Post-Death Tax Options

Dale Forbes

Attorney, Church, Harris, Johnson & Williams

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Emphasis in recent years has been placed on the so-called “Estate Planning”. Everyone has horned in — usually for commercial reasons—and for good or bad has assisted the general public with the planning of their estates. If the attorney is included in the propaganda issued by the various estate planners, it is usually only incidentally. There is one area, however, where these new found estate planning friends abandon ship in helping to solve your client’s problem and that is when there is a death. At this point, the deceased’s friendly accountant, and his attorneys can pretty well plan on going it alone when various problems arise.

The first problem in post-death planning is to gather together sufficient information to recognize and solve the problem. There appears to be no “handy-dandy” tax manuals that one can thumb through to outline the various problems and their possible solutions. In fact, the work has been complicated because the statutes taxing trusts and estates are intermingled in the Internal Revenue Code. This confuses the problem because trusts and estates are frequently quite dissimilar as to their tax results.

This discussion will be limited to various options and elections which may be taken by the attorney, CPA or estate representative when working with the various tax matters related to a deceased person. This article will attempt to cover both Federal income taxes and estate taxes and discuss the inter-relation between the two when these options are taken.

A. First as to decedent’s last return:

1. The first option is whether or not to file a joint or an individual return on decedent’s last return. A preparer of a decedent’s return is given the same option as the decedent would have had himself, either to file jointly with the surviving spouse, or individually and on a normal filing date. The exception to this option being that if the surviving spouse remarries within a year of death, then no joint return can be filed.

2. Next, the surviving spouse has an option under certain limited circumstances to continue to receive the tax savings of joint return rates for two additional years after the date of death. The surviving spouse has to meet certain limited standards — one being maintenance of a...
home as a household and as a principal place of abode for the entire year and having a son, step-son, daughter or step-daughter of the surviving spouse as a dependent. There are other limitations and this is not a blanket election as one might suppose nor does it follow the definition normally accorded a dependent. If it appears that someone may fall under this category, check Code section 2 (b) and Regulation 1.2-2.

Under this election, for the two years the surviving spouse is entitled to the joint return tax rates. There are, however, no additional exemptions or deductions other than those attributable to the survivor. In effect, nothing in the way of exemptions or deductions from the deceased to a year subsequent to that of the spouse’s death is carried over.

3. It may be a misnomer to use either the term “option” or “election” as to the question of whether any payments coming to the deceased that are normally reportable on the decedent’s last return are tax-free. This refers specifically to gratuity payments made by the employer which are lump sums paid up to the amount of $5,000 which are tax-free to the recipient and deductible by the employer. This is a matter easily overlooked. Often payments sent by the employer as additional payments over and above wages are reported on a W-2 Form although generally no withholding is taken. This writer knows of at least two instances in the last year where the preparer of the last tax return of a decedent has had the widow pay income tax on monies which were tax-free and later was required to file for a refund. These payments of gratuities can be rather informal. The Court decisions allow even more informal arrangements than the regulations indicate and attention should be given to the Greely case in which a $13,000 gratuity paid by a corporation to a widow was held to be non-taxable income, the amount far exceeding the $5,000 specific exclusion. If one is willing to fight for it most of the Courts seem to follow the rule of the Greely case. The test applied by most of the Courts is whether the recipient performed services relating to the payment made. If not, then the payment is considered a gift. This can be a good device for disposing of an indebtedness which the deceased may owe to the corporation in which he is a stockholder if the remaining stockholders and directors see fit to forgive such indebtedness. The Greely case sets forth the majority rule followed by Judge Jameson but one is going to have to fight for it each and every time as the Revenue Service will not acquiesce in these cases and will try each and every one as far as this writer knows even though they lose them rather consistently. Also, care must be taken to insure that the corporation gets a deductible expense item.

*INT. REV. CODE OF 1954, § 2(b).*
*Id.*
*INT. REV. CODE OF 1954, § 152.*
*INT. REV. CODE OF 1954, § 101(b).*
*Treas. Reg. § 1.101-2 (1968).*
*35-2 CCH U.S. Tax Cas. ¶ 9734.*
4. The next item, again, is not an option by the preparer of the last return of a decedent or a subsequent fiduciary return but it is one of the most difficult areas for a practitioner in this field. This involves determining whether transactions which are incomplete at the date of death create income on the last return of the decedent or are to be reported subsequently on the fiduciary return.

If it is truly an incomplete transaction which has to be completed by certain actions done by the executor or representative of the estate, then for cash basis taxpayers the income should theoretically be reported on the fiduciary or estate return.\footnote{\textit{Int. Rev. Code of 1954, §§ 451(b) and 691.}} There are transactions, however, which are substantially completed by the taxpayer before death and must be reported on the final return of the taxpayer even though the proceeds are not paid until some subsequent date and are actually received by the representative of the estate.\footnote{\textit{Treas. Regs. §§ 1.451-1(b) and 1.451-2 (1968).}} This, of course, is required under the constructive receipt of income theory.\footnote{\textit{Id.}} Except for the unwary, usually constructive receipt of income could be worked out by careful handling of transactions between the taxpayer and the person with whom he is dealing. Of course, because death is not too well planned by most people, it can present a problem in straightening out where the income should go.

It should be remembered that contract law alone cannot be relied upon.\footnote{\textit{Treas. Reg. § 1.451-2 (1968).}} What is contractually sound may not avoid constructive receipt of income. As a rule of thumb, all acts performed by one party for the contract is one taxable year but payment received in another will lead to difficulties. There are, of course, many different factual situations. In Montana, for example, there is frequently a sale of cattle in which the cattle have been delivered but payment has not been made. It is up to the preparer of the return to finally determine whether this income should be reported on the last return of the decedent or whether the transactions were sufficiently incomplete so that it should be reported on the fiduciary return. Also, one has to watch the accrued interest due on bonds and matured interest coupons which have matured at the date of death but have not been received. Of course, if the decedent had elected to include his bond interest income on his annual return as it was earned then there is no problem; the interest earned during his final taxable year is included on his final return. When there has been no such election, the accrued interest income is generally considered income to the decedent even though the monies were later obtained by the fiduciary.\footnote{\textit{Rev. Rul. 58-436.}}

5. Income from growing crops, raising livestock or storing grain is not income with respect to a decedent.\footnote{\textit{E. O. Luce, 15 B.T.A. 169 (1930).}} In very recent history, the
government's theory was that all of these payments did constitute a form of income in respect to the decedent which was required to be reported on decedent's last return. The government lost so frequently in court on this theory that they ultimately gave up, acquiesced in the cases and later changed their position. This writer is somewhat leary, however, that the I.R.S. might again attempt to resurrect their former theory as it seems to be a sore point with the Treasury Department.

B. On the same subject of whether to report monies on the decedent's last return or on the fiduciary return of the estate, there is an interesting case which deals with rentals paid on a crops share basis which certainly would be of some significance in our area. The Davidson case held Rev. Ruling 58-436 inapplicable to crop or animal share payments which it held were income in respect of a decedent.\(^8\) It would appear from the decision that all crop rentals due and owing but not yet paid come under the constructive receipt theory and therefore should be reported on the final return of the decedent even though paid at a later date to the estate representative; that all crop rentals not yet due and owing (such as a growing crop to the extent of the landlords share) may be reportable on the fiduciary return.

C. The final matter involves dividends. Any dividends declared and paid, although not received, must be picked up in the federal estate tax return as an asset as of the date of death.\(^7\) It would appear, however, that unless actually received or in a position where they could have been received, but for the neglect of the deceased taxpayer, dividends are not income in respect to a decedent but ordinary income to the fiduciary.\(^8\) If one has a close case on the matter the case of M. Fox, Circuit Court of Appeals, Third Circuit, 55-1 USTC para. 9130, 218 Fed 2d 347, should be examined.

The next post-death tax option involves what property should be sold for the purpose of raising monies to pay taxes. In the rural areas, estates involving farms often have high values on land for the purpose of death taxes, and further are chronically short of money and non-liquid. If there are any liquid personal properties, they are usually of a conservative nature, such as government Series E Bonds. These bonds generally, of course, have a great deal of accrued interest and being cash basis taxpayers, the farmers almost uniformly elect not to accrue the interest each year. There is no question, of course, that all of this accrued interest, together with the principal on the bond, has to be included in the decedent's gross estate on the Federal estate tax return.\(^9\) Also, if the bonds are distributed to the beneficiaries in the estate, they are not going to accrue any income taxes until such time as they are cashed.

\(^8\)Davidson, 61-2 CCH U.S. Tax Cas. ¶ 9584.
\(^7\)INT. REV. CODE OF 1954, § 2033.
\(^8\)Estate of Putnam v. C.I.R., 324 U.S. 393 (1945).
\(^9\)Treas. Reg. § 20.2033-1(a) (1968); mim. 5202, 1941-2 CUM. BULL. 241.
If it is the decision of the representative of the estate that these bonds have to be cashed, and sometimes this is the only decision that he can reasonably make, the factor of accruing a good deal of interest income in one taxable period should be taken into account. It is true that there may be some offsetting benefit, by way of deduction for the Federal estate tax increment but this generally is a very limited value. This matter will be discussed in some greater detail at a later time. If there are other saleable personal property assets it is generally better to dispose of these instead of the bonds with accrued interest. Usually the cost basis of personal property assets is very close to what they are sold for (keeping in mind that a new cost basis has been assigned to the personal property as of the date of death). All other things being equal, it usually is best to sell assets other than government bonds to raise money in an estate. If those bonds go on to a beneficiary he can then take his time and work it into his own income tax planning for the purpose of disposing of them without too much lumping of income.

The next post-death tax planning involves whether an executor can exercise certain postponement of gain provisions available to the decedent. If an involuntary conversion has occurred prior to the date of death, immediately a question arises whether the representative of the estate has such an option to complete the reinvestment of the funds to come under section 1033 to postpone gains. The Circuit Court of Appeals, Third Circuit, said that a personal representative certainly could exercise these rights.

What about the right to postpone gain on the sale of a personal residence under section 1034? Because of the terminology used in section 1034, it would be this writer’s guess that the executor, together with the surviving spouse, if they made such an election, could complete the postponement of gain by reason of sale of the personal residence, which was done just before the decedent’s death. Also section 121 provides that a person over the age of 65 may exclude from his gross income capital gains up to the first twenty thousand dollars of an outright sale of the home, and for certain prorations and adjustments over and above the twenty thousand dollars, which would be of benefit to him. Without having any precedent of the formal cases, it would be this writer’s guess in reading the terminology of this section that this is a personal election which can be made by a person over the age of 65. If this is the deceased’s house, probably that election dies with him unless his wife can make an election in her own right by reason of her age or otherwise. An executor cannot help her much.

The next election or planning which a representative of an estate must do is to assure himself he can pay taxes, repairs and costs of handling real estate. Of course, on the last return of the decedent there

\[\text{Treas. Reg. } \S 1.691(b)-1 \text{ (1968).}\]

\[\text{253-2 CCH } \text{U.S. Tax Cas. } \S \text{ 9556.}\]
is little problem in deducting the various costs involved with real estate up to the date of death, and also taking the depreciation, if any, up to the date of death. Personal property goes to the executor (and there is some question even here as to the rights of an executor). Therefore, on the fiduciary returns any income derived from the personal property should be accounted for in the estate and in the fiduciary income tax return.

Montana has some rather unusual old statutes following the English common law, as it pertains to real estate. These statutes were passed long before the income tax became so popular. These statutes say in essence — first, that all real property vests to the devisees named in a will at the date of death;22 second, that the administrator or executor of an estate is entitled to possession of the real estate of the decedent and may receive rents and profits and upon order of the court is to deliver the rents and profits to the heirs or devisees after payment of their various expenses and costs of maintaining the building.23 Further, the executor or administrator may join with the heirs or devisees of the real property to maintain any actions such as quiet title or petitions or anything else that would affect the real estate.24 The fact that the real property is owned by the devisees at once, subject only to the limited right of the executor or administrator, has been acknowledged by case law.25

Section 91-2211, Revised Codes of Montana, 1947, says in effect that as soon as it satisfactorily appears to the court or the judge that the rents and profits of the real estate are not necessary and that there are other properties available to pay the debts of the decedent and further that it would not be necessary to sell the real estate for the purpose of paying the debts of an estate, then the court or judge at the length of time limited for presentment of claims against an estate (four months in Montana) must direct the executor or administrator to deliver the possession of the real estate to the heirs at law or devisees. If "must" means "must" this statute would appear to have some tax consequences for income tax purposes. Not only would it affect the accounting of the executor in the probate, but it would affect who would report rents and profits and take the deductions and expenses attributable to real estate owned by a deceased person. This fine point of the law as it involves real estate is probably uniformly ignored. Generally, in a fiduciary income tax return of an estate, one should pick up the rents and profits, deduct the expenses and deductions that involve the real estate, take the depreciation usually based on the new cost basis established at the date of death in the estate and treat it as an estate asset. There are evidently no tax cases interpreting this aspect of Montana law in light of the In-

22Revised Codes of Montana, § 91-225 (1947) (Hereinafter cited as R.C.M.).
23R.C.M. § 91-2210 (1947).
24Id.
25Eschamps Estate, 65 Mont. 207, 212 P.512 (1932).
ternal Revenue Code. However, in 8 T.C. 748, (1947), Estate of B. Brasley Cohen, the Tax Court construed California's identical statutes, and held that income from real estate is properly reported on the estate income tax return. The Brasley case should be conclusive on the issue in Montana. If, however, a revenue agent were to read those statutes carefully and also was to determine that the tax bracket of those receiving the real estate is higher than the tax bracket of the estate he could make a very good argument, where the estate was solvent and had sufficient personal property to meet the debts, that the fiduciary returns should not include any real estate related income at all.

Going back to the option a determination should be made early in the proceedings whether the real property is going to be necessary to handle the costs of the estate. Perhaps a court order or determination should be made one way or the other and then the tax policies and reporting of income tax should be consistent with the Court order.

Medical Expenses

One should be familiar with Code section 213(d) which provides that medical expenses paid by the executor within one year of the date of death may be taken again on an optional basis on the last return of the decedent. This is actually a two-way option because the tax preparer can put it on the last return of the decedent if it would be of the greatest tax benefit if paid within one year of death. In the alternative, this is also a valid deduction for Federal estate tax purposes. It is theoretically possible, for example, that the greatest benefit taking it on the final return of the deceased would be for the surviving spouse. Other heirs might be involved in the monies being derived from the estate and, therefore, it would be to their greatest benefit — forgetting about tax benefits for the moment — to have it deducted by having the election taken on the Form 706, fiduciary return, saving federal estate taxes. The individual making the option probably is not going to be subject to criticism if he takes the option that is to the greatest benefit in conserving monies as between people in the group he is representing and the federal government who is the "enemy" of all when it comes to collecting taxes. If the decedent’s income tax bracket and the federal estate tax bracket are about the same, making the savings in the tax essentially the same, depending upon the option taken, the optioner might find himself in a rather unpleasant circumstance of having conflicting interests.

The next area of discussion involves an inter-relation between federal estate taxes and income taxes which must be kept in mind every time an option is exercised. Valuation of all of the assets of the deceased has to be made as of the date of death, or under Code section 2032, can be made on the alternate valuation date of one year after death. Included in this valuation of the decedent’s assets is a number of items which constitute income that is constructively received and reported on the decedent’s last return or to be received by the estate if assets are sold.
which involve accrued income in them — such as government bonds, dividend checks on stock, or income that is going to have to be reported ultimately by a beneficiary. On this accrued income which is to be reported, there has been some federal estate tax paid up to the extent of the accrued income valued in the decedent’s estate at the date of death or on the alternate valuation date. They are granted a special estate tax deduction under provisions of Code section 691(c) and regulation 1.691(c)-1. There is a rather complicated formula for arriving at the amount of the deduction which can be found in the regulations, but an extreme oversimplification could be described as follows: if a beneficiary cashed Series E bonds on which there was accrued interest reported in the estate of a decedent in the amount of $1,500, if that estate return was in a 30 per cent federal estate tax bracket, there would have been paid on that $1,500, $500 worth of federal estate tax. There would then be a deduction allowable on the beneficiary’s income tax return (or the estate’s if the executor cashed the bonds) of $500 in the year the bonds were cashed in. No allowance is granted, however, above the total tax due and there are certain other limitations.

Finally, reference should be made concerning several items often overlooked at pre-death tax planning which have some serious effects on reporting of taxes after the death. Take, for example, the situation of a deceased partner who has certain rights, benefits and elections pursuant to a partnership agreement which might very seriously affect the nature and amount of taxes paid on monies received from the partnership for the deceased partner’s interest. Too often representatives of estates simply lump these payments as some kind of partner’s interest, pay federal estate tax, and pay income tax on the monies which would appear to be profits for the partnership through the date of death. Frequently, little thought is given to the partnership agreement which might very clearly spell out that certain portions of the monies are tax-free.

Also, it sometimes is difficult to handle installment sales. Often under the panic of doing something — and not necessarily as good estate planning — the father sells the ranch under an installment contract to a son. The capital gains are usually considerable and the balance due on the installment contract is taxed in full as part of the father’s gross estate for federal estate tax purposes. The regulations are specific that the installment contract capital gains go to recipients who continue to report on the installment basis. The only benefit derived is the federal estate tax deduction on the gains reported as noted above. These are of limited value. Also, it is interesting to speculate whether the balance is accelerated under the provisions of section 691 (equivalent to a sale) when the balance of the indebtedness is forgiven in the will of the father to the son. It

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2 Trea. Reg. § 1.691(c)-1(d) (1968).
5 Trea. Reg. § 1.691(c)-1 (1968).
could have disastrous tax results and create a tough problem for the son. This writer has never seen a return of a beneficiary which has taken advantage of the federal estate tax deduction for taxes previously paid on subsequent installment contract payments.

In any event installment sales of land late in life to the vendor's primary beneficiaries are a poor and expensive method of handling the transfer of farms and ranches. An option to purchase in a will would probably do the job much more effectively.

While discussing this subject a review of section 691(a)(4) allowing a pro-rata federal estate tax deduction (credit) and determining what is or is not "income with respect to decedent" are important considerations. Items not found to be "income in respect to decedent" have as their basis the appraisal in the estate.

Return of an estate or trust

The next options or elections to be discussed involve the fiduciary return to be prepared by the representative of the estate of the decedent. The area is rather maddening because the regulations and revenue statutes co-mingle estates with trusts, simple and complex. Because most of the trust rules don't seem to have anything to do with estates, it is much more difficult to glean out what information is necessary to prepare fiduciary returns. There are, nevertheless, a number of elections. The first and most important is the period in which to file the federal estate tax return. There is an election to file either on a calendar year basis, which means filing for a short year covering the period of time between the date of death and the close of the calendar year of December 31st, or on a fiscal year basis which would be one year from the date of death. In both instances one has three months and fifteen days in which to file the return after the close of the year. This calls for a little prior planning and getting an estimate of what income is coming in and when. It also demands waiting until such time as the estate is about to be closed and this sometimes means that the attorney has waited too long to make such an election. Most estates generally will have a number of sales of property, some of which will result in gains and income tax consequences to the fiduciary, and often times the sale date can be quite flexible. In other words, sales of machinery should be made after the first of the year as opposed to before the first of the year. These elections are often made without giving proper thought as to the tax consequences. This is particularly true when you have an attorney running the estate and an accountant handling the tax matters. Generally, the accountant doesn't have the slightest idea when the attorney is making or setting up sales

\[\text{INT. REV. CODE OF 1954, § 1014.}\]
\[\text{INT. REV. CODE OF 1954, § 441.}\]
\[\text{Id.}\]
\[\text{INT. REV. CODE OF 1954, § 6072(a).}\]
in the estate. The attorney is thinking mostly in terms of when money is needed as opposed to tax consequences and by the time the information gets to the accountant, he doesn’t have any say in some elections which could have serious tax consequences. To make this point clear, let’s take one matter which can be of great consequence. This is an estate which includes a growing crop at the death date which crop is ultimately harvested by the estate. As a practical matter the decision of when to sell is made strictly on the basis of when the money is needed. In short, the decision is made to sell when the attorney is to be paid and when the taxes are to be paid. In reality, there is a great deal of flexibility. Oftentimes sales are made of crops in the fall in which harvested when, as far as the estate is concerned, they could be just as easily sold some six or eight months later or after the end of the calendar year. The following additional thoughts should enter into the election: first, a serious consideration should be given to the appraisal of the growing crops in the estate. Far too many estate inventory and appraisements say “x” number of acres of land “x” dollars without in any way attempting to allocate a portion of those monies to a growing crop although the appraisers may well have been taking into consideration that the crop was about ready to be harvested at the time they appraised the land. If the appraisers do not, the Revenue Service will try to raise the valuation. For the estate of a deceased operating farmer — “operating” farmer should be emphasized because crops received by a landlord have a different consequence — the appraisal value becomes the crop’s cost basis.34 If the federal estate tax bracket is lower than the income tax bracket, there is going to be some savings in taxes because on the income tax return of the estate only the difference between the cost basis and the actual sales price of the crop will be taxed for income tax purposes.35

Next, the price of the crop will be reported for income tax purposes. Then, one has to determine whether income is going to come in and whether the return is to be filed on a calendar basis. Perhaps some of the grain should be sold before the end of the calendar year, a calendar year elected and the balance sold the next year to keep the overall tax down. As one would assume, if a fiscal year basis is taken then a sale at any time within that fiscal year is going to be income and there is going to be no opportunity to divide it between different taxable years. To complicate matters further, in most smaller estates there is not going to be an election or even a consideration of an alternative valuation date for federal estate tax purposes. This can involve a number of farm returns where there is a surviving spouse. The estate is distributed on the return to the beneficiaries in the proportion to which they receive the estate — thus, if you hold a crop over the end of the year and have elected on a calendar year basis in an estate, then that income derived from the sale of crops after the first of the year — assuming that you

25Id.
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distribute the estate at any time during that year — is going to have to be distributed to the beneficiaries of the estate and taken in with their other income. This is true even though the beneficiaries do not get any income and the profit is strictly a paper profit. All they are getting from the estate are assets which probably total less than their inventoried value because of various taxes and costs of administration. Paper profits are not too popular with anyone. The solution is to judiciously select the taxable year for the distribution and termination of the estate so that the estate pays the tax as opposed to the beneficiary. An estate on a calendar year basis which normally might be closed out October 1st might very well be held over until January of the following year solely for the purpose of completing its taxable year, so that the calendar year beneficiaries could pay the tax on their next year's return. This election would have to be taken up with the beneficiaries and involves their income from outside sources. An attorney can get into a nasty conflict between beneficiaries. One of them may not have much income and could care less about taxes and really wants to get his hands on the assets of the estate but a second beneficiary who is already in the 30 per cent bracket is hardly enthused about taking any more income. Some estates that have potential heirs with lots of money who are not very anxious to take any income from the estate apparently have held estates open for long periods of time. However, there comes a time when the government will refuse to recognize the estate as a separate tax payer for tax purposes. 36 On the other hand, if there is a good reason for a delay in an estate, although the government may not like having a separate taxpayer, it has been held that even 11 years was not unreasonable under certain factual circumstances such as protracted litigation involving the estate. 37

The next planning involves a widow's allowance and the possibility of using it for income tax purposes. Assume an estate in the taxable year involved has $15,000 income and a widow who, through jointly held properties and other methods, has certain assets which derive income of approximately $2,000. Further assume that the estate, because it is a rather substantial one, is taking most of the deductions authorized for either the 706 form or the 1041 so no elections can be made to decrease the amount of the taxable income on the 1041. This writer would suggest the possibility of going to court during the year in which the estate derives this amount of income and asking for a widow's allowance to be paid out of estate income at the rate of $650.00 per month. The estate has sufficient funds to pay this and it may have the result of transferring $7,800 to the widow during the year to go with her $2,000 giving her total income of $9,800 and leaving the balance of $7,200 in the estate. By this method the widow's income is greater than the estate's. This points out another situation. An estate does not have any type of elec-

37 A. T. Miller, 333 F.2d 400 (8th Cir. 1967).
tion for standard deductions and must itemize their deductions.\(^38\) If it has none or if they are used on the Form 706, the federal estate tax return, then there will be a higher net taxable income in the estate. Whereas the widow, even if she has no itemized deductions, will be entitled to take certain deductions: perhaps she gets a double exemption for being over 65 or, in any event, presumably she can stand more income than the estate and she can use what is generally referred to as a "rolling standard deduction".\(^39\) A note of caution should be made. Montana's statutes involving widow's allowance are old and archaic and do not take into consideration anything about income tax planning. The statutes\(^40\) are explicit that the widow has such an allowance and the court had better give it to her over and above everybody's claim, but it does not say whether it comes out of income nor do we even know for sure whether it is a vested right or not for purposes of the section 2056 marital deductions. This is something currently being litigated as it involves federal estate tax. This writer sees no reason why, if the income is available in the estate the court cannot order that the widow's allowance be paid out of the income held by the executor in the estate. If the court order properly states that the widow's allowance is payable out of income it would appear that the division of the income as suggested in the example above is justified.\(^41\)

A third suggestion for tax planning on fiduciary returns involves the redemption of stock in a closely held corporation. There is an important section, Code section 303, which grants representatives of estates the right to redeem or cancel stock for the purpose of paying death taxes and some costs of administration. It is a very important option which must be kept in mind by the representative of the estate. There are certain limitations, namely, that the stock in the corporation must comprise 35 per cent of the value of the decedent's gross estate or more than 50 per cent of the taxable estate.\(^42\) Also there is the question of several closely held corporations as opposed to one and the limitations imposed thereon. There is a time limitation on when this right can be exercised.\(^43\) Finally and most important, Commissioner's regulations 1.303-2(a) state what maximum amount of stock can be redeemed under the provision. Generally that is measured in terms of the value of stock necessary to pay death taxes plus interest, funeral and administrative expenses.\(^44\) Finally, when exercising this option, the executor must watch the attribution rules of other stockholders.\(^45\) For example, if a widow holds jointly owned stock in the company, and she is also redeeming stock,
the amount that the executor may take under code section 303 without fear of running into dividends may very well be reduced.

The next planning that must be handled by the fiduciary in the estate is a determination of where the administrative expenses of the estate are going to be deducted. The Code, in sections 2053 and 2054, concerning administrative expenses and losses during administration, allows deductions from the gross estate for federal estate tax purposes of these expenses, or in the alternative from the gross income of the estate for income tax purposes. Although there are various administrative expenses, an example will demonstrate how this works. If the estate has an attorney’s fee in the amount of $3,500, this may be taken either off the federal estate tax return, Form 706, to reduce the net taxable estate, or in the alternative, it may be taken on the fiduciary return of the estate when paid. Section 642(g) provides that a waiver must be filed where the items are not taken on the 706. For example, if the attorney’s fee is taken on the fiduciary return there should be a waiver filed with the Form 706 stating that no attorney’s fee is taken, and the reason why. This is to prevent a double deduction. There were a few miscellaneous items such as trust fees that were previously deductible in both places. This has been changed by a 1966 law. This election by the executor between the estate or the fiduciary income tax return for the estate is a very important one, and has been utilized a great deal. Keep in mind that the last tax return for the estate in the year of distribution requires that any retaxable income be distributed and taxed to the heirs. If there are heirs with substantial other income who dislike paper profits, and the income tax bracket of the estate is as high as that of the federal estate tax, then there is probably a good justification for taking the costs of administration or a portion of them on the final fiduciary return. It should be emphasized that a number of cases have held that costs of administration can be divided to the best benefit of the taxpayer between the fiduciary return and the federal estate tax return. In other words, if it is to the best tax benefit of the parties, $1,250 of a twenty-five hundred dollar attorney fee could be deducted on the fiduciary return and the remainder on the federal estate tax return. If it is impossible to make a determination in advance, another way of approaching the matter is to file the 706 federal estate tax return without taking the deduction. If it is later determined that it would be better to have done so after the close of a calendar year, then a refund claim can be processed on the 706 form. But once a waiver is filed it is conclusive and there can’t be an alteration or change at a later date.

The question arises whether an election can be made to take so much
of the cost of administration against the income of the estate so that in 
the year of distribution the estate distributes to the beneficiary what, in 
effect, constitutes a loss. For example, if an estate in the year of closing 
has two thousand dollars worth of income and $3,000 of administration 
expenses elected pursuant to § 642, to be taken on the 1041, this leaves 
a $1,000 loss. If there are two residuary heirs, "A" and "B", and each 
of them are entitled to the income and the deductions from the estate, 
the net effect would be a $500 deduction for each of them.51 This pro-
cedure has the indirect effect of off-setting the costs of administration 
against income of the beneficiary.

FEDERAL ESTATE TAX

Election to take alternative valuation date for Federal Estate Tax purposes

1. This option in favor of the executor or the administrator is au-
thorized by Code section 2032. As to the actual election only two prob-
lems arise. The first is to make sure that the election is made within the 
15-month period or within the time authorized and extended by the 
District Director. If it is not, the election no longer is available.52 Care 
must be taken that the election is properly made, because if it has been 
mistakenly made there is no opportunity for changing it.

2. If the estate representative choses the alternate valuation date, 
all valuations will then be made one year from the date of death. This 
election is generally made where the assets have certain volatility to their 
valuations — more particularly if there are a number of stocks and bonds.

A problem arises with properties that are disposed of during the 
year. The Code provides that these properties will then be valued at the 
time they are "sold, distributed, exchanged or otherwise disposed of 
during the year". Therefore, as to "sold" or "exchanged" items, the 
sales prices would be the valuation price for federal estate tax purposes.53 
"Distributed" or "disposed of" might present some problems. The typ-
ical example would be where a specific bequest was made of 15 shares 
of AT&T stock. The executor determines that the distributee needs the 
stock and, therefore, gets a court order authorizing distribution two or 
three months after the date of death. It would appear that the delivery 
date of the stock by the executor to the distributee would be the time 
for valuation. This foreseeably could give the executor some control 
over valuations although in most instances the executor is guessing for 
or against the market. Once he has done this, apparently no changes 
can be made.

3. Adjustments are also allowable for value placed on assets as 
of the alternate valuation date where these adjustments are not reflecting

51 Treas. Reg. § 1.642(h)-3 (1968).
52 Rev. Rul. 64-105.
53 INT. REV. CODE OF 1954, § 2032(a) (2).
the mere lapse of time. Typical "mere lapse of time" type adjustments would be depreciation, payments reducing the value of the mortgage, etc. during the interim period, and, of course, these adjustments would not be allowed. But any adjustments can be made where it can be shown "mere lapse of time" is not a determining factor. A typical example would be where property of some value is flooded during the one-year period substantially reducing the value of the property.

4. Dividends and other income received during the year are not includable in the decedent's gross estate by reason of the executor's election to adopt the alternate valuation date but the right to income, if it is accrued at the date of death, would be includable. As to income items, there is no one-year later election. It would be the same as if one had taken the valuation at the date of death. Also, any payments on principal on interest-bearing obligations are not includable in the gross estate during the one-year period. Normally dividends paid during the one-year period are excluded from the alternate valuation date; however, the government in Revenue Ruling 58-576, 1958-2 CB 625 leaves the government an "out" by saying that any stock dividend or dividend that should effect the value of decedent's total share, to the extent that the total shares "do not reasonably represent the same property existing at the date of death," will have to be included in the gross estate. It is probable that this prevents any type of dividend planning in a closely-held corporation which would substantially reduce the valuation of stock for estate purposes. Also, in making this election one should keep in mind that depreciation and values of insurance policies, caused by the death of the insured during the one-year period, must be included and is not considered as earned or accrued during the period according to Revenue Ruling 63-52, 1963-1 CB 173.

Reduction of marital deduction with inter-related death taxes

This last matter to be discussed cannot technically be classified as an election. In fact, the federal estate tax contemplates the reduction of the marital deduction by inter-related death taxes on a rather complicated formula. In view of the Marans case in Montana, there is some question currently whether the marital deductions, at least in cases of where the will is silent as to how the taxes should be prorated, should be reduced at all by the state death taxes. The situation is as follows: assuming "A" should die intestate leaving a wife and one daughter, the property would normally be divided 50-50 in accordance with the intestacy statutes in the State of Montana. Without and equitable apportionment, statutes in the State of Montana, or rule, the prior rule in Montana has been to reduce the marital deduction to the extent of the inter-related death taxes using the above-mentioned formula. This reduces the marital deduction

6Treas. Reg. § 20.2056(b)-4(c) (1968).
7Estate of Marans, 143 Mont. 388, 390 P.2d 443 (1964).
which, in turn, increases the federal estate tax. The determination of the interest which parties receive in an estate is determined on the local state level in accordance with the probate law. If it is assumed that under the Marans decision the widow is entitled to 50 per cent outright, she only having to share the federal estate tax in proportion to the extent to which property she inherits creates a federal estate tax, then one-half would be free and clear for marital deduction purposes. This is the amount that she receives under the estate and there would be no justification for reducing her marital deduction by inter-related death taxes or the amount of the federal estate tax. On a slightly different interpretation of the same set of facts, it may be that it would be necessary to reduce her share of the estate by her amount of estate inheritance tax but there would be no justification for reducing her share of the estate by a proportionate share of the federal estate tax. There is probably no solution to this problem but hopefully the courts will have one in the near future. In any event this is an election or option which the executor currently is going to have to decide in the State of Montana at the time he makes a determination as to the amount of the marital deduction under certain factual situations as outlined above.