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Post-Mortem Tax and Estate Planning Elections

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POST-MORTEM TAX AND ESTATE PLANNING
ELECTIONS

David L. Johnson*

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I. INTRODUCTION

The practitioner engaged in estate planning will devote considerable time during the client's lifetime to the implementation of a coordinated estate plan so that the assets are ultimately distributed in an appropriate fashion to the intended beneficiaries, with the minimum shrinkage because of state and federal death taxes and income taxes. The death of a client does not end the need for further tax and estate planning. After death there are a variety of elections available to the personal representative of the estate which need to be considered. If the estate qualifies, these elections can result in considerable savings to the estate and the beneficiaries.

There have been a number of recent significant developments which have made the post-mortem planning process more difficult. Several major new elections were added by the Tax Reform Act of 1976;¹ the Revenue Act of 1978² also has an impact on after-death planning decisions.

Reproduced as Appendix A is a summary checklist of the post-mortem elections which are discussed in this article. The checklist was designed for use in each estate administered, and to help the practitioner make a timely decision as to whether an election should be made. The order of discussion of the elections in the checklist and in this article is by subject matter, not chronology. In practically every instance, if an election is not timely, it will not be available. Prompt attention to the alternatives is therefore essential.

The importance of proper planning is not limited to saving tax dollars for the client. Increased satisfaction by the beneficiaries of the estate and the avoidance of liability for failure to make a proper decision are additional reasons for being aware of the options. Finally, the availability of choices increases the opportunity for creative administration.

II. ELECTIONS RELATING TO DECEDENT'S FEDERAL INCOME TAX

A. Election to File Joint Return With Surviving Spouse

A final federal income tax return must be filed for each decedent covering the period from the beginning of the decedent's final taxable period (normally January 1) through the date of death. The return is due at the same time the return would have been required to have been filed had the decedent lived for the full taxable year, which would be April 15 of the following year for taxpayers having a calendar year taxable year. If the death occurred in the first several months of the year, two returns may be necessary—one for the full preceding year, and one for the final taxable period. If the decedent had filed a declaration of estimated tax, no further payments are required after death. However, if there is a surviving spouse, the surviving spouse is required to continue the payments unless an amended declaration is filed setting forth the spouse's estimate of separate tax for the year.

1. Income Includable

It is necessary to include only the decedent's income up to the date of death. Income in respect of a decedent is not reported in a cash basis decedent's final return.

Special rules apply if the decedent were either a partner in a partnership or a shareholder in a Subchapter S corporation. If the partnership tax year does not close concurrently with the death of the partner, the decedent's share of partnership income (including withdrawals made by the decedent prior to death) is taxable to the decedent's estate or other successor in interest. However, if the

3. I.R.C. § 6072(a). Unless otherwise specified, all references are to the Internal Revenue Code of 1954, as amended.
6. Although nowhere specifically defined, income in respect of a decedent (IRD) generally includes most items of income which were unpaid at death to which the decedent had a legal right to receive as of the moment of death. Typical IRD items include accrued compensation, dividends and interest. See I.R.C. § 691.
partnership closes concurrently with the death of the partner, the deceased partner's share of partnership income is taxed in the decedent's final return.  

For Subchapter S income, the decedent's estate is required to report in its tax return the income attributable to the shares for the entire taxable year of the corporation in which the decedent died. The IRS has ruled that none of the income is income in respect of a decedent, and thus the section 691(c) deduction will not be allowed to the estate or other person receiving the income. In effect, the income to date of death could be subjected to both estate and income taxes. Subchapter S losses are treated differently. The pro rata share of the loss to the date of death is reported on the decedent's final income tax return, and the pro rata loss from the date of death to the end of the corporation's taxable year is reported by the decedent's estate.

2. Joint Return Procedures

If the decedent's spouse has not remarried by the end of the spouse's full taxable year, the estate has the option to either file a joint return with the spouse, or to file a separate return for the decedent. If a personal representative has not been appointed by the due date, the spouse can file the joint return. Thereafter, the personal representative may disaffirm the joint return by filing a separate return within one year after the due date.

If a personal representative has been appointed, the joint return can be filed only with the joint consent of the personal representative and the spouse. If separate returns have been filed, and thereafter it is determined that the filing of joint returns would produce the better result, the election can be reversed by filing joint returns within three years of the due date for separate returns.

3. Factors to Consider in Joint Return Election

In most instances, the combined income tax on a joint return will be less than the total tax which would be payable if separate returns were filed for the decedent and for the surviving spouse.
The following tables illustrate the savings which are available by filing joint rather than separate returns.

<table>
<thead>
<tr>
<th>Taxable Income</th>
<th>Separate Returns</th>
<th>Joint Returns</th>
<th>Savings</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Decedent</td>
<td>Spouse</td>
<td></td>
<td></td>
</tr>
<tr>
<td>$ 8,000</td>
<td>$ 3,000</td>
<td>$ 1,320</td>
<td>$ 80</td>
</tr>
<tr>
<td>20,000</td>
<td>5,000</td>
<td>5,640</td>
<td>1,010</td>
</tr>
<tr>
<td>26,000</td>
<td>20,000</td>
<td>12,990</td>
<td>170</td>
</tr>
<tr>
<td>50,000</td>
<td>10,000</td>
<td>22,610</td>
<td>2,930</td>
</tr>
<tr>
<td>70,000</td>
<td>10,000</td>
<td>35,180</td>
<td>4,700</td>
</tr>
</tbody>
</table>

If the decedent had an unused capital loss carryover or a net operating loss carryover, a joint return may offset the spouse's income, otherwise the carryovers would be lost. Note that if a joint return is filed, the estate becomes jointly and severally liable with the surviving spouse, and thus may be exposed to unknown tax liabilities, particularly if the surviving spouse omits income.

4. Determination of the Federal Estate Tax Deduction

The accrued federal income tax owed by the decedent is deductible on the federal estate tax return. It is also deductible by the successor who ultimately pays the tax, and thus is characterized as a "double deduction." To determine the amount of the accrued tax which is attributable to the decedent, the joint return tax liability is apportioned between the estate and the surviving spouse in accordance with the proportions which the respective tax liabilities on separate returns bear to each other, times the joint return liability.

B. Accrual of E Bond Interest on Final Return

Section 454(a) permits a cash basis taxpayer to elect to report the accruing interest on a Series E bond as the interest accrues. Most taxpayers have not made the election, and thus the interest income is not recognized until the bond is redeemed. This produces several planning opportunities after the death of the bond holder for the minimization of income tax on the accrued interest, as the personal representative has the option to elect to have all of the accrued interest to date of death included in the decedent's

15. The tax calculations are based on the rate schedules in effect for 1980.
17. I.R.C. § 6013(d)(3).
final income tax return. 19

If the decedent’s final federal return otherwise would produce little or no taxable income, the election may afford an opportunity to “cleanse” the bonds of the previous accruals at little or no tax cost. If the election is made, it applies to all of the Series E bonds, and also to the unreported interest portion of any Series H bonds which had been received by the taxpayer in exchange for Series E bonds. 20

1. Election Alternatives

If the personal representative determines that the accrued interest should not be reported on the decedent’s final return, consideration should be given to an election during the estate proceedings if the estate would otherwise have little or no taxable income. 21 Once the election is made in the estate, all additional accruing interest will be reportable as income, until the termination of the estate. Another option would be to selectively redeem the bonds during taxable periods of little or no income. The final option would be to do nothing if it would be more beneficial to have the ultimate recipients of the bonds report the income when redeemed or during a time of little or no income.

2. Election Consequences

As with many post-mortem elections, the E bond election has an effect on other areas which needs to be considered in determining whether the election should be made. If the accrued interest is reported on the final return, and thus produces more tax on that return, the additional tax is deductible on the federal estate tax return. However, the section 691(c) deduction available to the redeeming beneficiary for the death taxes attributable to the accrued bond interest will be eliminated. Also, if a formula marital deduction clause is involved, the marital deduction will be decreased by one-half of the additional estate tax deduction for the increased federal income tax.

It may also be necessary for the personal representative to make accounting adjustments, since an election may adversely affect some of the beneficiaries. This suggests the desirability of a

21. Rev. Rul. 58-435, 1958-2 C.B. 370. The election to report the interest accruals on the estate’s return is available only if the estate becomes the successor owner of the bonds; the election is unavailable if the bonds were owned by joint tenants or payable on death to a named person.
flexible administrative power in the wills of those clients who have large holdings of these bonds.

C. Unpaid Medical Expenses as Income Tax Deductions

Medical and drug expenses of the decedent which are unpaid at date of death are deductible on the federal estate tax return. If those expenses are paid within one year after death, an alternative is available. Section 213(d) allows the alternative deduction on the income tax return of the decedent for the year in which the expense was incurred. Although frequently this will be the decedent's final return, if the expenses were actually incurred in a previous period, they are deductible only in that period, and this may necessitate the filing of amended returns or a claim for refund.

1. Election Considerations

Normally, the personal representative is faced with a simple comparison of the marginal rate of tax on the appropriate income tax return versus the marginal rate on the federal estate tax return. In those estates with no federal estate tax, the deduction should always be made on the income tax return.

Claiming the deduction on the income tax return will decrease the income tax and also decrease the deduction on the federal estate tax return of the accrued income tax payable. That election will also increase the marital deduction if the will contains a formula marital deduction clause. Observe that this is not an "all or nothing" election; a portion of the unpaid medical expenses can be claimed on the federal estate tax return, and the balance can be claimed on the appropriate income tax return.

If the expenses are deducted on the income tax return, the net benefit will only apply to the extent that the expenses exceed the 3%-1% exclusions. Some practitioners had theorized that the portion of the expenses which were in effect wasted because of the 3%-1% exclusions could be deducted on the federal estate tax return. The IRS has taken a contrary position in ruling that the exclusion percentage amounts are not deductible for estate tax purposes.

2. Waiver Procedure

If the unpaid medical expenses are claimed on the federal in-

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come tax return, a duplicate statement must ultimately be filed waiving the deduction on the federal estate tax return, and stating that the expenses have not been allowed as an estate tax deduction.\(^\text{24}\) If there is any doubt as to the appropriate return, it may be best to wait until audit before a final waiver is submitted.

In Montana, where the state income tax is based on a reference to federal statutes, if the expenses are deducted on the decedent's federal income tax return, it is possible to obtain a double deduction for state purposes on both the Montana income tax return and the Montana inheritance tax return. In this instance, there is no statute which precludes the double deduction.

III. FEDERAL ESTATE TAX ALTERNATE VALUATION ELECTION

For federal estate tax purposes, the assets are valued as of the date of death. The election under section 2032 permits the personal representative to value all of the assets as of the six-month anniversary date of the decedent's death, rather than value the assets on the date of death.\(^\text{25}\) The primary purpose of the use of the alternate valuation date is to reduce the federal estate tax if the assets should decline in value during the six-month period.

A. Election Requirements

The election is available only to those estates which are obligated to file a federal estate tax return. For decedents dying on or after January 1, 1981, the election cannot be made unless the gross value of the estate at date of death equals or exceeds the minimum filing requirements of $175,000.\(^\text{26}\)

It is imperative, as with most of the post-mortem elections, that the election be timely. The election must be made by the due date of the federal estate tax return (within nine months of the date of death), or within the period of any extension of time granted by the IRS. The election is made by checking the appropriate box on page 2 of the federal estate tax return Form 706, and by showing both the date of death and six-month values for the estate assets.\(^\text{27}\) The courts have been quite strict in requiring a timely election. The election is unavailable even if there is "reason-

\(^{24}\) I.R.C. § 213(d)(2).

\(^{25}\) There is no choice for Montana inheritance tax purposes; all assets are valued at date of death.


\(^{27}\) An election can be salvaged if the information on the return evidences a clear intention to exercise the election. Rev. Rul. 61-128, 1961-2 C.B. 150.
able cause” for filing a delinquent return.\(^\text{28}\)

**B. Dispositions or Sales Within the Six-Month Period**

Any estate assets which are distributed, sold, exchanged or disposed of within the six-month period are to be valued as of the date of disposition rather than the six-month anniversary date.\(^\text{29}\) Recognition of a sale or distribution of property to a beneficiary is often easily determinable. However, there are other forms of distributions or dispositions which are not so obvious, and require a careful review of the transactions during the six-month period. The IRS has issued a number of rulings\(^\text{30}\) involving revocable and testamentary trusts, and whether certain acts constitute a distribution. Note also that persons other than the personal representative, such as a surviving joint tenant, may be the ones causing the sale, exchange or disposition.\(^\text{31}\)

**C. Included and Excluded Property**

It is sometimes difficult to determine exactly what should or should not be included in the gross estate when the alternate valuation election is made.\(^\text{32}\) Basically, all accrued interest to date of death, dividends of record prior to death, and accrued rents are considered “included” property and are thus part of the gross estate. However, property earned or accrued after date of death is not to be taken into account. Normally, shares of stock received as a dividend during the interim period are to be included, but interim capital gain dividends on mutual fund stock are excluded, if the dividend is not extraordinary.\(^\text{33}\)

**D. Election Considerations**

In most instances, the six-month election will be made if that produces less federal estate tax. The election will also have an impact on the amount of the marital deduction, and may also affect the ability of the estate to qualify for the section 303 stock redemption, the sections 6166 and 6166A installment payment elections, and the section 2032A special real estate valuation for farm

\(^{28}\) Bradley v. Commissioner, 511 F.2d 527 (6th Cir. 1975), aff’g 33 T.C.M. 70 (1970).
\(^{29}\) I.R.C. § 2032(a)(1).
and ranch lands, since all of those statutes impose threshold valuation requirements for eligibility.

In some situations, particularly those estates which would not otherwise incur any federal estate tax because of the unified credit and marital deduction, it may be desirable to elect the alternate valuation even if the assets on that date have a greater value. This will enable the estate to obtain additional basis for income tax purposes under the "stepped-up basis" rules. 34

IV. SPECIAL USE VALUATION FOR FARM AND RANCH REAL ESTATE

A significant election was added by the Tax Reform Act of 1976, which permits estates that meet the eligibility requirements to elect to value real estate used for farming purposes in a manner which is virtually certain to produce lesser estate tax values than the traditional valuation of the lands at their "fair market value." The special use election under section 2032A has great potential for tax savings in situations where the farm or ranch will continue to be used by the family for farming purposes.

The 1979 Montana legislature adopted similar provisions for Montana inheritance tax purposes, which, except for some stylistic changes, are nearly verbatim with the federal statute. 35 The Montana enactment includes all of the amendments to section 2032A resulting from the Revenue Act of 1978.

A. Summary of Election

The detailed eligibility requirements which must be met in order to qualify for the special use election have been discussed at length in other articles. 36 To briefly summarize, the adjusted value of the real estate used in the farm or ranch must be at least 25% of the adjusted value of the decedent's gross estate. 37 If the 25% test is met, then there is a further requirement that the land and the personal property devoted to the qualifying use must be at least 50% of the adjusted value of the gross estate. 38

34. If a decedent's entire estate passes to the surviving spouse, and has a death value of $300,000, and an alternate value of $340,000, the alternate valuation election will increase the basis of the assets by $40,000, at no federal estate tax cost; the unified credit and marital deduction would still offset any estate tax payable.


To insure that the election is not available to those families which are not truly engaged in farming or ranching, there is also a current and prior use requirement, and a material participation requirement. Thus, as of the date of death, the real estate must have been used as a farm, and have been owned for at least five of the previous eight years by the decedent or a member of the decedent’s family. In addition, during the same eight-year period, either the decedent or a member of the decedent’s family must have “materially participated” in the operation of the farm for at least five years. Finally, the real estate (together with the personal property necessary to meet the 50% test) must pass from the decedent to someone who is described as a “qualified heir.” All of the qualified heirs must sign an agreement consenting to personal liability for any recapture tax.

The maximum decrease in the value of the real estate is limited to $500,000. If the election is made, there is a full recapture of the estate tax savings if the lands are disposed of or if there is a cessation of the qualified use, during the first ten years after death. From the tenth year through the fifteenth year, the recapture is forgiven at the rate of 1/60th per month. To secure the recapture tax, the IRS is granted a special lien on the real estate. The IRS has issued final regulations describing in detail the method and form of election. The election, together with the agreement by the qualified heirs, must be timely filed with the federal estate tax return.

B. Valuation of the Real Estate

It has been erroneously assumed by some that the special use election will have applicability only to those estates consisting of farm real property which has an inflated value because the lands adjoin an urban area, or are located in an area where recreational values have inflated the land values in excess of those normally prevailing for farm or ranch lands without any unusual incremental value. Although it may have been the congressional intent to provide relief for those special situations, the election is not so lim-

42. I.R.C. §§ 2032A(d)(2) and 2032A(c)(6).
43. I.R.C. § 2032A(a)(2).
44. I.R.C. § 2032A(c).
45. I.R.C. § 6324B.
ited but is available to any estate which qualifies, and the use of either of the two statutory methods of valuation\(^{47}\) will in many cases result in land values for estate tax purposes which are significantly below the "going" values for similar agricultural lands which are not inflated in value because of special factors.

These results are especially possible if the estate is able to employ the mathematical formula of valuation set out in section 2032A(e)(7). Under the automatic formula, the land values are calculated by dividing the average annual gross cash rent for comparable lands (less real estate taxes) by the average annual effective interest rate on loans made by the Federal Land Bank. If cash rent comparables can be obtained, there is support for the conclusion that the real estate values can be reduced to as little as 24\% of the comparable selling prices for similar land, even where those similar lands are not inflated by reason of urban or recreational pressures.\(^ {48}\)

An example of the possible savings: In Montana all grazing lands have been classified by the Department of Revenue according to their estimated carrying capacity, and this carrying capacity can be further equated to animal units. The predominant arrangement for the leasing of grazing lands is for the rental to be in cash, with the amount to be based on the animal unit carrying capacity of the lands. Using some of the available cash rent comparables, the case can be made that medium quality grazing lands, which might have a current fair market value of about $70 per acre, would have a value of about $23 per acre under the special use automatic formula.\(^ {49}\) The potential decrease in the value of irrigated lands and in non-irrigated crop lands is also very substantial.\(^ {50}\)

\(^{47}\) I.R.C. §§ 2032A(e)(7) and 2032A(e)(8).

\(^{48}\) Elections to date in various IRS districts show discounts from fair market value ranging from 23\% to 76\%. Hartley, Final Regs. Under 2032A: Who, What and How to Qualify for Special Use Valuation, 53 J. Tax. 306, 308 (1980).

\(^{49}\) Grazing lands receiving a Grade 3 classification will require about 33 acres to carry one animal unit (a cow and calf or a 1000# steer) for a ten-month grazing season. Although actual cash rent figures are difficult to locate, in the author's experience it could be said that the average monthly cash rental rate per animal unit in Montana for the five years preceding 1980 may approximate $7.00, or $70.00 for a ten-month grazing season. Thus, the average annual cash rent for Grade 3 grazing lands in the hypothetical estate of a 1980 decedent would be $2.12 ($70.00 ÷ 33 acres). The Federal Land Bank interest rate for that period for Montana decedents is 9.31\%. Rev. Rul. 80-179, 1980-27 I.R.B. 20. Ignoring the real estate taxes, which are nominal, the special use value is arguably $22.77 per acre ($2.12 ÷ 9.31\%).

\(^{50}\) Irrigated lands in Montana may have a special use value of about $859 (net cash rent of $80 per acre ÷ 9.31\%), compared to market values of about $1,300 to $1,400 per acre. For non-irrigated crop lands, the special use value appears to be about $118 per acre (net cash rent of $11.00 per acre ÷ 9.31\%) as compared to market values in excess of $300.
The estate tax savings can be very dramatic. If the full $500,000 decrease in land value is achieved, and if the estate is otherwise in a 30% federal estate tax marginal rate bracket, the estate tax savings is $150,000.

C. Other Consequences of the Election

Not unlike other post-mortem elections, the determination of whether the special use election should be made is not solely a function of calculating the estate tax savings. The election will have other consequences which may result in the conclusion that the election should not be made. One of the more obvious results is that the estate may not qualify for either of the estate tax deferral provisions (sections 6166 and 6166A) or the section 303 redemption, since the value of the closely-held farm or ranch business will be based on the reduced values after the special use election, and therefore the eligibility percentage requirements of those other elective statutes may not be met. The personal representative is thus faced with a choice as to which elective provision is the most desirable.

1. Administration Implications

If there is any possibility that the qualified heir should need to borrow funds during the 15-year recapture period, the special lien of the IRS on the qualified real property may cause a financing institution to refuse to make advances. A provision of the Revenue Act of 1978, permitting the IRS to subordinate its first lien, may be helpful.\(^1\)

The need to avoid the recapture tax may cause the qualified heir to forgo what would otherwise be a sound business decision, such as a land swap with a neighbor. The legislative history indicates that even a tax free exchange will be considered a recapture event.\(^2\)

There are a host of other administration problems which although not insurmountable, need to be considered before the election is made. At a minimum, the duties and responsibilities of the attorney and the personal representative for the estate are measurably increased. Furnishing the affected beneficiaries with a detailed summary of the advantages and disadvantages of the election would appear to be a minimum obligation, and the

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51. I.R.C. § 6325(d)(3).
beneficiaries perhaps need to be advised to obtain independent counsel. Moreover, the intricate rules of recapture must be explained, with the attendant policing problems for the full 15-year period. Whether or not the prevailing fee arrangement is suitable needs to be explored. 63

It may also be difficult to obtain appraisers sufficiently qualified to calculate the special use values, and increased appraisal fees can be expected. There is also some question as to the manner in which the "fair market value" is to be finally determined; this amount is of course very relevant in case there is a subsequent recapture tax, and is also important for state inheritance tax purposes.

2. Marital Deduction Implications

Example: Assume an estate with $500,000 of nonbusiness assets, which pass to the surviving spouse, and qualified real property (fair market value of $1,000,000, special use value of $500,000) which is distributable to decedent's son. If there is a formula marital deduction clause, note that the estate tax benefit of the election in the decedent's estate is in reality only the savings on one-half of the incremental value of $500,000.

If the son disposes of the property during the recapture period, or there is a cessation of use, the recapture tax is the difference between what the estate tax would have been if the election had not been made and the reduced estate tax. Presumably, the recomputation would allow for the increased marital deduction, but this would seem to apply only if the surviving spouse were entitled to receive and does in fact receive an interest in the realty at the time of the recapture event. If that result does not occur under the substantive law of the decedent's jurisdiction, then the potential increase in the marital deduction would appear to be lost.

If the example is reversed (realty to the spouse), is it possible that the real estate will not qualify for the marital deduction on the theory that the spouse has received a terminable interest because of the potential recapture tax? If there is a recapture, the spouse would be personally liable for the tax, but what is the result where the will provided that the son was to bear the entire estate tax burden? These questions are currently unanswerable, and must

53. Montana statutes provide that the personal representative and the estate attorney are entitled to a reasonable fee for their services, not to exceed (without court order) a percentage of the total value of the estate. MCA §§ 72-3-631 and -633 (1979). The section 2032A election decreases the total value, thus reducing the amount of the fees. In many instances, it will be necessary to seek court approval of a higher fee.
await future litigation or rulings by the IRS.

3. Recapture Tax

If the recapture tax is imposed because of a disposition of the lands or cessation of use, it appears that the qualified heirs' income tax basis in the lands will be limited to the basis at time of death computed on the reduced values, and there will be no restoration or “step-up” in basis because of the recapture. However, keep in mind that the estate will still have the benefit of an interest-free deferral of the recapture tax from the date the tax would have been otherwise payable, to the recapture tax payment date.

There can be extreme liquidity problems at the time of recapture. First, the gain on a disposition, and the resulting income tax will be greater because of the reduced basis in the lands. Second, the recapture tax itself is payable within six months after the recapture date. Finally, if the sale is structured as a deferred payment sale, the payments received in the year of sale may be less than that necessary to pay the income tax and the recapture tax.

Of smaller consequence, but still a factor, is the probability that a state inheritance tax deduction will be lost. In some states, such as Montana, the federal estate tax is an allowable deduction in the computation of the state death tax. If the recapture occurred beyond the appropriate state refund limitations period, the recapture tax would probably not be available as a deduction.

The special use election is not limited to those situations in which the decedent had a fee ownership interest in the lands. Ownership is deemed to include indirect ownership through partnerships, corporations and trusts. If the qualified lands were owned by a corporation, and there were a cessation of use, the estate shareholder would be subject to the recapture tax. However, even if there were sufficient funds within the corporation, it may be difficult to have those funds distributed to the estate shareholder without additional tax in the form of dividends.

V. Election to Exclude Joint Tenancy Property

Section 2040(a) establishes the general rule that the entire value of property owned as joint tenants is to be included in the

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54. There is no statutory authority permitting the recapture tax to be added to basis, under the carryover basis rules, or for an increase in the stepped-up basis for the recapture value.

55. I.R.C. § 2032A(c)(5).

decedent's gross estate, unless the surviving joint owner can establish that he or she has contributed to the acquisition of the property, in which event the value of the consideration furnished by the survivor is excluded from the gross estate. Because of the difficulty in factually establishing contribution, Congress decided to offer some relief by the addition of section 2040(c) under the Revenue Act of 1978. The goal of the statute is to recognize the involvement by the surviving spouse in the farm or business, and to translate that participation into an amount which can be excluded from the gross estate if various eligibility requirements are met.

It is difficult to conceive of a factual situation where the lifetime estate plan would deliberately contemplate the use of the joint tenancy exclusion after death. Because of the inherent problems with joint tenancy ownership, including possible overqualification of the marital deduction and unnecessary inclusion of a greater value than necessary in the gross estate because of the normal section 2040(a) contribution rule, it would appear that the use of this new election should be limited to those estates which have not been properly planned.57

A. Qualification Requirements

To qualify for this new election, which applies to persons dying after 1978, the joint property must have been used for farming purposes or in a trade or business, and the surviving spouse must have materially participated in the farm or business. The exclusion applies only to real estate or tangible personal property used in the farm or trade or business; the exclusion does not apply to intangible personal property. Also, the joint ownership must have been limited to the decedent and his or her spouse; any other co-owners would cause the property to be ineligible for the election. Finally, the joint interest must have been created either by the decedent, by the decedent's spouse, or by both.

B. Determination of Amount Excludable

If the eligibility conditions are met, the amount which can be excluded is 2% times each year of material participation by the surviving joint owner (with an effective limit of 25 years), multiplied by the excess of the date-of-death value of the property over the original consideration, appreciated at the rate of 6% per annum. Consideration originally furnished by the surviving spouse,

57. See Messinger, Section 2040(c): More Complexity and Limited Relief in Taxation of Jointly Held Interests of Spouses, 34 Tax Law. 89 (1980).
plus assumed appreciation on that contribution at the rate of 6% per annum, would also be excluded. The maximum exclusion is 50% of the value of the joint interest, and the total decrease in the value of the gross estate cannot exceed $500,000.

*Example:* A husband purchased farm real estate for $10,000, entirely with his funds, and caused the title to be placed in the names of the husband and wife as joint tenants. Upon his death ten years later, the fair market value of the land is $100,000. The wife can establish material participation for the entire holding period. Under section 2040(c), $16,800 would be excluded from the estate, and the balance of $83,200 would be includable, as follows:

<table>
<thead>
<tr>
<th>Value of joint interest</th>
<th>$100,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less:</td>
<td></td>
</tr>
<tr>
<td>Husband's original consideration</td>
<td>$10,000</td>
</tr>
<tr>
<td>Assumed appreciation ($100,000 times 6% times 10 years)</td>
<td>$6,000</td>
</tr>
<tr>
<td>Excess value</td>
<td>$84,000</td>
</tr>
<tr>
<td>Amount excludable: 2% times 10 years of participation times excess value of $84,000</td>
<td>$16,800</td>
</tr>
</tbody>
</table>

**C. Election Considerations**

In most instances, this new election (which must be made in a timely filed federal estate tax return) should be made as a matter of course. However, there are at least two situations in which the election should not be made. The first is where the estate would not be subjected to federal estate tax even if the full value of the joint interest were included because of the marital deduction and unified credit. By including the full value, the income tax basis would be that value under the stepped-up basis rule.

The second circumstance is where the surviving spouse has furnished partial consideration for acquisition of the interest. The spouse's percentage contribution under traditional rules can exceed the formula exclusion where the number of years of material participation is less than the maximum 25 years. In the above example, if the surviving wife had contributed $3,000 of the initial $10,000 investment, then 30% of the $100,000 date-of-death value, or $30,000, could be excluded under the regular rule of section 2040(a). Under section 2040(c), only $21,600 would be excludable,
as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value of joint interest</td>
<td>$100,000</td>
</tr>
<tr>
<td>Less:</td>
<td></td>
</tr>
<tr>
<td>Husband's original consideration</td>
<td>$7,000</td>
</tr>
<tr>
<td>Assumed appreciation ($7,000 times 6% times 10 years)</td>
<td>4,200</td>
</tr>
<tr>
<td></td>
<td>11,200</td>
</tr>
<tr>
<td></td>
<td>88,800</td>
</tr>
<tr>
<td>Less:</td>
<td></td>
</tr>
<tr>
<td>Wife's original consideration</td>
<td>$3,000</td>
</tr>
<tr>
<td>Assumed appreciation ($3,000 times 6% times 10 years)</td>
<td>1,800</td>
</tr>
<tr>
<td></td>
<td>4,800</td>
</tr>
<tr>
<td>Excess value</td>
<td>$84,000</td>
</tr>
<tr>
<td>Amount excludable: 2% times 10 years of participation times excess value of $84,000</td>
<td>$16,800</td>
</tr>
<tr>
<td>Plus: Consideration by spouse</td>
<td>4,800</td>
</tr>
<tr>
<td>Total exclusion</td>
<td>$21,600</td>
</tr>
</tbody>
</table>

VI. PAYMENT OF THE FEDERAL ESTATE TAX 58

A. Ten-Year and 15-Year Installment Payment Elections

For many years estate representatives have had the automatic right pursuant to section 6166 to pay the federal estate tax attributable to a closely-held business interest in up to 10 equal annual principal installments, plus interest. To qualify, the business interest must exceed 35% of the gross estate or 50% of the taxable estate. The purpose of the election is to make it easier for estates with closely-held business interests to pay the federal estate tax, as frequently such estates have liquidity problems.

The Tax Reform Act of 1976 renumbered former section 6166 as section 6166A, and added a new section 6166, which allows estates to elect a more liberal payment schedule, for up to 15 years, in situations where the closely-held business interest is a significantly larger proportion of the estate (65% of the "adjusted" gross estate). A similar 15-year deferral statute is now available for Montana inheritance and estate tax. 59

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59. MCA §§ 72-16-451 through -465 (1979). Although the Montana deferral statute is virtually a duplicate of Section 6166, since the amount of the state death tax credit which is allowable on the federal estate tax return must be paid within the limitations period under the Internal Revenue Code, only that portion of the Montana inheritance tax and Montana estate tax which is in excess of the state death tax credit is effectively deferrable.
Although similar in design, there are a number of variations between sections 6166 and 6166A. Appendix B to this article sets forth the major variations.

1. Basic Qualification Requirements

To qualify under either the 10-year or 15-year installment elections, an interest in a closely-held business must be included in the gross estate. The closely-held business must be carrying on a trade or business at date of death, and the value of the business interest must exceed the percentages described above. Notice of the election in each instance must be filed on or before the due date (including extensions) of the federal estate tax return, except that a late election can be made under the 15-year election with respect to deficiency assessments.

2. Maximum Tax Deferrable

The formula for determining the maximum tax which can be deferred over the installment periods is slightly different. In both instances, the net federal estate tax is multiplied by a fraction, the numerator of which is the value of the closely-held business interest. However, in the case of the 10-year election, the denominator is the gross estate, while for the 15-year election the denominator is the “adjusted” gross estate. The “adjusted” gross estate is the gross estate reduced by the allowable deductions under sections 2053 and 2054, and thus would be a smaller amount than the actual adjusted gross estate if some of the administration expenses were claimed as an income tax deduction rather than as an estate tax deduction.

3. Payment of the Installments

Under both elections, the non-deferrable portion of the federal estate tax is payable in full on the regular nine-month due date. In the case of the 10-year election, if made for the full ten years, the first 1/10th installment is also due on the regular nine-month estate tax due date. The remaining installments are payable annually on the next nine anniversary dates, together with interest on the declining unpaid balance. If the 15-year election is made, there are no payments due on

60. I.R.C. § 6166A(b).
61. I.R.C. § 6166(a)(2).
63. I.R.C. § 6166A(e).
the nine-month due date with respect to the closely-held business interest. Thereafter, interest only is payable for the next four years. On the fifth anniversary of the nine-month federal estate tax due date, the first of ten equal annual principal installments is to be made, plus interest. The final installment is due on the fourteenth anniversary of the nine-month due date.⁶⁴

4. Interest Rates on the Deferred Tax

Under the 10-year election, the deferred portion of the estate tax bears interest at the general rate on obligations to the IRS, which is currently 12%.⁶⁵

The 15-year election is much more liberal in that the interest rate on the deferred tax is only 4% for the entire 15 year period.⁶⁶ However, the 4% rate will apply only to that portion of the deferred tax which does not exceed the difference between $345,800 and the available unified credit. Taking into account the state death tax credit, this would permit the use of the 4% rate on the estate tax attributable to closely-held business property having a value of up to about $1,093,000. For any additional deferred tax, the interest rate is the general rate of 12%.

5. Impact of the Unification Concept

The 1976 Tax Reform Act integrated the federal estate and gift tax laws into a unified tax system. Thus, the federal estate tax is now calculated by adding the amount of the taxable estate (which is the gross estate less deductions) to any “adjusted taxable gifts” (taxable gifts made more than three years prior to death), and then applying the estate tax rates.⁶⁷

In determining eligibility, note that the value percentage minimum is based solely on the gross or taxable estate for the 10-year election, and solely on the adjusted gross estate for the 15-year election. In addition, in each case, the closely-held business interest must be included in the gross estate. This means that any business interests (as well as nonbusiness interests) which were gifted

⁶⁴. I.R.C. §§ 6166(a)(3) and 6166(f). Since the last installment is payable nine years after the regular estate tax due date, under I.R.C. § 6166A, and 14 years in the case of I.R.C. § 6166, these elections should be referred to as the 9-year and 14-year installment elections, but are herein referred to as the 10-year and 15-year elections, in accordance with the general terminology in use.
⁶⁵. I.R.C. § 6601(a). The general rate is adjusted periodically in accordance with I.R.C. § 6621.
⁶⁶. I.R.C. § 6601(j).
away more than three years before the decedent's death will not be part of the computation, even if those gifts are included in the tax base as "adjusted taxable gifts."

In some circumstances, this may be to the taxpayer's advantage. Assume a taxable gift of a $100,000 nonbusiness asset by the decedent four years before death. At date of death the estate consists of the following:

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business interest</td>
<td>$150,000</td>
</tr>
<tr>
<td>Other property</td>
<td>$70,000</td>
</tr>
<tr>
<td>Gross estate</td>
<td>$220,000</td>
</tr>
<tr>
<td>Less: Form 706, Schedules</td>
<td>$20,000</td>
</tr>
<tr>
<td>J &amp; K deductions</td>
<td></td>
</tr>
<tr>
<td>Adjusted gross estate</td>
<td>$200,000</td>
</tr>
</tbody>
</table>

The business interest ($150,000) is 75% of the adjusted gross estate of $200,000, thus section 6166 may be elected, even though the ratio of the business interest to the "tax base" of $300,000 is only 50%. In addition, 75% of the total net estate tax is deferrable, even though a portion of the tax is attributable to the $100,000 gift which is added to arrive at the tax base.

6. **Qualifying Business Interests**

The whole thrust of the two election statutes is to limit the election to those closely-held businesses which are carrying on a trade or business at the date of the decedent's death. If the businesses are primarily generating passive income, it is unlikely the elections would be available. The IRS has issued a number of revenue rulings and private letter rulings which furnish some guidelines as to those businesses which the Service considers to be carrying on a trade or business.

There are also some numerical tests which have to be met before the business interest will be considered "closely-held." If a sole proprietorship is involved, the assets and the liabilities are netted to determine whether or not either the 35% - 50% test or the 65% test has been met. To qualify for the 10-year election, the decedent's shares in a corporation must be at least 20% or more in value of the voting stock, or the corporation must have ten or fewer shareholders. In the case of the 15-year election, the corpora-

68. I.R.C. § 6166(a)(2).
69. I.R.C. §§ 6166(b)(1) and 6166A(c).
70. For a summary of the rulings, see Barcal, IRS' Active Trade or Business Requirement for Estate Tax Deferral: An Analysis, 54 J. Tax 52 (1981).
71. I.R.C. §§ 6166(b)(1) and 6166A(c).
tion can have as many as 15 shareholders. Under the Revenue Act of 1978, members of the decedent's immediate family are counted as a single shareholder for purposes of this test.\footnote{I.R.C. § 6166(b)(2)(D).}

For partnership interests, under the 10-year election, 20% or more of the partnership's capital interests must be included in the gross estate, or the partnership must have 10 or fewer partners. For the 15-year election, the number of partners can be increased to 15.

If the decedent owned an interest in more than one closely-held business, the value of the business interests can be combined for the purpose of determining eligibility under the percentage tests. However, more than 50% of the total value of each business must be included in the gross estate for the 10-year election, or more than 20% of the total value of each business for the 15-year election.\footnote{I.R.C. §§ 6166(c) and 6166A(d).}

### 7. Acceleration of Installments

The privilege to continue to pay over the installment period is terminated after notice and demand from the IRS, in three situations. Acceleration will occur if there is a failure to pay any installment of tax, or if a certain amount of funds are withdrawn from the business during the election period, or if there is a disposition of a certain percentage of the decedent's interest in the business. There may also be a partial acceleration if the estate accumulates net income beyond amounts permitted by the Code.\footnote{I.R.C. §§ 6166(g) and 6166A(h).}

### 8. Election Procedure and Strategy

For the 10-year election, a timely-filed notice of election must be made in the form of a letter to the IRS setting forth the amount of tax to be deferred, the number of installments, identification of schedule and item number of each closely-held interest, and a showing of percentage qualification.\footnote{Treas. Reg. § 20.6166A-1(e)(2) (1960) (T.D. 7710, 1980-36 I.R.B. 12, 17, provides that “[s]ections 20.6166-1, 20.6166-2, 20.6166-3 and 20.6166-4 are redesignated §§ 20.6166A-1, 20.6166A-2, 20.6166A-3 and 20.6166A-4 respectively.”).}

A similar notice of election is required for the 15-year election.\footnote{Treas. Reg. § 20.6166-1 (1980).} A sample election letter is set forth in Appendix C to this article.

If the estate does not qualify for the election on the basis of the values returned, or if it qualifies but there is no tax due as
disclosed by the return, it is necessary, with respect to the 10-year election, to file a protective election with the return in order to qualify for installments on any deficiency or tax which is unpaid at the final determination by the IRS.\textsuperscript{77} However, a protective election is unnecessary for a deficiency assessment if the estate then qualifies for the 15-year election.\textsuperscript{78} The election can be made within 60 days after the IRS demands payment, and the 4\% interest rate will apply. A protective election is still necessary for any other unpaid tax, such as tax extended for reasonable cause under section 6161.

9. \textit{Factors to Consider in Making the Election}

For many estates with true lack of liquidity to pay the federal estate tax, the installment elections are most desirable and often necessary to give the estate sufficient time to raise the necessary funds to pay the estate tax.

However, since the election is automatic for those estates which qualify, there are purely economic advantages to making the elections even if sufficient liquidity is on hand, if those funds can be invested to yield an amount greater than the 4\% or 12\% interest accruing on the unpaid tax. For example, if the funds which would otherwise be used to pay the federal estate tax are invested to return 10\%, the use of those funds over the 15-year period effectively reduces the obligation owed to the IRS by about one-third, on a present worth analysis.

It is also possible to coordinate the annual installment payments with periodic redemptions of stock under section 303, for maximum use of those two elective statutes.\textsuperscript{79}

One of the primary disadvantages of the election is that normally the estate must remain open until final payment of the estate tax; prolonging the estate proceedings may be objectionable to the beneficiaries. In addition, there is continuing personal liability of the personal representative under section 2002, unless a discharge is received under section 2204 or the special lien procedure of section 6324A.


\textsuperscript{78} I.R.C. § 6166(h).

B. Deferral of Estate Tax on Remainder or Reversionary Interest

If the estate assets include either a remainder interest or a reversionary interest, the estate tax which is attributable to the value of the interest can, by election under section 6163, be deferred until six months after the termination of the preceding interest. The election must be made by the due date of the federal estate tax return. A notice of election is filed with the return, together with a copy of the document creating the interest.\(^8\)

Since very few estates contain such an interest, the election will be available only in rare instances. The most common application will be where the decedent was the creator of a short-term trust, sometimes referred to as a ten-year or Clifford trust.

Example: In 1976, a father created a short-term trust for his daughter, transferring securities with a value of $20,000. The trust provided that all income was to be paid to the daughter and in 1986 the trust would terminate and the securities would revert to the father. If the father died in 1981, the reversionary interest would be includable in his estate. The estate tax on the value of that interest can be deferred until six months after the termination of the trust.

C. Extension of Time to Pay Estate Tax for "Reasonable Cause"

Prior to the adoption of the Tax Reform Act of 1976, the IRS, in its discretion and upon application by the estate, could extend the time for payment of the estate tax for up to one year after the normal due date if the estate could establish "reasonable cause" for the extension. If a more stringent standard of "undue hardship" were met, former section 6161(a)(2) permitted the IRS, also in its discretion, to extend the time for payment for up to a total of 10 years, on a year-by-year basis. Congress concluded that the Service had been too restrictive in exercising its discretion to grant extensions, and they thus deleted the "undue hardship" clause of section 6161. Now, extensions can be granted for up to ten years if "reasonable cause" can be established. The regulations furnish some guidelines as to what acts constitute reasonable cause.\(^9\)

The reasonable cause extension is also available if the estate finds that it will be unable to pay any installment due under either

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A discretionary extension of time within which to pay the Montana inheritance tax may also be available.\textsuperscript{83}

D. \textit{Section 303 Stock Redemption}

Another post-mortem election which is designed to ease the liquidity problems of estates is the privilege, under section 303, to have shares of stock which the successor acquires from the decedent redeemed by the corporation. The property or cash received by the succeeding shareholder in exchange for the stock will not be treated as a dividend, as would be the normal rule under section 301, but is treated as a sale or exchange, and thus qualifies for capital gain treatment. The amount of cash or property which may be distributed by the corporation in exchange for the shares of stock is limited to the sum of the death taxes (including interest) and the allowable funeral and administration expenses.

1. \textit{Eligibility Requirements}

Formerly, the estate would qualify if the value of the shares in the closely-held business exceeded 35\% of the gross estate or 50\% of the taxable estate. An amendment to section 303 by the Tax Reform Act of 1976 made it more difficult for estates to qualify, as the value now must be 50\% of the decedent’s gross estate less the allowable funeral and administration expenses.\textsuperscript{84} Multiple business interests can be combined if more than 75\% in value of each corporation is included in the estate.\textsuperscript{85}

Note that only shares of stock which are part of the gross estate are eligible for redemption.\textsuperscript{86} Thus, shares which were gifted away more than three years prior to death will not be eligible, even if the value of those shares which is in excess of the $3,000 annual gift tax exclusion is included in the estate tax base as an “adjusted taxable gift.”

2. \textit{Tax Burden Requirement}

There is now a tax burden requirement that requires much

\begin{itemize}
\item \textsuperscript{82} I.R.C. § 6161(a)(2)(B).
\item \textsuperscript{83} MCA § 72-16-438 (1979). The Montana Department of Revenue may permit deferral of payment for not more than five years. The deferral terms are determined by the department.
\item \textsuperscript{84} I.R.C. § 303(b)(2)(A).
\item \textsuperscript{85} I.R.C. § 303(b)(2)(B).
\item \textsuperscript{86} I.R.C. § 303(a).
\end{itemize}
greater planning before death in order to assure that the section 303 redemption will be available. Under prior law, there was no requirement that the redeeming shareholder must have actually paid or have been liable for the taxes and expenses. As amended, section 303 will now permit nontax dividend treatment to apply only to the extent that the recipient shareholder’s interest is reduced directly by any payment of the death taxes and allowable items, or if the shareholder has a binding obligation to contribute.

These changes increase the importance of appropriate tax allocation clauses in the will or trust. For example, if the surviving spouse has no obligation for the death taxes or expenses, shares distributable to the spouse cannot be redeemed so as to achieve nontax dividend treatment under section 303.

3. Redemption Considerations

The distribution from the corporation need not be cash; section 303(a) contemplates any “property” distribution. This provides an opportunity for the corporation to distribute appreciated property without recognition of gain by the corporation. Also, the corporation may issue a note in lieu of cash or property.

If a section 2032A election is in effect, a section 303 redemption of decedent’s stock in a corporation which contains the qualifying lands could theoretically be construed as a disposition resulting in a section 2032A(c) recapture tax. Until a definitive IRS interpretation is forthcoming, caution should be exercised in proceeding with such a redemption.

The redemption must normally occur within 90 days after the expiration of the three-year federal estate tax assessment period provided in section 6501(a). The time period can be extended up to 10 years if the section 6166A election is made, and up to 15 years if the section 6166 election is made. This permits greater flexibility in allowing annual redemptions to meet the current estate tax installment payments.

E. Use of Treasury Bonds to Pay Estate Tax

If owned by the decedent at date of death, certain United States treasury bonds can be redeemed at par to pay the federal

87. I.R.C. § 303(b)(3).
estate tax. These bonds, commonly referred to as "flower bonds," can be purchased at a substantial discount in the open market, because the stated interest rates are below prevailing market rates. They can be a particularly attractive investment for clients of advanced age or for those who are terminally ill.

To the extent that the bonds are usable to pay the federal estate tax, they must be valued at par, regardless of whether they are so used. It is therefore inconceivable that the personal representative would intentionally fail to use the bonds for payment purposes.

Caution must be exercised if more bonds are on hand at the time of the payment of the estate tax than appear necessary for the tax then due. If the excess bonds are disposed of by the personal representative, and if thereafter the IRS is successful in asserting a deficiency, bonds which could have been used for payment of the deficiency plus accrued interest are valued at par for federal estate tax purposes, even if they are no longer held by the estate.

As a result of a 1970 decision of the Montana Supreme Court, treasury bonds which are redeemed in payment of the federal estate tax are valued for inheritance tax purposes at the lower market value on the date of death, rather than the par value actually received by the estate. Other states have reached a contrary result.

VII. DISCLAIMERS

Most states have adopted legislation permitting various persons to refuse to accept an interest in property upon the death of another person. The refusal to accept the interest is called a disclaimer, or sometimes a renunciation.

The right to disclaim, and the types of property interests which can be disclaimed, are strictly matters of the substantive law of the state having jurisdiction. Under many of these statutes, the renouncing person may be an heir with respect to an intestate share; a devisee or legatee under a will, including a beneficiary of a testamentary trust; or, the donee or appointee of a testamentary power of appointment. Some statutes have gone even further and permit a disclaimer by a surviving joint tenant or the beneficiary of an insurance contract. The state statutes normally provide that ab-

sent a specific alternative provision in the will or trust, the interest
which is renounced will pass as if the disclaimant had predeceased
the decedent. It is therefore imperative to analyze the state law
and the relevant instruments to determine who will receive the
property interest if there is a disclaimer, bearing in mind that an
anti-lapse statute might cause the property interest to be distrib-
utable to the children of the disclaimant.

The Montana disclaimer statute is incorporated in the Mon-
tana version of the Uniform Probate Code (U.P.C.). The 1981
Montana legislature enacted a number of revisions to the Montana
version of the U.P.C., including amendments to the disclaimer pro-
visions. Compliance with Montana law is necessary, since compli-
ance with state law is essential in order to predict the federal es-
state and gift tax consequences.

A. Federal Estate and Gift Tax Treatment of Disclaimers

Prior to the adoption of the Tax Reform Act of 1976, an effec-
tive disclaimer under state law was frequently given effect for both
federal gift tax purposes and federal estate tax purposes. Congress
concluded that because of variances from state to state as to
whether or not a disclaimer was effective under local law, undesir-
able inconsistencies resulted which should be remedied with new
federal legislation governing the estate and gift tax consequences
of disclaimers.

Section 2518 was added by the Tax Reform Act of 1976, in an
effort to provide definitive disclaimer rules. If a person makes a
“qualified disclaimer” the refusal to accept the property will not be
treated as a gift. In addition, the disclaimer will be given full effect
for federal estate tax purposes, under section 2045. Likewise, in
determining the distributive shares of beneficiaries for Montana
inheritance tax purposes, a disclaimer which complies with Mon-
tana law will be given effect so that none of the property which is
disclaimed will be taxed to the disclaimant.

Briefly stated, the refusal by a person to accept an interest in
property will be a “qualified disclaimer” only if four requirements
are satisfied: (1) the disclaimer must be in writing, (2) it must be

97. See Senate Bill 38, 47th Mont. Legislature § 1 (1981). The significant changes af-
fecting disclaimers include: expanding the right to disclaim to the representative of an inca-
 pacitated or protected person; expanding the time for disclaiming from six months to nine
months; and, clarifying the time within which a future interest may be disclaimed. See
Comment, Probate Law in Montana — Changes by the 1981 Legislature, 42 Mont. L. Rev.
timely made, (3) the person refusing (the disclaimant) must not accept the benefits of the interest, and (4) the interest must pass to another person, without direction by the disclaimant. 98

It is therefore essential to comply with both state and federal law if the disclaimer is to be given effect for gift and estate tax purposes. The practitioner should be familiar with the proposed disclaimer regulations recently issued by the IRS. 99

B. Use of Disclaimers in Post-Mortem Planning

The use of the disclaimer to achieve after-death estate and gift tax advantages has always been one of the tools available to salvage an otherwise poorly planned estate, or to shift property interests to other persons, thereby achieving desired estate planning results. The Congressional involvement in this area has served to focus attention on the many valuable uses of the disclaimer.

1. Shifting Property Interests to the Next Generation

Under the Tax Reform Act of 1976, it is much more difficult to transmit property to the next generation through lifetime gifts, since all gifts in any year in excess of $3,000 to any donee will be added to the donor's estate at death as an adjusted taxable gift. 100 Under some circumstances, a disclaimer may be used to shift the property to the next generation without creating a gift.

*Example:* Decedent's will leaves his entire estate to his son, with a contingency clause that if the son is not living, then the entire estate is to be distributed to decedent's grandchildren. If decedent's son does not want all or a portion of the property, he can disclaim and have the disclaimed property pass directly to the grandchildren; the disclaimer by the son will not be treated as a gift for gift tax purposes.

*Example:* Under the appropriate state law, the intestate estate of a decedent who had no lineal descendants would pass to his surviving sister, the closest heir. If the sister already has sufficient assets, a prompt disclaimer by her of her intestate share would cause the estate to be divided equally between the sister's two children. If instead the sister had first received the property, and then attempted to gift it to her two children, the gifting limits would have

98. I.R.C. § 2518(b).
99. The proposed regulations and proposed amendments to existing regulations are set forth in [1981] FED. EST. & GIFT TAX REP. (CCH) ¶ 11,920.
100. I.R.C. § 2001(b). Special rules apply to gifts within three years of death (I.R.C. § 2035) and gifts to a spouse (I.R.C. § 2056).
prevented a rapid transmission of the assets to her children.

2. Using the Disclaimer to Affect the Marital and Charitable Deductions

Occasionally, a disclaimer can be used to modify an estate plan (or lack of a plan) to increase the property passing to a spouse which would qualify for the estate tax marital deduction, to limit the overqualification of the marital deduction, or to salvage an estate tax charitable deduction.

Example: Decedent devised specific assets to his wife, with the residue to his children. After death, it is discovered that the specific assets far exceed the value necessary to obtain the maximum marital deduction. The wife may elect to disclaim as to some of the specific devises, so that the children will receive the disclaimed property, thereby decreasing the wife's separate estate and the death taxes upon her death. If the example is reversed, a disclaimer by the children will increase the property qualifying for the marital deduction.

Example: The residue of decedent's estate was placed in trust for the ultimate benefit of a charitable beneficiary. However, an intervening life income interest was given to the decedent's spouse. Immediately after death the estate representatives realized that the value of the charitable interest would not qualify for the estate tax charitable deduction because the trust did not meet the test of either a charitable remainder annuity trust or a charitable remainder unitrust. If the spouse has no need for the income interest, a disclaimer may salvage the estate tax charitable deduction for the entire value of the trust.

VIII. Elections Involving Estate and Beneficiary Income Taxes

A. Choice of Fiscal Year

The estate, as a separate taxpayer, is obligated to file fiduciary income tax returns. The estate's first fiscal year may end at any time provided that it is the last day of a month and it is twelve months or less in length. This is an automatic right and prior approval of the IRS is not required. After selection of a fiscal year, all subsequent tax years except the last must be twelve months.

To establish a fiscal year, an appropriate return must be filed by the due date (the fifteenth day of the fourth month following
the end of the fiscal year) even if the estate has no income during that period. The failure to file a return will force the estate to report on a calendar year basis.\footnote{102}{Treas. Reg. § 1.441-1(d) (1957).}

The estate representative should, immediately upon commencement of the estate proceedings, make an analysis of the anticipated receipts and disbursements so that a tentative decision can be made as to the estate's initial fiscal year, keeping in mind the estimated closing date of the estate, so that there will be an overall plan for the fiduciary returns. In many instances, the subject is not given proper attention until it is too late to elect what might have been an otherwise desirable shorter initial fiscal year.

One of the obvious benefits is to secure an additional $600 exemption. For example, if the administration period is estimated at 16 months, the filing of an initial return for the first three months, followed by a 12-month return, and distribution during the final month, will permit two $600 exemptions. On the other hand, if the initial return is for 12 months, and the estate is distributed four months later, only one $600 exemption will be available.\footnote{103}{In the final income tax return for the estate the $600 exemption is in effect not allowable. All of the DNI in the final return is deemed distributed; I.R.C. § 643(a)(2) precludes the exemption deduction.}

In addition, if substantial income in respect of a decedent is anticipated during the first several months of administration, selecting a short initial fiscal year may enable the division of that income between two separate returns, with possible reduced overall tax.

The selection of the first fiscal year will have an impact on the tax consequences flowing down to the beneficiary in the final estate return. Improper planning may cause the beneficiaries to report considerably more than 12 months of income in one calendar year.\footnote{104}{It is possible for as many as 23 months of income to be reportable by a beneficiary in a single year. For example, if an estate's fiscal year ends on January 31, 1982, and all of the net income for that period is distributed or deemed distributed, and if the estate is closed on December 26, 1982, the beneficiary will report 11 months of 1981 income and nearly 12 months of 1982 income.}

B. Administration Expense Election

One of the most significant post-mortem elections relates to the deductibility of administration expenses. Administration expenses incurred during the estate proceedings are deductible for federal estate tax purposes under section 2053. These expenses also may be deducted on the estate income tax return in the year

\footnote{102}{Treas. Reg. § 1.441-1(d) (1957).}
\footnote{103}{In the final income tax return for the estate the $600 exemption is in effect not allowable. All of the DNI in the final return is deemed distributed; I.R.C. § 643(a)(2) precludes the exemption deduction.}
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paid, pursuant to section 212. To preclude a "double deduction," section 642(g) prohibits a final deduction of these expenses on the estate income tax return, unless the estate files a statement waiving an estate tax deduction. The choice between the two tax returns is not an "all or nothing" choice; a portion of the expenses or a portion of a single expense may be claimed on one return, and the balance on the other.\textsuperscript{105}

The practitioner should be aware of the fact that Montana has not enacted a statute prohibiting double deductions similar to section 642(g). Thus, if an administrative expense is deducted on the federal income tax return, it is deductible on both the Montana income tax return and the Montana inheritance tax return.

1. Deductible Expenses

To qualify as an administration expense, the item must be allowable under state law,\textsuperscript{106} and must be incurred for the administration, preservation or distribution of the estate.\textsuperscript{107} Typically administration expenses will include the fees of the personal representative, attorney, appraiser and accountant, as well as court costs, filing fees, and bond premiums.

The IRS has held that interest payable on estate tax deferred under section 6166 is deductible as an administration expense.\textsuperscript{108} If it is anticipated that the interest would not generate tax savings on the estate fiduciary returns over the installment period, it would be best to claim the interest on the federal estate tax return.\textsuperscript{109}

To be distinguished from the administration expenses and the prohibition against double deductions are certain obligations owing at the time of death, sometimes referred to as deductions in respect of a decedent. These items may be deducted on both the federal estate tax return and the fiduciary income tax return, and a choice is not necessary. Examples of true double deductions include trade or business expenses under section 162, interest under section 163, taxes under section 164, and production of income expenses under section 212.

\textsuperscript{105} Treas. Reg. § 1.642(g)-2 (1956); Rev. Rul. 70-361, 1970-2 C.B. 133.
\textsuperscript{106} I.R.C. § 2053(a).
\textsuperscript{109} However, only the interest incurred from time to time (and not the projected future interest) is deductible. Rev. Rul. 80-250, 1980-37 I.R.B. 15. This necessitates the periodic filing of amended returns since the accrued interest deduction is interrelated with the computation of the federal estate tax. See Gerhart, Estate Tax Deferrals Lose Value Due to IRS' No-Deduction Position on Estimated Interest, 54 J. Tax. 244 (1981).
2. Waiver Procedure

If there is any doubt as to which return will ultimately produce the greatest tax benefit from the administration expenses, caution must be exercised as to the timing of the filing of the necessary statement and waiver required under section 642(g). The regulations require that the statement be filed in duplicate with Form 1041, and must be to the effect that the items have not been allowed as estate tax deductions. Further, there must be a waiver of the right to have them so allowed in the future.\textsuperscript{110} If there is doubt, the statement and waiver need not be filed with the 1041 return, but may be filed later, such as at the time of the audit of the return. Once filed, however, the election becomes irrevocable. Likewise, once the expense has been finally allowed for estate tax purposes, it may not be claimed for income tax purposes. The IRS has specifically permitted claiming the items on both returns, without a waiver, so long as the issue is resolved at the time the first return is audited.\textsuperscript{111}

3. Election Considerations

The choice of the appropriate return on which to claim the administration expenses is normally resolved by calculating the net tax benefit on each return and then claiming the expenses on the return producing the greatest benefit. With the unified credit and the marital deduction, many fairly substantial estates will not incur any federal estate tax, in which event all of the administration expenses should be claimed on the estate income tax return. If there is a formula marital deduction clause, claiming the administration expenses on the federal estate tax return will produce a benefit only to the extent of one-half of those expenses, since the other one-half will reduce the marital deduction by that amount.

4. Excess Deductions Upon Termination of Estate

Frequently, the major administration expenses are paid and deducted on the estate's final income tax return. The excess of the deductions over the income in the final period are reportable by the persons who are deemed the "succeeding beneficiaries."\textsuperscript{113} The excess deduction will be a tax benefit to the succeeding beneficiary only if that beneficiary itemizes deductions on the beneficiary's

\begin{itemize}
\item \textsuperscript{110} Treas. Reg. § 1.642(g)-1 (1956).
\item \textsuperscript{111} Id.
\item \textsuperscript{112} Treas. Reg. § 1.642(h)-2(a), T.D. 7564, 1978-2 C.B. 19, 63.
\end{itemize}
personal income tax return.\textsuperscript{113} If beneficiaries cannot itemize, their shares of the excess deduction will be lost. Moreover, there is no carryover or carryback of the excess deduction.

The deduction can also be lost upon a distribution of the estate to a testamentary trustee. If the trust has insufficient gross income for its first taxable year, the excess deduction may be of little or no benefit.\textsuperscript{114}

5. \textit{Beneficiary Adjustments}

The decision by the personal representative to claim an income tax deduction may favor an income beneficiary of the estate at the expense of a remainderman, since the expenses are normally deemed to be a charge to estate corpus regardless of the place of deduction. Absent a controlling will provision, the courts have required the income beneficiaries to reimburse principal for the lost estate tax savings.\textsuperscript{115} However, any additional savings will inure to the benefit of the income beneficiaries.

C. \textit{Estate Selling Expenses}

If an estate sells assets during the course of administration, and incurs expenses in connection with the sale, such as broker's commissions, realtor's fees, etc., the question arises as to the proper place of deduction of those expenses. Under prior law, taxpayers had considerable success in claiming selling expenses both as a deduction on the federal estate tax return, as an administration expense, and also as an income tax deduction as an offset or reduction in the selling price. The IRS's effort to have the expenses disallowed as double deductions under section 642(g) met with defeat in the Bray\textsuperscript{116} case.

The Tax Reform Act of 1976 reversed the Bray decision, and eliminated the double deduction for estate selling expenses.\textsuperscript{117} Those expenses must now either be claimed as an administration expense, or as an offset or reduction of the selling price for income tax purposes. Moreover, if the IRS concludes that the selling expenses are "unnecessary," the estate can anticipate a challenge to an administration expense deduction, in which event the choice would not be available and only an income tax deduction would be

\textsuperscript{113} Id.
\textsuperscript{114} Rev. Rul. 57-31, 1957-1 C.B. 201.
\textsuperscript{115} In re Warms, 140 N.Y.S.2d 169 (1955).
\textsuperscript{116} Bray v. Commissioner, 396 F.2d 452 (6th Cir. 1968).
\textsuperscript{117} I.R.C. § 642(g).
allowable. 118

D. Installment Payment of Estate Income Tax

Every estate has an automatic right to elect to pay the estate's federal income tax in quarterly installments, without interest. 119 If the election is made, one-quarter of the tax must be paid at the time of the filing of the return. The balance of the tax is payable in equal quarterly installments thereafter, that is, the third, sixth and ninth months following the due date of the return.

Although this election is normally of minor importance, it is desirable if the estate has a temporary or permanent lack of funds with which to pay the tax. The election is available to all estates, even if there is sufficient liquidity. If large amounts of tax are payable, it may be economically worthwhile to make the election so that the estate will have the investment use of the deferred funds. The election is also suitable if there is any possibility of a deficiency assessment. The deficiency will be prorated to each installment, decreasing the interest payable. 120

Although the separate instructions for Form 1041 mention the availability of the election, there is no specific place on Form 1041 to make the election. Either a notation on the return that the election is being made, or a separate brief statement of election by the personal representative, referring to section 6152(a)(2), should be sufficient.

The election must be made in a timely return. A late return, even though thereafter excused on the basis of reasonable cause, precludes the installment election. 121 Also, if any quarterly installment is not timely paid, the IRS has the right to accelerate the deferred balance.

E. Distributions From the Estate

The estate is a separate taxpayer for income tax purposes, and if there are no distributions to the estate beneficiaries during a particular fiscal year, the entire income is taxable to the estate. Property distributed, however, whether classified as income or principal under state law, and whether in cash or in kind, is taxable to the beneficiaries to the extent of the estate's modified taxa-
ble income, known as distributable net income (DNI).\textsuperscript{122} Concurrently, the estate receives a distributions deduction\textsuperscript{123} in the same amount, so that if all of the DNI is distributed, the estate will have no remaining taxable income on which to pay tax. There is an exception for specific bequests, as satisfaction of those bequests will not normally cause the beneficiaries to report any of the DNI.\textsuperscript{124}

Since the personal representative in most states, and particularly in those states with the Uniform Probate Code, has considerable flexibility as to the timing and amount of distributions, it is possible to use a number of techniques to minimize the overall taxes paid on the estate income. Already mentioned was the option the estate has to select the initial fiscal year. If the estate has minimal DNI for that period, the personal representative may make distributions in the first short taxable year, causing little taxable income to be reportable by the distributees.

Another widely used concept is to spread the income to multiple beneficiaries, particularly if they are in lower rate brackets. In addition to maintaining a balance between the taxable income of the estate and its beneficiaries, the spreading can be expanded if trusts established under the will are funded early in the administration, since the trusts will be separate taxpayers, as will the trust beneficiaries.

Another technique, known as a "trapping distribution," is a distribution of estate principal to a simple trust. The DNI carried by the distribution is taxed to the trust and is "trapped" there because the distribution enters the trust as principal, and is not distributable to the income beneficiaries. This distribution may require the trustee to later reimburse the principal account from the income account.\textsuperscript{125}

In agricultural estates, the decedent may have incurred the major production expenses prior to date of death. If the corresponding income from the sale of the crops or livestock cannot be matched against those expenses, the deductions may be lost or reduced in value. One possible solution is to have the estate select a fiscal year ending on December 31 or earlier, and make distributions to the surviving spouse before the end of the calendar year, so that the DNI can be reported in a joint return, and matched with the pre-death expenses.

Assuming the beneficiaries are agreeable to an extension of the

\begin{itemize}
  \item \textsuperscript{122} I.R.C. § 662.
  \item \textsuperscript{123} I.R.C. § 661.
  \item \textsuperscript{124} I.R.C. § 663(a)(1).
  \item \textsuperscript{125} In re Holloway, 327 N.Y.S.2d 865 (1972).
\end{itemize}
estate administration, it is generally advantageous to maintain the estate as a separate taxpayer for as long as possible. This may be particularly helpful if an installment obligation will ultimately be distributed to a beneficiary who is also the obligor. However, the administration cannot be unduly prolonged, without the risk of a challenge by the IRS that the estate has in fact terminated for income tax purposes.

IX. MISCELLANEOUS ELECTIONS

A. Termination of Subchapter S Election

The estate of a deceased shareholder in a Subchapter S corporation is treated as a "new" shareholder. The Subchapter S election will continue unless the estate affirmatively refuses to consent to the election within 60 days after the date of the appointment of the personal representative or within 60 days after the last day of the taxable year of the corporation in which the decedent died, whichever comes first. The estate personal representative must therefore make an early decision as to whether or not it is desirable, both from the standpoint of the estate and the other corporate shareholders, to let the Subchapter S election continue, or terminate. Involved in that decision are the basic questions which one must answer in the first instance as to whether it would be preferable for the corporation to be taxed in the normal fashion, or to have most of the tax consequences flow through to the shareholders under Subchapter S of the Code.

B. Partnership Election to Increase Basis of Partnership Property

Section 754 permits a partnership to elect to increase the basis of the assets in which the decedent had a proportionate interest to the fair market value of those assets. The stepped-up basis benefits only the decedent's estate, the decedent's successors, but not the other partners. If the election were not in effect at decedent's death, it must be made by the partnership not later than the due date.
date of the partnership return for the partnership taxable year in which the decedent died.\textsuperscript{129}

The principal advantage of the election is to generate additional depreciation deductions with respect to the decedent’s interest in the partnership, and thereafter to the successors to such interest. Note, however, that the increased basis portion can be depreciated only on the straight-line method.\textsuperscript{130}

Once the election is made, it applies to all subsequent transfers of partnership interests. This could result in a decrease of basis if the fair market value of the partnership interest of a second deceased partner were less than the basis of the assets to the partnership.

C. Waiver of Fees by Personal Representative

It is not uncommon to consider whether or not the personal representative, if a family member, should waive the fee to which the personal representative would otherwise be entitled under local law. If the fee is claimed, it is taxable income to the representative. It is therefore necessary to calculate the estimated income tax payable by the representative, as compared to the net tax savings as a result of deducting the fee either on the estate tax return or the estate income tax return.

If the representative is not the sole beneficiary, pure economics will often suggest that the fee not be waived. This may create family friction. In two separate rulings,\textsuperscript{131} the IRS has suggested the manner in which a fee should be waived, and the time for waiver.

D. Estate Tax Exclusion for Retirement Plan Distributions

Many estate planning clients have a vested interest in a qualified pension or profit-sharing plan through a corporate employer, a Keogh plan, or an individual retirement account. The value of such an interest at death can be quite significant.

If the proceeds payable at death cannot be used to pay death taxes and estate expenses, and are paid in a \textit{lump sum}, an election can be made to exclude the proceeds (other than voluntary contributions) from the gross estate.\textsuperscript{132} However, if the estate tax exclusion is elected, the recipient must report the entire amount of the

\begin{itemize}
\item \textsuperscript{129} Treas. Reg. § 1.754-1(b), T.D. 7208, 1972-2 C.B. 396.
\item \textsuperscript{130} Treas. Reg. 1.167(c)-1(a)(6) (1956).
\item \textsuperscript{132} I.R.C. § 2039(f).
\end{itemize}
proceeds in the recipient's income tax return in the year received.

For estates with little or no federal estate tax, it may be preferable to bypass the exclusion election and allow the qualified plan proceeds to be included in the gross estate. If done, favorable income tax rules will prevail and a special ten-year forward averaging rule is available for lump sum distributions.

If the death benefits are paid in other than lump sum, such as in the form of an annuity or in periodic annual installments, no election is available. The proceeds are automatically excluded from the gross estate, but, on the other hand, the ten-year averaging rule is not available; the income element is reportable as received by the beneficiary.

A beneficiary, and plan participants who are planning the ultimate distribution of their qualified accounts, are thus confronted with the choice between an estate tax exclusion (if the distribution is not a lump sum distribution) or the more favorable income tax results, if it is a lump sum distribution. Obviously, the determination of the time and form of payment from the qualified plan should be a lifetime decision, to the extent possible, rather than a post-death determination.

X. Options Under the Uniform Probate Code

Several post-mortem options are available in those states which, like Montana, have adopted the Uniform Probate Code. Earlier in this article the subject of disclaimers was discussed. There are, however, additional options under the U.P.C. which may facilitate post-mortem planning.

A. Elective Share of Spouse

In those common law property states which have adopted the U.P.C., the surviving spouse is given the protective right to take an elective share equal to one-third of the "augmented estate." The augmented estate is calculated by adding to the probate estate all prior transfers of property to the surviving spouse, together with transfers by the decedent to third persons during the marriage of a type where the decedent continued to enjoy the benefits from the property. Such transfers include retained life interests, joint tenancy property, and also gifts within two years of death.
exceeding $3,000 to any donee. 137 There is then subtracted funeral and administrative expenses, homestead and family allowances and exemptions, and the enforceable claims against the estate.

The surviving spouse, upon election, is first charged with property previously transferred to the spouse, before receiving additional property from the estate to make up the balance of the one-third elective share. The election must be made within six months after probate, or nine months after death, whichever expires last. However, local versions of the U.P.C. may differ from the standard U.P.C. provision.

In most estates, the election by the surviving spouse will not be done for planning purposes, but will be made solely for the reason that the surviving spouse concludes that he or she will receive a greater share of the estate than would be the case if the election were not made. The situation will occasionally arise where the decedent deliberately left the surviving spouse a lesser amount, and the spouse was in agreement, particularly where the surviving spouse has separate assets. After death, it might be concluded that this was poor planning, and that it would be desirable to have more assets pass to the surviving spouse that would qualify for the estate tax marital deduction. The election may thus be made by the spouse to increase the property passing to the spouse, thereby decreasing the federal estate tax. This would be desirable only if other potential remedies were unavailable to increase the spouse's share, such as the disclaimer. The elective share or statutory share concept is of course not limited to U.P.C. states; most of the other common law property states will have a similar election.

B. Homestead, Exempt Property and Family Allowance

Two other provisions of the Uniform Probate Code grant benefits to the surviving spouse which need to be considered after death. Under one, the surviving spouse is entitled to a homestead allowance of a specified dollar amount, 138 and under the other the surviving spouse may claim exempt property of a specified value. 139 The IRS has ruled that both the homestead allowance and the exempt property allowance are not terminable interests, under the version of the U.P.C. enacted in Arizona, and therefore qualify for the marital deduction. 140

Another provision entitles the surviving spouse and the minor

children to a reasonable family allowance during the administration of the estate.\textsuperscript{141} The Official Comment to that U.P.C. provision concludes that the allowance is a terminable interest and therefore fails to qualify for the marital deduction.

C. Other U.P.C. Provisions

If there are co-representatives of the estate, and if after death it is concluded that some of the powers granted to the representatives might produce unfavorable tax results because of the identity of one of the co-representatives (such as a spouse), consideration should be given to a delegation of powers from one co-representative to another.\textsuperscript{142}

Also, if the marital deduction is in jeopardy because of failure of the will to comply with Revenue Procedure 64-19,\textsuperscript{143} it could be argued that U.P.C. § 3-906,\textsuperscript{144} which expresses a preference for distribution in kind, mandates that distribution date values apply. This could counter an IRS argument that the representative could use estate tax values in satisfaction of a pecuniary formula legacy, which values do not fairly reflect appreciation or depreciation.

Finally, during informal proceedings under the U.P.C., flexibility has been increased for the personal representative to make distributions and pay administration expenses whenever it would be to the greatest overall tax advantage to the estate. This flexibility enhances the techniques of appropriately timing distributions and making the determination of the proper place of deduction for the estate administration expenses.

XI. Conclusion

Effective use of the numerous post-mortem elections imposes a special burden on the estate practitioner to promptly analyze the special facts of each new estate to determine the available options. Since timely elections are so critical, all relevant due dates should be diaried at the outset, to avoid inadvertent loss.

An informed decision requires that potential elections be explored with the personal representative and the beneficiaries well in advance of the election date. For example, the possible use of a disclaimer should be at least briefly discussed during the initial family conference after the decedent’s death, so that there will be

\textsuperscript{141} MCA § 72-2-803 (1979) (U.P.C. § 2-403).
\textsuperscript{142} Delegation is permitted by MCA § 72-3-622 (1979) (U.P.C. § 3-717).
\textsuperscript{143} 1964-1 C.B. 682.
\textsuperscript{144} MCA § 72-3-902 (1979).
ample time to make what sometimes can be a difficult decision.

Although the focus of this article has been on post-death determinations, lifetime planning to insure the availability of various elections should not be overlooked. This is especially true for the “percentage” elections of sections 6166, 6166A, 303 and 2032A. Appropriate business changes or asset transfers may open the right to a post-mortem option that would otherwise be unavailable.
## Checklist of Post-Mortem Elections

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<tr>
<th>ESTATE ACCOUNT</th>
<th>FILE #</th>
<th>ATTORNEY</th>
<th>D.O.D.</th>
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<tr>
<th><strong>APPLICABLE TO THIS ESTATE?</strong></th>
<th><strong>DUE DATE</strong></th>
<th><strong>DATE ELECTION COMPLETED</strong></th>
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<tr>
<td><strong>NO</strong></td>
<td><strong>YES</strong></td>
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<tr>
<td>1. Joint return with surviving spouse</td>
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<td>2. Series E bonds accrued interest</td>
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<td>3. Unpaid medical expenses</td>
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<td>4. Alternate valuation</td>
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<td>5. Special use valuation for farm or ranch real estate—federal</td>
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<td>6. Special use valuation—Montana</td>
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<td>7. Exclusion of joint tenancy property</td>
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<td>8. 10-year installment payment of federal estate tax</td>
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<td>9. 15-year installment payment of federal estate tax</td>
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<td>10. 15-year installment payment of Montana inheritance and estate tax</td>
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<td>11. Deferral of federal estate tax on remainder or reversionary interest</td>
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<td>12. “Reasonable cause” extension of time to pay federal estate tax</td>
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<td>14. I.R.C. § 303 stock redemption</td>
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<td>15. Flower bonds</td>
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<td>16. Disclaimers</td>
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<td>17. Fiscal year of the estate</td>
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<td>18. Estate administration expenses</td>
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<td>19. Estate selling expenses</td>
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<td>20. Quarterly installment payment of estate income tax</td>
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<td>21. Distributions from the estate</td>
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<td>22. Termination of Subchapter S election</td>
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<td>23. Adjustment to basis of partnership property</td>
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<td>24. Waiver of fees by personal representative</td>
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<td>25. Qualified plan distributions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>26. Elective share of the surviving spouse</td>
<td></td>
<td></td>
</tr>
<tr>
<td>27. Homestead and exempt property allowances</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Variations Between the 15-Year and 10-Year Installment Elections

<table>
<thead>
<tr>
<th></th>
<th>15-Year</th>
<th>10 Year</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Eligibility</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>a. Value of business</td>
<td>More than 65% of adjusted gross estate</td>
<td>More than 35% of gross estate, or 50% of taxable estate</td>
</tr>
<tr>
<td>b. Corporate interest</td>
<td>20% of voting stock or 15 or less shareholders</td>
<td>20% of voting stock or 10 or less shareholders</td>
</tr>
<tr>
<td>c. Partnership interest</td>
<td>20% of partnership capital or 15 or less partners</td>
<td>20% of partnership capital or 10 or less partners</td>
</tr>
<tr>
<td>d. Attribution</td>
<td>Immediate family counted as only one shareholder or partner</td>
<td>No provision</td>
</tr>
<tr>
<td>e. Combination of interests for 20% rule and commingling</td>
<td>Aggregation permitted</td>
<td>No provision</td>
</tr>
<tr>
<td>f. Commingling—multiple business interests</td>
<td>More than 20% of value of each in gross estate</td>
<td>More than 50% of value of each in gross estate</td>
</tr>
<tr>
<td>g. Indirect interests</td>
<td>Deemed owned by shareholders, partners or beneficiaries</td>
<td>No provision</td>
</tr>
<tr>
<td>h. Farm dwellings</td>
<td>Includable</td>
<td>No provision</td>
</tr>
<tr>
<td><strong>Deferrable tax</strong></td>
<td>Ratio of interest to adjusted gross estate</td>
<td>Ratio of interest to gross estate</td>
</tr>
<tr>
<td><strong>Maximum deferral</strong></td>
<td>14 years</td>
<td>9 years</td>
</tr>
<tr>
<td><strong>Interest only</strong></td>
<td>First 4 years</td>
<td>None</td>
</tr>
<tr>
<td><strong>Interest rate</strong></td>
<td>4% on first $345,800 of tax (less unified credit)</td>
<td>All at general rate (now 12%)</td>
</tr>
<tr>
<td><strong>Protective election</strong></td>
<td>Unnecessary for deficiencies</td>
<td>No provision</td>
</tr>
<tr>
<td><strong>Acceleration</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>a. Withdrawal of funds</td>
<td>1/3 of value of the entire business</td>
<td>1/2 of value of the entire business</td>
</tr>
<tr>
<td>b. Disposition of decedent's interest</td>
<td>More than 1/3</td>
<td>More than 1/2</td>
</tr>
<tr>
<td>c. Distribution by trustee to a beneficiary</td>
<td>Not an acceleration</td>
<td>No provision</td>
</tr>
<tr>
<td></td>
<td>Partial acceleration if UNI after first principal installment</td>
<td>Partial acceleration of UNI in 5th or later taxable year</td>
</tr>
<tr>
<td>----------------</td>
<td>---------------------------------------------------------------</td>
<td>--------------------------------------------------------</td>
</tr>
<tr>
<td>d. Undistributable net income (UNI)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
APPENDIX C

Installment Payment Election Under I.R.C. § 6166

Internal Revenue Service Center
Ogden, Utah 84201

Decedent: John Farmer
289-32-6221
Date of death: January 7, 1980
Form 706 due date: October 7, 1980

Gentlemen:

Pursuant to the provisions of I.R.C. § 6166 you are notified that the undersigned does hereby elect to pay in installments the estate tax attributable to decedent's stock interest in Plains Farming Co., described as item 2, Schedule B.

The deferrable estate tax is $47,460, as follows:

1. Value of decedent's stock $491,000
2. Value of adjusted gross estate $724,000
3. Ratio of value of stock interest to the adjusted gross estate: $491,000 = 67.8%, which exceeds the $724,000 65% requirement of I.R.C. § 6166(a)(1)
4. Deferrable estate tax: 67.8% business interest times the net federal estate tax of $70,000 = $47,460.

The non-deferrable estate tax payable with the return is $22,540 (net estate tax of $70,000 less deferrable estate tax of $47,460). Payments made with the return, representing U.S. treasury bonds, total $30,540, which exceed the tax due with the return by $8,000, and leaves a balance of deferred tax payable of $39,460.

The undersigned further elects to pay the deferred tax in annual installments of $4,746 each, commencing October 7, 1985, and to treat the excess payments with the return of $8,000 as a full prepayment of the installment due October 7, 1985, and a partial prepayment of the installment due October 7, 1986, so that the payment schedule will be as follows:

<table>
<thead>
<tr>
<th>Date</th>
<th>Installment</th>
<th>Prepayment</th>
<th>Tax Installment Due</th>
</tr>
</thead>
<tbody>
<tr>
<td>10-7-81</td>
<td>Interest only</td>
<td>-0-</td>
<td>-0-</td>
</tr>
<tr>
<td>10-7-82</td>
<td>Interest only</td>
<td>-0-</td>
<td>-0-</td>
</tr>
<tr>
<td>10-7-83</td>
<td>Interest only</td>
<td>-0-</td>
<td>-0-</td>
</tr>
<tr>
<td>10-7-84</td>
<td>Interest only</td>
<td>-0-</td>
<td>-0-</td>
</tr>
<tr>
<td>10-7-85</td>
<td>$ 4,746</td>
<td>$4,746</td>
<td>-0-</td>
</tr>
<tr>
<td>10-7-86</td>
<td>4,746</td>
<td>3,254</td>
<td>$1,492</td>
</tr>
<tr>
<td>10-7-87</td>
<td>4,746</td>
<td>-0-</td>
<td>4,746</td>
</tr>
<tr>
<td>10-7-88</td>
<td>4,746</td>
<td>-0-</td>
<td>4,746</td>
</tr>
<tr>
<td>10-7-89</td>
<td>4,746</td>
<td>-0-</td>
<td>4,746</td>
</tr>
<tr>
<td>10-7-90</td>
<td>4,746</td>
<td>-0-</td>
<td>4,746</td>
</tr>
<tr>
<td>10-7-91</td>
<td>4,746</td>
<td>-0-</td>
<td>4,746</td>
</tr>
<tr>
<td>10-7-92</td>
<td>4,746</td>
<td>-0-</td>
<td>4,746</td>
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<tr>
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<td>4,746</td>
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<tr>
<td>10-7-94</td>
<td>4,746</td>
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<td>10-7-95</td>
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<tr>
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<tr>
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<td>-0-</td>
<td>4,746</td>
</tr>
<tr>
<td>10-7-99</td>
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<td>-0-</td>
<td>4,746</td>
</tr>
<tr>
<td>10-7-10</td>
<td>4,746</td>
<td>-0-</td>
<td>4,746</td>
</tr>
<tr>
<td></td>
<td>$47,460</td>
<td>$8,000</td>
<td>$39,460</td>
</tr>
</tbody>
</table>

Plains Farming Co. was engaged in a trade or business at the time of decedent's death; decedent's 58.3% stock interest therein qualifies under I.R.C. § 6166(b)(1)(C)(i).

In the event of any determination that the I.R.C. § 6166 election is not applicable, the undersigned does hereby make a protective election under I.R.C. § 6166A.

Dated: October 5, 1980.

Ann Farmer, Personal Representative of the Estate of John Farmer
Route 1
Billings, Montana 59102