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The Estate Tax Deduction for Administration Expenses: Reformulating Complementary Roles for Federal and State Law Under I.R.C 2053 (a)(2)

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THE ESTATE TAX DEDUCTION FOR ADMINISTRATION EXPENSES: REFORMULATING COMPLEMENTARY ROLES FOR FEDERAL AND STATE LAW UNDER I.R.C. § 2053(a)(2)

Section 2053(a)[:] an excellent small segment of legislation woefully buffet[ed] about and otherwise abused by judge and scholar alike. [1]

Section 2053(a)(2) of the Internal Revenue Code provides for the deduction of administration expenses under the federal estate tax[2] if they are "allowable by the laws of the jurisdiction . . . under which the estate is being administered."[3] According to the Treasury regulations promulgated under section 2053,[4] however, state law allowability is merely one of the tests governing deductibility. The regulations also require that amounts deductible as administration expenses be limited to expenses "actually and necessarily incurred in the administration of the decedent's estate."[5] Courts[6] and commentators[7] disagree on whether

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1 R. STEPHENS, G. MAXFIELD & S. LIND, FEDERAL ESTATE AND GIFT TAXATION ¶ 5.03[1], at 5-7 (4th ed. 1978); *see infra* note 164 (charging Professors Stephens, Maxfield, and Lind with similarly mistreating I.R.C. § 2053(a)(2) (1976)).

2 Administration expenses are deducted from the value of the gross estate (I.R.C. § 2031 (1976)) in determining the value of the taxable estate (*id.* § 2051) to be taxed under § 2001 of the Internal Revenue Code (*id.* § 2001).

3 *Id.* § 2053(a)(2).

4 *Id.* § 7805(a) authorizes the Secretary to prescribe regulations implementing the provisions of the Code. For a discussion of the distinction between "legislative" and "interpretative" regulations, see *infra* note 99.

5 Treas. Reg. § 20.2053-3(a) (1958); *see also id.* § 20.2053-3(d) (miscellaneous administration expenses, including selling expenses, must be "necessary").

6 The Fifth and Ninth Circuits, and the Tax Court, have sustained the necessity requirement of the regulations. *See* Hibernia Bank v. United States, 581 F.2d 741, 744 (9th Cir. 1978); Pitner v. United States, 388 F.2d 651, 659 (5th Cir. 1967); Estate of Posen v. Commissioner, 75 T.C. 355, 366-68 (1980). The Sixth and Seventh Circuits, on the other hand, have ruled that the necessity requirement impermissibly restricts the state law component of the statute. *See* Estate of Park v. Commissioner, 475 F.2d 673, 676 (6th Cir. 1973); Ballance v. United States, 347 F.2d 419, 423 (7th Cir. 1965). The Eighth Circuit, without reference to the regulations, has held that allowance of administration expenses under state law is controlling. *See* Scott v. Commissioner, 69 F.2d 444, 445 (8th Cir. 1934).

Other courts have avoided the issue in cases in which the applicable state law imposed a necessity requirement that was interpreted as coterminous with the requirement in the regulations. *See, e.g.,* Estate of Smith v. Commissioner, 510 F.2d 479, 483 (2d Cir.), *cert. denied,* 423 U.S. 827 (1975). The Seventh Circuit has retreated from its position in *Ballance* and has embraced this approach. *See* Estate of Jenner v. Commissioner, 577 F.2d 1100, 1105 n.12 (7th Cir. 1978); *cf.* Magill v. Commissioner, 43 T.C.M. (CCH) 859, 871-72 (1982) (emphasis in original) ("There is some uncertainty, though, as to whether the [Seventh Circuit] considers allowability under local law to be the *conclusive* test of deductibility.").

Both the Second and Third Circuits are uncommitted on the validity of the necessity requirement of the regulations. *See, e.g., Posen,* 75 T.C. at 366; Estate of Streeter v. Commis-

this necessity requirement impermissibly restricts the statutory

sioner, 73-2 U.S. Tax Cas. (CCH) ¶ 12,934, at 82,606 n.2 (3d Cir. 1973), *vacated on other grounds,* 491 F.2d 375 (3d Cir. 1974). *But see* Dauphin Deposit Trust Co. v. McGinnes, 208 F. Supp. 228, 237-39 (M.D. Pa. 1962), *aff'd on other grounds,* 324 F.2d 458 (3d Cir. 1963) (deduction allowed for expenses of sale of testator's realty without finding sale necessary for proper administration of estate as required by Treas. Reg. § 81.32 (1939) (predecessor of Treas. Reg. § 20.2053-3(a) (1958))).

The Service's position in this controversy is curious. The Service considers the *Dauphin Deposit* decision "[in]correct and distinguishable." Ltr. Rul. 7706030890A. Yet the Service did not seek certiorari in *Park,* and has announced that it will follow *Park* in cases within the Sixth Circuit "for practical reasons only and may choose to litigate the issue again at some more opportune time in the future." Ltr. Rul. 7933005; *see also* Ltr. Rul. 7912006 (same); Ltr. Rul. 7802006 (same).

7 Some commentators argue that the necessity requirement impermissibly subverts the state law requirement of § 2053(a). *See* Erwin, *Estate Administration Expenses—the Ninth Circuit Enters the Conflict,* 11 TAX ADVISER 27, 31 (1980) ("[T]he fact remains that the clear language of Sec. 2053(a)(2) only requires that administration expenses be 'allowable by the laws of the jurisdiction . . . under which the estate is being administered' in order to be deductible for federal estate tax purposes."); Zaritsky, *The Long Year in Review: An Estate Planner's Perspective on Tax Developments From September 1980 Through December 31, 1981,* 6 NOTRE DAME EST. PLAN. INST. 1, 236 (1982); Note, *Current Problems Facing the Executor Taking the Section 2053 Estate Tax Deduction,* 30 VAND. L. REV. 795, 812 (1977); Note, *Estate Tax—Administrative Expense Deductions—A Reaffirmation of the Section 2053(a) Standard,* 52 N.C.L. REV. 190, 201 (1973) ("[T]he Treasury's necessity requirement goes beyond any standard suggested by Congress."); Comment, Estate of Smith—*Deductibility of Administration Expenses Under the Internal Revenue Code and Under the Treasury Regulations: Resolving the Conflict,* 17 WM. & MARY L. REV. 363, 382 (1975) ("[Rejecting the necessity requirement of the regulations] provides a . . . practical solution, one that recognizes the realities of estate administration . . . [and is] more consonant with the statutory mandate. Section 2053(a), by its express terms, makes its operation dependent upon state law; any additional limitation should come from Congress."); *cf.* Note, *Deductibility of Estate Selling Expenses,* 51 S. CAL. L. REV. 101, 103 (1977) (necessity requirement inconsistent with "sound theory of asset valuation.").

Other commentators support the validity of the necessity requirement of the regulations. *See, e.g.,* R. STEPHENS, G. MAXFIELD & S. LIND, *supra* note 1, ¶ 5.03[3], at 5-12 n.38 (*Park* "improperly refused to follow [the] regulation[s] and . . . treated deductibility as governed by state law alone . . . . Most other courts properly hold to the contrary, requiring not only allowance by state law but also that deductible expenses be administrative expenses within the meaning of that term in the federal statute. They see the regulations as appropriate interpretation."); S. SURREY, W. WARREN, P. MCDANIEL & H. GUTMAN, FEDERAL WEALTH TRANSFER TAXATION 637 (2d ed. 1982) ("Although the [necessity requirement] . . . is not set forth in the literal language of section 2053, [it] appear[s] to place a reasonable limitation on deductible administration expenses . . . .").

Other commentators merely report the conflict without suggesting the preferred approach. *See, e.g.,* 1 H. HARRIS, HANDLING FEDERAL ESTATE & GIFT TAXES § 224, at 296 n.10 (rev. 3d ed. 1978 & Supp. 1982); D. LINK & L. SODERQUIST, LAW OF FEDERAL ESTATE AND GIFT TAXATION: CODE COMMENTARY § 2053, at 63-64 (1978); C. LOWNDES, R. KRAMER & J. MCCORD, FEDERAL ESTATE AND GIFT TAXES § 15.11, at 387 n.11 (1974); 4 J. RABKIN & M. JOHNSON, FEDERAL INCOME, GIFT AND ESTATE TAXATION § 53.02(8), at 5319-22 (1982); D. WESTFALL, ESTATE PLANNING LAW AND TAXATION § 11.03[1][e], at 11-23 to 11-24 & n.87 (1981); ABA Comm. on Post Mortem Estate and Tax Planning Probate and Trust Division, *Deduction of Administration Expenses Updated,* 16 REAL PROP., PROB. & TR. J. 382, 389-90 (1981); Hardee, *Income and Deductions of Estates,* 40 N.Y.U. INST. ON FED. TAX'N 8-1, 8-24 to 8-26 (1982); Milligan, *Permissible Estate Tax Deductions Under Section 2053—A New Look,* 40 N.Y.U. INST. ON FED. TAX'N 9-1, 9-8 to 9-9 (1982); Olson, *Recent Cases and Rulings on Estate and Gift Taxation,* 5 REV. TAX'N OF INDIVIDUALS 316, 318 (1981) ("[T]he great difference between the two positions on the validity of the regulations under Section 2053 suggests

directive.[8]

This Note discusses the state law component of section 2053(a)(2) and examines the application of the necessity requirement to two classes of commonly-incurred administration expenses: selling and interest expenses. The Note then considers the validity of the necessity requirement and concludes that the regulations are inconsistent with the statute that they purport to implement. Finally, the Note advocates a two-tiered approach under section 2053(a)(2), using a federal definition of "administration expenses" and federal court supervision of the "allowable by [state] law" component of the statute.

I

THE TWIN PILLARS OF DEDUCTIBILITY: STATE LAW ALLOWABILITY AND THE NECESSITY REQUIREMENT

A. *Section 2053(a)(2) and State Law Allowability*

Section 2053(a)(2)[9] conditions the deductibility of administration

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that tax equity requires either a clarifying decision by the Supreme Court or a statutory amendment by Congress to bring the circuits into harmony."); Schnee & Edwards, *Planning to Improve an Estate's Chances of Justifying Administration Expense Deductions,* 28 TAX'N FOR ACCT 96, 96, 100 (1982) ("We have not seen the last of the litigation concerning the validity of the [necessity requirement] . . . . Eventually, the Supreme Court may have to consider the issue."); Spragens, *Current Appellate Cases Create Conflict in Deductibility of Selling Costs as Administration Expenses Under Sec. 2053(a)(2),* 54 TAXES 429, 436 (1976) ("[G]iven the present state of affairs, . . . further estate tax controversy on administration expense deductibility is necessarily encouraged."); Wallace, *Current Problems in Postmortem Tax Planning,* 3 NOTRE DAME EST. PLAN. INST. 657, 712 (1979) ("The parameters of the necessity requirement will undoubtedly continue to pose problems for executors in those jurisdictions where that requirement is still considered a condition precedent to the estate tax deduction under section 2053 until the requirement is either abandoned or more meaningful guidelines for differentiating between necessary and unnecessary administration expenses are forthcoming."); Wyatt, *Problems of the Fiduciary in Deducting Administration Expenses,* 14 U. MIAMI INST. ON EST. PLAN. 13-1, 13-9 (1980) ("This area must be considered a prime one for litigation until the Supreme Court or Congress resolves the issue. . . ."); Note, *Second Circuit 1974 Term—Estate Taxation: Interplay of Federal and State Law in Determining Deductibility of Administration Expenses*—Estate of Smith v. Commissioner, 50 ST. JOHN'S L. REV. 357, 365-66 (1975); Recent Development, *Estate Tax Deductibility of Underwriters' Expenses After an Executor's Sale of Stock: A Loophole in Section 2053,* 32 VAND. L. REV. 1003, 1010 (1979).

[8] The Service supports the validity of "the [necessity requirement] of Treas. Reg. § 20.2053-3(a) [as] separate from the requirement of allowability under local law." G.C.M. 37885 (1979).

[9] I.R.C. § 2053(a) (1976) provides:

> (a) GENERAL RULE.—For purposes of the tax imposed by section 2001, the value of the taxable estate shall be determined by deducting from the value of the gross estate such amounts—
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> (1) for funeral expenses,
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> (2) for administration expenses,
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> (3) for claims against the estate, and
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> (4) for unpaid mortgages on, or any indebtedness in respect of, property where the value of the decedent's interest therein, undiminished by

expenses[10] on whether the expenses are allowable[11] under state probate law.[12] Most states impose a necessity test for determining whether administration expenses are permissible in probating an estate.[13] Other

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> such mortgage or indebtedness, is included in the value of the gross estate,
>
> as are allowable by the laws of the jurisdiction, whether within or without the United States, under which the estate is being administered.

10 A preliminary issue is the meaning to be given the term "administration expenses." This involves a determination under federal law. *See infra* notes 104-13, 147-52 and accompanying text.

11 The term "allowed" appeared in § 812(b) of the Internal Revenue Code of 1939, 53 Stat. 123 (1939), and all prior versions of current I.R.C. § 2053 (1976). In Pitner v. United States, 388 F.2d 651, 655 (5th Cir. 1967), the Fifth Circuit noted that the change to the term "allowable" implies "that the policy of the Code is not to rely upon formal probated actions in determining permissible deductions." *See also* 4 J. MERTENS, THE LAW OF FEDERAL GIFT AND ESTATE TAXATION § 26.02, at 7 n.7 (1959). The term "allowed," however, had been interpreted as not requiring local court approval for deductibility:

> The use of the term "allowed" in section 812(b)(3) [now 2053(a)(3)] is not to be construed as meaning that unless a claim against the estate has been allowed by the state court no deduction therefor will be permitted. Deductibility is not conditioned on a claim's allowance by a local court, but rather upon its enforceability under local law.

Smyth v. Erickson, 221 F.2d 1, 3 (9th Cir. 1955); *see also* Comment, *Estate and Income Tax: Claims Against the Estate and Events Subsequent to Date of Death,* 22 U.C.L.A. L. REV. 654, 669 & n.84 (1975).

12 Although this Note focuses on probate court allowance of administration expenses under state law, § 2053(a) also encompasses "countries where administration of estates is had otherwise than through courts, if any such countries exist." Commissioner v. Bronson, 32 F.2d 112, 114 (8th Cir. 1929) (emphasis omitted), *quoted in* Pitner v. United States, 388 F.2d 651, 655 (5th Cir. 1967).

13 *See* Estate of Smith v. Commissioner, 510 F.2d 479, 482 (2d Cir.), *cert. denied,* 423 U.S. 827 (1975) ("[M]ost state laws concerning executors and administrators . . . require an administrative expense to be 'necessary' in order to be allowable."). Some state statutes impose a necessity requirement on the allowance of a representative's administration expenses. *See, e.g.,* OKLA. STAT. ANN. tit. 58, § 525 (West 1965) (representative allowed "all necessary expenses in the care, management and settlement of the estate."). Courts in other states have grafted a necessity requirement onto general statutes allowing the administration expenses of an estate's representative. *See, e.g.,* McMahon v. Krapf, 323 Mass. 118, 123, 80 N.E.2d 314, 317-18 (1948) (construing the predecessor of MASS. ANN. LAWS ch. 206, § 16 (Michie/Law. Coop. 1981)); *see also* 2 G. NEWHALL, SETTLEMENT OF ESTATES AND FIDUCIARY LAW IN MASSACHUSETTS § 278, at 206 n.24 (4th ed. 1958).

Other state statutes are modeled after the Uniform Probate Code formulation of the propriety and priority of estate payments, which permits the personal representative to pay the "costs and expenses of administration." Unif. Prob. Code § 3-805(a)(1) (1977). Courts in many of these states have imposed a necessity requirement in connection with this general statutory standard. *See, e.g., In re* Estate of Sharp, 18 Cal. App. 3d 565, 580-81, 95 Cal. Rptr. 816, 829 (1971) (expenses must be "necessary and proper"; construing CAL. PROB. CODE § 950 (West 1981)); Puhrman v. Ver Vynck, 99 Ill. App. 3d 1130, 1133-34, 426 N.E.2d 921, 924 (1981) (expenses must be "reasonably necessary"; construing ILL. ANN. STAT. ch. 110 1/2, § 18-10 (Smith-Hurd 1978)); *cf. In re* Estate of Fraysher, 47 Cal. 2d 131, 136, 301 P.2d 848, 851 (1956) (expenses must be reasonable and necessary); Unif. Prob. Code § 3-720 (1977) (representative allowed "necessary expenses" in defending or prosecuting in good faith any action involving the estate).

Some states also impose a necessity requirement in analogous contexts. *See, e.g.,* CAL. REV. & TAX CODE § 13988 (West 1970 & Supp. 1982) ("ordinary" administration expenses deductible under state inheritance tax; under CAL. ADMIN. CODE tit. 18, R. 13988.6 (1982),

jurisdictions condition the allowance of administration expenses upon a finding of reasonableness or good faith.[14] In the interest of expediting their probate process, however, many states that purportedly require necessity in practice apply a lesser standard of reasonableness or good faith.[15]

Federal courts determining the deductibility of expenses under section 2053(a)(2) face the question of state law allowability in two scenarios.[16] First, there may be no state probate court determination on the permissibility of an expense when the federal tax issue arises.[17] Second, when a state court has approved an administration expense, the Service still may choose to challenge the court's application of state law.[18] The federal courts disagree on what constitutes the proper degree of federal supervision over a state court's application of state probate law.

Some federal courts insist that a state probate court's approval of an administration expense must control for section 2053(a)(2) purposes.[19] This approach, however, violates the Supreme Court's decision

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selling expenses not deductible unless "sale is necessary to raise funds to pay taxes, debts, or costs of administration, or the property is taken in a condemnation proceeding"); ILL. ANN. STAT. ch. 110 1/2, § 19-1(a) (Smith-Hurd 1978) (representative only may sell estate property if "necessary for the payment of claims, expenses of administration, estate or inheritance taxes or the proper administration of the estate"); *cf.* N.Y. Surr. Ct. Act ch. 928, § 222, 1920 N.Y. LAWS 631 (representative may pay "from time to time, as shall be necessary, his legal and proper expenses of administration necessarily incurred by him") (repealed by N.Y. EST., POWERS & TRUSTS LAW § 11-1.1(b)(22) (McKinney Supp. 1981)).

14 *See, e.g.,* N.Y. EST., POWERS & TRUSTS LAW § 11-1.1(b)(22) (McKinney Supp. 1981) (representative authorized to pay "reasonable and proper expenses of administration").

15 For example, although New York previously provided by statute that administration expenses were allowable if necessary, *see supra* note 13, New York courts in applying that standard had sanctioned administration expenses that met a lower standard of reasonableness or good faith. *See, e.g., In re* Estate of Hart, 32 A.D.2d 961, 961, 303 N.Y.S.2d 82, 83-84 (1969), *aff'd,* 27 N.Y.2d 560, 261 N.E.2d 268, 313 N.Y.S.2d 138 (1970) (good faith); *In re* Estate of Morawetz, 35 Misc. 2d 762, 765, 768, 231 N.Y.S.2d 1000, 1005, 1007 (1962) (reasonableness).

16 The parties to an administration expense deduction controversy, of course, may concede an expense's allowability under state law. Application of the necessity requirement in these cases hinges on the federal court initially upholding the validity of the regulations. *See, e.g.,* Estate of Park v. Commissioner, 475 F.2d 673, 676 (6th Cir. 1973); Marcus v. Dewitt, 81-2 U.S. Tax Cas. (CCH) ¶ 13,431, at 88,796-97 (M.D. Fla. 1981).

17 *See, e.g.,* Pitner v. United States, 388 F.2d 651, 652 (5th Cir. 1967); Ballance v. United States, 347 F.2d 419, 420-21, 423 (7th Cir. 1965); Ferguson v. United States, 48 A.F.T.R.2d (P-H) ¶ 148,472, at 81-6253 (D. Ariz. 1981); Maehling v. United States, 67-2 U.S. Tax Cas. (CCH) ¶ 12,486, at 85,617-18 (S.D. Ind. 1967); Estate of Posen v. Commissioner, 75 T.C. 355, 359 (1980).

18 *See, e.g.,* Hibernia Bank v. United States, 581 F.2d 741, 743 (9th Cir. 1978); Estate of Jenner v. Commissioner, 577 F.2d 1100, 1102 (7th Cir. 1977); Bank of Nev. v. United States, 80-2 U.S. Tax Cas. (CCH) ¶ 13,361, at 85,817 (D. Nev. 1980); Estate of Smith v. Commissioner, 57 T.C. 650, 660-61 (1972), *aff'd,* 510 F.2d 479 (2d Cir.), *cert. denied,* 423 U.S. 827 (1975).

19 *See* Estate of Park v. Commissioner, 475 F.2d 673, 676 (6th Cir. 1973) ("[The administration expenses] were paid out of probate assets and they were approved in two different

in *Commissioner v. Estate of Bosch*,[20] which describes the respective roles of state and federal courts in deciding issues of state law incident to a federal tax controversy.[21] The Court in *Bosch*[22] held that "where the federal estate tax liability turns upon . . . state law, federal [courts] are not bound by the determination made . . . by a state trial court."[23] Accordingly, if a federal court decides that a probate judge[24] erred in allowing an administration expense under state law, the court may disallow the deduction under section 2053(a)(2) after giving "proper regard"[25] to the

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accountings filed with the probate court. Hence they are deductible under § 2053(a)[(2)]."); Ballance v. United States, 347 F.2d 419, 423 (7th Cir. 1965); Scott v. Commissioner, 69 F.2d 444, 445 (8th Cir. 1934); *see also* Estate of Posen v. Commissioner, 75 T.C. 355, 369-70 (1980) (Goffe, J., dissenting); Estate of Smith v. Commissioner, 57 T.C. 650, 665 (1972) (Goffe, J., concurring in part, dissenting in part), *aff'd*, 510 F.2d 479, 484 (2d Cir.) (Mulligan, J., dissenting) ("The laws of the state are interpreted and administered by the courts of the state and not by the [Federal courts]."), *cert. denied*, 423 U.S. 827 (1975). Some commentators support this position. *See, e.g.*, Chaffin, *Estate Planning and Taxation: Current Estate and Gift Tax Developments*, 10 GA. ST. B.J. 427, 441-42 (1974); Note, *supra* note 7, 52 N.C.L. REV. at 196-97.

20 387 U.S. 456 (1967).

21 *See, e.g.*, Estate of Smith v. Commissioner, 510 F.2d 479, 482-83 (2d Cir.), *cert. denied*, 423 U.S. 827 (1975); Estate of Posen v. Commissioner, 75 T.C. 355, 359 (1980).

22 In *Bosch*, the decedent had created a revocable inter vivos trust. The trust gave the decedent's wife a life estate in the trust income and a general power of appointment over the corpus of the trust. The wife released the general power of appointment prior to the decedent's death. 387 U.S. at 457-58. The release, if valid, would have excluded the proceeds of the trust from the marital deduction under I.R.C. § 2056(b)(5). Both the Tax Court and the Second Circuit considered themselves bound by the state court decree invalidating the release under state law. 43 T.C. 120, 122-24 (1964), *aff'd*, 363 F.2d 1009, 1013-15 (2d Cir. 1966). The Supreme Court reversed. 387 U.S. at 462-66.

23 387 U.S. at 457. Prior to *Bosch*, the Court required that a state trial court's determination of state law control for federal tax purposes unless there was evidence of collusion. *See* Frueler v. Helvering, 291 U.S. 35, 45 (1934); *see also* Blair v. Commissioner, 300 U.S. 5 (1937). The federal courts in that period struggled to define collusion. The Third Circuit embraced the minority view and defined collusion as actual fraud or deceit. *See, e.g.*, Estate of Darlington v. Commissioner, 302 F.2d 693 (3d Cir. 1962); Gallagher v. Smith, 223 F.2d 218 (3d Cir. 1955). Under the majority rule, however, federal courts afforded conclusive effect to state trial court judgments only if the proceeding were truly adversarial. *See, e.g.*, Estate of Pierpont v. Commissioner, 336 F.2d 277 (4th Cir. 1964), *cert. denied*, 380 U.S. 908 (1965); Faulkerson v. United States, 301 F.2d 231 (7th Cir.), *cert. denied*, 371 U.S. 887 (1962). *See generally* C. LOWNDES, R. KRAMER & J. MCCORD, *supra* note 7, § 4.18, at 61-62. For criticism of the pre-*Bosch* approach, see Braverman & Gerson, *The Conclusiveness of State Court Decrees in Federal Tax Litigation*, 17 TAX. L. REV. 545 (1962); Richter, *Effect of State Court Interpretation of Wills*, 24 N.Y.U. INST. ON FED. TAX'N 257 (1966); Sacks, *The Binding Effect of Nontax Litigation in State Courts*, 21 N.Y.U. INST. ON FED. TAX'N 277 (1963); Teschner, *State Court Decisions, Federal Taxation, and the Commissioner's Wonderland: The Need for Preliminary Characterization*, 41 TAXES 98 (1963).

24 Federal courts, however, are bound by the decision of the highest court in the state. *Estate of Bosch*, 387 U.S. at 462; *see also* State St. Bank & Trust v. United States, 634 F.2d 5, 9 n.4 (1st Cir. 1980) ("In matters of federal taxation dependent upon state law principles, federal courts are bound by decisions of the highest state court.") (citing *Bosch*); Sun First Nat'l Bank of Orlando v. United States, 607 F.2d 1347, 1354 (Ct. Cl. 1979); 1 H. HARRIS, *supra* note 7, § 7, at 8-10; *id.* § 215, at 284-85. Federal courts seldom will face a situation in which state allowability determinations are binding because such decisions typically issue from lower state courts.

25 *Bosch*, 387 U.S. at 465. Treas. Reg. § 20.2053-1(b)(2) (1958), promulgated prior to

state court decision.[26]

Bosch, furnishes criteria for when the Service will accept a decision by a state trial court for federal tax purposes:

> The decision of a local court as to the amount and allowability under local law of a[n] . . . administration expense *will ordinarily be accepted* if the court passes upon the facts upon which deductibility depends. If the court does not pass upon those facts, its decree will, of course, not be followed . . . . [T]he decree will not necessarily be accepted even though it purports to decide the facts upon which deductibility depends. It must appear that the court actually passed upon the merits of the claim[ed administration expense] . . . . The decree will not be accepted if it is at variance with the law of the State . . . . On the other hand, a deduction for the amount of a . . . reasonable expense of administration, will not be denied because no court decree has been entered if the amount would be allowable under local law.

Id. (emphasis added). The "ordinarily be accepted" standard of the regulations would appear to require that federal courts reviewing a redetermination of a state probate court's application of state law by the Service accord greater deference to the state court decision than the *Bosch* "proper regard" formulations would demand. *But see* Milligan, *supra* note 7, at 9-5 (arguing that "[t]he language of [*Bosch*] . . . appears more restrictive than the regulations."). Neither the federal courts nor the Service have ruled on whether fidelity to the more restrictive approach in the regulations is required in light of the *Bosch* "proper regard" standard.

26 Some courts and commentators argue that the *Bosch* formulation is inapplicable to determinations of state law under § 2053(a). *Bosch* involved an application of the marital deduction. I.R.C. § 2056(a). These critics rely on the Court's pronouncement in *Bosch* that:

> We cannot say that the authors of [section 2056(a)] intended that the decrees of state trial courts were to be conclusive and binding on the computation of the federal estate tax as levied by the Congress. *If the Congress had intended state trial court determinations to have that effect on the federal actions, it certainly would have said so—which it did not do.*

387 U.S. at 464 (emphasis added). The critics distinguish § 2053 from § 2056, contending that § 2053 expressly grants jurisdiction to the state courts and renders the state court decision binding for estate tax purposes. *See, e.g.,* Estate of Smith v. Commissioner, 510 F.2d 479, 484 n.1 (2d Cir.) (Mulligan, J., dissenting) (observing that in *Bosch* there "was no act of Congress . . . ceding jurisdiction to the state [courts] . . . ."), *cert. denied,* 423 U.S. 827 (1975); Comment, *supra* note 7, at 377 (*Bosch* inapplicable because § 2053(a) "itself specifically makes its operation dependent upon state law."); Note, *supra* note 7, 30 VAND. L. REV. at 803-04 ("[R]eliance [on *Bosch*] is misplaced. . . . [T]he Court in *Bosch* was considering the marital deduction under section 2056. In contrast, section 2053(a) *does* proclaim that state court determinations are conclusive. . . ."") (emphasis in original).

The critics improperly limit the *Bosch* decision to § 2056(a). *Bosch* expressly held that when federal tax questions depend on the application of state law, federal courts must determine that state law is applied correctly. *See supra* note 23 and accompanying text. Treas. Reg. § 20.2053-1(b)(2) (1958) supports this position: "The decree [of a lower state court] will not be accepted [for federal tax purposes] if it is at variance with the law of the State. . . ." The applicability of the *Bosch* standard to § 2053(a) determinations of state law, therefore, requires that federal courts examine the probate court decree under state law. *See, e.g.,* Estate of Jenner v. Commissioner, 577 F.2d 1100, 1106-07 (7th Cir. 1978); Kasishke v. United States, 426 F.2d 429, 435 (10th Cir. 1970); Underwood v. United States, 407 F.2d 608, 610 (6th Cir. 1969); R. STEPHENS, G. MAXFIELD & S. LIND, *supra* note 1, ¶ 5.03[1], at 5-7; Note, *supra* note 7, 50 ST. JOHN'S L. REV. at 360-61 & n.19.

Even if the applicability of *Bosch* to § 2053(a) is conceded, the standard itself and the Court's reliance on Erie R.R. v. Tompkins, 304 U.S. 64 (1938), may still be criticized. *See, e.g.,* Browne & Hinkle, *Tax Effects of Non-Tax Litigation:* Bosch *and Beyond,* 27 N.Y.U. INST. ON FED. TAX'N 1415 (1969); Scharf, *State Law in the Tax Court—Controlling Precedents,* 26 TAX LAW. 293 (1972); Wissbrun, Bosch *and its Aftermath, The Effect of State Court Decisions on Federal Tax Questions,* 114 TRUST & ESTATES 8 (1975); Wolfman, Bosch, *Its Implications and Aftermath: The*

Once a federal court finds that certain expenses are not allowable under state law, federal deductibility must be denied.[27] If the expenses are allowable, however, the inquiry shifts to the application and validity[28] of the necessity requirement of the regulations.

B. *Treasury Regulation Section 20.2053-3: "Necessary" Expenses*

The regulations under section 2053(a) graft a second requirement onto the statutory definition of deductible administration expenses. Under this formulation, the expense not only must be allowable under state law, but also must comply with a necessity test:

> The amounts deductible from a decedent's gross estate as "administration expenses" . . . are limited to such expenses as are *actually and necessarily incurred* in the administration of a decedent's estate; that is, in the collection of assets, payment of debts, and distribution of property to the persons entitled to it.[29]

Many courts struggle over the validity of the regulations in light of the statutory directive that state law[30] governs deductibility.[31] Those courts that sustain the necessity requirement inconsistently apply the regulations to two types of commonly-incurred administration expenses: selling and interest expenses.[32]

Effect of State Court Adjudications on Federal Tax Litigation, 3 U. MIAMI INST. ON EST. PLAN. 2-1 (1969); Comment, *State Court Determinations in Tax Litigation: A New Era*, 41 S. CAL. L. REV. 197 (1967); *see infra* notes 153-56 and accompanying text for further discussion of the *Bosch* standard.

27 I.R.C. § 2053(a)(2) (1976).

28 The court's inquiry ends, of course, if it determines that the necessity requirement of the regulations is invalid. *See* Estate of Park v. Commissioner, 475 F.2d 673, 676-77 (6th Cir. 1973). Some courts assume arguendo that the necessity requirement is valid and proceed to determine whether the expense in question satisfies the regulations. *See, e.g.*, Estate of Reilly v. Commissioner, 76 T.C. 369, 372 & n.4 (1981).

29 Treas. Reg. § 20.2053-3(a) (1958) (emphasis added). The regulation further states that:

> The expenses contemplated in the law are such only as attend the settlement of an estate and the transfer of the property of the estate to individual beneficiaries or to a trustee, whether the trustee is the executor or some other person. Expenditures not essential to the proper settlement of the estate, but incurred for the individual benefit of the heirs, legatees, or devisees, may not be taken as deductions. Administration expenses include (1) executor's commissions; (2) attorney's fees; and (3) miscellaneous expenses.

Id.; see also id. § 20.2053-3(d)(1) ("Expenses *necessarily incurred* in preserving and distributing the estate are deductible [as administration expenses]. . . .") (emphasis added).

30 For a discussion of the role of federal law in giving content to the term "administration expenses" used in § 2053(a)(2), see *infra* notes 104-13, 147-52, and accompanying text.

31 *See infra* notes 88-98 and accompanying text.

32 Although consistent application of a regulation is not a benchmark in determining its validity, uneven application of the regulations provides grounds for criticism of the necessity requirement. *See infra* notes 33-36, 67-73, and accompanying text.

1. *Selling Expenses*

An executor faced with a shortage of liquid assets to meet an estate's obligations is authorized in most states to sell property of the estate to raise the needed funds.[33] For an estate to deduct the expenses incurred in such a sale from the federal gross estate tax, the regulations demand more than compliance with state law under section 2053(a)(2). The sale must meet a necessity test as well: "Expenses for selling property of the estate are deductible if the sale is *necessary* in order to pay the decedent's debts, expenses of administration, or taxes, to preserve the estate, or to effect distribution."[34] Although the tax consequences will influence the selling decision, the courts applying the necessity requirement have not provided the executor with "meaningful guidelines"[35] to determine whether the resulting expenses will be deductible.[36]

Some courts strictly apply the necessity requirement in order to deny a deduction for selling expenses.[37] In *Estate of Smith v. Commissioner,*[38] a sculptor left 425 pieces of "nonrepresentational metal sculptures" as the principal asset of his estate.[39] The executors, faced with a

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33 *See, e.g.,* N.Y. EST. POWERS & TRUSTS LAW § 11-1.1(b)(5)(B) (McKinney 1967 & Supp. 1981).

34 Treas. Reg. § 20.2053-3(d)(2) (1958) (emphasis added). According to the regulation, "expenses for selling property" include "brokerage fees and other expenses attending the sale, such as the fees of an auctioneer if it is *reasonably necessary* to employ one." *Id.* (emphasis added). The regulation further requires that:

> Where an item included in the gross estate is disposed of in a bona fide sale (including a redemption) to a dealer in such items at a price below its fair market value, for purposes of this paragraph there shall be treated as an expense for selling the item whichever of the following amounts is the lesser: (i) The amount by which the fair market value of the property on the applicable valuation date exceeds the proceeds of the sale, or (ii) the amount by which the fair market value of the property on the date of the sale exceeds the proceeds of the sale. The principles used in determining the value at which an item of property is included in the gross estate shall be followed in arriving at the fair market value of the property for purposes of this paragraph.

Id. Treas. Reg. § 20.2053-3(d)(1) (1958) provides that:

> Miscellaneous administration expenses include such expenses as court costs, surrogates' fees, accountants' fees, appraisers' fees, clerk hire, etc. Expenses necessarily incurred in preserving and distributing the estate are deductible, including the cost of storing or maintaining the property of the estate, if it is impossible to effect immediate distribution to the beneficiaries. Expenses for preserving and caring for the property may not include outlays for additions or improvements; nor will such expenses be allowed for a longer period than the executor is reasonably required to retain the property.

35 Wallace, *supra* note 7, at 718.

36 For a discussion of the adverse effects of this uncertainty on the efficient administration of estates, see *infra* notes 140-44 and accompanying text.

37 *See, e.g.,* Estate of Posen v. Commissioner, 75 T.C. 355 (1980); Estate of Park v. Commissioner, 57 T.C. 705 (1972), *rev'd on other grounds,* 475 F.2d 673 (6th Cir. 1973); Estate of Smith v. Commissioner, 57 T.C. 650 (1972), *aff'd,* 510 F.2d 479 (2d Cir.), *cert. denied,* 423 U.S. 827 (1975).

38 57 T.C. 650 (1972), *aff'd,* 510 F.2d 479 (2d Cir.), *cert. denied,* 423 U.S. 827 (1975).

39 57 T.C. at 651. The estate also contained over $210,000 in liquid assets. *Id.* at 654.

potential estate tax liability that they could not determine with certainty,[40] decided to sell the sculptures. Because the market for the sculptures was highly speculative and volatile, the executors gradually liquidated them in order to obtain a higher price than would have been possible if all of the pieces had been sold at once.[41] The executors contended that the commissions were incurred in sales necessary to meet the decedent's anticipated tax liability.[42] Both the Second Circuit and the Tax Court held that the commissions were deductible only for those sales needed to pay the decedent's debts, expenses of administration, and taxes as finally determined;[43] commissions paid on sales generating revenues in excess of this amount violated the necessity requirement.[44]

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40 The extent of tax liability hinged on the value of the sculptures. Because of the abstract nature of the works and uncertainties in the market for the pieces, valuations ranged from $700,000 to $4.2 million. *Id.* at 654-55. The Tax Court settled on a value of $2.7 million. *Id.* at 651. This valuation was not challenged on appeal. 510 F.2d at 480.

41 The decedent enjoyed limited, but increasing, commercial success during his lifetime; sales of his works had increased from an average value of $630 to over $20,000. 57 T.C. at 651-52.

42 The executors feared that a public sale of the sculptures would reveal that a number of pieces were available and would cause a significant decline in their value. The executors thus "held back" certain works for future sales in order to sustain interest in the decedent's sculptures. The executors argued that this pattern of selling, although it resulted in greater commissions, was necessary to maximize the return on sales. *Id.* at 653.

43 510 F.2d at 483; 57 T.C. at 662. The estate was required to pay $790,000 for various administration expenses, debts of the decedent, and taxes. Initial sales of the sculptures brought in over $870,000 (incurring commission expenses of $290,000), and in combination with the $210,000 in other liquid assets of the estate was enough to satisfy the estate's obligations. 57 T.C. at 654. The Surrogate Court, applying New York law, allowed as administration expenses commissions incurred by the estate in other sales totalling $1.6 million. Had the Commissioner's original valuation prevailed, the estate would have been liable for $2.4 million in additional federal estate taxes, and $570,000 in additional New York estate taxes. 510 F.2d at 480. The Second Circuit limited the amount of deductible sales commissions to $750,000. This amount represented the commissions incurred to raise the amount needed to pay the appropriate taxes on the estate valued at $2.7 million. *Id.* at 480-81.

The decision places the executor in a precarious position. As the case illustrates, it may take 10 years or more for valuation questions to be settled. During this period, the executor is unable to distribute the sculptures in kind to the beneficiaries because he is uncertain to what extent they will be needed to satisfy the estate's liabilities. Yet, the executor should not hold the pieces for ten years until the estate's liabilities are certain, if a process of gradual liquidation is necessary to combat the vagaries of a speculative and volatile market. The court, in effect, places an impossible burden upon the executor of ealculating precisely the estate's future tax liability. In dissent, Judge Mulligan criticized the majority's strict application of the necessity requirement in light of these problems:

> Faced with an estate [constituting abstract non-representational sculptures] and recognizing the *necessity* of liquidation to satisfy estate taxes which could not be determined with any degree of certainty in view of the unpredictable and volatile nature of artistic tastes and fashions, the fiduciaries liquidated some of the sculpture in the estate. The determination below that they were improvident in disposing of the sculptures . . . is made only with the infallible acuity of hindsight.

Id. at 485 (Mulligan, J., dissenting) (emphasis added).

44 The court held that the commissions on sales exceeding the amount necessary to pay the final debts of the estate violated the state allowance provision, which the court deemed

The Tax Court recently embraced a strict approach in applying the necessity requirement in *Estate of Posen v. Commissioner.*[45] In *Posen,* the decedent died intestate, leaving an estate comprised of a cooperative apartment[46] and other assets worth $170,000.[47] The estate needed approximately $10,000 to pay expenses and taxes.[48] Rather than withdraw money prematurely from time deposits and incur a penalty,[49] the administratrix sold the apartment to generate the needed funds.[50]

The court held that the selling expenses incurred were not deductible under section 2053(a)(2) because the sale failed the necessity test[51]

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coterminous with the necessity requirement in the federal regulations. 510 F.2d at 482. At the time of the *Smith* case, New York law provided for the allowance of necessary administration expenses. N.Y. Sur. Ct. Act, ch. 928, § 222, 1920 N.Y. LAWS 631. The New York courts applying this standard, however, only required that the executor act reasonably and in good faith. *See supra* note 15. Subsequent to *Smith,* New York replaced the necessity standard with a statutory reasonableness test that was in accord with the prior decisions. N.Y. EST. POWERS & TRUSTS LAW § 11-1.1(b)(22) (McKinney Supp. 1981). Because the Tax Court earlier had recognized that an administration expense could be allowable under the New York necessity test without meeting the regulations' necessity requirement, Estate of Sternberger v. Commissioner, 18 T.C. 836, 842-43 (1952), *acq. and nonacq.,* 1953-1 C.B. 6, 7, *aff'd per curiam,* 207 F.2d 600 (2d Cir. 1953), *rev'd on other grounds,* 348 U.S. 187 (1955), the federal necessity requirement, and not the state allowance test, probably compelled the result in *Smith.* The *Smith* court, in holding that the two requirements were coterminous, misapplied the state law. *See Smith,* 57 T.C. at 665 (Goffe, J., concurring in part, dissenting in part). The Surrogate Court's allowance of the full amount of sales commissions thus represented a proper application of New York law. Although the Second Circuit was free to reexamine the Surrogate Court's decision, it should not have denied deductibility of the expenses because the allowance was consistent with state law. *See infra* notes 153-63 and accompanying text.

45 75 T.C. 355 (1980). Because the case arose in the Second Circuit, which had not passed on the validity of the regulations, *see supra* note 6, the Tax Court in *Posen* was free to determine independently the validity of the necessity requirement. 75 T.C. at 360. For a general discussion of *Posen,* see Olson, *supra* note 7.

46 The apartment did not produce income and required a monthly maintenance fee of $670. 75 T.C. 356.

47 The assets comprised $164,000 in various bank accounts, $750 in stocks and bonds, and $6,000 in miscellaneous property. *Id.* at 356. Over $160,000 in the bank accounts were in time deposits earning interest at a minimum rate of 6.5%. *Id.* at 356-57.

48 At the date of death, the decedent had no debts. The administratrix disbursed $19,000, exclusive of federal estate tax payments and expenses incurred in maintaining and selling the apartment. The estate had to make a $30,000 payment for federal estate taxes on Oct. 23, 1975, to obtain an extension of time for filing a completed estate tax return which otherwise would have been due on Oct. 27, 1975. *Id.* at 357-58.

49 The penalty for early withdrawal of principal for each of the accounts maturing in 1975 was the forfeiture of three months' interest and a reduction in the rate of interest to 5.5%. *Id.* at 357 n.4.

50 The estate incurred $7,500 of expenses in the sale. *Id.* at 358.

51 Contrary to the court's holding in Estate of Smith v. Commissioner, 57 T.C. 650 (1972), *aff'd,* 510 F.2d 479 (2d Cir.), *cert. denied,* 423 U.S. 827 (1975), the *Posen* court held that the expenses were allowable under New York state law. 75 T.C. at 360. The *Posen* court's decision on state law was premised on revisions in the New York statute which formally changed the criterion from necessity to reasonableness. *See supra* note 44. *But see* N.Y. Est. Powers & Trusts Law § 11-1.1(b)(23) revisers' note 4 (McKinney 1967) (current version at § 11-1.1(b)(22) (McKinney Supp. 1981)) (implying that current New York state statute incorporates the necessity requirement); Note, *supra* note 7, 50 ST. JOHN'S L. REV. at 362 n.23 (same).

of the regulations.[52] First, the court found that the payment of estate taxes did not dictate the sale of the apartment,[53] because the penalty for premature withdrawal of the time deposit funds would have been less than the selling expenses incurred.[54] The court also held that the sale of property was not necessary to effect distribution of the estate because no

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52 The majority expressly upheld the validity of the necessity requirement of the regulations. 75 T.C. at 365-68. Judge Goffe argued in dissent that the regulations were invalid. *Id.* at 368-70. Judge Wilbur presented two arguments in a dissenting opinion joined by Judges Dawson, Hall, and Goffe. He stated that the necessity requirement violated the statutory language of § 2053(a)(2). *Id.* at 370-71. He then argued that even if the regulations were proper, the expenses in *Posen* met the necessity requirement. *Id.* at 371-73. Judge Chabot agreed with the majority that the regulations were valid, but endorsed the position of Judge Wilbur that the selling expenses satisfied the necessity requirement and were deductible under § 2053(a)(2). *Id.* at 373-74.

In holding that the sale was not neeessary to pay taxes, to effect distribution, or to preserve the estate, the majority noted that

> the issue of whether selling expenses pass muster under [the] regulations lies in the recognition that a balancing of several reasons for a particular sale may be required and that such balancing may be infiuenced by variations in factual situations of each case. . . .
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> . . . .
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> . . . [There is a] need for flexibility and the avoidance of mechanical counting of liquid assets in determining whether a particular expense meets the requirements of [the] regulations.

Id. at 364-65.

53 The court instead found that the administratrix sold the apartment because, as sole heir at law, she did not want the apartment distributed to herself. The court made three observations: (1) the building was unsuited to her lifestyle; (2) she could not afford the maintenance fee; and (3) she considered holding the apartment as too risky of an investment. *Id.* at 356, 361-62.

Judge Wilbur argued in dissent that although "the sale also benefited the sole heir [,this] should not defeat the deductibility of the selling expenses. A necessary administration expense often produces dual benefits to both the estate and the beneficiaries." *Id.* at 371-72 (Wilbur, J., dissenting). Judge Wilbur stated that executors should be permitted to take an heir's wishes into consideration when making the selling decision:

> [T]he implication of the majority's rcasoning [is] disturbing. Suppose a man dies intestate owning primarily two assets: a rare coin collection and his residence. The rare coin collection has a recognized fair market value, is easily marketable, and will involve minimal selling costs, whereas the sale of the house will involve several thousand dollars in brokerage fees. The sole heir has absolutely no desire for the house, but would very much like to keep the coin collection for a special remembrance of his father's life-long efforts. When the executor needs cash to pay the estate's creditors, the son requests him to sell the house. Under the majority's reasoning, if the executor complies with the request, no deduction should be allowed for the selling expenses because the sale was based on the "personal predilections" of the heir rather than being necessarily incurred for the benefit of the estate—the coin collection could have been disposed of much more cheaply. Even a sacrifice sale of the collection might be required if the sacrifice involved—in the words of the majority—"only a few hundred dollars."

Id. at 373 n.4.

54 The court stated that the penalty would have cost the estate only "a few hundred dollars," in contrast to the $7,000 of expenses incurred in the sale of the apartment. *Id.* at 362 & n.11. Judge Goffe criticized the court for requiring the executor "to justify in dollars and cents why he sold one asset instead of another in order to deduct the expenses of sale." *Id.* at 369 (Goffe, J., dissenting). Judge Wilbur agreed:

testamentary direction precluded distribution of the apartment in kind.[55] Finally, the court concluded that the sale was not necessary to preserve the estate because the administratrix could have avoided the maintenance cost of the apartment and resulting financial drain by promptly distributing the property.[56]

Other courts, however, apply a more malleable necessity analysis to executors' decisions to sell property of the estate. For example, in *Estate of Jenner v. Commissioner,*[57] the Seventh Circuit did not require the executor to prove that the entire underwriting fee incurred in the registration and sale of 300,000 shares of stock was strictly necessary to pay the estate's claims, taxes, and administration expenses. The court held that the sale of some shares was necessary,[58] and that once the executor established the need to employ an underwriter,[59] the full underwriter's fee[60] was deductible as an administration expense under section 2053(a)(2).[61]

The case law under section 2053(a)(2) thus indicates that the de-

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> This Monday-morning quarterbacking is an unwarranted intrusion into the discretionary powers of a fiduciary administering an estate.
>
> The crucial factor is that there was not enough readily available cash on hand to pay the expenses and taxes *of the estate.* Something had to be liquidated. The choice was between withdrawing principal prematurely from time deposits and forfeiting interest already accrued or selling an unwanted non-income-producing asset, requiring large maintenance payments. Petitioner, as administratrix of the estate, chose to sell the apartment, and the proceeds of the sale were used to pay estate taxes. Clearly, then, the sale was necessarily incurred in administering the estate.

Id. at 371 (Wilbur, J., dissenting) (footnote omitted) (emphasis in original).

55 *Id.* at 362-63 (citing N.Y. EST. POWERS & TRUSTS LAW § 11.1-1(b)(21) (McKinney 1967) (authorizing fiduciary to make distributions in kind)).

56 75 T.C. at 363-64.

57 577 F.2d 1100 (7th Cir. 1978).

58 The estate was faced with over $10 million in claims, taxes, and administration expenses, and another $3.6 million under the Service's deficiency assessment. *Id.* at 1105. The estate held over 300,000 shares of common stock of Baker, Fentress & Co., and possessed only $2.8 million in other marketable stocks and cash. *Id.* at 1101-02, 1105. The executor concluded that it would be necessary to raise an additional $5.8 million to $8.8 million to meet the estate's obligations. *Id.* at 1102.

59 Because of the large number of shares that the estate needed to sell (300,000), and the large percentage of the total outstanding stock which that block represented (approximately 11%), the only feasible method for selling the stock was through a registered secondary offering by an underwriter. *Id.* at 1102.

60 The estate received $12.6 million from the sale of the 300,000 shares and paid $945,000 in underwriting fees. *Id.* at 1105-06. For further discussion of the deductibility of underwriting fees, see Estate of Joslyn v. Commissioner, 566 F.2d 677, 677-79 (9th Cir. 1977); 4 J. RABKIN & M. JOHNSON, *supra* note 7, § 53.02, at 5320; Wallace, *supra* note 7, at 714-16; Recent Development, *supra* note 7, at 1010.

61 *See also* Estate of Papson v. Commissioner, 73 T.C. 290 (1979) (brokerage commission deductible when incurred by executor in obtaining new tenant for lease that gencrated more than sufficient income to pay deferred estate tax); Estate of Vatter v. Commissioner, 65 T.C. 633 (1975) (selling expenses on sales of property that generated more income than needed to meet estate's cash needs held necessary to effect distribution of residuary estate, because real estate was neither specifically devised nor intended to be distributed in kind).

ductibility of selling expenses depends upon the courts' rigor in applying the necessity requirement. The courts' failure to provide clear guidance in turn prevents executors from making informed sales decisions based on a reasonable anticipation of their tax consequences.[62]

2. *Interest Expenses*

Section 2053(a)(2) and the necessity requirement of the regulations[63] also are concerned with the deductibility of interest expenses accruing after a decedent's death. Interest accruing before a decedent's death is deductible either as a claim against the estate,[64] or as part of a secured indebtedness.[65] The Service divides post-death interest into two categories: interest that the decedent agreed to pay (and that he would have been liable to pay had he lived), which is not deductible as an administration expense, and *additional* interest expenses incurred by the executor, which may be deductible if they meet the necessity requirement.[66]

Courts[67] and commentators[68] criticize the Service's position that the post-death interest that the decedent had agreed to pay fails the necessity requirement. The critics maintain that the distinction between nondeductible post-death interest incurred on obligations of the decedent and deductible additional interest incurred by the executor lacks coherence.[69] For example, if an executor borrows funds to pay the debts of a decedent, both the courts[70] and the Service[71] allow a deduction for the interest on the loan as an administration expense. However, if the executor allows interest on the decedent's debts to accumulate, rather than selling estate assets at sacrifice prices to pay those debts, the Service

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62 *See infra* notes 140-42 and accompanying text.

63 Treas. Reg. § 20.2053-3(a) (1958).

64 I.R.C. § 2053(a)(3) (1976). Treas. Reg. § 20.2053-4 (1958) provides:

> The amounts that may be deducted as claims against a decedent's estate are such only as represent personal obligations of the decedent existing at the time of his death, whether or not then matured, and interest thereon which had accrued at the time of death. Only interest accrued at the date of the decedent's death is allowable even though the executor elects the alternate valuation method under section 2032.

65 I.R.C. § 2053(a)(4) (1976); Treas. Reg. § 20.2053-7 (1958).

66 Rev. Rul. 77-461, 1977-2 C.B. 324, 325-26.

67 *See, e.g.,* Estate of Wheless v. Commissioner, 72 T.C. 470, 476-79 (1979); Estate of Webster v. Commissioner, 65 T.C. 968, 981-82 (1976), *acq. and nonacq.,* 1977-2 C.B. 2, 3.

68 *See, e.g.,* Wallace, *supra* note 7, at 716-22; Wyatt, *supra* note 7, at 13-10 to 13-12. *But see* Treanor, *Cases Allowing Post-Death Interest As Administrative Expense Have Limited Scope,* 45 J. TAX'N 152 (1976).

69 *Cf.* Treanor, *supra* note 68, at 152 ("[T]houghtful analysis of the problem has been singularly lacking.").

70 *See* Hipp v. United States, 72-1 U.S. Tax. Cas. (CCH) ¶ 12,824, at 84,679-80 (D.S.C. 1971); Estate of Todd v. Commissioner, 57 T.C. 288, 294-96 (1971), *acq.,* 1973-2 C.B. 4.

71 Rev. Rul. 77-461, 1977-2 C.B. 324, 325.

will not allow the executor to deduct the post-death interest.[72] The Tax Court rightly balks at this result.[73]

The courts and the Service have defined three categories of additional interest expenses that presumptively meet the necessity requirement and are deductible if allowable under state law: (1) interest on a tax liability that the executor contested in order to preserve estate assets;[74] (2) interest on deferred tax installments;[75] and (3) interest on money borrowed by an executor to pay estate debts and expenses.[76] Special circumstances, however, may lead the courts and the Service to

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72 *Id.*

73 *See* Estate of Wheless v. Commissioner, 72 T.C. 470, 479 (1979):

> The estate, though solvent, did not have the cash to pay the decedent's debts. Some assets were sold to raise money but a forced sale of the balance of the assets would not have realized their fair market value. Consequently, the petitioners decided to pay the interest on the debts in lieu of a forced sale. The executors had responsibilities to the decedent's creditors and to the beneficiaries of his estate. In their judgment, these responsibilities could best be discharged by paying interest on the debts until such time as a sale at a fair price could be negotiated. We have no doubt that petitioners chose this course in order to settle the estate and pay off its creditors and at the same time preserve as much of the estate as possible for the beneficiaries. These circumstances are sufficient to satisfy the requirement that the expenses at issue be "necessarily incurred."

See also Estate of Webster v. Commissioner, 65 T.C. 968, 981-82 (1976) *acq. and non acq.*, 1977-2 C.B. 2, 3:

> The record does not reveal whether, upon their appointment, the executors could have immediately retired the debt and stopped further running of interest, but even if they could have retired the debt, we see no requirement for them to do so. The unpaid balance on the loans was over $3.5 million at decedent's death. Considering the various items of major value in the estate, as for example, stocks and bonds, the executors would perhaps have lost money had they tried to raise such a great sum. We think it was eminently reasonable for them to pay the interest instead.

One commentator has noted with understatement that "the Internal Revenue Service is in a vulnerable position on this point." Wallace, *supra* note 7, at 721.

74 *See* Union Commerce Bank v. Commissioner, 339 F.2d 163, 167-68 (6th Cir. 1964); Maehling v. United States, 67-2 U.S. Tax Cas. (CCH) ¶ 12,486, at 85,618 (S.D. Ind. 1967); Estate of Webster v. Commissioner, 65 T.C. 968, 979-81 (1976), *acq. and nonacq.*, 1977-2 C.B. 2, 3; Rev. Rul. 79-252, 1979-1 C.B. 333; Rev. Rul. 69-402, 1969-2 C.B. 176.

75 *See* Rev. Rul. 81-256, 1981-2 C.B. 183 (interest on deferral of state death taxes); Rev. Rul. 81-154, 1981-1 C.B. 470 (interest on late payment of federal estate tax deductible regardless of reason incurred); Rev. Rul. 80-250, 1980-2 C.B. 278 (interest on federal estate tax incurred by extended payment under I.R.C. §§ 6161, 6163 or 6166 (1976)); Rev. Rul. 79-252, 1979-2 C.B. 333 (interest on federal estate tax deficiency); Rev. Rul. 78-125, 1978-1 C.B. 292 (announcing acquiescence in Estate of Bahr v. Commissioner, 68 T.C. 74 (1977) (interest on estate tax paid in installments under I.R.C. § 6166)) (revoking Rev. Rul. 75-239, 1975-1 C.B. 304, and following Rev. Rul. 70-284, 1970-1 C.B. 34 (interest accrued on tax not part of "tax" assessed)); 1977-2 C.B. 2, 3, *acq. and nonacq.*, in Estate of Webster v. Commissioner, 65 T.C. 968 (1976) (acquiescing in holding that post-death interest on gift tax deficiency deductible); Rev. Rul. 69-402, 1969-2 C.B. 176 (following Maehling v. United States, 67-2 U.S. Tax Cas. (CCH) ¶ 12,486, (S.D. Ind. 1967) (post-death interest on income tax deficiency)).

76 *See* Hipp v. United States, 72-1 U.S. Tax Cas. (CCH) ¶ 12,824, at 84,679-80 (D.S.C. 1971); Estate of Todd v. Commissioner, 57 T.C. 288, 294-96 (1971), *acq.*, 1973-2 C.B. 4; Rev. Rul. 77-461, 1977-2 C.B. 324, 325.

deny a deduction for post-death interest as an administration expense even if it falls within one of these categories.

In *Hibernia Bank v. United States,*[77] the Ninth Circuit held that certain additional interest expenses were not necessary expenses of administration and thus not deductible under section 2053(a)(2). The decedent's will provided several specific bequests of personal property and directed that the residuary estate be divided among four testamentary trusts. After two years of administration, all of the specific bequests had been satisfied and "virtually all" claims against the estate had been paid.[78] Instead of distributing the estate's remaining assets (a mansion and 10,000 common shares of Hibernia Bank stock) to the testamentary trust and then closing the estate, Hibernia Bank, as administrator, elected to dispose of the mansion before final distribution. The estate incurred approximately $420,000 in maintenance costs in the seven years that it took to sell the mansion.[79] The administrator borrowed the funds required to maintain the residence rather than sell the estate's shares of Hibernia Bank stock.[80] Because the administrator could have distributed the mansion in kind to the heirs, the Ninth Circuit agreed with the district court's holding that "the estate had been kept open *much* longer than necessary, thereby rendering the loans and interest payments made during the excess period also unnecessary."[81]

Although the bank's self-dealing justified this result,[82] the court's reasoning is inconsistent with those cases approving the deductibility of interest incurred on an amount borrowed to pay estate expenses.[83] Thus, in addition to the Service's untenable distinction between post-death interest obligations of the decedent and those incurred by the ex-

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77 581 F.2d 741 (9th Cir. 1978).

78 *Id.* at 742.

79 *Id.*

80 Of the $190,000 in interest that the estate incurred, $130,000 was paid to Hibernia Bank as lender on two of the four loans secured by the estate. *Id.* The court noted that "[a]lthough the ethical quality of Hibernia's conduct as the estate's administrator does not bear on our disposition of this case, we do observe that Hibernia allowed itself to be placed in positions fraught with potential for abuse." *Id.* n.1. The court characterized the decision not to sell the stock as "the outward appearance of an attempt by Hibernia to avoid placing a large block of its own stock on the market at the expense of the [decedent's] estate." *Id.; see also id.* at 748 (Duniway, J., concurring) ("Hibernia Bank was on every possible side of the probate proceeding . . . . No matter which way it turned, it met itself."). Hibernia Bank stated that it refused to sell the stock because (1) the market was inadequate; and (2) the decedent's will indicated an intent that the estate retain the stock. Although the district court refuted these contentions, 75-2 U.S. Tax Cas. (CCH) ¶ 13,102, at 88,900-01 (N.D. Cal. 1975), the Ninth Circuit did not address them. 581 F.2d at 744 n.3.

81 581 F.2d at 743 (emphasis in original); *see also id.* at 747; 75-2 U.S. Tax Cas. (CCH) at 88,901-02.

82 *See supra* note 80; *see also infra* notes 158-60 and accompanying text (arguing that result in *Hibernia Bank* could have been reached by proper application of California probate law).

83 *See supra* note 76.

ecutor,[84] the necessity requirement has generated uncertainty in determining the deductibility of interest expenses under section 2053(a)(2).

II

THE VALIDITY OF THE NECESSITY REQUIREMENT

The courts and the Service have struggled in applying the necessity requirement to selling[85] and interest[86] expenses. This inquiry need not be undertaken if the necessity requirement is found to be inconsistent with the statutory directive of section 2053(a)(2).[87]

A. *The Validity Dispute*

Courts disagree on the validity of the necessity requirement of the regulations.[88] Those courts sustaining the requirement support their position with three arguments. First, the language of section 2053(a)(2) and its legislative history do not require that state law alone governs deductibility.[89] Second, because the necessity requirement of the regulations has been in effect in substantially similar form since 1919,[90] Congress has approved the requirement by reenacting section 2053(a)(2) and its predecessors[91] without materially changing the statute.[92] Third, policy grounds justify the requirement: (1) federal interests underpinning the estate tax should not be subject to the "vagaries" of local law;[93] and (2) expenses necessary for the administration of the estate are distin-

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84 *See supra* notes 67-73 and accompanying text.

85 *See supra* notes 33-62 and accompanying text.

86 *See supra* notes 63-84 and accompanying text.

87 A preliminary question is whether the expense is allowable by state law. *See supra* notes 9-28 and accompanying text; *infra* notes 153-55 and accompanying text.

88 *See supra* note 6.

89 *See* Hibernia Bank v. United States, 581 F.2d 741, 746-47 n.9 (9th Cir. 1978) ("We find no confiict between Treas. Reg. § 20.2053-3(a) and section 2053 . . . [W]e believe this regulation embodies a correct principle."); Pitner v. United States, 388 F.2d 651, 659 (5th Cir. 1967); Estate of Posen v. Commissioner, 75 T.C. 355, 367 (1980) ("[W]e do not believe that the literal language of section 2053(a) requires that State law alone govern deductibility of expenses from the gross estate nor that Congress intended that such be the ease. . . .").

90 T.D. 2910, 21 Treas. Dec. 752, 778-79 (1919).

91 *See* Internal Revenue Code of 1954, ch. 11, § 2053(a)(2), 68A Stat. 389 (1954); Revenue Act of 1932, ch. 209, § 805, 47 Stat. 280 (1932); Act of Feb. 26, 1926, ch. 27, § 303(a)(1), 44 Stat. 72 (1926); Act of Sept. 8, 1916, ch. 463, § 202(a)(1), 39 Stat. 778 (1916) (original federal estate tax statute).

92 *See* Hibernia Bank v. United States, 581 F.2d 741, 746-47 n.9 (9th Cir. 1978); Estate of Posen v. Commissioner, 75 T.C. 355, 366 (1980).

93 *See* Hibernia Bank v. United States, 581 F.2d 741, 747-48 (9th Cir. 1978) (Duniway, J., concurring); Pitner v. United States, 388 F.2d 651, 659 (5th Cir. 1967); Estate of Posen v. Commissioner, 75 T.C. 355, 367-68 (1980) ("The interests served by State law may diverge significantly from the Federal interests underlying the estate tax. . . . We do not believe that Congress intended to allow the integrity of the Federal estate tax to be undermined by the vagaries of State law.").

guishable from those incurred for the benefit of the beneficiaries.[94]

Other courts invalidating the necessity requirement dispute these contentions. First, the language of section 2053(a)(2) and its legislative history dictate that state law alone governs deductibility.[95] Second, the "age" of a regulation and its subsequent reenactment should not determine its validity.[96] Third, policy reasons do not empower the Treasury to alter the statute,[97] and in any event those policy considerations asserted in support of the necessity requirement are not compelling.[98]

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94 *See* Estate of Smith v. Commissioner, 510 F.2d 479, 482-83 (2d Cir.), *cert. denied,* 423 U.S. 827 (1975); Estate of Posen v. Commissioner, 75 T.C. 355, 367 (1980) ("[A] distinction can and should be drawn between expenses necessary to the estate and those incurred solely for the benefit of the beneficiaries.").

95 *See* Estate of Park v. Commissioner, 475 F.2d 673, 676 (6th Cir. 1973) ("By the literal language of § 2053(a), Congress has left the deductibility of administrative expenses to be governed by their chargeability against the assets of the estate under state law."); Ballance v. United States, 347 F.2d 419, 423 (7th Cir. 1965) ("[T]he definition of 'administration expenses' in the treasury regulation as such expenses as are 'necessarily' incurred in the administration of the estate cannot serve to override the statutory [directive that state law alone governs deductibility]."); *see also* Estate of Posen v. Commissioner, 75 T.C. 355, 369 (1980) (Goffe, J., dissenting) ("Section 2053(a)(2) allows all administration expenses as deductions with the only limitation being State law. . . . The Commissioner has not just defined 'administration expenses' in [the necessity requirement]; he has legislated a further requirement for deductibility and has done so without the benefit of any congressional intent."); *id.* at 370-71 (Wilbur, J., dissenting) ("The 'necessary' requirement contained in the regulations is contrary to the clear and unequivocal language of section 2053(a) and is unsupported by the legislative history underlying the enactment. . . ."); Estate of Smith v. Commissioner, 57 T.C. 650, 663 (1972) (Goffe, J., concurring in part, dissenting in part) ("[T]he regulations impose a limitation upon the deductibility of selling expenses not prescribed by the Code . . . ."), *aff'd,* 510 F.2d 479, 484 (2d Cir.) (Mulligan, J., dissenting) ("[I]n § 2053(a) of the Code, the Congress decided without any limitation that the state law controlled . . . . [T]he Regulation conflicts with the Code, is contrary to the intent of Congress, and is therefore invalid."), *cert. denied,* 423 U.S. 827 (1975); Note, *supra* note 7, 52 N.C.L. REV. at 201; Comment, *supra* note 7, at 380.

96 *See* Estate of Park v. Commissioner, 475 F.2d 673, 676 n.3 (6th Cir. 1973) ("The reasons that the regulations have been infrequently challenged appears to us to be speculative at best, and their longevity is not a persuasive factor where the statutory language is clear and unambiguous as we deem it to be in this case."); *see also* Estate of Smith v. Commissioner, 57 T.C. 650, 664 (1972) (Goffe, J., concurring in part, dissenting in part), *aff'd,* 510 F.2d 479 (2d Cir.), *cert. denied,* 423 U.S. 827 (1975).

97 *See* Estate of Park v. Commissioner, 475 F.2d 673, 676-77 (6th Cir. 1973); *see also* Estate of Posen v. Commissioner, 75 T.C. 355, 369 (1980) (Goffe, J., dissenting) ("The Commissioner may not use the vehicle of a Treasury regulation to rewrite a statute simply because he may feel that the scheme created by such statute could be improved upon."); Estate of Smith v. Commissioner, 57 T.C. 650, 665 (1972) (Goffe, J., concurring in part, dissenting in part), *aff'd,* 510 F.2d 479, 484 (2d Cir.) (Mulligan, J., dissenting), *cert. denied,* 423 U.S. 827 (1975).

98 *See* Estate of Park v. Commissioner, 475 F.2d 673, 676 (6th Cir. 1973) ("The [Commissioner] would have us distinguish between what is necessary for the estate and what is for the individual benefit of the beneficiaries. We decline to draw such a distinction, primarily because it is not warranted by the wording of § 2053(a). Also the distinction is untenable because any action that benefits the estate will also in effect benefit the beneficiaries."); *see also* Estate of Posen v. Commissioner, 75 T.C. 355, 370 (1980) (Goffe, J., dissenting) (disputing majority's contention that "Congress could not have intended to allow the integrity of the Federal estate tax to be undermined by the 'vagaries of State law'. . . ."); Estate of Smith v.

B. *Resolving the Dispute*

Challenges to the necessity requirement must overcome the presumptive validity of Treasury regulations.[99] A court will not invalidate a regulation unless the taxpayer proves that the regulation is unreasonable and inconsistent with the statute that it purports to implement.[100] As the Supreme Court recently stated, "[i]n determining whether a particular [tax] regulation carries out the congressional mandate in a proper manner, [courts] look to see whether the regulation harmonizes

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Commissioner, 57 T.C. 650, 665 (1972) (Goffe, J., concurring in part, dissenting in part), *aff'd*, 510 F.2d 479, 485 (2d Cir.) (Mulligan, J., dissenting), *cert. denied*, 423 U.S. 827 (1975); Note, *supra* note 7, 30 VAND. L. REV. at 806.

99 In considering the legal effect of Treasury regulations, courts distinguish "legislative" and "interpretative" regulations. Legislative regulations involve express delegations by Congress of its lawmaking power. *See, e.g.*, I.R.C. §§ 105(b), 167(b), 167(d), 248, 1502, 2053(d)(1) (1976). These regulations are said to have the "force and effect of law, so long as they were reasonably adapted . . . to the administration and enforcement of the act and did not contravene some statutory provision." Allstate Ins. Co. v. United States, 329 F.2d 346, 349 (7th Cir. 1964). Interpretative regulations, on the other hand, interpret the rules Congress has prescribed in the statute. According to some courts, these regulations are subject to more searching judicial review than is accorded legislative regulations. *See, e.g.*, Koshland v. Helvering, 298 U.S. 441, 446-47 (1936); Caterpillar Tractor Co. v. United States, 589 F.2d 1040, 1045 (Ct. Cl. 1978); Farrel-Birmingham Co. v. United States, 121 F. Supp. 636, 638 (Ct. Cl. 1954); *see also* 4 B. BITTKER, FEDERAL TAXATION OF INCOME, ESTATE AND GIFTS ¶ 110.4.2 (1981); 1 J. MERTENS, THE LAW OF FEDERAL INCOME TAXATION § 3.20 (rev. ed. 1981); 3 C.D. SANDS, STATUTES AND STATUTORY CONSTRUCTION § 66.04 (1974) (rev. 3d ed. of J. SUTHERLAND, STATUTORY CONSTRUCTION).

Some commentators argue that the necessity requirement of the regulations should be accorded less judicial deference because it was promulgated as an interpretative regulation under § 2053(a)(2). *See, e.g.*, Note, *supra* note 7, 30 VAND. L. REV. at 802. Professor Bittker, however, rightly concludes that the purported differences between legislative and interpretative regulations should not affect a court's inquiry into the validity of the regulation:

> [I]n practice the distinction between legislative and interpretative regulations is often blurred, and the supposedly diverse standards of judicial review tend to converge and even to coalesce . . . .
>
> When all is said and done, for practical purposes there is only a single standard of judicial review, which requires *all* regulations to be reasonable relative to whatever criteria or guideposts were enacted by Congress. If the legislative standards are vague or general, the judicial oversight must perforce be limited; in this situation, regulations have the force of law not because they are "legislative" but because it is difficult or impossible to show that they are inconsistent with the only available legislative criteria. But if Congress left more ample clues to its objectives, the regulations must be consistent with them; and they are subject to stricter judicial review not because they are "interpretative" but because Congress supplied more detailed standards, to which the agency was expected to conform.

4 B. BITTKER, *supra*, ¶ 110.4.2, at 110-30 to 110-31 (footnotes omitted) (emphasis in original). Professor Bittker proceeds to warn that "whatever residual nuances in the standards of judicial review may separate the two types of regulations, persuading *any* court that *any* regulation is invalid is a major and chancy undertaking." *Id.* (emphasis in original).

100 *See, e.g.*, Commissioner v. Portland Cement Co., 450 U.S. 156, 169 (1981); Thor Power Tool Co. v. Commissioner, 439 U.S. 522, 533 n.11 (1979); Bingler v. Johnson, 394 U.S. 741, 750 (1969); Commissioner v. South Tex. Lumber Co., 333 U.S. 496, 501 (1948); *see also* 4 B. BITTKER, *supra* note 99, ¶ 110.4.2; 1 J. MERTENS, *supra* note 99, §§ 3.20, 3.21.

with the plain language of the statute, its origin, and its purpose."[101] Under this test, the necessity requirement is an improper means of giving content to the administration expense provision of section 2053(a)(2). The requirement violates the congressional purpose manifested in the statutory language that the *primary* criterion for the deductibility of administration expenses is allowability under state law. Congressional reenactment of section 2053(a)(2) and the policy considerations behind the deductibility of administration expenses do not alter the conclusion that the regulations impermissibly subvert the statutory design of section 2053(a)(2).

1. *Section 2053(a)(2): Language, Origin, and Purpose*

The language of section 2053(a)(2) is the starting point in examining the validity of the necessity requirement.[102] Section 2053(a)(2) permits the deduction of such "administration expenses . . . as are allowable by [state law]."[103] The section expressly conditions deductibility of administration expenses on allowability under state law.

Federal law governs the meaning of a term in the Internal Revenue Code;[104] "local nomenclature and characterization are not controlling."[105] The courts and the Service, therefore, may fashion federal law to determine the scope of the term "administration expenses."[106] The regulatory gloss on the statute, however, cannot eviscerate the function of state law.[107] Judges and commentators examining the validity of the

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101 National Muffler Dealers Ass'n v. United States, 440 U.S. 472, 477 (1979), *quoted in* Rowan Cos. v. United States, 452 U.S. 247, 253 (1981).

102 *See, e.g.,* Watt v. Alaska, 451 U.S. 259, 265 (1981) (" 'The starting point in every case involving construction of a statute is the language itself.' ") (quoting Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 756 (1975) (Powell, J., concurring)); F. FRANKFURTER, SOME REFLECTIONS ON THE READING OF STATUTES 16 (1947) ("Though we may not end with the words in construing a disputed statute, one certainly begins there."); 2A C.D. SANDS, *supra* note 99, § 45.01, at 1.

103 I.R.C. § 2053(a)(2) (1976); *see supra* note 9.

104 This principle has been well settled since 1938. Lyeth v. Hoey, 305 U.S. 188, 193 (1938) ("The question as to the construction of [a term] in the federal statute is not determined by loeal law. . . . [T]he meaning of [a term in a] federal statute necessarily is a federal question."); *see also* United States v. Stapf, 375 U.S. 118, 130 (1963); R. STEPHENS, G. MAXFIELD & S. LIND, *supra* note 1, ¶ 4.05[2][a], at 4-88.

105 R. STEPHENS, G. MAXFIELD & S. LIND, *supra* note 1, ¶ 4.05[2][a], at 4-88.

106 *See, e.g.,* United States v. Stapf, 375 U.S. 118, 130 (1963); Hibernia Bank v. United States, 581 F.2d 741, 744 n.5 (9th Cir. 1978); Estate of Smith v. Commissioner, 510 F.2d 479, 482 n.4 (2d Cir.), *cert. denied,* 423 U.S. 827 (1975); United States v. Pitner, 388 F.2d 651, 659 (5th Cir. 1967); *see also infra* notes 147-52 and accompanying text.

107 Interpretations of § 2053(a) that ignore the state law component of the statute violate the canon of statutory construction dictating that effect be given to all parts of a statute. *See, e.g.,* United States v. Menasche, 348 U.S. 528, 535 (1955); American Radio Relay League, Inc. v. FCC, 617 F.2d 875 (D.C. Cir. 1980); Zeigler Coal Co. v. Kleppe, 536 F.2d 398 (D.C. Cir. 1976); 2A C.D. SANDS, *supra* note 99, § 46.06. Under this rule of construction, courts should disfavor the necessity requirement because it negates any role for state law in determining the deductibility of adminstration expenses under § 2053(a)(2). *See infra* text accompanying note 111.

necessity requirement have misunderstood the role of federal law in this equation. Those who argue that the necessity requirement is a permissible interpretative gloss on the term "administration expenses"[108] ignore the statute's primary emphasis on state law allowability.[109] On the other hand, those who maintain that the plain meaning[110] of section 2053(a)(2) dictates that state law alone controls unduly restrict the federal prerogative to define statutory terms. Federal law may define the categories of expenses that qualify as administration expenses under the statute, but state law must govern the deductibility of expenses within these categories.

The current regulatory regime under section 2053(a)(2), by hinging deductibility on whether an administration expense is within the necessity requirement, renders the state law provision of the statute merely pro forma. State law will never disallow an administration expense that the necessity requirement otherwise would permit.[111] The necessity requirement transforms the deductibility of administration expenses solely into a question of federal law, in violation of the statutory language that expressly defers to state law.

The legislative history of section 2053(a)(2) also indicates that Congress intended that state law predominate in determining the deductibility of administration expenses: "[A]dministration expenses . . . are deductible in computing the taxable estate . . . . [The] deduction is

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108 *See supra* note 89.

109 *See supra* note 107.

110 The plain meaning of § 2053(a)(2) does not dictate that state law completely control the provision's meaning; such an approach would unduly restrict the federal prerogative to define statutory terms. Moreover, ascertaining the plain meaning of a statute does not foreclose examination of other tools of construction in interpreting a statute. *See, e.g.,* Watt v. Alaska, 451 U.S. 259, 265 (1981); Train v. Colorado Pub. Interest Research Group, 426 U.S. 1, 10 (1976); United States v. American Trucking Ass'ns, 310 U.S. 534, 543-44 (1940) ("When aid to construction of the meaning of words, as used in the statute, is available, there certainly can be no 'rule of law' which forbids its use, however clear the words may appear on 'superficial examination.'"); Boston Sand & Gravel Co. v. United States, 278 U.S. 41, 48 (1928) (Holmes, J.) ("[The plain meaning rule is] rather an axiom of experience than a rule of law, and does not preclude consideration of persuasive evidence if it exists."); *cf.* Cabell v. Markham, 148 F.2d 737, 739 (2d Cir.) (L. Hand, J.), *aff'd,* 326 U.S. 404 (1945):

> Of course it is true that the words used, even in their literal sense, are the primary, and ordinarily the most reliable, source of interpreting the meaning of any writing: be it a statute, a contract, or anything else. But it is one of the surest indexes of a mature and developed jurisprudence not to make a fortress out of the dictionary; but to remember that statutes always have some purpose or object to accomplish, whose sympathetic and imaginative discovery is the surest guide to their meaning.

111 The most stringent state laws impose a necessity requirement governing the allowability of administration expenses. *See supra* note 13. Although these laws theoretically are coterminous with the regulations, many of the states that purportedly require necessity in practice apply a lesser reasonableness or good faith standard. *See supra* note 15. Many state statutes also impose these lesser standards. *See supra* note 14. These state laws requiring reasonableness or good faith would allow expenses for which the regulations would deny a deduction. *See supra* notes 44 & 51.

limited to those expenses allowable by laws of the jurisdiction under which the estate is being administered . . . ."[112] The legislative history makes no mention of either the necessity requirement or the role of federal law in giving content to the term "administration expenses."[113]

2. *Statutory Reenactment*

The necessity requirement has been firmly entrenched in the regulations since 1919.[114] Congress has reenacted section 2053(a)(2) and its predecessors several times in the intervening years without materially changing the statute.[115] The principle of statutory reenactment provides that " 'Treasury regulations and interpretations long continued without substantial change, applying to unamended or substantially reenacted statutes, are deemed to have received Congressional approval and have the effect of law.' "[116] Courts sustaining the necessity requirement rely on the principle of statutory reenactment to support their position.[117] This reliance is misplaced for several reasons.

The legislative history offers no indication that Congress was cognizant of the necessity requirement when it reenacted section 2053(a)(2) and its predecessors.[118] The courts[119] and commentators[120] criticize the

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112 S. REP. NO. 1622, 83d Cong., 2d Sess. 124 (1954); H.R. REP. NO. 1337, 83d Cong., 2d Sess. 91 (1954).

113 S. REP. NO. 1622, 83d Cong., 2d Sess. 124 (1954); H.R. REP. NO. 1337, 83d Cong., 2d Sess. 91 (1954).

114 T.D. 2910, 21 Treas. Dec. 752, 778-79 (1919).

115 *See supra* note 91.

116 United States v. Correll, 389 U.S. 299, 305-06 (1967) (quoting Helvering v. Winmill, 305 U.S. 79, 83 (1938)); *see also* Lorillard v. Pons, 434 U.S. 575, 580 (1978) ("Congress is presumed to be aware of an administrative or judicial interpretation of a statute and to adopt that interpretation when it re-enacts a statute without change. . . ."); Albermarle Paper Co. v. Moody, 422 U.S. 405, 414 n.8 (1975); Fribourg Nav. Co. v. Commissioner, 383 U.S. 272, 283 (1966). *See generally* 4 B. BITTKER, *supra* note 99, ¶ 110.4.2, at 110-29 ("[R]egulations can gain additional force if Congress subsequently reenacts the applicable statutory provision without change . . . since action of this type is sometimes viewed as an acceptance or endorsement of the agency's interpretation."); 1 J. MERTENS, *supra* note 99, § 3.22; 2A & 3 C.D. SANDS, *supra* note 99, §§ 49.09, 66.04.

117 *See supra* note 92.

118 *See* S. REP. NO. 1622, 83d Cong., 2d Sess. 124-25 (1954); H.R. REP. NO. 337, 83d Cong., 2d Sess. 91 (1954); *see also* Estate of Smith v. Commissioner, 57 T.C. 650, 664 (1972) (Goffe, J., concurring in part, dissenting in part) ("The committee reports for the Internal Revenue Code of 1954 reflect no consideration of [the necessity requirement]."), *aff'd*, 510 F.2d 479 (2d Cir.), *cert. denied*, 423 U.S. 827 (1975).

119 *See, e.g.*, Commissioner v. Glenshaw Glass Co., 348 U.S. 426, 431 (1955); Helvering v. Wilshire Oil Co., 308 U.S. 90, 100-01 (1939); F.W. Woolworth Co. v. United States, 91 F.2d 973, 976 (2d Cir. 1937) (L. Hand, J.), *cert. denied*, 302 U.S. 768 (1938).

120 *See, e.g.*, 1 J. MERTENS, *supra* note 99, § 3.24, at 50-53; Brown, *Regulations, Reenactment, and the Revenue Acts*, 54 HARV. L. REV. 377 (1941); Feller, *Addendum to the Regulations Problem*, 54 HARV. L. REV. 1311 (1941); Griswold, *A Summary of the Regulations Problem*, 54 HARV. L. REV. 398 (1941); Paul, *Use and Abuse of Tax Regulations in Statutory Construction*, 49 YALE L.J. 660 (1940); Surrey, *The Scope and Effect of Treasury Regulations Under the Income, Estate and Gift Taxes*, 88 U. PA. L. REV. 556 (1940).

use of statutory reenactment as support for a regulation when such affirmative indicia are lacking. The primary objection is that "the rule is purely fictional; Congress neither knows nor can be expected to know about the administrative constructions of the statute, and its reenactment of the statute, therefore, indicates not even the slightest approval of the [regulations]."[121] As a result, commentators view the rule as an "anachronism,"[122] and urge that "the mere reenactment of a statute following administrative construction should be given no weight whatever in determining the proper construction of the statute."[123]

Despite this criticism, courts continue to invoke the principle of statutory reenactment.[124] The rule, however, can never constitute the sole support for sustaining a regulation; it "is no more than an aid in statutory construction."[125] Courts consistently hold that legislative reenactment cannot support a regulation that goes beyond the limits of the statute.[126] The principle of statutory reenactment alone therefore cannot defeat a finding that the necessity requirement violates the statutory directive of section 2053(a)(2).[127]

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121 Brown, *supra* note 120, at 383; *see also* Steinhort v. Commissioner, 335 F.2d 496, 503 (5th Cir. 1964) (congressional inaction does not necessarily approve settled administrative policy); Griswold, *supra* note 120, at 402; Paul, *supra* note 120, at 663-65.

122 1 J. MERTENS, *supra* note 99, § 3.24, at 59.

123 Griswold, *supra* note 120, at 400, 403; *see also* Commissioner v. Glenshaw Glass Co., 348 U.S. 426, 431 (1955) ("[R]e-enactment—particularly without the slightest affirmative indication that Congress ever had the [prior interpretation] before it—is an unreliable indicium at best."); Helvering v. Wilshire Oil Co., 308 U.S. 90, 100 (1939); F.W. Woolworth Co. v. United States, 91 F.2d 973, 976 (2d Cir. 1937) (L. Hand, J.) ("To suppose that Congress must particularly correct each mistaken construction under penalty of incorporating it into the fabric of the statute appears to us unwarranted; our fiscal legislation is detailed and specific enough alrcady."), *cert. denied,* 302 U.S. 768 (1938); Association of Am. R.R. v. ICC, 564 F.2d 486, 493 (D.C. Cir. 1977) (reenactment doctrine not applicable unless Congress was aware of administrative interpretation and affirmatively indicated its intent); Interstate Drop Forge Co. v. Commissioner, 326 F.2d 743, 746 (7th Cir. 1964).

Professor Griswold believes that "since the enactment rule is so lacking in substance, it should be wholly and completely discarded as a guide in determining the effect which should be given to administrative regulations." Griswold, *supra* note 120, at 403. Other commentators are not so harsh. *See, e.g.,* Brown, *supra* note 120, at 378-79:

> [T]here is nothing sacred in Treasury regulations or other administrative rulings. They are simply aids . . . in interpretation of the statutes; but they are inherently no more binding than other devices that may be available. Nor should reenactment by Congress of the provision of the act thus construed render the interpretation binding, although that fact may add somewhat to the weight to be accorded the regulation.

See also Feller, *supra* note 120, at 1318 ("What I suggest is an application of the reenactment rule with varying degrees of light and shade depending on the circumstances of reenactment.").

124 *See supra* note 116.

125 Helvering v. Reynolds, 313 U.S. 428, 432 (1941).

126 *See, e.g.,* Estate of Sanford v. Commissioner, 308 U.S. 39, 53 (1939); Burnet v. Chicago Portrait Co., 285 U.S. 1, 16 (1932); Commissioner v. Anderson, 371 F.2d 59, 64-65 (6th Cir. 1966), *cert. denied,* 387 U.S. 906 (1967); Brown, *supra* note 120, at 391.

127 *See supra* note 96.

3. *Policy Considerations*

Although some courts and commentators use policy arguments to support the necessity requirement, policy considerations cannot justify regulations that subvert the language of section 2053(a)(2).[128] In addition, policy considerations that courts use to support the necessity requirement are not persuasive.[129] Moreover, compelling policy arguments can be made against the regulations and their current application.

In *Estate of Posen v. Commissioner,*[130] the Tax Court upheld the validity of the regulations by concluding that "Congress [did not intend] . . . to allow the integrity of the Federal estate tax to be undermined by the vagaries of State law."[131] This position is untenable for several reasons. First, section 2053(a)(2) expressly conditions deductibility on whether an administration expense is allowable under state law.[132] Second, other sections of the estate tax similarly cede questions of federal tax liability to state law.[133] Finally, federal court supervision of state law under section 2053(a)(2) adequately protects federal interests in the estate tax.[134]

A second policy consideration that courts use to support the necessity requirement focuses on the distinction between acts that benefit the estate as a whole, and those that promote the interests of the benefi-

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128 *See, e.g.,* Aaron v. SEC, 446 U.S. 680, 695 (1980) (public policy not applicable in interpreting statute when statutory language and legislative history clear); 2A C.D. SANDS, *supra* note 99, § 46.01; *see also supra* note 97.

129 *See supra* note 98.

130 75 T.C. 355 (1980).

131 *Id.* at 367-68.

132 *See supra* notes 102-13 and accompanying text; Estate of Posen v. Commissioner, 75 T.C. 355, 370 (1980) (Goffe, J., dissenting) ("The majority somehow concludes that Congress could not have intended to allow the integrity of the Federal estate tax to be undermined by the 'vagaries of state law,' yet section 2053(a) specifies in no uncertain terms that administration expenses are deductible if allowable by [state law] . . . ."); Estate of Smith v. Commissioner, 57 T.C. 650, 665 (1972) (Goffe, J., concurring in part, dissenting in part), *aff'd,* 510 F.2d 479 (2d Cir.), *cert. denied,* 423 U.S. 827 (1975):

> The majority feels that the limitation imposed only by the regulations is necessary to safeguard the integrity of the estate tax. Congress apparently did not feel such a safeguard was necessary. Congress provided that deductions for selling expenses were allowable if permitted under State law. That is the sole limitation provided by Congress in the statute and reflected in the committee reports.

See also Note, *supra* note 7, 52 N.C.L. REV. at 200-01; Comment, *supra* note 7, at 382.

133 *See* Estate of Posen v. Commissioner, 75 T.C. 355, 370 (1980) (Goffe, J., dissenting):

> The estate tax law reeks with provisions causing the estate tax liability to vary according to the "vagaries of State law"; e.g., common law States versus community property States, credit for State death taxes, executor's fees, dower and courtesy [sic] interests, joint interests in property, claims against the estate, qualifying marital deduction.

134 *See infra* notes 157-63 and accompanying text.

ciaries. The Tax Court in *Posen*[135] stated that "a distinction can and should be drawn between expenses necessary to the estate and those incurred solely for the benefit of the beneficiaries."[136] Several courts and commentators dismiss this distinction by noting that any action in the best interest of the estate also will benefit the beneficiaries.[137] This latter position, however, fails to recognize that executors may act to a beneficiary's advantage without benefiting the estate.[138] A sounder criticism of the distinction is that the terms of section 2053(a)(2) do not support it.[139]

Additional policy arguments weigh against the necessity requirement. The prineipal policy consideration against the requirement is that it unduly hamstrings the executor in the exereise of his duties. For example, the executor may foresee the need to sell some of the estate's assets in order to meet anticipated debts, expenses, and taxes. Such expenses should be dcductible if allowable under state law, which usually employs standards of reasonableness and good faith.[140] The regulations, however, by limiting the administration expense deduction to those selling expenses judged necessary to meet the estate's *actual* liabilities, impose an unrealistic burden on the executor; they require him to determine the indeterminable with complete accuracy.[141] The problem is exacerbated when the assets pose difficult valuation problems or are not easily convertible into cash.[142]

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135 Estate of Posen v. Commissioner, 75 T.C. 355 (1980).

136 *Id.* at 367.

137 *See* Estate of Park v. Commissioner, 475 F.2d 673, 676 (6th Cir. 1973); Sussman v. United States, 236 F. Supp. 507, 509 (E.D.N.Y. 1962); Estate of Posen v. Commissioner, 75 T.C. 355, 371-72 (1980) (Wilbur, J., dissenting) ("That the sale also benefited the sole heir should not defeat the deductibility of the selling expenses. A necessary administration expense often produces dual benefits to both the estate and the beneficiaries."); Note, *supra* note 7, 52 N.C.L. REV. at 196 ("[W]hat benefits the estate as a whole also benefits the heirs of that estate."); Note, *supra* note 7, 30 VAND. L. REV. at 806 ("*[A]ny* action benefitting the estate also will benefit the heirs, legatees, and beneficiaries.") (emphasis in original); Comment, *supra* note 7, at 382.

138 Professor Spragens discusses a typical example:

> [W]here estate property could as easily have been distributed in kind, but is instead sold by the executors merely as a convenience to the distributees, the sales commissions and other selling costs eannot be said to constitute a proper charge on the estate deductible as an "administration" expense. Here, the estate is merely paying a nondeductible cost of the heirs in their disposition of the property, and there is no reason why the federal Treasury should subsidize the sale by permitting the estate a deduction for these selling costs.

Spragens, *supra* note 7, at 430.

139 *See* Estate of Park v. Commissioner, 475 F.2d 673, 676 (6th Cir. 1973) ("The [Service] would have us distinguish between what is necessary for the estate and what is for the individual benefit of the beneficiaries. We decline to draw such a distinction, primarily because it is not warranted by the wording of § 2053(a).").

140 *See supra* notes 14-15 and accompanying text.

141 *See* Note, *supra* note 7, 52 N.C.L. REV. at 196-97; Note, *supra* note 7, 30 VAND. L. REV. at 806; Comment, *supra* note 7, at 382.

142 *See* Spragens, *supra* note 7, at 435; *supra* notes 39-44 and accompanying text.

A similar situation confronts the executor deciding whether to seek a loan to meet the estate's potential obligations. Both the decision to secure a loan and the size of the loan are subject to a later determination by the courts or the Service, with the "infallible acuity of hindsight,"[143] that the interest expense was not necessary. The resulting uncertainty hinders the executor in administering the estate.[144]

III

SECTION 2053(A)(2) AS THE LONE PILLAR: A SUGGESTED TWO-TIERED APPROACH

In considering the validity of the necessity requirement, courts split over the effect accorded state court approval of an administration expense under section 2053(a)(2). Those courts sustaining the necessity requirement posit that the federal fisc cannot be placed at the mercy of state probate proceedings and argue for federalization of the administration expense deduction.[145] Courts invalidating the necessity requirement insist that a literal reading of the statute requires that, for federal estate tax purposes, state court approval of an administration expense control.[146] A third approach, however, is preferable. This two-tiered approach should focus on the twin requirements of deductibility set forth in section 2053(a)(2): (1) "administration expenses" that are (2) "allowable by [state] law."

As discussed earlier,[147] federal law[148] properly is invoked in deter-

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143 Estate of Smith v. Commissioner, 510 F.2d 479, 485 (2d Cir.) (Mulligan, J., dissenting), *cert. denied,* 423 U.S. 827 (1975).

144 Commentators have suggested other policy considerations that undermine the wisdom of the necessity requirement. These include considerations of judicial economy and convenience of the executor. *See* Note, *supra* note 7, 52 N.C.L. REV. at 196-97; Note, *supra* note 7, 30 VAND. L. REV. at 805-07; Comment, *supra* note 7, at 381-82.

145 *See* Hibernia Bank v. United States, 581 F.2d 741, 747-48 (9th Cir. 1978) (Duniway, J., concurring) ("[Section] 2053(a)(2) of the Internal Revenue Code [permits] the deduction of those expenditures only which are expenses of administration within the meaning of federal estate tax law. . . . [I]t was [not] the intention of Congress in adopting § 2053(a)(2) of the Internal Revenue Code to place the federal fisc at the mercy of [state law]."); Pitner v. United States, 388 F.2d 651, 659 (5th Cir. 1967); Estate of Posen v. Commissioner, 75 T.C. 355, 367-68 (1980).

146 *See* Estate of Park v. Commissioner, 475 F.2d 673, 676 (6th Cir. 1973) ("[T]he deductibility of an expense under 2053(a) (or its predecessor) is governed by state law alone."); *see also* Estate of Posen v. Commissioner, 75 T.C. 355, 369-70 (1980) (Goffe, J., dissenting); Estate of Smith v. Commissioner, 57 T.C. 650, 665 (1972) (Goffe, J., concurring in part, dissenting in part), *aff'd,* 510 F.2d 479, 484 (2d Cir.) (Mulligan, J., dissenting), *cert. denied,* 423 U.S. 827 (1975).

147 *See supra* notes 104-10 and accompanying text.

148 An element of state law, however, enters into the calculus. *See* R. STEPHENS, G. MAXFIELD & S. LIND, *supra* note 1, ¶ 5.03[1], at 5-7 n.9 ("The term 'expense' connotes a paid obligation. The obligation to pay can arise only by way of local law. Consequently, we are talking about *state* recognized obligations to make payments that are, for example, within the *federal* concept of [administration] expenses.") (emphasis in original).

mining the scope of the term "administration expenses" in the statute. The inquiry, however, should be limited to whether an expense is "of the *type* [Congress] intended to be deductible."[149] Federal law should determine only the categories of expenses that fall within the statutory term. Categories such as executor's commissions,[150] attorney's fees,[151] and other miscellaneous expenses, including selling and interest expenses,[152] properly are set forth in the regulations as a gloss on the *types* of administration expenses permitted under section 2053(a)(2).

The second tier requires that an item found to be an administration expense within the meaning of the statute also be allowable under applicable state law to qualify for an estate tax deduction under section 2053(a)(2).[153] Contrary to some decisions under section 2053(a)(2),[154] federal courts making this determination need not defer completely to a state probate court's allowance of an administration expense. Under the proper approach to the second tier, a decision of a state court other than the highest court in the state is not binding on a federal court deciding a federal tax controversy.[155] Thus, if a federal court decides that a probate judge erred in allowing a specific administration expense under state law, the federal court may disallow the deduction based on its contrary interpretation of state law, giving "proper regard" to the local decision.[156] If the state court correctly applied state law, however, the federal court must allow the expense as a federal estate tax deduction.

The two-tiered approach combines due regard for state law as specified in section 2053(a)(2) with sufficient federal supervision to protect the integrity of the federal estate tax. In the first tier, the federal definition of "administration expenses" will ferret out irregular administration expenses even if they are allowable under state law. For example, if state law allowed daily living expenses of an executor as administration expenses, a federal court, as a matter of federal law, properly could reject the state law as not within the *type* of expenses deductible under section 2053(a)(2).

In the second tier, the *Bosch* standard protects federal coffers by

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149 United States v. Stapf, 375 U.S. 118, 130 (1964) (emphasis added); *see also* Hibernia Bank v. United States, 581 F.2d 741, 744 n.5 (9th Cir. 1978); Estate of Smith v. Commissioner, 510 F.2d 479, 482 n.4 (2d Cir.), *cert. denied,* 423 U.S. 827 (1975); Estate of Posen v. Commissioner, 75 T.C. 355, 367 (1980).

150 Treas. Reg. § 20.2053-3(b) (1958).

151 *Id.* § 20.2053-3(c).

152 *Id.* § 20.2053-3(d). Other miscellaneous expenses include "court costs, surrogates' fees, accountants' fees, appraisers' fees, [and] clerk hire." *Id.*

153 *See supra* notes 9-28 and accompanying text.

154 *See supra* note 146.

155 Commissioner v. Estate of Bosch, 387 U.S. 456, 457 (1967). Even a decision of the highest court in the state is not binding on federal courts when there is evidence of fraud, bad faith or collusion. *See, e.g.,* Bank of Nev. v. United States, 80-2 U.S. Tax Cas. (CCH) ¶ 13,361, at 85,821 (D. Nev. 1980).

156 *Bosch*, 387 U.S. at 465.

permitting federal court review of state court decisions allowing administration expenses under state law. This federal reexamination of state law often will eliminate the same section 2053(a)(2) deductions for abusive administration expenses that the necessity requirement eliminates currently. Because most states impose a necessity requirement on the allowance of administration expenses,[157] federal courts will be able to monitor the deductibility of administration expenses; the focus merely will shift from federal law to state law. For example, the laudable result in *Hibernia Bank v. United States*[158] of denying the deduction of post-death interest[159] could have been reached if the federal court had declared that the probate court's allowance of the administration expenses was contrary to California law.[160]

In jurisdictions without a necessity requirement,[161] however, or in jurisdictions where "necessary" is interpreted as requiring only a showing of reasonableness or good faith,[162] federal courts cannot deny administration expense deductions for items that fulfill the requirements of the first tier and are allowable under these more permissive state law provisions. In such cases, only a change in the state law or congressional revamping of section 2053(a)(2) would justify disallowance of the deduction.[163]

The controversy over section 2053(a)(2) stems from the failure of courts and commentators to consider each of the separate tiers in applying the section. Courts invalidating the necessity requirement focus on the state law component of the statute at the expense of federal author-

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157 *See supra* note 13.

158 581 F.2d 741 (9th Cir. 1978).

159 *See supra* notes 77-81 and accompanying text.

160 *See In re* Estate of Sharp, 18 Cal. App. 3d 565, 580-81, 95 Cal. Rptr. 816, 829 (1971) (administration expenses must be "necessary and proper") (construing CAL. PROB. CODE § 950 (West 1981)); *cf. In re* Estate of Fraysher, 47 Cal. 2d 131, 136, 301 P.2d 848, 851 (1956) (administration expenses must be reasonable and necessary); CAL. REV. & TAX CODE § 13988 (West 1970 & Supp. 1982) ("ordinary" administration expenses deductible under state inheritance tax; under CAL. ADMIN. CODE tit. 18, R. 13988.6 (1982), selling expenses not deductible unless "sale is necessary to raise funds to pay taxes, debts, or costs of administration, or the property is taken in a condemnation proceeding").

Federal supervision under the second tier thus refutes the Service's current view of the necessity requirement as the only alternative to the *Park* approach, which gives primacy to state probate court allowance of administration expenses. Under the second tier, representatives of the estate do not "answer only to a probate court, [when] the potential for abuse abounds because probate courts are notoriously liberal in allowing expenses." G.C.M. 38262 (1980).

161 *See supra* note 14.

162 *See supra* note 15.

163 *See* Estate of Smith v. Commissioner, 57 T.C. 650, 665 (1972) (Goffe, J., concurring in part, dissenting in part) ("If additional safeguards are needed they should come from Congress, not from the Secretary or his delegate in the form of unauthorized regulations. In my opinion the integrity of the estate tax must be safeguarded from unauthorized and unwarranted limitations imposed by regulations as well as abuses which may occur elsewhere"), *aff'd,* 510 F.2d 479 (2d Cir.), *cert. denied,* 423 U.S. 827 (1975).

ity to define "administration expenses." In contrast, courts upholding the necessity requirement emphasize the role of federal law in defining "administration expenses," and by doing so have emasculated the state law component of the statute. The two-tiered approach[164] should eliminate the confusion in the case law and commentary on section 2053(a)(2).[165]

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164 Professors Stephens, Maxfield, and Lind correctly note the general relationship between federal and state law under § 2053(a). With regard to the first tier, they posit a state statute authorizing an executor to purchase an around-the-world trip for a bereaved widow as a funeral expense under state law. They correctly conclude that the expense "is not a Section 2053(a)(1) 'funeral expense' merely because of its local characterization, as it is clearly not within the *congressional* meaning for that term." R. STEPHENS, G. MAXFIELD & S. LIND, *supra* note 1, ¶ 5.03[1], at 5-7 (emphasis in original). Moving to the second tier, they hypothesize a state statute authorizing executors to purchase solid silver caskets. Because the cost of a casket is a funeral expense within the *federal* definition, they conclude that

> the cost of a solid silver casket becomes a "funeral expense" (federal question) "allowable" by local law (state question) which a federal judge cannot properly hold nondeductible because of some feeling of parsimony that he may harbor. . . .
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> . . . .
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> [However,] if the judge in the [federal] tax case decides a probate judge erred in holding the purchase of a solid silver casket allowable under local law, he may disallow a deduction on the basis of his contrary interpretation of the local law, giving only "proper regard" to the local decision.

Id. ¶ 5.03[1], at 5-8.

Professors Stephens, Maxfield, and Lind, however, misapply this general framework to the question of the validity of the necessity requirement under § 2053(a)(2). They state that the requirement is a proper gloss on the term "administration expenses" in the statute. *Id.* ¶ 5.03[3], at 5-12 n.38. This conclusion ignores the eviscerating effect of the necessity requirement on the state law component of the statute, and is contrary to their own analysis of the relationship between federal and state law under § 2053(a). Consider the following situation. A state statute authorizes an executor to sell assets of the estate when "necessary" to meet an estimated future obligation of the estate. The executor incurs selling expenses in raising funds that he anticipates will be necessary, but that later prove to be excessive. State law allows such selling expenses as administration expenses. These selling expenses can be analogized to the silver casket example. Because selling expenses are an appropriate category of administration expense under federal law (just as the caskets were an appropriate funeral expense), and are allowable under state law, they must be deductible under § 2053(a)(2). The necessity requirement now permits a "parsimonious" federal judge to deny a deduction for these selling expenses. If Professors Stephens, Maxfield, and Lind consistently applied the rationale underlying their silver casket hypothetical to this situation, a federal judge would have to allow a deduction for the selling expenses. The necessity requirement is inconsistent with their own analysis of the relationship between federal and state law under § 2053(a), and is not, as the authors assert, an "appropriate interpretation." *Id.*

165 Estate of Smith v. Commissioner, 510 F.2d 479 (2d Cir.), *cert. denied,* 423 U.S. 827 (1975), exemplifies this confusion. In *Smith,* a Surrogate's Court had allowed sales commissions as administration expenses under a state statute that imposed a necessity requirement. The Second Circuit held that "the federal courts cannot be precluded from reexamining a lower state court's allowance of adminstration expenses." *Id.* at 482 (footnote omitted). Because this examination entailed an inquiry under *Bosch* into the factual necessity of the expenditures under state law, the court expressly stated that "[i]t is, therefore, unnecessary to pass on whether [the necessity requirement imposed by the regnlations] is invalid if read to deny a deduction properly allowed by state law." *Id.* at 483. In a footnote, the court acknowledged the role of federal law in defining the term "administration expenses." *Id.* at 482-

CONCLUSION

Taxpayers and the Internal Revenue Service long have grappled with the application of the necessity requirement of the regulations under the administration expense deduction provision of section 2053(a)(2). Courts and commentators, in the resulting mélange of conflicting rulings and decisions, disagree on the validity of the necessity requirement. The choice traditionally has been an unattractive one. Some courts sustain the requirement, thereby subverting the role of state law under the statute. Others subject the federal fisc to the capriciousness of probate court allowance of administration expenses in invalidating the necessity requirement. An alternative two-tiered approach to deductibility under section 2053(a)(2) is preferable. Under the first tier of this approach, the Service may determine the *types* of deductible "administration expenses" to be included within the statutory phrase. Federal court review for this tier is limited to whether the Service in its categorization has correctly divined congressional intent. An item meeting this threshold requirement is deductible if allowable by state law under the second tier. Federal courts may reexamine a probate court's application of state law in the allowance of administration expenses, giving proper regard to lower state court decisions. The necessity requirement of the regulations eviscerates the role of state law under this framework and must fail. This third alternative allows federal courts to safeguard the integrity of the federal estate tax while giving full effect to the state law requirement of section 2053(a)(2).

*Paul L. Caron**

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83 n.4. Although the Second Circuit misapplied the state law, *see supra* note 44, *Smith* supports the two-tiered approach advanced in this Note.

In spite of clear language to the contrary in the opinion, many commentators incorrectly cite *Smith* as having validated the necessity requirement of the regulations. *See* 1 H. HARRIS, *supra* note 7, § 213, at 74 (Supp. 1982); Wallace, *supra* note 7, at 702; Wyatt, *supra* note 7, at 13-8 to 13-9; Comment, *supra* note 7, at 377-78, 380. Courts and other commentators correctly cite *Smith* as not having ruled on the validity of the necessity requirement. *See* Hibernia Bank v. United States, 581 F.2d 741, 744-45 n.5 (9th Cir. 1978); Estate of Posen v. Commissioner, 75 T.C. 355, 366 (1980); Estate of Papson v. Commissioner, 73 T.C. 290, 299 n.9 (1970); R. STEPHENS, G. MAXFIELD & S. LIND, *supra* note 1, ¶ 5.03[3], at 5-12 n.38; Olson, *supra* note 7, at 318.

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