from estate income and the ensuing reduction in the estate's residue when an increased estate tax is paid.[134] When the widow is given the "maximum marital deduction" via a formula bequest in the will, an adjustment in favor of residuary legatees is normally not required.[135] Such a clause in the will involves the fiduciary's duty to act impartially, and the residue should arguably be reimbursed by the amount that the 642 (g) election caused the estate tax to increase.[136] The better view holds that the discretionary power arises out of a combination of the will's terms and the Code, and the executor does not abuse his power by making an election that increases the marital deduction.[137] Requiring no restitution promotes both the decedent's intent of giving his widow the maximum share possible and an over-all reduction in taxes.[138]

Estate of Bixby, 140 Cal. App. 2d 326, 295 P.2d 68 (1956); *In re* Veith's Estate, 26 Fla. Supp. 145 (County J. Ct. 1965); *In re* Kent's Estate, 23 Fla. Supp. 133 (County J. Ct. 1964).

130. 23 Fla. Supp. 133 (County J. Ct. 1964).

131. One state, New York, has given the reimbursement legislative sanction, but the decedent's will may provide otherwise. N.Y. EST., POWERS & TRUST LAW §11-1.2 (A) (McKinney 1967). Many draftsmen are inserting clauses in the will requiring or forbidding any adjustments as the case may be. *See* Herberich, *Problems in the Preparation of Fiduciary Returns Including Elections*, N.Y.U. 27TH INST. ON FED. TAX. 251, 257 (1969). Note 37 of that article contains such a clause.

132. Report, *Current Tax Problems of Decedents' Estates*, 3 REAL PROPERTY, PROBATE & TRUST J. 361, 375 (1968).

133. *See* CODE §2056 (c).

134. Rev. Rul. 55-643, 1955-2 CUM. BULL. 386.

135. Matter of Levy, 9 Misc. 2d 561, 167 N.Y.S.2d 16 (Sur. Ct. 1957), holding an adjustment to be proper.

136. Browne, *supra* note 86, at 1252.

137. *E.g.*, Estate of Inman, 22 Misc. 2d 573, 196 N.Y.S.2d 369 (Sur. Ct. 1959).

138. New York has enacted a statute favoring this position. N.Y. EST., POWERS & TRUST LAW §11-1.2 (B) (McKinney 1967). The statute also provides that when the will defines the marital share as the "maximum deduction," it is not to be construed as a directive to deduct administration expenses on the estate's income tax return. It should also be noted that when the widow is bequeathed the residuary, the equitable "*Warms* adjustment" will be required. *In re* Warms, 140 N.Y.S.2d 169 (Sur. Ct. 1955).

Unless a will provision eliminates the problem the executor is faced with the possibility of a disgruntled residuary legatee. As in the case of the remainderman's conflict with the income beneficiary, a clause specifying the testator's desire either for or against an adjustment should be included in the will.[139] The clause should further exempt the executor from liability for a result that benefits one person to another's detriment.[140]

PROCEDURAL ASPECTS OF AN ELECTION

The use of administration expenses or casualty losses as income tax deductions is conditioned upon the executor filing a statement of his intentions with the Service.[141] The executor must state: (1) the items have not been allowed as estate tax deductions and (2) waive the right to do so.[142] The statement[143] need not be filed with the return but may be filed at any time prior to the expiration of the statute of limitations on the return.[144] As long as the estate tax return has not been "finally allowed,"[145] the deductions are not precluded on the income return because they have been taken as an estate deduction.[146]

Thus, because the estate tax return must be filed fifteen months after decedent's death[147] and the period of assessment expires three years after that date,[148] the executor has at least three years and nine months to make an election. Actually, the period may be longer. If the executor chooses the

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139. For such a clause, see Fager, *Administration Expenses Deductible by Estates and Beneficiaries*, N.Y.U. 25TH INST. ON FED. TAX. 1167, 1180 (1967).

140. These adjustment problems reveal a need for congressional action. Perhaps the most desirable course would be a repeal of §642(g). An alternative to repeal might be additional regulations to guide an executor whose actions affect divergent interests. *See* FERGUSON, *supra* note 7.

141. Even when the gross estate is less than $60,000 and no estate tax return need be filed, the deduction of the expenses on the income tax return is conditioned upon a statement and waiver. Estate of C. M. Sutton, 5 CCH Tax Ct. Mem. 213 (1946).

142. Treas. Reg. §1.642(g)-1 (1956).

143. Although no form is provided, the following is suggested:

The undersigned, as execut_____/administrat_____ of the above decedent's estate hereby certifies that the administration expenses and casualty losses claimed on the Federal Fiduciary Income Tax Return (Form 1041) for the period beginning ________________, 19___, and ending ________________, 19___, have not been allowed as deductions under 2053 or 2054 of the Internal Revenue Code of 1954, as amended, on the Federal Estate Tax Return (Form 706) filed for said estate, and he/she/it hereby waives the right to do so at any time. Stopperan, *supra* note 111, at 704 n.85.

144. Treas. Reg. §1.642(g)-1 (1956).

145. Treas. Reg. §1.642(g)-1 (1956). Rev. Rul. 58-484, 1958-2 CUM. BULL. 363, construed "finally allowed" to be when the statute of limitations has run on the estate tax return. Rev. Rul. 63-240, 1963-2 CUM. BULL. 227, extends the meaning of "finally allowed." If a refund claim has been filed and thereafter the period of assessment expires, the executor may still shift the deduction since the Service is not precluded from reauditing the return.

146. CODE §165(c)(3) gives an erroneous belief that this is not true with casualty loss deductions. However, Treas. Reg. §1.165-7(c) (1958) is in accord with Treas. Reg. §1.642(g)-1 (1956), and this procedure will also be possible with casualty loss deductions.

147. CODE §6075(a).

148. CODE §6501(a).

estate's taxable year to begin with the decedent's death, the first income tax return must be filed by the 15th day of the fourth month following the close of that year.[149] The period of assessment closes three years later,[150] giving the executor four years, four months, and fifteen days to decide on the election. This liberality is welcome since considerable time may pass after decedent's death before the election's effect can be determined.[151]

Despite the lengthy time periods allowed to make an election, some procedural pitfalls exist. The election is irrevocable[152] after a statement and waiver are filed, even if the statement is in error.[153] Moreover, since income tax deductions may be utilized only for the year in which they are paid, failure to pay expenses in a particular year will result in the loss of an income deduction and the lengthy time periods become useless. Thus, if in doubt over the 642 (g) election, the executor should tentatively use the deductions on the income tax return and pay administration expenses as they arise, and provide himself with the maximum time to make a final decision. Although the deductions may be tentatively used on the estate tax return, it is the first return that becomes final and an income tax deduction might be inadvertently lost.

CONCLUSION

Section 642 (g) precludes an otherwise advantageous interrelationship of federal income and estate tax law. Its application to casualty losses flagrantly disregards economic reality and tax theory. If the executor chooses to deduct losses from income, an estate tax must be paid on property that does not exist. If a loss is used to reduce estate tax liability, the estate is denied an income tax deduction that other taxpayers receive. Similarly, if administration expenses are used as income tax deductions, the estate tax is unrealistically inflated. When administration expenses are deducted from the gross estate, the Code denies an income tax deduction otherwise available. Deductions arise through congressional largess for a variety of reasons, and it is inconsistent to deny them in special circumstances because the interrelationship of two tax theories works to the disadvantage of the Government. Thus, from the taxpayer's viewpoint, section 642 (g) should be repealed. Additionally, executors would find repeal desirable because of inequities arising from application of 642 (g). Repeal is unlikely, however, since Congress' only action upon the section since its enactment has broadened its application.

149. Treas. Reg. §1.6072-1 (a) (1956).

150. CODE §6051 (a).

151. Treas. Reg. §1.642 (g)-2 (1956) permits different deductions to be used on the different returns or even splitting the same item into deductions on both returns. Also, the expenses of one year can be taken as income tax deductions without affecting the right to use administration expenses of another year as estate tax deductions. Rev. Rul. 70-361, 1970 INT. REV. BULL. No. 28, at 22.

152. Treas. Reg. §1.642 (g)-1 (1956); Rev. Rul. 240, 1953-2 CUM. BULL. 79.

153. Estate of Mary E. Morris, Jr., 25 CCH Tax Ct. Mem. 974 (1966); Darby's Estate v. Wiseman, 323 F.2d 792 (10th Cir. 1963). *But see* Metzer, *supra* note 86, at 482.

Because of the election's impact on post mortem estate planning, the executor should make the following considerations before deciding upon a final election:

(1) the relative estate tax and the estate income tax brackets;
(2) the election's effect upon a charitable bequest of the estate's residuum;
(3) the election's effect upon the marital deduction;
(4) the estate's liquidity and ability to pay estate taxes when estate assets consist substantially of shares in a close corporation;
(5) the election's effect upon estate tax credits;
(6) obtaining stipulations from beneficiaries divergently affected when an election is made.

If an election is made to deduct expenses on the estate income tax return, the following equitable adjustments may have to be made:

(1) between estate income and the beneficiaries or remaindermen of testamentary trusts;
(2) between income beneficiaries and remaindermen;
(3) between a widow receiving the maximum marital share and residuary legatees.

Election procedures are liberal in many respects, but they may work to place an unnecessary time limitation on the unwary executor. By recognizing the procedural requirements, the executor may enjoy the maximum time available to make the 642(g) election — a procedure that sound tax theory and economic reality dictate should be unnecessary.

RONALD D. FAIRCHILD