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Federal income Taxation of Estates and Beneficiaries. By M. Carr Ferguson, James L. Freeland, and Richard B. Stephens

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BOOK REVIEW

FEDERAL INCOME TAXATION OF ESTATES AND BENEFICIARIES. By M. Carr Ferguson, James L. Freeland, and Richard B. Stephens. Boston, Massachusetts: Little, Brown and Company. 1970. xxvi + 749 pages + Supplement (40 pages). $27.50.

RONALD H. JENSEN*

This comprehensive volume should help fill a void which tax practitioners have long endured. As the authors properly point out,[1] though many volumes have been written on *estate taxation* and estate planning, relatively little attention has been given to the *income tax* consequences resulting from death. Indeed, to my knowledge, the only current volume on this subject is a 1966, revised Practicing Law Institute publication, *Income Taxation of Estates and Trusts,* by Authur M. Michaelson.[2] Michaelson's work, though an excellent introduction to the subject, is of only limited value to the active tax practitioner: It is only 90 pages in length—only 52 of which are devoted to the income taxation of estates; the balance is concerned with the taxation of grantor trusts and other special types of trusts. The present volume is, therefore, a welcome and needed addition to the sparse body of literature on this subject.[3]

Functionally, the book may be divided into three main parts: the first deals with the final tax return of the decedent and the options available to his executor regarding the filing of a joint tax return, etc. (Chapter 3, Decedent's Income Tax Liability for the Year of His Death); the second with the definition and treatment of income in respect of a decedent (Chap-

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1. P. v.

2. A 1970 revised edition of the Michaelson work has recently been published. There are also discussions of estate income taxation in the general treatises on taxation, *e.g.*, 6 MERTENS, THE LAW OF FEDERAL INCOME TAXATION §§ 36.01-36.135 (rev. ed. 1968), and in the treatises on fiduciary administration, 2 NOSSAMAN, TRUST ADMINISTRATION AND TAXATION §§ 42.01-42.45 (2d ed. 1964) (primary emphasis on *trust* income taxation as opposed to *estate* income taxation), but Michaelson's work appears to be the only current work specifically devoted to estate and trust income taxation other than the book under review.

3. The timing of the book's publication, however, has turned out to be somewhat unfortunate. Although the Tax Reform Act of 1969 did not affect many of the Code sections bearing directly upon estate income taxation, it did affect many sections collaterally referred to in the text. The publisher has attempted to rectify this problem by providing a complimentary interim supplement setting forth the changes brought about by the 1969 Act. The information contained in this interim supplement will be incorporated in the first standard annual supplement to be published in January, 1971.

ter 4, Income in Respect of Decedents); and the third with the income taxation of estates and beneficiaries (Chapter 5, Distributable Net Income; Chapter 6, The Charitable Deduction; Chapter 7, Distributions; and Chapter 8, Estate Termination). In addition, there are discussions on the meaning of "estate" within the context of the income tax law, the relevance of local law and local adjudication in federal tax cases, and the executor's personal liability for the income taxes of the decedent and his estate (Chapters 1, 2 and 9). Thus, the volume, contrary to what its title might suggest, is not strictly limited to the income taxation of estates and their beneficiaries, but rather attempts to comprehend all income tax consequences flowing from the decedent's death including the estate's tax liability for income attributable to the decedent during his last taxable year and the taxation of income in respect of a decedent. Comprehensive as this treatment might seem, the work could have been more usefully expanded first, by including a discussion of the tax mechanics and problems peculiar to trusts (possibly excluding grantor trusts),[4] and secondly, by including a discussion of the fiduciary adjustments which are frequently necessary to equitably allocate income tax burdens (and benefits) among income beneficiaries and remaindermen.[5] Undoubtedly, the authors felt that a discussion of trust income taxation would stray from their assigned topic. Yet, the tax practitioner who deals with estates is also likely to deal with trusts (both inter vivos and testamentary), and the close similarity in the principles of trust income taxation and estate income taxation make their treatment in a single source desirable. Again, the authors may have felt that the fiduciary adjustments arising from the idiosyncrasies of the tax law should properly be discussed in a book devoted to estate administration rather than one on taxation. But, again, the person who makes use of this book is also likely to be the same person who has to advise what adjustments, if any, between the income and remainder interests should be made to equitably apportion the income tax burdens. More importantly, the purpose and propriety of such adjustments can only be fully understood in the context of the workings of the tax law which gave rise to the adjustments in the first place. And, finally, the dearth of commentary or authority on these questions

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4. *E.g.*, INT. REV. CODE OF 1954, §§ 665-69 (application of the so-called throwback rules).

5. For example, should some adjustment be made on behalf of a remainderman where items paid out of principal (attorney's fees, principal commissions, etc.) are used, under the federal tax law, to reduce the income tax liability of the income beneficiary? *See In re* Estate of Dick, 29 Misc. 2d 648, 218 N.Y.S.2d 182 (Sur. Ct. 1961) (holding that no adjustment could be made since such an adjustment would alter the impact of the tax statute).

would make such a discussion useful. These omissions, though arguably justifiable, make the work less valuable than one would have hoped.

The reader will, however, find many admirable qualities in this book. The extremely complex mechanics of Subchapter J are explained in detail and with clarity.[6] At the same time, the authors have avoided the peril of becoming lost in details, successfully keeping in the fore the underlying structure and policies of Subchapter J. Moreover, the work is not a sterile recitation of rules and cases; questions are raised, arguments are analyzed and positions are taken. The reader should especially enjoy the discussions wherein the authors grapple with unlitigated and unresolved questions. While the authors dissect the various arguments with technical precision, they do it with a sense of the underlying policy considerations. Finally, the book is the most convenient and comprehensive compilation extant of the rules governing the income taxation of decedents, their estates and beneficiaries. It does not merely describe the rule involved, but, in addition, shows how the rule is applied in different contexts and how it interrelates with different sections of the Code.[7]

On the other hand, the authors frequently ignore or pass over tax-saving and tax-planning techniques—matters which are naturally of great concern to the active tax practitioner. Several examples should suffice to illustrate:

(1) *Estate of Viola E. Bray*[8] held that expenses incurred in liquidating an estate to pay claims and death taxes (for example, brokerage commissions) could be used both as an *estate tax* deduction on the estate tax return and also as an offset to capital gain on the fiduciary income tax return, despite the prohibition of section 642(g) of the Internal Revenue Code against double deductions. The court reasoned that such selling expenses were offsets rather than deductions and, hence, did not come within the scope of section 642(g). This decision is extremely important since it involves a matter which is likely to arise in virtually every taxable estate. Yet, only a single sentence in the text is devoted to this question.[9] There is no discussion of the relative merits of the arguments for and against the result,

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6. Pp. 301 to 653.

7. For a good example of this technique *see* Pp. 211-64 (discussion of the interplay between the income in respect of a decedent concept and the rules of partnership taxation).

8. 46 T.C. 577 (1966), *aff'd mem.*, Comm'r v. Estate of Bray, 396 F.2d 452 (6th Cir. 1968), *not acquiesced in*, 1970 INT. REV. BULL. No. 30, at 7.

9. P. 320.

no indication as to its import, and no consideration of the possible limitations or extensions of the doctrine pronounced in the decision.[10]

(2) It has been suggested by some writers that dramatic tax savings to an income beneficiary of a testamentary trust can be effected during the period of estate administration by having the estate make substantial principal distributions to the trust concurrently with the payment of its income to the income beneficiary.[11] Since the estate's taxable income is normally allocated among the recipients of estate distributions in proportion to the amount distributed to each (regardless of whether the particular distribution is classified as principal or income under state law), the income beneficiary may be taxed on virtually no income even though he has in fact received the entire income (in the trust accounting sense) earned by the estate. Despite the prominence given to this and similar techniques in the professional literature, the intrinsic interest of such techniques and the dramatic tax savings which may be involved, there is no discussion of these techniques in the book.

In spite of these limitations, I would recommend the book to anyone who is frequently involved in the administration of estates.

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10. For example, would the *Bray* doctrine apply where assets are sold at a loss rather than a gain, so that the effect of applying the selling expenses would be to increase the loss rather than reduce a gain? The Commissioner has argued that since a loss is treated as a "deduction" under Section 165, any selling expense which has the effect of increasing that loss is also a "deduction" (rather than an "offset"), and thus the prohibition of section 642(g) against double deductions is effective. This argument was recently rejected by the Tax Court in Estate of Dorn, 54 T.C. No. 162 (Aug. 26, 1970).

11. *See, e.g.,* Parr, *Distributions by Estates,* 107 TRUSTS AND ESTATES 97, 98-100 (1968); Fremont-Smith, *Techniques for Controlling Income Tax Consequences of Trusts and Estates and Their Beneficiaries,* N.Y.U. 25TH INST. ON FED. TAX. 1019, 1036-37 (1967); Goldberg, *Using Trust Income as Corpus,* 109 TRUSTS AND ESTATES 101 (1970). The advantages of these techniques may have been reduced, however, by the amendments to the so-called throwback rules effected by the Tax Reform Act of 1969. *See* Goldberg, *id.* at 104.