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Taxation - Estates and Trusts - Double Deduction of Trustees' Fees

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TAXATION — ESTATES AND TRUSTS — DOUBLE DEDUCTION OF TRUSTEES' FEES.

Two months before her death, the decedent transferred property into a revocable trust, retaining a life estate therein. Upon her death the value of the property so transferred was included in her gross estate for federal estate tax purposes under the authority of Internal Revenue Code of 1954, §§ 2035,[1] 2036,[2] and 2038.[3] Under the trust agreement the trustee was authorized to perform certain duties[4] after the settlor's death, and in connection therewith the trustee paid trustee's fees in the amount of $22,934.79. Of this amount the Tax Court[5] allowed a deduction of $21,934.79 on the trust's income tax return under the authority of section 212,[6] and also allowed a deduction of $22,096.78 on the estate tax return under the authority of section 2053(b).[7]

The Court of Appeals for the Tenth Circuit affirmed, holding (1) that section 642(g)[8] does not require the disallowance of double deductions in computing the income tax of a trust, even though the trust property was included in the taxable estate; and (2) that the authority of Treasury Regulation § 1.212-1(o),[9] which applies to sections 212 and 162[10] in the disallowance of double deductions, has no

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[1] Relating to transactions in contemplation of death. All transfers of property, without adequate consideration, made within three years of the decedent's death are presumed to have been made in contemplation of death and therefore are included in the gross estate. (All Section references are to the Internal Revenue Code of 1954 unless otherwise indicated.)

[2] Relating to transfers with a retained life estate. Such a transfer is accomplished when, without adequate consideration, a person placing property in a trust retains for his life the possession, enjoyment, or right to the income from the property.

[3] Relating to revocable transfers. When property has been transferred without adequate consideration into a trust, it is includable in the gross estate of the one so transferring if on the date of the death of that person he held the power to alter, amend, revoke, or terminate the trust.

[4] The trust agreement authorized the trustee to pay the expenses of the settlor's last illness, pay the estate and inheritance taxes, and make certain distributions.

[5] Mary E. Burrow Trust, 39 T.C. 1080 (1963).

[6] Relating to expenses for the management and conservation of income, the property from which it is produced, and expenses paid in connection with the determination of any tax.

[7] Relating to administrative expenses of nonprobate property.

[8] Section 642(g) "Disallowance of Double Deductions. — Amounts allowable under section 2053 or 2054 as a deduction in computing the taxable *estate of a decedent* shall not be allowed as a deduction in computing the *taxable income of the estate* . . . . " (Emphasis supplied.)

[9] Treas. Reg. § 1.212-1(o) (1957) "The provisions of section 212 are not intended in any way to disallow expenses which would otherwise be allowable under section 162 and the regulations thereunder. Double deductions are not permitted. Amounts deducted under one provision of the Internal Revenue Code of 1954 cannot again be deducted under any other provision thereof."

effect on section 642(g). *Commissioner v. Mary E. Burrow Trust,* 333 F.2d 66 (10th Cir. 1964).

Prior to 1942 there were no statutory provisions regarding the deduction of one expense in computing both the taxable estate and the taxable income thereof. However, it was held in court decisions that the deduction would be allowed in computing both the taxable estate and the taxable income since the taxes were provided for under different statutes[11] and were based upon different theories.[12] Unless Congress had specifically prohibited the double deduction of an expense, it would be deductible under both statutes allowing for the deduction.[13]

A 1942 amendment[14] to the Code provided that if an item was deducted in accordance with section 812(b)[15] in computing the taxable estate, it could not be again deducted as an expense under section 23[16] in computing the taxable income of the estate. The purpose of section 162(e) was to prevent a taxpayer from claiming one expense as a deduction for two separate purposes,[17] though there were

[10] Relating to trade or business expenses.

[11] Kleberg v. Commissioner, 31 B.T.A. 95 (1934). Acquiesced in by the Commissioner, XIII-2 Cum. Bull. 11 (1934). *But see* O'Neil v. Commissioner, 31 B.T.A. 727 (1934), in which the court did not allow property taxes owing at the date of the decedent's death to be deducted in computing the estate's taxable income when the item had already been deducted in computing the taxable estate. It appears that the only reconciling feature between these two cases is that in the *Kleberg* case the amounts expended were for the administration of the decedent's property after his death, while in the *O'Neil* case the amount expended only represented an accrued expense at the decedent's death, and thus only properly deducted from the estate corpus on the estate tax return.

[12] Kleberg v. Commissioner, *supra* note 11, at 100. The estate tax is a one-time excise on the transfer of property while the income tax is an annual tax on net income.

[13] Adams v. Commissioner, 110 F.2d 578 (8th Cir. 1940); Brown v. Commissioner, 74 F.2d 281 (10th Cir. 1934).

[14] Int. Rev. Code of 1939, § 162(e), added by ch. 619, 56 Stat. 861 (1942).

[15] Int. Rev. Code of 1939 § 812(b), relating to the expenses, losses, indebtedness, and taxes of an estate.

[16] *Id.* § 23, relating to the allowable deductions from gross income.

[17] Luehrmann's Estate v. Commissioner, 287 F.2d 10 (8th Cir. 1961).

no prohibitions against allocating the expense deduction between the taxable estate and the taxable income of the estate in any manner desired.[18] Accordingly it was subsequently held that an executor who deducted his commissions in computing the taxable estate could not deduct these commissions in computing the taxable income of the estate.[19] The provisions of section 162(e) were essentially carried over as section 642(g) of the 1954 Code.[20]

The *Burrow Trust* case is the first to determine whether section 642(g) extends to trusts the property of which is included in the taxable estate. The decision of the court is in accord with the well-established rules that tax statutes are to be strictly construed,[21] and that there are to be no implications from the statute beyond the clear language used therein.[22] The court reasoned that Congress must have intended to omit the words "or trust" following the words "taxable income of the estate" in section 642(g), since all the other subsections of section 642 use the words "estate or trust."

The Commissioner argued that the language of Treasury Regulation § 1.212-1(o),[23] that "Amounts deducted under one provision of the Internal Revenue Code of 1954 cannot again be deducted under any other provision thereof," applies to all sections of the 1954 Code.[24] The court disagreed, observing that the Regulation refers specifically to deductions which might properly be made under either section 212 or under section 162, which provides for deductions for trade or business expense. Judge Lewis noted that the substance of Treasury Regulation § 1.212-1(o) was already in effect when section 162(e) of the 1939 Code was enacted,[25] and concluded that if the Commissioner's contention was correct there would have been no need for section 162(e).

In addition to section 642(g) there is at least one other Code provision which allows the same expense to be deducted on both the estate tax and the income tax returns. Section 691(b) allows a deduction on the estate's income tax return for the payment of ex-

[18] Rev. Rul. 240, 1953-2 Cum. Bull. 79.

[19] Simon v. Hoey, 88 F. Supp. 754 (S.D. N.Y. 1949), *aff'd*, 180 F.2d 354, *cert. denied*, 339 U.S. 966 (1950).

[20] *Supra* note 8.

[21] Masonite Corp. v. Commissioner, 194 F.2d 257 (5th Cir. 1952).

[22] Kohl v. United States, 226 F.2d 381 (7th Cir. 1955); DeLuxe Check Printers v. Kelm, 99 F. Supp. 785 (D.C. Minn. 1951); Mead Corp. v. Commissioner, 116 F.2d 187 (3rd Cir. 1941); Pennsylvania Co. for Ins. on Lives and Granting Annuities v. United States, 39 F. Supp. 1019 (E.D. Pa. 1941).

[23] *Supra* note 9.

[24] This argument was not raised in the Tax Court.

[25] Treas. Reg. § 1.212-1(o) (1957) was Treas. Reg. 103, § 19.23 under Int. Rev. Code of 1939. Immediately prior to the enactment of the 1954 Code, the Regulation was cited as Treas. Reg. 118, § 39.23(a)-15(m).

penses which were accrued on the date of the decedent's death.[26] The accrued expenses also constitute claims against the estate, and as such are deductible under the authority of section 2053(a)(3) in computing the taxable estate. Although section 642(g) refers to section 2053 generally, the Regulations state that section 642(g) will not affect the operation of section 691(b).[27] The reason for this is that section 691(b) relates to expenses accrued at the date of death, while section 642(g) only pertains to those expenses incurred after the date of death.

The Commissioner generally follows a policy of either acquiescence or nonacquiescence in a decision of the Tax Court since he does not feel bound by a Tax Court decision as a matter of law.[28] As of the date of this Comment, the Commissioner has published neither his acquiescence nor nonacquiescence in the decision of the *Burrow Trust* case. There has been no appeal since the Solicitor General denied the Commissioner the authority to file a writ of certiorari.[29] As a result, we are left with a decision by which the Commissioner does not feel bound, and consequently future attempts at the kind of deductions used in *Burrow Trust* will probably be met by opposition from the Internal Revenue Service.

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[26] Under Int. Rev. Code of 1939 the comparable provision was section 126(b). This provision is limited to expenses arising from either a trade or business, interest, taxes, production, conservation, or management of income, or depletion.

[27] Treas. Reg. § 1.642(g)-2 (1956).

[28] 9 MERTENS, FEDERAL INCOME TAXATION § 50.94 (Zimet Revision 1958).

[29] CCH STAND. FED. TAX REP., vol. 7, p. 70,807 (revised to 10-14-64).