Post Mortem Estate Planning

Kinsey Spotswood

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POST MORTEM ESTATE PLANNING

Kinsey Spotswood

Post death estate planning is an extremely extensive subject and in order to break it down into realistic components, the presentation is divided into three main sections: (I) The Survivor/Survivors as the Estate Planners; (II) Remedies with Respect to Closely Held Businesses, Non-Liquid Estates and Other Specialized Situations; and (III) The Estate, the Decedent, and Others as Separate Taxable Entities. The first part is perhaps the most important and, for this reason, most of the presentation will be centered to this particular feature.

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I. The Survivor/Survivors as the Tax Planners

A. Disclaimers and Renunciations.—The terms disclaimers and renunciations are used interchangeably in the same general context. Disclaimer is the more widely accepted terminology and in view of the use of this term under the Virginia Disclaimer Act, the word disclaimer will be used throughout.

Simply stated, a disclaimer is a gratuitous refusal to accept property or to exercise control over the property. Once accepted, property cannot be disclaimed and the disclaimer must be absolute and unconditional.

For Federal Income, Estate and Gift tax purposes, there is no clean-cut definition and the closest thing to a definition is found in the Regulations under Section 2511.¹

Virginia, in 1972, enacted disclaimer provisions² hereinafter sometimes referred to as the Act. The Virginia Act follows, in general, the Model Disclaimer Act.³

According to a recent compilation, 34 states have enacted disclaimer statutes, some of which follow the model act and some of which are of a hybrid nature. The District of Columbia and 16 states have no disclaimer statute of any description. However, in the non-statutory states, disclaimers are generally recognized under the common law concept that a person can not be forced to accept property.

(1) Effect of a Disclaimer & Timing for State and Federal Purposes.—

(a) Disclaimers under the Virginia Act.—In Virginia the lapse approach has been adopted and treats the disclaimant as having predeceased the decedent⁴ in situations involving testamentary instruments. There is one exception to this where the disclaimant takes after one or more preceeding estates and, in this instance, the interest of the disclaimant would descend or be distributed as if the decedent had himself died at the time of the close of the preceeding estate.⁵ The same is true of disclaimers under non-testamentary instruments.⁶

The Virginia Act is quite broad on who can disclaim and the persons who are entitled to disclaim include the appointee, under both testa-

¹ Treas. Reg. 25.2511-1(c) which states that the disclaimer must be a complete and unqualified refusal to accept ownership of property transferred from a decedent whether the transfer is effected by the decedent’s will or by the Law of Descent and Distribution of intestate property provided it is made within a reasonable time after knowledge of the existence of the transfer and is effective under local law.
² Chapter 8, Title 64.1, Code of Virginia, 1950, as amended.
⁴ Sec. 64.1-190, Code of Virginia.
⁵ Ibid.
⁶ Sec. 64.1-191, Code of Virginia.
mentary and non-testamentary instruments as well as the personal representative of any other person such as a legatee, heir, etc.\textsuperscript{7}

Disclaimers under a testamentary instrument must be filed within 6 months after the death of the decedent or if the interest is contingent, then 6 months after such interest has become ascertained and indefeasibly vested both in quality and quantity.\textsuperscript{8} On the other hand, disclaimers under non-testamentary instruments must be filed within 10 months after the effective date of the non-testamentary instrument or, as above, if the interest is contingent, then 10 months after it has become ascertained and indefeasibly vested both in quality and quantity.\textsuperscript{9}

\textit{(b) Disclaimers under the Applicable Federal Income, Estate and Gift Tax Provisions.}—Disclaimers are recognized in certain areas of the Federal tax structure but the treatments accorded for income, estate and gift tax purposes vary to a considerable extent. On the income tax side, Section 678(d) of the Internal Revenue Code provides nothing more than requiring a disclaimer to be filed within a reasonable time after the disclaiming party first becomes aware of his or her interest in the property. This provision of the Code deals with the question of when a party other than the Grantor is considered the owner of the trust for income tax purposes.

Rev. Rul. 66-167, again on the income tax side, provides that a fiduciary may disclaim fees and commissions provided it is done within 6 months after appointment and without any prior inconsistent conduct on the part of the fiduciary.\textsuperscript{10}

Swinging over to the estate tax side, Section 2041(a)(2) of the IRC provides that the donee of a general power of appointment, that is, the type that would cause the value of the trust property to be includible in his estate under Sections 2035 through 2038 of the IRC, may disclaim. However, it must be effective under local law and made within a reasonable period of time.\textsuperscript{11}

Section 2055(a) of the IRC deals with the charitable deduction and here a disclaimer is recognized but it must result in the disclaimed interest passing for charitable purposes and must be made within 9 months (plus any extensions).\textsuperscript{12} It is to be noted that there is no requirement that it be effective under local law but perhaps this is implicit in view of the fact that it must pass to a charity and local law would be determinative of this result.

Section 2056(d)(1) provides the machinery for a surviving spouse to disclaim an interest in property which would otherwise pass into the marital share. Here again, there is no time limit nor is there any re-

\textsuperscript{7} Sec. 64.1-188 and Sec. 64.1-191, Code of Virginia.
\textsuperscript{8} Sec. 64.1-189, Code of Virginia, as amended in 1974.
\textsuperscript{9} Sec. 64.1-192, Code of Virginia.
\textsuperscript{11} Treas. Regs. 20.2041-3(d)(6).
\textsuperscript{12} Treas. Regs. 20.2055-2(c)(1).
quirement that it be effective under local law but it should be noted that it must pass to the person or persons entitled to receive such interest and, as such, it would seem to be implicit that the effectiveness of local law comes into play.

Section 2056 (d)(2)(A) of the IRC provides for a person other than a surviving spouse to disclaim an interest in property provided it is accomplished 9 months from the date of the decedent's death (plus any extensions). If so, it will be considered as passing to the surviving spouse and it would seem that the same effectiveness under local law would be an essential requirement.18

Moving over to the gift tax side, the only treatment on disclaimers is found under Section 2511 of the IRC but the actual requirements are contained elsewhere.14

Thus it becomes quite obvious that the overlying structures of the various state disclaimer laws as compared to the Federal structure will and can produce rather bizarre results. For instance, in the 34 states which have enacted disclaimer statutes, the period for filing runs from a maximum of 15 months in some states and as little as 2 months after probate in other states. Other states have a filing period somewhere in between with the exception of 4 which are geared to reasonable time. As a result, disclaimers might be effective for Federal tax purposes and ineffective for state inheritance tax purposes and vice versa. In the states still adhering to the common law rule the same general results would obtain and, insofar as the Federal gift tax provisions under Section 2511, it would result in a taxable gift for Federal purposes and an inheritance tax under the Hardenburg Rule15 for any takers under the law of that jurisdiction. Hardenburg stands for the proposition that property passing by intestate succession becomes a vested interest at the moment of the decedent's death and cannot be disclaimed and, as such, the requirements under Treasury Regulations Section 25.2511-1(c) could not be met. This would have also been the case in Virginia prior to 1972. However, the problem seems to be cured provided the filing of the disclaimer is made within 10 months and that this constitutes reasonable time under Federal standards.

Accordingly, it is quite evident that there is much need for improvement in the way of conformity and to some extent this may be achieved by the proposed Federal Disclaimer Act.

(c) Proposed Federal Disclaimer Act.—The American Bar Association at its Annual Meeting in August 1974, recommended that the draft of the Federal Disclaimer Act as proposed by the Estate and Gift Tax

13 Estate of C. Warren Caswell, 62 TC 51 (1974). It should also be noted that the amendment to Sec. 2056(d)(2) by P.L. 89-621, opening the door for disclaimers be persons other than the surviving spouse has not been reflected in the Estate Tax Regulations.
14 See footnote 1.
15 Ianthe B. Hardenburg, 17 TC 166, affd. 198 Fed. 2d 63 (CCA8, 1952).
The proposal is quite comprehensive in scope and there is a strong likelihood that something of this nature will be enacted into legislation by Congress in 1975. While this is not the final product, it is interesting to note that the time period for filing the disclaimer is 9 months. As a result, there will certainly be no conformity insofar as the filing period is concerned. Another interesting feature has to do with the situation where a disclaimer is ineffective under local law. In a situation like this, the disclaimer would be recognized for Federal purposes if, in fact, the disclaimer or other instrument actually transferred the property or the interest therein. In this instance, the disclaimant would be home free under Federal law but would be saddled with adverse consequences insofar as state gift and inheritance tax provisions are concerned.

(2) Disclaimer of Property Passing under Testamentary and Non-Testamentary Arrangements.

(a) The Disclaimer Act provides that any and all property and any interest therein may be disclaimed. Specifically included as a proper disclaiming party is the appointee under a power of appointment. The statute is silent on the donee of a power of appointment as a permissible disclaimant. The question here turns on whether or not the donee’s power would constitute property or an interest therein. The Act should be carefully reviewed as to what constitutes property or an interest therein as well as permissible disclaimants. Permissible in Virginia under Sections 64.1-195 & 55-286.1.

(b) Under a non-testamentary arrangement the same general rules would apply under a living trust. With respect to intestacy, the same general rules would apply to disclaimants and types of property and interests therein.

(c) In addition, there are special types of property over and above that herein set forth:

1. Life insurance.—It seems clear that a beneficiary under a life insurance policy can disclaim under the Act.
2. P.O.D. Accounts both with financial institutions and Bonds.—The beneficiary would be viewed in the same legal capacity as with life insurance.
3. Totten Trusts.—The same rule applies. QUERY—is a Totten trust valid under Virginia law?\(^\text{17}\)

(d) Certain types of property cannot be disclaimed by reason of the operation of the title registration and other factors:

1. Property held as tenants by the entireties with the right of sur-\(^\text{16}\)
vivorship is controlled by the law of the jurisdiction rather than being property that passes from the decedent to the surviving spouse. It would seem that the spouse’s vested interest in the property at the time of the creation of the tenancy would constitute an acceptance at that time and, as such, would not be an interest in property that could subsequently be effectively disclaimed.

2. Joint bank accounts present a problem and again it would depend upon the facts and circumstances surrounding the arrangement. The surviving joint tenant normally has accepted the property at the time of its creation and, of course, acceptance defeats a disclaimer. On the other hand, if the account was set up for purposes of the convenience of the party making the contribution then a different rule would apply. In this case there would have been no prior acceptance and it would seem that the surviving joint tenant would come within the purview of the Act.

(3) Use of Disclaimers for Tax Advantages.—It should be remembered that disclaimers, whether tax motivated or otherwise, must be carefully screened in order to determine whether or not the disclaimer moves the property to the desired person, keeping in mind that the control is built in to the terms of the will or trust in a testamentary situation and the rules on descent and distribution under intestacy. A disclaimer is not a conveyance or a transfer and can only be controlled by pre-death arrangement or as set forth above.

(a) Federal Estate Tax:

Marital deduction.—In cases of underqualification, Section 2056(d) (2) of the IRC provides the machinery for other persons disclaiming in favor of the surviving spouse.

Underqualification can also be partially cured by renunciation, here-inbelow treated in more detail under B., where the spouse takes the statutory share in situations where the property interest left to the spouse does not qualify under Section 2056 as well as in situations where the surviving spouse does not receive a substantial bequest under the decedent’s will and trust.

In cases of overqualification, the problem can also be cured under Section 2056(d) (1) of the IRC. In addition, there will be some situations where in over funding rather than having the surviving spouse disclaim, allow such person to take the full bequest and then make a charitable gift which will produce an income tax deduction whether it be an outright gift or a retained interest under an annuity, unitrust or pooled income fund.19


19 Sections 170, 642 (c) (5), 664, 2055 (e) and 2522, IRC.
Charitable deductions.—(i) The charitable deduction may be enlarged if, in fact, the noncharitable beneficiary disclaims with the result that the disclaimed interest will pass to a charitable organization. Again, care must be taken to see that the terms of the will would produce this result.

(ii) If a bequest in trust does not meet the requirements of an annuity trust or unitrust, a disclaimer by the noncharitable beneficiary will produce an allowable deduction if the charity actually receives the bequest.20

Powers of appointment.—A general power of appointment, that is one within the definition set forth under Section 2041(b), can be disclaimed both for Federal purposes and under the Act. The fact that Section 64.1-195 of the Code of Virginia provides that the Act is not exclusive brings the power of appointment provisions into play. The term power includes both general powers of appointment and special or limited powers of appointment. It is specifically provided that a release of a power is treated as a disclaimer if action is taken by the donee to release such power within two years from the effective date of the instrument creating the power.21 However, it should be pointed out that to be effective for both Federal and state tax purposes, it should be filed within 9 months plus any extensions.

Generation skipping.—It will quite often be useful to a person who is the recipient of a devise, bequest or an interest in property from intestacy to take advantage of the disclaimer machinery. For instance, a parent who is entitled to property from a decedent may wish to remove the value of such property from his own taxable estate and by use of the antilapse statute22 or perhaps under the terms of the instrument can cause the property to move down to children or grandchildren if there be no children.

(b) Federal Income Tax:

High income tax bracket taxpayer.—In situations of this type where the beneficiary under a trust effectively disclaims his income interest then it will not be includible in his gross income for Federal income tax purposes and under the Act. A cautionary note—in situations of this type where the disclaiming party also has a future interest in the property generating the income23 a disclaimer of an income interest will operate as a disclaimer of any future interest under the Act.

Section 678(a) of the IRC owners.—A person other than the Grantor will be considered the owner of a trust if such person alone can divert income or corpus to himself. Thus, it may be desirable to unload this

20 Cf. Estate of Iaecker. 58 TC 166 (1972), acq. IRB 1974-13, 7; Section 2055(a) IRC; Treas. Reg. 20.2055-2(c).
21 Section 55-2861, Code of Virginia.
22 Section 64.1-64, Code of Virginia.
23 Section 64.1-190, Code of Virginia.
power and the machinery for disclaiming is provided under Subpara-
graph (d) of Section 678 of the IRC.

Sole beneficiary also fiduciary.—In the typical situation where the
husband names the wife as the sole executor it may be that executor's
fees and commissions should be waived especially if she is going to
be in a high income tax bracket. A comparison of the estate tax bracket
with the deduction for such fees should be made to the income tax
bracket in making an election to file a disclaimer under Rev. Rul. 66-
167. In other words, the most advantageous method should be
selected whether the sole beneficiary/executrix takes the fees and com-
misions or passes same.

(c) Federal Gift Tax:

Relief from a taxable gift.—(1) The individual situation arises when a
parent or other person would take an interest in property under in-
estacy and would prefer to pass such property directly to a child. By
use of the disclaimer under the Act and the cross action of Section
2511 there would be no Federal gift tax liability nor would there be a
gift under the Act. The same situation might also present itself under
a testamentary arrangement.

(ii) Again, caution should be exercised in the non-statutory states
under the Hardenburg Rule and if a transfer is effected then there
would be both a Federal gift tax liability and state gift tax liability.

(d) State Inheritance and succession taxes.— Generally speaking in
the statutory states the person actually receiving the property as a re-
sult of a disclaimer is subject to succession or inheritance tax at the
rates applicable to such person. This would be the case in Virginia
under the Act. Again, in non-statutory states under intestacy the per-
son or persons becoming vested at the time of the decedent's death
would include the value of such property at the applicable state inheri-
tance tax rates.

(e) State gift taxes.—Generally speaking state gift taxes, if they are
based upon the succession concept, are imposed upon the value of the
property to which the various donees succeed. Accordingly, the donee
can effectively disclaim any such property and in so doing will be
removed from the personal liability in the State of Virginia.

B. Elections by the Surviving Spouse

(1) Elections by the Surviving Spouse to Take a Forced Statutory
Share of the Decedent's Estate.—

(a) Nature of the statutory election.—Generally speaking, the elec-
tion to take against the decedent's will by the surviving spouse has the

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24 See footnote 10.
25 Treas. Regs. 25.2511-1(c).
26 Section 58-227, Code of Virginia.
effect as if the decedent died intestate with respect to the surviving spouse’s interest in the decedent’s estate. In Virginia the above rule is applicable.\textsuperscript{27}

(b) Necessity of affirmative action on the part of the surviving spouse.—As a general rule it is necessary for the surviving spouse to affirmatively elect to take against the will in accordance with the procedures set forth in the various states. In Virginia the surviving spouse must renounce within 12 months from the time that the will is admitted to probate either by doing so in person before the court or by a writing recorded in the court.\textsuperscript{28} This right of election is personal to the elector and, in most states, may not be exercised by heirs or personal representatives. In New York and California, the “widow’s election” may be exercised by a personal representative.\textsuperscript{29} In addition, in New York, the court may authorize an exercise of an election for an incompetent and may also authorize the exercise of an election for a minor.\textsuperscript{30} In Virginia, it would appear that under unusual circumstances where there is an incompetent surviving spouse, the court must either renounce or decline to renounce.\textsuperscript{31}

(c) Surviving spouse’s right to dower or courtesy.—The law will vary among the various jurisdictions as to the right of the surviving spouse to take his or her courtesy or dower interest but, generally speaking, if the right to same has not been barred or relinquished, the surviving spouse is entitled upon the election to take against the will an interest in the deceased spouse’s real estate. In Virginia the surviving spouse shall be entitled to dower or courtesy in all real estate owned by the deceased spouse.\textsuperscript{32}

(d) Property interests to which the surviving spouse is entitled after election.—Generally speaking, the surviving spouse is entitled to a fraction or percentage of the decedent’s personal estate and the decedent’s real estate. In Virginia the surviving spouse is entitled to $\frac{1}{2}$ of the net personal estate if the deceased spouse is survived by children or issue; otherwise, $\frac{1}{2}$ of the net estate.\textsuperscript{33} Again, for dower or courtesy, the surviving spouse is entitled to a fraction or a percentage of the deceased spouse’s real estate. In Virginia the surviving spouse is entitled to a life estate in $\frac{1}{2}$ of the deceased spouse’s real estate but if the deceased spouse is not survived by children or issue, then to a life estate in the whole.\textsuperscript{34}

\textsuperscript{27} Sections 64.1-16 and 64.1-11, Code of Virginia. \textit{cf.} Alexandria National Bank, Exec., etc. vs Thomas 213 Va. 620, 627 (1973).
\textsuperscript{28} Section 64.1-13, Code of Virginia.
\textsuperscript{29} Estate of Field, 38 Cal. 2d 151 (1952); Estate of Kelley, 122 Cal. App. 2d 82 (1953).
\textsuperscript{30} N. Y. EPTL 5-1.1(d) (4) (B).
\textsuperscript{31} See First National Exchange Bank of Roanoke vs. Hughson 194 Va. 736, 751.
\textsuperscript{32} Section 64.1-19, Code of Virginia.
\textsuperscript{33} Section 64.1-16, Code of Virginia.
\textsuperscript{34} See footnote 32.
of his or her interest in the real estate, normally in situations where the interest cannot be conveniently laid off and assigned in kind. This rule is applicable in Virginia.\textsuperscript{38}

(2) Treatment of Probate and Non-Probate Properties.—The law is not at all clear or consistent with the proper handling of non-probate property. There is considerable variance among the various states.\textsuperscript{36}

(a) The surviving spouse's right to bring non-probate property in which he or she had an interest prior to decedent's death into the statutory share turns, in general, on the question of whether the spouse took a vested interest prior to death. For instance, property held as tenants by the entireties or a joint and survivor arrangement would, in most cases, pass to the surviving spouse over and above the statutory share. A few jurisdictions would treat the value of such property as a contribution to the statutory share.

(b) Life insurance payable to the surviving spouse does not affect the election. If the insurance is payable to the decedent's estate, then it would be includible in the share.

(c) Where the surviving spouse is the remainderman under a revocable trust there is a degree of uncertainty. If the arrangement is testamentary in character, then it would seem to be includible in the share. Where some other person takes the remainder, some states, by statute, bring such property into the elective share. In other jurisdictions, in the absence of fraud, such property cannot be reached by the surviving spouse.

(d) In cases of the irrevocable trust, the rule seems to be that this property cannot be reached by the surviving spouse in the absence of fraud or the trust being either illusory or testamentary in character. Where the surviving spouse is the remainderman, then the trust properties would pass outside of the elective share unless illusory or testamentary.

(3) Tax Consequences of Elections.—

(a) Marital deduction.—Depending upon the nature of the interest in the statutory share it may or may not qualify for the marital deduction.\textsuperscript{37} The interest in the property received by the spouse must qualify for the marital deduction. Normally an election to take the intestate share will qualify.\textsuperscript{38} In Virginia the statutory share in the personal estate of the deceased spouse qualifies for the deduction. This is so because the share passes outright and the electing spouse is entitled to a pro rata share of the income during the administration of the

\textsuperscript{38} Section 64.1-36, Code of Virginia.

\textsuperscript{36} See Real Property, Probate and Trust Journal, Vol. 2, No. 3 (Fall 1967) 310 for a general discussion.

\textsuperscript{37} Treas. Reg. 20.2056(e)-2.

\textsuperscript{38} Isaac Harter, Jr. 39 TC 511 (1962).
estate. Insofar as dower and courtesy rights are concerned, it depends on the law in the various states as to whether or not it is an interest in property within the meaning of Section 2056. In Virginia, dower and courtesy can be assigned in the form of a life estate and, if this is done, the value of the interest is knocked out as being a terminable interest. On the other hand, if the surviving spouse has the right and actually commutes the value of his or her dower or courtesy, the value of such interest is an allowable deduction. A cash settlement received by a surviving spouse in a will contest settlement, if bona fide, will produce an allowable deduction.

(b) Use of the electives in achieving desired tax results.—Quite often through drafting inadvertence or otherwise, the share intended to pass to the widow as a marital deduction may not qualify by reason of being a terminable interest or otherwise. In this event, the defective bequest can be cured by having the surviving spouse elect to take his or her statutory share. In other cases of underqualification or nonqualification, it is quite obvious that the elective machinery can operate to build up the allowable marital deduction. In cases of overqualification such as when the surviving spouse receives substantial insurance and other non-probate property at the time of the deceased spouse's death or is independently wealthy, then the surviving spouse may elect to take the statutory share in lieu of the bequest under the will which would otherwise qualify for the deduction. The surviving spouse may then make a life time gift of the share to the decedent's children. However, if the statutory share is substantial and would trigger a sizeable Federal gift tax liability and if the deceased spouse's estate contains substantial real estate holdings, then to skate around the gift tax liability, the surviving spouse would not have the dower or courtesy commuted but leave it as a life estate which would not cause any additional estate liability at the time of his or her death. By the same token, if after dower or courtesy has been assigned and the surviving spouse's total statutory share has become fixed both in quality and quantity, such spouse then has the option to disclaim this interest under the Act. On the other hand, if the beneficiary does not need a gift from the spouse, then consideration should be given towards taking the full statutory share with commuted dower or courtesy with a follow-up gift to charity, either outright or through a retained life interest in an annuity, unitrust or pooled income fund.

References:

90 Section 2056(b) IRC.
93 Isaac Harter, Jr. 39 TC 511 (1962).
94 Section 64.1-189, Code of Virginia.
95 See footnote 19; cf. Isaac Harter, Jr. 39 TC 511 (1962).
C. Elections by the Surviving Spouse to File Joint Federal Income and Gift Tax Returns with Deceased Spouse's Personal Representative.—

The surviving spouse as the estate planner has many options and elections in the general area but the alternatives are tricky and can result in unexpected tax liabilities to both parties. Accordingly, it is essential to proceed with caution and not to make elections or consents until a thorough analysis has been made. While there is some relief mechanism available to both parties such machinery does not operate as a bailout on the broad front.

(1) Income Tax Returns.—The decedent's personal representative is required to file the fractional year return if there has been a qualification within one year after probate.46 If there has been no qualification, then other persons including the surviving spouse may file the return.47

(a) Election to file a joint return.—The decedent's personal representative and the surviving spouse may file a joint return if the surviving spouse is not remarried before the end of the year.48 There are special rules whereby the personal representative can initially file a separate return and then, before the statute runs, turn things around and file a joint return.49 Also, if the surviving spouse files the joint return and a personal representative is thereafter appointed, it may disaffirm the joint return by filing a timely separate return for the deceased spouse.50 The joint return includes income of the decedent for the fractional year and the income of the surviving spouse for the entire year.51

(b) Final opportunity to utilize decedent's tax factors.—

(i) One of the more interesting features has to do with the medical expenses deduction especially where the deceased spouse was terminable for a long period of time and the medical expenses are substantial. This presents an opportunity for a so-called double deduction if the surviving spouse, prior to death, actually pays the medical bills. If this is done, then there would be an income tax deduction on the final return and a “second deduction” resulting from the depletion of the value of the decedent's estate by getting the medical expenses out before death.52 On the other hand, if this cannot be done, then if the medical expenses are paid by the estate within one year of death, the surviving spouse and the personal representative have an election to treat the item as a deduction on the decedent's final return or as an estate tax deduction. The payment is treated as being paid when in-

46 Section 6012(a)(1) IRC.
47 Section 6012(b)(1) IRC.
48 Section 6013(a)(2) IRC.
49 Section 6013(b)(1) IRC.
50 Section 6013(a)(3) IRC.
52 Treas. Reg. 1.213-1(d)(2).
curred and is not based on the actual liability to pay same.\textsuperscript{53} However, in order to take the deduction for income tax purposes, a waiver must be filed disclaiming the right to take same for estate tax purposes.\textsuperscript{64} Of course, an estate tax deduction can be taken in lieu of the income tax deduction as a debt of the decedent under Section 2053 of IRC. There is further flexibility in this area in the way of taking part of the expenses deduction in excess of the 3\% floor as an income tax deduction and then take the 3\% as an estate tax deduction.\textsuperscript{55}

(ii) Another item of importance is the deceased spouse's \textit{unused depreciation deduction} which may be used only in the decedent's final return.\textsuperscript{56}

(iii) The \textit{unused charitable deduction carryover} expires at the time of the deceased spouse's death and, as a result, can only be used in the decedent's final tax return.\textsuperscript{57}

(iv) By the same token, the \textit{unused capital loss carryover} is lost unless it is used in the decedent's final tax return.\textsuperscript{58}

(v) \textit{Subchapter S losses} for the year of death can only be deducted in the decedent's final tax return.\textsuperscript{59}

There are other so-called special rules that require separate treatment including constructive receipt of certain items of income\textsuperscript{60} and when constructive receipt is applicable it should be distinguished from Section 691 income (income with respect of a decedent) which is includible only on the estate income tax return.

(c) \textit{Tax planning and consequencies}.—

(i) If the decedent has substantial deductions and less income than the surviving spouse, a joint return enables the spouse to maximize the above type deductions to offset the spouse's income.

(ii) There is also the opportunity to shift substantial income attributable to the decedent from the estate where it would be exposed at the highest rates applicable by having the estate distribute the income to the surviving spouse and have the election to file a joint return. The estate, of course, would be entitled to a distribution deduction in determining income tax liability.

The important thing to keep in mind is to get the benefit of separate returns on the joint return or, in the alternative, to file separate returns if the tax advantages lie in that direction. In making the decision as to what should be done, it should be borne in mind that where joint return is filed both the surviving spouse and the personal representative

\begin{itemize}
  \item \textsuperscript{53} Treas. Reg. 1.213-1 (d).
  \item \textsuperscript{54} Treas. Reg. 1.213-1 (d) (2).
  \item \textsuperscript{55} cf. Rev. Rul. 59-32 CB 1959-1, 245.
  \item \textsuperscript{56} Rev. Rul. 67-400 CB 1967-2, 99.
  \item \textsuperscript{57} Treas. Reg. 1.170-2(g) (6) (iii).
  \item \textsuperscript{58} Rev. Rul. 74-175 IRB 1974-16, 6 superseding Rev. Rul. 54-207 CB 1954-1, 147.
  \item \textsuperscript{59} Section 1374(b) IRC.
  \item \textsuperscript{60} Treas. Reg. 1.451-2.
\end{itemize}
are jointly and severally liable for tax liability, interest and penalties although there is one relief provision for the so-called innocent spouse. It should be noted that the consenting surviving spouse cannot disaffirm a post mortem joint return once the election has been made but, on the other hand, the personal representative can disaffirm a post mortem joint return filed by the surviving spouse without his consent provided such action is taken within one year from qualification.

(2) Gift Tax Returns.—The surviving spouse with the deceased spouse’s personal representative may elect to have gifts of both spouses split and treated as if made one-half by each. It should be noted however that such election creates joint and several liability for any tax for that particular year.

The surviving spouse can use his or her $30,000 specific exemption under Section 2521 but care should be exercised in such use as it could adversely affect the surviving spouse’s future use of his or her exemption which may result in an unnecessarily high gift tax liability.

II. Remedies with Respect to Closely Held Businesses, Non-liquid Estates and Other Specialized Situations

A. Section 303 Redemptions:

(1) Statutory requirements.—(i) Section 303 of the Internal Revenue Code provides relief from ordinary income treatment of stock redemptions if, in fact, the value of the stock owned by the decedent at the time of death in one or more corporations is 35% or more of his gross estate or 50% or more of his taxable estate. If the estate can meet this test, then distributions of cash or other property in redemption of decedent’s stock will not fall within the dividend trap under Sections 301 and 302. In addition, the attribution rules under Section 318 are not applicable. There is a special rule for holdings in two or more corporations.

(ii) The dollar amount falling within this provision of the Code can not exceed the total of estate, inheritance, legacy, and succession taxes plus the amount of funeral and administrative expenses allowable as deduction to the estate. It should be noted that while this is a permissible maneuver there is no actual requirement that the redemption proceeds be used for the purpose of paying or discharging any of the above items but there may be situations where failure to do so will defeat the estate’s tax objectives in related areas. Generally speaking, no

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61 Section 6013 (e) IRC.
63 Section 6013 (a) (3) IRC and Treas. Reg. 1.6013-1 (d) (5).
64 Treas. Reg. 25.2513-2 (c); cf. Treas. Reg. 25.2513-1 (b) (1).
65 Section 2513 (d) IRC.
66 Section 303 (b) (2) IRC.
67 Section 303 (b) (2) (B) IRC.
68 Section 303 (a) IRC.
capital gain will be involved unless there is substantial appreciation in
the closely held stock between date of death and date of redemption.

(iii) The stock redemption must take place within 3 years plus 9
months, plus 90 days from date of death. In other words, there is a 4
year period in which the redemption can take place but if the rede-
emption is challenged and litigated, then this period can be further ex-
tended until 60 days after final decision of the Tax Court. Thus, if it is
necessary to litigate and additional time is needed, then the Tax Court
route is the only means available for further extension.

(iv) Corporate accumulations can be set aside for redemption for
the year of the decedent's death and all subsequent years without fall-
ing into the accumulated earnings tax.\(^\text{60}\)

(2) Planning aspects to Preserve 303 Redemption.—

(i) Alternate valuation date.—This may be useful in the marginal
case where the 35/50% test is too close for comfort. This is especially
useful when there has been a general decrease in the value of other
properties in the decedent's estate.

(ii) Unexpected inclusion of the value of properties in decedent's
estate—It should be noted that the basic estate might be adjusted up-
wards by reason of bringing the value of property in under Sections
2035, 2036, 2037, 2038, 2040 and 2041. Again, should this happen and up-
set the 35/50% test, then redemptions made prior to knowledge of these
features could result in dividend treatment of the redeemed stock. In
this context, it may be important to request an early audit so that the
estate can be closed for audit purposes within 9 months after the due
date of the return.\(^\text{70}\)

(iii) A corporation may recognize gain if certain appreciated proper-
try is distributed in redeeming the stock.\(^\text{71}\) Lifo inventory distributed
also produce recognizable gain to the corporation.

(iv) In the event Section 303 is not applicable there is always the
possibility of coming within the exception under Section 302(b)(3)
where there is a complete termination of the stock held by the estate.
If this alternative is used, care should be taken to postpone redemption
for a period of 12 months after date of such distribution in order to
avoid gain on appreciated property.\(^\text{72}\)

(v) Care should be exercised in not distributing closely held stock
to the surviving spouse under a marital deduction pecuniary formula as
this would be considered in satisfaction of the bequest. This rule would
not apply in the use of a fraction of the residue formula.

(vi) In the event of a post death recapitalization under Section 368,
if there is an exchange of common for new preferred, such stock would

\(^{60}\) Section 537(a)(2) and Section 537(b)(1).

\(^{70}\) Section 2204, IRC.

\(^{71}\) Sections 1245, 1250 IRC.

\(^{72}\) Section 311(d)(2)(A) IRC.
be available for redemption.\textsuperscript{73} This is true for Section 306 stock whether exchanged before or after the decedent's death.

**B. Reasonable Cause, Undue Hardship and Election to Pay Estate Tax in Installments.**

(1) *Reasonable cause.*—If it can be shown to the satisfaction of the Commissioner, the period for payment of tax can be extended for 12 months after due date of return.\textsuperscript{74} There are examples of what constitutes reasonable cause.\textsuperscript{75}

(2) *Undue hardship.*—If it can be shown to the satisfaction of the commissioner that the liquidation of estate properties would result in undue hardship, then the period may be extended up to 10 years with interest at the rate of 4\% rather than 6\% under Section 6161(a)(1).\textsuperscript{76} There are examples of what constitutes undue hardship.\textsuperscript{77} In the event the District Director does not allow the extension, then the estate has the right to appeal within 10 days to the appropriate Regional Commissioner.

(3) *Election to pay estate taxes in installments.*—(i) Section 6166 provides the machinery for the election to pay the estate tax attributable to an interest in a closely held business in installments not to exceed 10 years with an interest rate of 4\%. This election is not discretionary with the Commissioner but if the estate meets the tests and requirements under the statute the right to do so is absolute notwithstanding the Commissioner's power to accelerate under certain circumstances. Stock held in a corporation including Subchapter S in which the decedent had an interest, will meet the requirements under the same 35/50\% test for Section 303 redemptions.\textsuperscript{78} Under the rules relating to closely held businesses involving a proprietorship or an interest in a partnership carrying on a trade or business the percentage test is different from that of an interest held by the estate in a corporation.\textsuperscript{79} The election must be made at the time that the estate tax return is filed. The deferred tax relates only to that proportion of the total taxable estate attributable to the decedent's interest in a closely held business.

(ii) Care should be taken in the management of the closely held business as well as the estate's holdings in such business so as not to produce an acceleration.\textsuperscript{80} For instance, if 50\% or more of the value of the interest is distributed, sold, exchanged, or otherwise disposed of, acceleration would result. The transfer of an interest in such closely

\textsuperscript{73} Section 303(c) IRC.

\textsuperscript{74} Section 6161(a)(1) IRC.

\textsuperscript{75} S. Rept. 91-1444 91st Cong., 2d Sess.

\textsuperscript{76} Section 6161(a)(2) IRC.

\textsuperscript{77} Treas. Reg. 20.6161-1(a)(2).

\textsuperscript{78} Section 6166(a) IRC.

\textsuperscript{79} Section 6166(c) IRC.

\textsuperscript{80} Section 6166(h) IRC.
held business to a beneficiary or a testamentary trustee will not, in itself, accelerate the payment.

(iii) Redemptions under Section 303 do not necessarily produce an acceleration but if certain percentages of the estate tax are not paid and certain 303 distributions exceed under the 50% test, then acceleration is triggered.\(^81\)

(iv) Section 303 and Section 6166 can be used together.\(^82\) There is no requirement that the estate be liquid in order to secure an extension and in the presently unique economic conditions, there is substantial leverage between the 4% interest rate on installments and the going rate for cash held in the estate. In practically every instance, a protective election should be filed and the same would follow with respect to electives under Section 6161. There is nothing to be lost and if the estate decides not to take advantage of this machinery, it can always withdraw or voluntarily accelerate the extended period by paying the tax.

(4) Specialized Situations.—Prior to December 31, 1972, defective drafting of charitable remainder trusts, i.e., annuity and unitrust, could be cured if the governing instrument provided the trustee with the power to amend the trust to conform with the provisions of Section 664 or if judicial proceedings in the way of a reformation were instituted to comply with Section 664. If either of these was accomplished prior to the cutoff date the charitable contribution deduction under Sections 170, 2055, 2106, or 2522 would be allowable.\(^83\) In view of the fact that a number of trusts did not meet the requirements, Congress enacted a relief provision (P. L. 93-483, October 26, 1974) extending the period for amendment or reformation to December 31, 1975 for trusts created prior to September 21, 1974. The provision applies to estates of decedent's dying after December 31, 1969. It should be noted that where the instrument does confer the power to amend, the amendment has to be executed and effective prior to the cutoff date. The mere power to amend is not sufficient.

The original transitional rules insofar as judicial reformation is concerned were accorded special relief to the extent that the principle set forth under Commissioner v. Bosch, 387 US 456 (1967) would not be rigidly applied.\(^84\) In other words, for state law to be controlling for Federal tax purposes, it was not necessary that the characterization or determination be that of the highest court of the jurisdiction involved. In Virginia, for instance, a true adversary proceeding at the Circuit

\(^{81}\) Rev. Rul. 72-188, CB 1972-1, 383; Sec. 6166(h) (1) (B).

\(^{82}\) Ibid.


Court level would be determinative of the allowability of the charitable deduction in the annuity trust-unitrust area. It is generally thought that the Internal Revenue Service will implement this ruling in again limiting the application of Bosch.

In another area, certain charitable remainder trusts have contained broad investment and administrative powers for the trustee and, as such, the deduction has been disallowed by reason of the fact that the value of the remainder interest is not ascertainable. This problem has been cured to some extent as a result of the new position taken by the IRS whereby “pregnant” powers can be cured if, in fact, the trustee together with the beneficiaries enter into an agreement with IRS to the effect that such powers will be exercised in an impartial manner and will not favor the interest of the non-charitable beneficiaries over the charitable beneficiaries.\footnote{\textit{Rev. Proc. 74-6, IRB 1974-12, 17 superseding Rev. Proc. 73-9, CB 1973-1, 758.}}

In addition, it would appear that broad administrative powers could result in the loss of a charitable deduction or the marital deduction and, if this be the case, it would appear that these powers can be effectively disclaimed for Federal estate tax purposes.\footnote{cf. Estate of Jaecker 58 TC 166 (1972) acq. IRB 1974-13, 7.} It should also be noted that the Virginia Disclaimer Act does not include provisions for unloading powers of this type as they would not fall within the meaning of property or an interest in property. However, this does not seem to be of any consequence because there is no requirement under \textit{Jaecker} that the disclaimer of such powers be effective under local law.

III. \textit{The Estate, The Decedent and Others as Separate Taxable Entities}

A. The Estate

\textit{(1) The Estate Tax Return and Related Features.}—The Personal Representative has to give special attention to the use of the alternate valuation under Section 2032 rather than date of death valuations.

(i) In making the determination as to which valuation date is going to be more beneficial from the overall standpoint, the Personal Representative has to take into consideration not only the so-called probate property includible in the estate but all other properties taxable in decedent’s gross estate such as decedent’s value attributable to property passing as tenants by the entireties, life insurance passing to a named beneficiary, revocable trusts created during the decedent’s lifetime, devisee of real property and other non-probate items which may be brought into the taxable estate.

If the alternate valuation date is selected, then all properties are valued as of that date with the exception of properties liquidated between date of death and alternate valuation date which would be determined by the value of property including cash received from the
sale. In this context, the Personal Representative may fix the value of
probate properties if there is a distribution in kind to a beneficiary. The
value of any such property would be determined by market value at
the time of distribution.

(ii) Care should be taken on distribution of closely held stock to
the surviving spouse under a marital deduction pecuniary formula (dis-
cussed, in brief, under C. (2) (v), page 69, supra.) Any such distribu-
tion will bust a Section 303 redemption insofar as the marital trust is
concerned.\textsuperscript{87} Thus, if the trust plans to redeem such stock, it would
have to go the Section 302(b)(3) route dealing with a complete termi-
nation. However, the Section 318 attribution rules would be applicable
and if the estate retains part of the closely held stock, then it is doubt-
ful if the estate would fall within the definition of a person entitled to
waive under Section 302(c) (2). A recent case held that the estate was
a person within the meaning of this provision.\textsuperscript{88} However, the Com-
missioner has filed a non-acquiescence with respect to the Crawford\textsuperscript{89}
holding and, as a result, this point is up for grabs at this particular time.

(iii) If the election is selected, it requires affirmative action; that is,
the filing of a timely estate tax return.\textsuperscript{90} Election is lost if the return is
not filed within 9 months plus any extension.\textsuperscript{91} Once election has been
made, it is final and applies to all properties includible in decedent's
taxable estate.\textsuperscript{92}

\textit{(2) Estate Income Tax Return.}—The estate is required to include all
items of income generated from the time of decedent's death until the
estate is terminated. Such items may include income in respect of de-
cedents. This topic will be discussed in some detail below.

(i) If the estate is holding Subchapter S stock, then it must file an
election consenting to being a stockholder in the corporation.\textsuperscript{93} The
election must be made by the Personal Representative of the estate even
though the stock passes directly to a legatee.\textsuperscript{94} Generally speaking, the
consent must be filed within 30 days after appointment of the Personal
Representative but there are special rules for deferring or extending the
time period.\textsuperscript{95}

(ii) Partnerships.—If the decedent had an interest in a partnership
at the time of his death, the decedent's estate is a partner until the in-

\begin{itemize}
\item \textsuperscript{87} Rev. Rul. 60-87, CB 1960-1, 286 and Treas. Reg. 1.303-2 (f).
\item \textsuperscript{88} Lillian M. Crawford, 59 TC 830 (1973).
\item \textsuperscript{89} IRB 1974-43, 6.
\item \textsuperscript{90} Treas. Reg. 20.2032-1 (b) (2).
\item \textsuperscript{91} Estate of Norma S. Bradley, T. C. Memo. 74-017; and Estate of Johanna Ryan,
\item \textsuperscript{92} Rosenfield vs. U.S., 254 F.2d 940 (CCA 3, 1958); and Treas. Reg. 20.2032-
1 (b) (2).
\item \textsuperscript{93} Section 1371 (a) (2) IRC and Treas. Reg. 1.1372-3 (b).
\item \textsuperscript{94} Rev. Rul. 62-116, CB 1962-2, 207.
\item \textsuperscript{95} See Treas. Reg. 1.1372-3 (b) and Treas. Reg. 1.1372-3 (c).
\end{itemize}
terest is liquidated. There is a contra rule in special situations where the partnership is terminated upon the death of a partner. The estate as the successor partner continues to share in profits and/or losses.

(iii) There are special rules with respect to the taxable year of the partnership and that of the estate as well as the selection of different taxable years insofar as the estate is concerned. The rules on the interrelationship between the partnership and the decedent's estate are not only complex but very extensive. There are special rules on optional adjustment to basis of partnership property, income in respect of decedent, termination of estate's partnership interests, distributions of partnership property, all of which are beyond the scope of this outline.

(iv) Deductions to which the estate is entitled on the Federal income tax returns will be discussed in some detail under Paragraph C. below.

B. Decedent's Final Tax Return

The requirements and elections with respect to decedent's final Federal income tax returns are discussed in paragraph C(1), beginning on page 66, supra.

C. Double Deductions and Alternative Deductions

(1) Double deductions, that is, deductions on the decedent's final income tax return, the estate tax return, and the estate income tax return are normally prohibited. There is one special exception with respect to medical expenses if such expenses were paid prior to the decedent's death. Section 642 (g) provides the general rule on double deductions on the estate income tax return and the estate tax return but the regulations seem to liberalize the statutory provision in allowing deductions for claims against the estate being a double item for estate tax purposes and income tax purposes. It appears that under Section 2053 relating to expenses, indebtedness and taxes that funeral expenses are only deductible on the estate tax return whereas administrative expenses can be deducted either on the estate tax return or the income tax return if a proper waiver is filed. It is interesting to note that the regulations, in disallowing the double deduction, only treat Section 2053(a)(2) dealing with administrative expenses. As a result, claims against the estate under Subparagraph 3 and certain unpaid mortgages under Subparagraph 4 would be deductible on both returns.
(2) Alternate Deductions including Deductions that may be lost by reason of transition at the time of decedent's death with deductions that may be taken only on this return.—There are some 40 odd items that receive so-called specialized treatment but detailed coverage of each of these items is beyond the scope of this paper.  

D. Practical Aspects on Payment of Major Administrative Expenses and Distributions to Beneficiaries/Heirs.

(1) Timing Major Administrative Expenses.—It is important to preserve and utilize deductions so that they are not lost and also that they be offset against high bracket income whether it be the estate or distributees. One of the more important illustrations in this area has to do with substantial administrative expenses, mainly in the form of executor's commissions, legal fees, and other administrative commissions that may or may not bunch in one particular taxable year. In situations where it is known that the estate income is going to be modest during the initial years, perhaps by reason of the fact that the estate is holding substantial non-income producing property or low-income producing property, then it becomes important to defer as much of the deductions arising from administrative expenses to the final year of the estate as is possible. Then the excess deductions not used to offset estate income can be distributed to the beneficiary or beneficiaries on a pro-rata basis at the time the estate is closed.  

If this is not done, then the deductions can be lost to the extent that they are not offset by estate income. On the other hand, net capital losses and net operating losses arising during the administration of the estate can be distributed to the beneficiaries during the year of termination even though the capital loss or operating loss in question may have taken place during a prior taxable year.  

It might be pointed out that the personal exemption to which the estate is entitled during the final year, if not used against estate income, can not be distributed to the beneficiaries. In this context, it is important to select and arrange short taxable years and fiscal years for the estate so that both the personal exemption and deductions can be properly used in off-setting income. Even though the first taxable year of the estate may be only several months, the estate is entitled to the full exemption for that first taxable year and, of course, the final return of the decedent is also entitled to the full exemption.  

(2) Distributions of Income and Property to the Beneficiaries/Heirs.—There is considerable interplay in this area with respect to the timing

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102 See Table 4 in Tax Management of an Estate During Administration: A Functional Approach, Boebm.
103 Section 642(h)(2) IRC; Treas. Reg. 1.642(h)-2.
104 Treas. Reg. 1.642(h)-1.
105 Treas. Reg. 1.642(h)-2.
106 Treas. Reg. 1.443-1(a)(2).
of distributions and also the proliferation of taxable entities. In the way of illustration, if the estate has a substantial amount of taxable income and a number of beneficiaries in low income tax brackets, then it may be desirable to distribute most of this income from which the estate is entitled to a distribution deduction and the low income beneficiaries then pick up their pro-rata share at the applicable income tax bracket. On the other hand, if the estate has a modest amount of income and only, for instance, one or two beneficiaries, both of whom are in high income tax brackets, then the estate should plan to retain the income in the estate and pay the lower bracket income tax and then, upon termination of the estate, the accumulated income can be distributed tax free to the beneficiaries. This also applies to the situation where there are a number of separate trusts which are the ultimate beneficiaries under the decedent’s will or trust. In this context, an estate is specifically removed from the operation of the throwback rules under Sections 665 through 669 of the Code.107

Again, it should be pointed out that the estate can not be carried on for an unreasonable length of time; otherwise, the Commissioner will determine that the estate will be considered closed under the authority set forth in Treasury Regulations 1.641(b)-3.

(3) Specialized Situations:

(a) Installment obligations.—Care should be exercised in the handling of any installment obligation held in the estate by reason of the fact that a distribution of an installment obligation is considered as being in satisfaction at other than face value108 and triggers the recognition of deferred gain. Thus, the entire deferred income, whether it be ordinary income or capital gain would be includible in the estate’s taxable income for that year. In order to continue the benefits of installment payment, the obligation should be held in the estate as long as practical.

It has also been held that the transfer by an executor to a testamentary trust has produced the same result.109

On the other hand, if the installment obligation passes directly to a distributee as a legatee under the decedent’s will or as an heir under intestacy, such person would be compelled to treat the gain from the property as Section 691 income (income in respect of decedents) and, in general, the installment obligation would have the same character in the hands of the distributee as was the case with the decedent. The distributee is entitled to the income tax deduction attributable to the inclusion of the proportionate value of the installment obligation in the decedent’s Federal estate tax.110 The estate is also entitled to a deduction.111

108 Section 453(d) (1) (A) IRC.
109 Henry H. Rogers Estate, 1 TC 629, aff’d. 143 F.2d 695 (CCA 2, 1944).
110 Section 691 (c) (1) (A) IRC.
111 Section 691 (c) (1) (B) IRC.
(b) Watch distributions of closely held stock in satisfaction of a pecuniary marital bequest. This also applies to satisfying a specific dollar amount legacy. Either one of these will result in problems with respect to redemption of the closely held distributed stock by the distributee.\textsuperscript{113}

\textit{E. Income In Respect of a Decedent.}—This is a very important area in planning and not only are the items of income extensive in quantity, they are extremely tricky insofar as when, where and what return they are includible as well as the proper basis of the property. The same problems exist with respect to deductions. I.R.D. (also known as 691 income) is involved in practically every estate to some degree. In the way of illustration in the negative sense, the rules are inapplicable only to a decedent who, at the time of death, had accounted for all of his income, claimed all of his deductions, and paid all of his liabilities. However, from a realistic standpoint, this simply does not happen. Perhaps the simplest example and one of the most consistent to occur is the situation where the decedent, who as a stockholder, was entitled to a dividend by virtue of owning stock at the time the corporation declared the dividend to the owners of record but, the decedent dies prior to the actual receipt of the dividend.

\begin{enumerate}
\item \textit{I.R.D. in the Hands of the Successor, Whether It be the Decedent’s Estate, a Specific Legatee under the Decedent’s Will, or a Taker by Intestate Succession.}—The character of the income remains the same as that of the decedent. In other words, a capital asset would, in the hands of the successor, be treated as a capital asset.\textsuperscript{118}
\item \textit{Availability of Double Deductions in Certain Instances.}—This is one of the few areas where the double deduction is clearly applicable and is best described in connection with Section 453 installment obligations. The value of the installment obligation is includible in the decedent’s estate at its fair market value even though the obligation may to a large extent represent deferred income. Expenses incident to an item of this type are deductible on the estate tax return as claims against the estate attributable to such property under Section 2053(a)(3). By the same token, the successor to the property is entitled to an income tax deduction for the amount properly attributable to the inclusion of this item in the decedent’s estate tax return. The amount of the deduction is worked out by a simple formula.\textsuperscript{114}
\end{enumerate}

The basis for property of this type does not ordinarily get a stepped up basis but the successor takes the same basis as that in the hands of the decedent.\textsuperscript{115}

\textsuperscript{113} Rev. Rul. 60-87, CB 1960-1, 286; and Treas. Reg. 1.303-2(f).
\textsuperscript{114} Section 691(a)(3) IRC.
\textsuperscript{115} Section 691(a)(4)(A) & Section 1014(c) IRC.
(3) Such items as income accrued to date of death, insurance renewal commissions, salary and deferred compensation which were earned by the decedent prior to death are includible as I.R.D. income whether the decedent was on a cash basis or on an accrual basis. With respect to the last item, if the payment is labeled as a death benefit then the first $5,000 normally is exempt income. Other items, too numerous to discuss in detail, fall under three general headings; namely, (1) Items principally based on personal services performed during decedent's lifetime; (2) Items based on income from traditional property rights; and (3) Income principally based on capital values or transactions which originated during the lifetime of the decedent.

All such income is taxable to the successor at the successor's individual tax rates.

(4) In general, the successor is entitled to certain deductions arising primarily from Section 162 (business expenses), Section 163 (interest), Section 164 (taxes), Section 212 (investment expenses), and Section 611 (depletion).

The three areas that seem to present the most problems are: Gains on unconsummated sales of capital assets; Partnership income; and Installment obligations.

(a) The manner in which the decedent disposed of property or attempted to dispose of property during his lifetime determines whether or not any gain from such property is I.R.D. Generally speaking, if everything had been consummated relative to a sale or exchange such as an executed contract the amount of which would be payable at a subsequent date and there is nothing further that need be done by the decedent, then the gain from such transaction would be treated as I.R.D. During the years, there have been two tests to determine the tax consequences as to when property is sold, the first being a so-called economic activity, but it would seem that the better rule is right or entitlement distilled under Keck. On the other hand, if the decedent does not pass the right or entitlement test, then it would seem that the so-called conditions, restrictions, etc., would remove it from being I.R.D. If it is not I.R.D., then it is treated as any other property and is includible in the decedent's estate tax return and such property would

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116 Treas. Reg. 1.691(a)-1(b)(1).
117 Treas. Reg. 1.691(a)-2(b).
118 S. Rept. No. 538, 73d Cong., 2d Sess., 28 (1934); Treas. Reg. 1.691(a)-2(a).
119 Section 101(b) IRC.
120 For quick reference see Tables 3-1, 3-2 and 3-3 in Tax Management of an Estate During Administration: A Functional Approach, Boehm.
121 Section 691(a)(2) IRC.
122 Section 691(b) IRC.
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be accorded a stepped up basis under Section 1014. On the other hand, when it is determined that it is I.R.D., Section 1014 is inapplicable.\textsuperscript{124}

(b) Partnership income can produce some weird results. Here again, the successor would be entitled to the deceased partner's distributive share of income generated during the partnership's taxable year in which the decedent died. The successor is required to pick up all income including a withdrawal by the deceased partner prior to his death even though the amount withdrawn would not be includible in the deceased partner's estate tax return.\textsuperscript{125} It should be noted that if the partnership arrangement is such that the surviving partners buy out the deceased partner's interest, the payment is considered a return of capital and is not taxable as a distributive share. This rule does not apply to amounts received for unrealized receivables of the partnership\textsuperscript{126} and normally it would not apply to good will unless a payment for good will is provided in the agreement.\textsuperscript{127}

The taxable year of the partnership and that of the successor are important in the so-called bunching of income problems. The rules on the taxable years of the partner and partnership are set forth in Rev. Rul. 68-215.\textsuperscript{128} Careful study should be made in this area as it involves many vexatious problems.

(c) Installment obligations have been discussed in some detail throughout this outline and we will not go into further ramifications other than to point out that decisional law and the regulations are entirely inconsistent on the treatment of this item. The same is true in the partnership area and care should be taken to explore the tax consequences against the particular facts and circumstances involved.

(5) Planning Aspects.—It is generally desirable to avoid sales of property by elderly persons but if a sale has been partially consummated, the case should be built in the way of treating it as an unconsummated transaction which would avoid I.R.D. and the property would get a stepped up basis. It might be said that in all such instances the sale of property and installment obligations should be avoided.

With respect to partnerships, it is important to have the partnership and the successor arrange the same taxable year. Otherwise, the successor might be saddled with partnership income which would be considered distributable at the end of the partnership year and, if this happened to be the first part of the succeeding taxable year for the successor, then as much as 23 months of income could be bunched in one year.\textsuperscript{129}

\textsuperscript{124} Section 1014(c) IRC.
\textsuperscript{125} Treas. Reg. 1.751-1(b) ; Rev. Rul. 67-305, CB 1967-2, 229.
\textsuperscript{126} Rev. Rul. 66-325, CB 1966-2, 249.
\textsuperscript{127} Section 736(b) (2) (B) IRC.
\textsuperscript{128} CB 1968-1, 312.
\textsuperscript{129} See Real Property, Probate and Trust Law Journal, Vol. 5, No. 3 (Fall 1970), p. 311 et seq. for a general discussion.
To the extent possible, distribute I.R.D. to as many beneficiaries as possible thereby affording the estate a distribution deduction and spreading the income tax among the other taxable entities. This, of course, is predicated on the distributees being in a low income tax bracket. If this can not be done, then special consideration should be given to electing to take the estate tax deductions for income tax purposes.

Care should be exercised in making distributions by the estate of the right to Section 691 income as a distribution of the estate’s right to receive payments measured by share of future partnership earnings would not necessarily be considered properly paid or credited or required to be paid\textsuperscript{130} nor property distributed in kind.\textsuperscript{131} If this be the case, then the estate remains fully taxable on its distributable net income for the year in which the property is distributed assuming that no other distribution deductions were allowed the estate.\textsuperscript{132}

The handling of deductions attributable to I.R.D. can generally be taken by the person entitled to the income although the deduction may have been paid by another person such as the decedent’s estate.\textsuperscript{133} It should be further noted that the depletion deduction is not treated in the same fashion as those found under Sections 162, 163, 164 and 212 and can only be deducted by the person who receives the income.\textsuperscript{134}

Along this line, the foreign tax credit under Section 33 is allowable only on the decedent’s estate tax return.

Conclusions.—It goes without saying that pre-death planning will, to a large measure, increase the effectiveness of post-mortem planning. There are certain things that can be done in designing the basic instrument in providing the necessary machinery to obtain the best possible post-mortem results. In other words, a projection of the likely administrative problems can be built into the instrument in an affirmative fashion so that the survivors and personal representatives will be able to pull the trigger in certain areas that are not specifically provided by local law, the IRC, and regulations thereunder, and decisional authority.

It might be desirable to empower the personal representative with the right to make elections in the overall tax area and exonerate such person from censure by certain beneficiaries who do not stand to gain from his action or, in the alternative, provide for adjustments to certain aggrieved beneficiaries. Also, in the administrative and investment powers conferred upon the fiduciary, it would work to the best advantage in certain cases involving charitable remainders, marital deductions, and powers of appointment to disclaim the so-called pregnant power or powers.

\textsuperscript{130} Section 661(a)(2) IRC.
\textsuperscript{131} Treas. Reg. 1.661(a)-2(c).
\textsuperscript{132} Rev. Rul. 68-195, CB 1968-1, 305.
\textsuperscript{133} Section 691(b)(1)(A) IRC.
\textsuperscript{134} Section 691(b)(2) IRC.
The election to take certain deductions on the estate tax return or the estate income tax return or vice versa under Section 642(g) should not be exercised until an analysis has been made in achieving the most advantageous tax results taking into consideration the increase or decrease in the marital deduction and it may be desirable to enlarge the marital deduction for the benefit of the surviving spouse even though it may work to the detriment of the beneficiaries under the residuary share. The same may be true with respect to selecting the alternate valuation date even though it may increase the ultimate estate tax liability but, on the other hand, it would provide a higher income tax base on the realization of recognizable gain on the sale or exchange of property. The elections and options between the partnership and the estate as a partner provide certain advantages and disadvantages in electing substituted adjustments in determining the basis of property. The surviving spouse’s election to take against the will in some situations has both advantages and disadvantages.

Perhaps the most important thing to keep in mind is that the use of elections, options, disclaimers, and renunciations should not normally be exercised or filed until the last practical moment with the exception of certain elections which may be revoked, provided same is done within the period of time available for such revocation. Naturally, each case stands on its own particular facts and circumstances and by way of illustration, it might not be realistic to delay a surviving spouse’s election to take against the will for a prolonged time if such spouse is quite elderly or in poor health. An incompetency or sudden death would remove this remedy in many jurisdictions.