

EXECUTOR'S ELECTION TO CLAIM CERTAIN DEDUCTIONS FOR INCOME OR ESTATE TAX PURPOSES

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The executor¹ of an estate subject to federal estate tax is often in a position to reduce the overall burden of federal taxes, income and estate, borne by the estate and its beneficiaries.

The executor of a smaller estate, not subject to the federal estate tax, sometimes has a comparable opportunity to reduce the burden on the estate or family of the income tax alone.

The opportunity, and the special problems it may carry with it, flow from a combination of:

1. the fact that, although federal estate and income taxes are completely different concepts of taxation, one expenditure may well meet the standards of deductibility of both taxes; and

2. the rule that the executor, with respect to his expenses of administration, must in such case elect where he will ultimately take his deduction.

The taxable income of an estate is in general taxed in the same manner as that of an individual.² Thus an executor is entitled to deduct expenses incurred for the production or collection of income, for the management or care of income property, as well as expenses of tax determination.³ However, for estate tax purposes, expenses in those classes, when properly incurred by an executor, also usually constitute deductible administration expenses.⁴

Congress, however, has said, in effect, that the executor is entitled to the benefit of the deduction of such an administration expense for the estate's income tax or for the estate tax, but not both.⁵ The 1954 Code labels this rule as a "Disallowance of Double Deductions." This is a convenient tag, but hardly accurate, since the two deductions dealt with are authorized under two separate taxes.

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¹ The term "executor" is used in the broad sense of the definition thereof in INT. REV. CODE OF 1954, § 2203, to include administrator or other personal representative.

² INT. REV. CODE OF 1954, § 641.

³ INT. REV. CODE OF 1954, § 212. Regulations provide: "Reasonable amounts paid or incurred by the fiduciary of an estate or trust on account of administration expenses, including fiduciaries' fees and expenses of litigation, which are ordinary and necessary in connection with the performance of the duties of administration are deductible under section 212, notwithstanding that the estate or trust is not engaged in a trade or business, except to the extent that such expenses are allocable to the production or collection of tax-exempt income." Rev. Reg. § 1.212-1(i).

⁴ INT. REV. CODE OF 1954, § 2053.

⁵ INT. REV. CODE OF 1954, § 642(g).

This election, forced on the executor by the double deduction disallowance, was not new with the 1954 Code.⁶ However, the tax saving opportunities it offers and the administrative problems it may create, are now receiving increasing attention.⁷

In this discussion we will look at the three major questions to be considered by an executor in exercising his election; but the executor has a preliminary determination to make. Although an expense may tentatively appear to meet the deduction standards of both the estate income and estate taxes, those standards are by no means the same. Thus, the executor's election may be determined by comparative firmness of deductibility rather than comparative tax rates. Clearly, a deduction supportable at ten per cent may be a wiser election than one debatable at twenty per cent.

Specifically, what sort of expenses are apt to be the subject of the executor's election? There is a letter, printed, but not published by the Service, discussing many of them.⁸ Its unofficial status makes it non-authoritative, but it serves as a useful collation. The letter lists the following as being administration expenses in the estate tax sense, which may also meet estate income tax standards of deductibility:

1. executor's commissions charged in one sum for services in assembling and collecting estate assets, paying debts and claims, making estate and inheritance tax returns and current income tax returns and handling the same with the tax examiners, distributing estate assets to devisees and legatees and conserving the estate during the period of administration (the duties, services and responsibilities usually covered by "executor's commissions");
2. attorneys' fees for service in connection with the above matters;
3. accountants' fees for services in connection with the above matters;
4. annual premium on executor's fidelity bond;
5. compensation paid to a custodian or caretaker of estate property during period of administration;
6. fees paid to the probate court for probating will and partial settlements and final settlement of executor;

⁶ The source of Section 642(g) is INT. REV. CODE OF 1939, § 162(e).

⁷ For a recent law review article containing a comprehensive discussion of the executor's election, including consideration of suggested changes in the existing estate income tax, and presenting a proposal for revision, see Gradwohl, *Current Issues in Probate Estate Income Tax Allocation*, 37 NEB. L. REV. 329 (1958). For report of institute proceedings see Randall, *Consequences of Executor's Elections as to Administrative Expenses*, N.Y.U. 15TH INST. ON FED. TAX 1011 (1957). For discussion of several probate income tax problems, see Miller, *Federal Income Tax Problems in Probate Practice*, 43 IOWA L. REV. 337 (1958).

⁸ Letter signed Lester W. Utter, Chief, Individual Income Tax Branch, May 24, 1954, 7 P-H 1954 FED. TAX SERV. ¶ 76,782.

7. appraisers' fee for appraising estate assets for death tax returns;
8. traveling expenses in connection with assembling or collecting estate assets, paying debts, protests or suits on estate and inheritance taxes, distribution of assets to legatees and devisees.

A list such as the above only suggests the more common expenses which may meet both estate tax and estate income tax deduction standards. Any disbursement or cost incurred by an executor should be submitted to the deduction tests of both income and estate taxes.⁹ As an example, the Service has recently ruled that the executor may include in deductible administration expenses, for estate tax purposes, expenses incurred in caring for and feeding cattle held for sale.¹⁰ Such expenses would also constitute a deduction under Section 212 as expenditures incurred in the maintenance of property held for production of income, since income in this context includes gains from the disposition of property.¹¹

What about expenses incurred in selling estate property? If an executor sells stock held in the estate in order to pay taxes, and a capital gain is recognized by the estate, a broker's commission on the sale would be an expense of administration for estate tax purposes;¹² at the same time, such a commission would constitute an offset against the sale price in determining capital gain on the sale.¹³ The Service has ruled,¹⁴ however, that expenses of sale of estate property are subject to the operation of Section 642(g), holding that such expenses may not be used as an offset against the sale price in determining gain or loss where they have already been allowed as a federal estate tax deduction. Although this ruling may be within the spirit of Section 642(g), it does violence to its

⁹ There is an interplay between Section 2054 and Section 165(c)(3) analogous to that between Section 2053 and Section 212. Election is required by Section 642(g) with respect to losses arising from fire, storm, shipwreck or other casualty, or from theft, not compensated for by insurance. However, "A special rule apparently applies in the case of casualty losses since the basic provision allowing a deduction for such losses specifically denies an income tax deduction if the casualty losses have been *claimed* on the estate tax return." 6 MERTENS, FEDERAL INCOME TAXATION § 36.101 (1957). But note that the Proposed Regulations under the 1954 Code, while containing the following sentence: "No loss described in this subdivision shall be allowed, if at the time the return is filed, such loss has been claimed for estate tax purposes in the estate tax return," appear to contemplate allowance of the income tax deduction if it is established that the loss has not been *allowed* under Section 2054, and provided a waiver is filed. § 1.165-3(a)(7)(iii), 21 FED. REG. 4925 (1956).

¹⁰ Rev. Rul. 58-436, 1958 INT. REV. BULL. No. 35, at 8.

¹¹ Rev. Reg. § 1.212-1(a)(2)(b).

¹² Rev. Reg. § 20.2053-3(d).

¹³ Rev. Reg. § 1.263(a)-2(e).

¹⁴ Rev. Rul. 43, 1956-1 CUM. BULL. 210.

terms since it is difficult to see how a sale price offset can be called a deduction. The ruling has been vigorously criticized.¹⁵

Expenses allowable as deductions in connection with income in respect of decedents are specifically exempted by Section 642(g), and hence, not subject to the disallowance of double deduction. If we net out the negatives here, we may say that such expenses are both estate and income tax deductions if they meet the standards for deductibility under both.

After the executor has determined what expenses are supportable deductions under both estate income and estate taxes and are therefore subject to his election, he faces these questions:

First, the mechanics of exercising and preserving his right,

Second, the tax dollar effects of the alternatives, and

Third, the effects those alternatives may have on the distribution of estate income and corpus and the shifting of tax benefits and burdens among beneficiaries.

MECHANICS OF THE ELECTION

The Congress and the Service are quite liberal as to both the time and the technique of the executor's election. To claim an income tax deduction, the executor files a statement in duplicate first, that any item of administration expense claimed as an income tax deduction has not been allowed as a deduction from the gross estate under Section 2053, and, second, that all rights are waived to have such item allowed at any time as a Section 2053 deduction. The earliest permissible filing of such statement is with the related income tax return; the latest is just prior to the expiration of the statutory period of limitation on the related income tax return.¹⁶ To claim an estate tax deduction, the executor refrains from filing a statement with or related to the income tax return and claims the deduction in the estate tax return.¹⁷

It is apparent from the regulations that the executor can *claim* the same expense as a deduction on both estate and income tax returns, despite the fact that Congress prohibits a double deduction.¹⁸ To do so, he simply claims deductions on both returns and refrains from filing a

¹⁵ Pincus, *Expenses of Sale by Estates*, 95 TRUSTS & ESTATES 1004 (1956); Sutter, *Income Taxation of Estates*, 95 TRUSTS & ESTATES 1108 (1956).

¹⁶ Rev. Reg. § 1.642(g)-1.

¹⁷ Rev. Reg. § 20.2053-1(d).

¹⁸ Revenue Regulation Section 1.642(g)-1 (1956) provides in part: "Allowance of a deduction in computing an estate's taxable income is not precluded by claiming a deduction in the estate tax return, so long as the estate tax deduction is not finally allowed and the statement is filed." In Rev. Rul. 58-484, 1958 INT. REV. BULL. No. 40, it was held that the phrase "finally allowed" used in the quoted portion of the regulations "may be construed as referring to an estate tax return in which the deduction in question has been allowed and with respect to which the statute of limitations on assessment has expired, or in which for any other reason, such as a closing agreement, an assessment of a deficiency resulting from disallowance of the deduction is prohibited."

statement of election with his income tax return. There is no impropriety in so claiming double deduction, and there may be valid reasons for it. The election statement once filed is binding.¹⁹ The executor may feel that until his returns are audited, he cannot determine ultimately effective tax rates, and hence cannot know his better course.

Although the executor may defer filing until just prior to expiration of the statute of limitations on the income tax return, he is not assured of so long a period. On examination of the estate's income tax return, an agent may properly require the executor to file his statement electing the income tax deduction, or alternatively accept disallowance.

The executor also has freedom to allocate one expense item to the estate tax return and another to the income tax return.²⁰ Further, he may break up a single item—attorney fees as an example—and allocate part to deduction under one tax, and the balance to the other tax.²¹ This may have a practical administrative advantage. The estate tax regulations permit claiming a reasonable estimate for attorney fees.²² It may be convenient to let this estimate stand, even though a larger amount has been or will be paid, and claim as an income tax deduction the amount of fees actually paid in excess of the estimated amount claimed on the estate tax return.

TAX DOLLAR EFFECTS OF ALTERNATIVES

Comforted by the fact that he may long defer finality in his double deduction election, the executor weighs the tax benefits of his alternatives. Does he have a duty to do so? A California court has indicated that the judicious course of the discreet executor is to seek maximum tax benefit where there is a "wide disparity" between estate and income tax rates.²³ That somewhat tentative expression of the existence of a direction of duty may well be as far as the rule should go. When he files his returns the executor may be able to make only an educated, and perhaps optimistic, guess as to the dollar tax benefit of a particular deduction. It would be unfair and impractical to evaluate the effects of his double deduction election performance apart from his overall handling of the estate's major tax problems. Furthermore, as considered below, a stringent rule requiring maximum tax benefit from each election would be unrealistic where the election may have a warping effect on distributions.

Whatever rule may be developed, however, the executor does have the pragmatic problem of satisfying the beneficiaries of the estate that

¹⁹ "[A]fter a statement is filed under section 642(g) with respect to a particular item or portion of an item, the item cannot thereafter be allowed as a deduction for estate tax purposes since the waiver operates as a relinquishment of the right to have the deduction allowed at any time under section 2053 or section 2054." Rev. Reg. § 1.642(g)-1.

²⁰ Rev. Reg. § 1.642(g)-2.

²¹ Rev. Reg. § 1.642(g)-2.

²² Rev. Reg. § 20.2053-3(c)(1).

²³ Estate of Bixby, 140 Cal. App. 2d 326, 337, 295 P.2d 68, 74 (1956).

he has done a competent job. Those beneficiaries are taxpayers, too, and apt to be devoted to the principle of minimizing tax burdens. In this context state court judges may also be deduction-minded taxpayers. Therefore, it is submitted that the executor should chart his election and deduction course with minimum tax burden as a most desirable goal.

In looking at the tax dollar effects of his election, the executor cannot limit his examination to the rate tables. He must think in terms of effective rates. Where the full marital deduction is claimed the effective rate of tax saving from an estate tax deduction of an administration expense is roughly one-half of the nominal estate tax rate.

The effective rate phenomenon also appears in the income tax computation where the estate has a material amount of tax exempt income. The regulations require that expenses, which are not directly attributable to a specific class of income, must be apportioned to both taxable and non-taxable income.²⁴ The expenses which must be so apportioned are those which as to the estate are in the nature of indirect or overhead expenses. Thus, executor's fees are overhead and must be apportioned. A property management fee allocable to rents would be directly chargeable to fully taxable income and not apportionable. Therefore, an executor who receives a material amount of tax exempt income might achieve maximum tax saving by taking overhead expenses as estate tax deductions and direct expenses allocable to taxable income as income tax deductions.

Determination of the effective estate tax rate may involve not only an estimate of the rate for the estate currently under administration, but conceivably may require a projection of the estate tax rate of a residuary legatee. If administration expense is deducted on the estate income tax return rather than the estate tax return, there will, of course, be an increase in estate tax. To the extent this is borne by a residuary legatee who thereafter dies, Section 2013 may afford an offsetting increase in the credit for property previously taxed in the estate of the deceased legatee. This will be of rare application and in any event is a practical consideration only where the residuary legatee dies during the course of administration. It does, however, point up the necessity of looking well beyond rate tables in determining the tax dollar effects of the executor's election.

The executor's fiscal period problems and opportunities have an interaction with the executor's election. It is here that the executor of the smaller estate, not subject to federal estate tax, probably has his most favorable opportunity to save income taxes for the estate and family as an economic unit. It is pointed out, *supra*,²⁵ how the executor through proper selection of a fiscal year for the estate can not only minimize

²⁴ Rev. Reg. §§ 1.652(b)-3, 1.265-1(c). Compare Rev. Rul. 59-32, 1959 INT. REV. BULL. No. 4, at 17.

²⁵ Williams, *Picking A Fiscal Year, Timing and Nature of Distributions*, 20 OHIO ST. L.J. 16 (1959).

taxes, but also to some extent control the time when the income will be taxed.

EFFECTS OF ELECTION ALTERNATIVES ON BENEFICIARIES

In an estate where the executor's income is distributable to the residuary beneficiary, the executor may base his election solely on tax benefits. However, where the income and residuary interests are not the same he may find that an election, based on comparison of effective tax rates, may warp the interests of competing beneficiaries.

The warping effect of the election most commonly arises from:

1. the fact that, usually, the effective income tax rate is higher than the effective estate tax rate, so that administration expenses are more profitably deducted on the executor's income tax return, combined with
2. the fact that, for probate accounting purposes, expenses of administration are usually principal charges which have the effect of reducing the residuary estate.

In some of the few reported cases where the distorting effect of the executor's election has been the subject of beneficiary complaint and judicial adjustment, the fact pattern has been broadly this:

1. an election by the executor to take administration expenses on his estate income tax return;
2. an increase in estate tax over what it would have been had expenses been taken as an estate tax deduction—a burden borne by residuary beneficiaries who do not share in estate income;
3. a decrease in the aggregate of estate and income taxes payable by the executor; and
4. a demand by the residuary beneficiaries that they be made at least whole.

The representative of the remaindermen in the *Warms* case²⁶ claimed, alternatively, that administration expenses should be charged to income when they are taken as income tax deductions, or that the principal account should be credited at least with the saving which would have resulted in estate tax had the expenses been deducted in the computation of that tax. The surrogate first ruled that the election option granted to the executor by the Internal Revenue Code cannot affect the propriety of the charge of administration expenses to principal. However, he did hold that the corpus of the residuary trust should be credited with the amount which represents the estate tax saving which it would have received had the administration expenses been deducted from principal in computing the estate tax.

In the *Bixby* case,²⁷ it has been pointed out that the parties were faced with five alternatives ranging from no adjustment to a sharing by

²⁶ Estate of *Warms*, 140 N.Y.S.2d 169 (Surr. Ct. 1955).

²⁷ Estate of *Bixby*, *supra* note 23.

the income beneficiary of part of her income tax benefits with remaindermen.²⁸ The court followed *Warms*,²⁹ requiring the principal to be restored to where it would have been had the expenses been taken as income tax deductions, but permitting the income beneficiary to retain the net tax savings in excess of the amount so restored.

The Internal Revenue Service has considered the interaction of the executor's election and the determination of the marital deduction. In Revenue Ruling 55-225,³⁰ the Service held that the ceiling on the marital deduction of fifty per cent of the value of the adjusted gross estate is increased by an election to take administration expenses as income tax deductions. It was held that the ceiling is to be determined by subtracting from the entire value of the gross estate the aggregate amount of the deductions actually claimed and allowed. However, the Service also said that the marital deduction cannot exceed the value of the property interests which actually pass to the spouse, and where such interests are in fact reduced by administration expenses, the marital deduction is likewise reduced. Thus, where an item of expense is claimed as an income tax deduction, but in the administration of the estate the expense is charged against principal, there is a proportionate reduction in the value of the property actually passing to the spouse. Here what the spouse receives is less than fifty per cent of the adjusted gross estate, and it is this lesser figure which will determine the marital deduction.

In Revenue Ruling 55-642,³¹ the Service considered the effect of the election where the decedent bequeaths to his surviving spouse one-half of the value of his adjusted gross estate as determined for federal estate tax purposes. Here the Service held that the election to deduct administration expenses on the income tax return increases not only the fifty per cent of adjusted gross estate ceiling, but also the value of what the spouse actually receives, thus increasing the marital deduction. The Service filed a *caveat* that this may not have been what the testator intended.³²

²⁸ Gradwohl, *supra* note 7, at 358-60.

²⁹ Estate of *Warms*, *supra* note 26, has also been followed in *Bell's Estate*, 8 Chest. 21, 7 Fiduciary 1 (Pa. Orphans' Ct. 1958), and in *Levy*, cited note 33 *infra* on another point. In *Levy* there was an income tax saving of \$25,000 at the cost of a \$7,000 increase in estate tax, as a result of deducting administration expenses on the income tax return.

³⁰ 1955-1 CUM. BULL. 460.

³¹ 1955-2 CUM. BULL. 386.

³² "Questions relating to the effect of the use of the marital deduction formula on the value of property passing to the surviving spouse are not within the jurisdiction of the Internal Revenue Service. However, the possibility that it may not have been the intention of the decedent by using the marital deduction formula clause to give his wife more than one-half of the net distributable estate after payment of debts and administration expenses, may give beneficiaries other than the wife a right to question any act of the executors which operates to decrease their interests under the will." *Ibid.*

In *Estate of Levy*,³³ the testator bequeathed to his widow a sum equivalent to one-half of his adjusted gross estate. The surrogate noted that the use of administration expenses as deductions for estate income tax purposes rather than estate tax purposes resulted in an increase in the adjusted gross estate by the amount of such expenses and an increase of the widow's bequest by one-half that amount. The question, however, was not whether the widow could keep the increase but rather what action should be taken to adjust for the increased estate tax. The court ruled that no part of the estate tax adjustment should be credited to the widow's bequest since it is freed of tax. The executors were directed to credit the benefit of all deductions which would have been available to the estate principal to the residuary estate.

Where a widow elects to take under the law rather than under the will, the executor in Ohio may face an algebraic problem in determining the effect on beneficiaries of his election to deduct administration expenses on the estate's income tax return. In *Campbell v. Lloyd*³⁴ it was held that where the widow elects to take under the law, her share of the net estate³⁵ was to be determined after the deduction of all debts and claims, including the federal estate tax. What is the interplay between this rule and the executor's election? If the executor deducts an item of administration expense on his income tax return, there will be a like decrease in estate tax deductions. There will then result an increase in estate tax from the combination and interplay of (a) the "loss" of the estate tax deduction for administration expenses and (b) the reduction in the marital deduction, due to the fact that the net estate from which the electing widow takes her share will be reduced by the increase in estate tax. The effects of the interaction and the problem of its solution are analogous to the determination of income tax where there is a taxable reimbursement of tax.

Where the residuary estate is retained in trust with the remainder interest to vest in a charity, the warping effect becomes almost circular. If the executor elects to take an administration expense as an income tax deduction, there will be an increase in estate tax. The increase in estate tax will reduce the remainder. The reduction in the remainder will reduce the charitable gift and the estate tax deduction therefor. This has been called a discouraging "carousel of computations."³⁶

It is probably too early to predict that there will develop a substantial body of case law prescribing rules for apportionment or allocation of estate income tax burdens and the benefit of deductions and

³³ 167 N.Y.S.2d 16 (Surr. Ct. 1957).

³⁴ 162 Ohio St. 203, 122 N.E.2d 695 (1954).

³⁵ Net estate is used in the Ohio probate sense: "In the event of election to take under the statute of descent and distribution, such spouse shall take not to exceed one-half of the net estate . . ." OHIO GEN. CODE § 10504-55 (1938) now incorporated in OHIO REV. CODE § 2107.39 (1953).

³⁶ Miller, *supra* note 7, at 346.

elections. However, if the case law does develop it is probably a safe speculation that, in time, statutory rules will follow.

An obvious possible parallel has been development of rules in the field of apportionment of death taxes. Litigation of the problems arising in this area has produced a considerable body of case law, as well as statutory rules, in many states.³⁷ However, there are important differences, both in character and dollar value, between death tax apportionment and estate income tax apportionment. Most commonly, death tax apportionment questions flow out of the inclusion in the federal estate tax base of transfers which are not subject to state probate administration. Estate income tax apportionment problems are, generally speaking, intramural. Death tax apportionment usually involves more dollars than the income tax apportionment problem. In death tax apportionment the question is where to place the burden of the tax, while in income tax apportionment, the most common question is whether there should be an adjustment to compensate for, at least partially, the warping effect of an expense burden being borne by an interest, which absent adjustment, gets no tax benefit or an increased tax. Common to both, however, is a widely held conviction that tax benefit or burden should follow the same road as the tax incident which gives rise to it.

The cases already discussed or cited arose out of a demand for adjustment for the warping effect of the executor's election to deduct administration expenses on the estate's income tax return. However, other income tax apportionment or allocation questions arise out of the interaction between the federal income tax and state probate administration rules. Where the executor receives and reports for taxation income which will ultimately go to charity, he may claim a deduction for the amount so set aside.³⁸ Where estate income follows the residuary disposition and where there are both charitable and noncharitable residuary beneficiaries, is the charitable beneficiary entitled to the benefit of the charitable tax deduction claimed by the executor on his income tax return?

In Illinois, in *Ginsberg's Estate*³⁹ the appellate court held that since nothing in the will referred to the federal income tax, that tax was an expense of administration to be paid from corpus prior to distribution and charged equally to the beneficiaries without regard to their character as taxable or exempt.⁴⁰ The Supreme Court of Rhode Island

³⁷ A recent article on death tax apportionment contains a state-by-state survey in an appendix. Lauritzen, *Apportionment of Federal Estate Taxes*, 1 TAX COUNSELOR'S QTRLY. 55 (1957).

³⁸ INT. REV. CODE OF 1954, § 642(c).

³⁹ 4 Ill. App. 2d 138, 123 N.E.2d 739 (1955).

⁴⁰ The approach of the Illinois court to estate income tax apportionment where there is a charitable residuary legatee is akin to that of the Ohio Supreme Court to a federal estate tax apportionment question. In *YMCA v. Davis*, 106 Ohio St. 366, 140 N.E. 114 (1922), *aff'd* 264 U.S. 47 (1924), the testatrix made a number of specific devises and bequests to relatives and left the residue to

declined to follow this precedent.⁴¹ Again the will was silent, but the court presumed that the testatrix intended her dispositions to be subject to the payment of taxes only to the extent that those gifts ordinarily would be taxable under the federal income tax law. The court felt that its view was strengthened by the fact that, if the executor had paid or credited all of the income to the legatees during the tax year, the estate would have had no income tax to pay, nor would the charities. The court held that the entire burden of the estate income tax should be borne by the noncharitable group. It was noted that this was a question of apportionment of federal income taxes on estates, not governed by any federal or state statute or controlling decision.

The decision in *Rice*⁴² involved a trust rather than an estate—but it points up the problem posed by the unorthodox by-products of the 1954 Code. The income beneficiary received \$241,000 of trust income, but only \$39,000 was taxable to him because of the net distributable income concept. Most of this reduction resulted from some \$202,000 of corpus expenses. In the same year the trust had a capital gain with a tax of \$100,000 paid by the principal. The court required the income beneficiary to repay the value to corpus of tax deductions allocated to the income beneficiary under 1954 Code rules. The court noted, perhaps wistfully, that “Prior to 1954, this case could not have arisen.”

A discussion of cases not involving the effects of the executor's election is an excursion from our immediate area. But whatever rules develop governing adjustments for the warping effects of the executor's election may well be only part of a general body of law dealing with estate income tax allocations and adjustments.

The case law on adjustment for the effects on competing interests of the executor's election is still in the incipient stage. Therefore, the following general guides are set forth only tentatively.

First. An executor should carefully consider the tax effects of his deduction election. When possible he should take it where it does the most good tax-wise. The California court in the *Bixby* case rated it as approaching a duty where there is a wide disparity in rates.

Second. Receipt of a benefit should bear its correlative tax burden; and the person or account charged with an

charities. The question was whether the federal estate tax was to be deducted from the bequests to individuals or charged against the residue. Both the Ohio and the United States Supreme Courts held that the estate tax was a charge against the entire estate and that residuary legatees took only what was left after payment of all charges including the estate tax. This case was followed in principle, but without citation, in *Hall v. Ball*, 162 Ohio St. 299, 123 N.E.2d 259 (1954).

⁴¹ *Rhode Island Hospital Trust Co. v. Sanders*, 125 A.2d 100 (R. I. 1956).

⁴² *Estate of Rice*, 8 Pa. D. & C.2d 379, 6 Fiduciary 225 (Orphans' Ct. 1956).

expense is entitled to the correlative tax benefit. However, it is doubtful that—express power being absent—an executor has inherent power to make adjustments.

Third. In the words of the California court in the *Bixby* case, the goal is that “. . . rights of all the takers under the will remain vested in the posture prescribed by the state rules governing rights and interests in the estates of decedents, undisrupted and undisturbed by the transient vagaries of the federal income tax laws.”⁴³

When the executor has determined his better election course from the tax dollar standpoint and when he sees that his election will produce a benefit for one estate interest at the expense of another, what does he do? These are possible courses:

- (1) He might dodge the problem of adjusting for the warping effects of the election, by deducting the expense on the return which does not produce distortion, at the cost of paying more taxes. However, an executor who pays more federal taxes than he must, solely to preserve distribution symmetry, risks complaint by the estate beneficiaries.
- (2) He may seek instruction of the probate court. This, however, may be costly and time consuming, so that if possible he is best advised to:
- (3) Bring together the affected beneficiaries, with their counsel, and seek their concurrence in his proposed course of election.⁴⁴

⁴³ Estate of *Bixby*, *supra* note 23, at 399, 295 P.2d at 76. We are on the lookout for non-transient vagaries. In any event the court may be unfair in its indictment. The executor's election, in substantially its present form, was added in 1942 by Section 161 of the 1942 Revenue Act. As federal income tax vagaries go, this one is relatively stable.

⁴⁴ How formal should such concurrence be? See articles, *supra* note 7. Randall, N.Y.U. 15TH INST. ON FED. TAX at 1027, says: “Until questions of this type are ruled on by the courts of the various states, it is quite obvious that the executor should consult with the interested parties (assuming they are all sui juris) before exercising his election. He will point out the various alternatives together with their respective economic results; and will endeavor to get the parties to agree upon the course of action to be pursued and to reach an agreement concerning their claims, if any, against one another.” But Gradwohl, *supra* note 7, at 362, n. 120, warns, “To the extent that the parties intentionally engage in a manipulation of income tax which is later reimbursed by the benefiting parties, there would appear to be the possibility of added income tax consequences to either the party whose income tax is reimbursed by another, or to the party whose income tax is paid for him for a fee. Also, where reimbursement is to be made in the fiduciary accounts, it would seem that the executor would have a duty to withhold the amounts which will be required to be repaid. But the amount may be impossible to calculate at the time of the proposed distribution. See *Third Nat'l Bank v. Campbell*, 145 N.E.2d 703 (Mass. 1957).”

To summarize:

The executor has considerable procedural freedom; he can defer final decision until his answer becomes clearer.

The executor has some duty—not yet fully or finally expounded by the courts—to hold down the aggregate of federal taxes within the framework of his deduction election.

The executor must weigh not only the dollar effects, but distribution effects, of his election. From the tax dollar standpoint it usually reduces the total tax burden to take administration expenses as income tax deductions, because of the higher income tax rate structure. Probate-wise, expenses commonly are a principal charge. Here, tax benefit and expense burden go off in opposite directions; a result which may strike beneficiaries as shocking (or delightful). Thus, an adjustment may be called for, either pursuant to court instruction or agreement of the beneficiaries. Here, the executor's life may be a happier one if the will draftsman has anticipated the problem and given him both wide discretion and criteria to guide him in its exercise.⁴⁵

⁴⁵ See, e.g., Polster, *Provisions of Wills Affecting Estate Administration and Their Tax Consequences*, 20 OHIO ST. L.J. 36, 41 (1959).