Estate Tax-"Disallowance of Double Deductions" in I.R.C. Section 642 (g) Applies Only to "Statutory Deductions"-*Estate of Bray*

ESTATE TAX—"Disallowance of Double Deductions" in I.R.C. Section 642(g) Applies Only to "Statutory Deductions"—*Estate of Bray**

Petitioners, as executors for a substantial estate, had to sell a large amount of securities in order to pay administration expenses incurred by the estate. The estate received $2,250,000 from this sale, which was $50,000 in excess of the value of the stock at the time of decedent's death and thus as reported on the estate tax return.[1] The brokerage commissions and taxes on the sale, which totaled $23,000, were deducted from the value of the gross estate as administration expenses pursuant to section 2053(a)(2) of the 1954 Internal Revenue Code.[2] The same $23,000 was also subtracted from the $50,000 received above the value of the stock at the time of decedent's death,[3] so that petitioners reported only $27,000 on the estate's income tax return as the gain realized from the sale. The Commissioner of Internal Revenue disallowed the use of the brokerage expenses as a reduction in computing the estate's taxable income on the grounds that a waiver of the right to use these same expenses as an estate tax deduction had not been filed in accordance with section 642(g).[4] The Tax Court, overruling the Commissioner, held that the petitioners did not have to comply with section 642(g) which disallows double deductions because the brokerage commissions were an *offset* against the selling price of the securities and not a *deduction* for income tax purposes.

Section 2053 provides that certain expenses associated with the

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* 46 T.C. 577 (1966) [hereinafter cited as principal case].

1. The dollar amounts have been rounded off and are not therefore the actual amounts involved in the case.

2. INT. REV. CODE OF 1954, § 2053(a) provides in part:

> (a) GENERAL RULE—For purposes of the tax imposed by section 2001, the value of the taxable estate shall be determined by deducting from the value of the gross estate such amounts—
>
> . . .
>
> (2) for administration expenses,
>
> . . .

as are allowable by the laws of the jurisdiction, whether within or without the United States, under which the estate is being administered.

3. INT. REV. CODE OF 1954, § 1014(a) states that the basis of property for estate tax purposes is the "value of the property at the date of the decedent's death."

4. INT. REV. CODE OF 1954, § 642(g) states:

> (g) DISSALLOWANCE 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 or of any other person, unless there is filed, within the time and in the manner and form prescribed by the Secretary or his delegate, a statement that the amounts have not been allowed as deductions under section 2053 or 2054 and a waiver of the right to have such amounts allowed at any time as deductions under section 2053 or 2054. This subsection shall not apply with respect to deductions allowed under part II (relating to income in respect of decedents).

This section was recently amended to include the words "or any other person" after "in computing the taxable income of the estate" in the first clause. This addition, however, does not affect the principal case. See S. REP. No. 1599, 89th Cong., 2d Sess. 3, 6 (1966).

administration of an estate may be deducted from the value of the gross estate in computing the estate tax. Some of the expenses which may be deducted for estate tax purposes under section 2053 may also be expenses for the production of income, and as such, may likewise qualify as deductions on the estate's income tax return under the provisions of section 212.[5] Expenses that do qualify as deductions under both sections are precluded from being deducted twice by section 642(g) which requires that a "deduction" be taken only once, either on the estate's income tax return or on the estate tax return.[6] Brokerage expenses incurred when an estate is forced to sell securities are clearly allowed as an administration expense deduction on the estate tax return under section 2053.[7] For income tax purposes, however, brokerage commission expenses of a nondealer in securities are not classified as a statutory deduction under any section of the Code, but rather have traditionally been considered an "offset" against gross receipts of sale.[8] Thus, the point of controversy in the principle case is the applicability of section 642(g) to brokerage commissions which, although not true income tax deductions, nevertheless reduce taxable income in a manner similar to deductions when such commissions are used as an offset against gross receipts. The Commissioner, in Revenue Ruling 56-43,[9] held that the term "deductions" in section 642(g) is used in a broad sense so as to disallow the double use of any item of expense which may have the *effect of reducing* both the taxable estate and the estate's taxable income.[10] The Tax Court in the principal case, however,

5. Treas. Reg. § 1.212-1(i) (1957).

6. See note 4 *supra*. An important exception to this prohibition against double deductions is deductions in respect of decedents. See generally Ferrari, Jr., *Income in Respect of a Decedent: Deductions, Capital Gains, and Double Deductions*, N.Y.U. 23D INST. ON FED. TAX 1209 (1965).

7. Treas. Reg. § 20.2053-3(d) (1965) provides in pertinent part:

> (2) Expenses for selling property of the estate are deductible if the sale is necessary in order to pay the decedent's debts, expenses of administration, or taxes, to preserve the estate, or to effect distribution. The phrase "expenses for selling property" includes brokerage fees and other expenses attending the sale . . . .

See Dudley S. Blossom, 45 B.T.A. 691 (1941), dealing with the predecessor to the present regulation.

8. Treas. Reg. § 1.212-1(n) (1957) states that "capital expenditures are not allowable as nontrade or nonbusiness expenses" and thus can not be used as income tax deductions. Treas. Reg. § 1.263(a)-2(e) (1958) gives as an example of a capital expenditure:

> Commissions paid in purchasing securities. Commissions paid in selling securities are an offset against the selling price, except that in the case of dealers in securities such commissions may be treated as an ordinary and necessary business expense.

The treatment of brokerage commissions as offsets is a long standing practice. See G.C.M. 15430, XIV-2 CUM. BULL. 59 (1935); *e.g.*, Spreckles v. Commissioner, 315 U.S. 626 (1942); Helvering v. Winmill, 305 U.S. 79 (1938). For a discussion of the distinction between capital expenditures and nonbusiness expenses, see Munson v. McGinnes, 283 F.2d 333 (3d Cir. 1960).

9. This ruling has been highly criticized. MONTGOMERY, FEDERAL TAXES, § 20.16 (38th ed. 1961); 4 RABKIN & JOHNSON, FEDERAL INCOME, GIFT, & ESTATE TAX § 54.02(7) (1966). See generally Bard, *The Disallowance to Estates of Double Deductions*, 42 TAXES 455 (1964); Pincus, *Expenses of Sale by Estates*, 95 TRUSTS & ESTATES 1004 (1956).

10. 1956-1 CUM. BULL. 210. This ruling states:

refusing to recognize this interpretation, agreed with the petitioner's contention that the inclusion of offsets within the concept of "deduction" as employed in sections 642(g) is not justified.

This decision finds ample support in both the statutory language and the legislative history of section 642(g). The Commissioner claimed that the congressional intent in passing section 642(g) was to prohibit the "windfall" which resulted when a fiduciary of an estate used a single expense from a single economic transaction to reduce both the estate's income tax and the taxable estate.[11] Thus, although a literal reading of the section would not include offsets, the Commissioner contended that, in order to give effect to the congressional purpose underlying the provision, the word "deduction" should be broadly interpreted. In support of such an interpretation, the Commissioner argued that the deductions and offset distinction which is used in the part of the Code dealing with the computation of an individual's income tax should not be carried over into a wholly different part of the Code which is concerned solely with prohibiting the double use of a single expense by an estate.[12] However, section 641(b), states that "the taxable income of an estate or trust shall be computed *in the same manner as in the case of an individual,* except as otherwise provided in this part."[13] This would seem to indicate that in disallowing double deductions, section 642(g) used the word "deduction" in the same way as it is used "in the case of an individual," there being no language to the contrary. Therefore, brokerage expenses incurred by an estate, just as those incurred by an individual nondealer, should not be treated as a deduction from gross income but rather as an offset against gross receipts in computing gross income.[14]

Moreover, the legislative history of the section strongly suggests that Congress only intended to prohibit the double use of *statutory* deductions and did not intend to prohibit generally the double use of every expense by an estate.[15] Congress could have easily used more

Expenses incurred in the sale of property, other than by a dealer, are considered as an offset against the sale price and not deductible as an ordinary and necessary business expense. See G.C.M. 15430, C.B. XIV-2, 59 (1935). However, such expenses may not be used as an offset against the sale price of property in determining gain or loss for Federal income tax purposes where they have already been allowed as a deduction for Federal estate tax purposes. Such items of expense fall within the concept of section 642(g) of the Internal Revenue Code of 1954. Although section 642(g) of the Code refers to the disallowance of double deductions, it is the position of the Internal Revenue Service that such section contemplates the disallowance, as a *reduction* in computing the taxable income of the estate, of such items which have been allowed as a deduction in computing the taxable estate. See Rev. Rul. 340, C.B. 1953-2, 79.

11. First Brief for Respondent, p 11.

12. *Id.* at 15.

13. Emphasis added. Treas. Reg. § 1.641(b)-1 (1956), points out that § 641 is subject to the special rules found in § 642.

14. See note 8 *supra.* See generally Pincus, *supra* note 9.

15. The courts have generally narrowly interpreted "deductions" when they have been asked to extend the definition. See Charles E. Good, 208 F. Supp. 521 (E.D. Mich. 1962); Universal Optical Co., 11 T.C. 608, 621-22 (1948). See Bard, *supra* note

specific language if it had meant to include "offsets" within the prohibition of section 642(g).[16] The distinction between deductions and offsets had been well settled for some time prior to the enactment of section 642(g).[17] Indeed, the double use of brokerage commission expenses as an offset for income tax purposes and as a deduction from the taxable estate had been allowed by one court just a year before the section prohibiting double deductions was originally enacted.[18] Furthermore, when the provision was first under consideration by the House of Representatives there is no question that it referred solely to statutory deductions,[19] for the House was specifically concerned with limiting the possibility of double deductions by estates, which possibility would arise after the passage of proposed section 23(a)(2) (predecessor to section 212 of the present Code) allowing, for the first time, certain non-business expenses as income tax deductions.[20] The House realized that the proposed allowances for non-business expenses would increase the possibility of an estate's claiming of double deductions since many of these deductible non-business expenses were also recognized estate tax deductions.[21] Ac-

9, at 460. Furthermore, courts have denied that the Code in general, or § 642(g) in particular, expresses an inherent disfavoring of double deductions. See, *e.g.*, Adams v. Commissioner, 110 F.2d 578 (8th Cir. 1940); Brown v. Commissioner, 74 F.2d 281 (10th Cir. 1934); Robert J. Kleberg, 31 B.T.A. 95 (1934); Mary E. Burrow Trust, 39 T.C. 1080 (1963), *aff'd*, 333 F.2d 66 (10th Cir. 1964). In *Mary E. Burrow Trust*, the court allowed a double deduction by holding that § 642(g) did not apply to trusts as the word "trust" was omitted in that subsection while it was used in the other seven subsections of § 642. *But see* 58 Nw. U.L. REV. 707 (1964). As a result of the decision in *Burrow's Trust*, Congress amended § 642(g) in 1966 so as to include trusts under the prohibition of double deductions. See note 4 *supra*.

16. Section 642(g) of the 1954 Code was originally § 162(e) of the 1939 Code which was added by amendment in 1942. See generally Bard *supra* note 9.

17. See, *e.g.*, Adams v. Commissioner, 110 F.2d 578 (8th Cir. 1940); Brown v. Commissioner, 74 F.2d 281 (10th Cir. 1934); Robert J. Kleberg, 31 B.T.A. 95 (1934).

18. Dudley S. Blossom, 45 B.T.A. 691 (1941); see principal case at 580 n.1.

19. H.R. REP. No. 2333, 77th Cong., 2d Sess. 75, 76 (1942); see Sutter, *Election to deduct expenses for estate or income taxes: effective use of 1954 Code*, 3. J. TAXATION 357 (1955).

20. INT. REV. CODE OF 1954, § 212 provides:

> In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year—
> (1) for the production or collection of income;
> (2) for the management, conservation, or maintenance of property held for the production of income; or
> (3) in connection with the determination, collection, or refund of any tax.

This section is substantially unchanged from § 23(a)(2) of the 1939 Code except that in 1954 subsection (3) was added.

21. It should be noted that there was no prohibition against double deductions before 1942. See cases cited note 17 *supra*. However, the only income tax deductions that could be taken by an estate were for business expenses, and since most expenses incurred in handling an estate were considered nonbusiness expenses, see, *e.g.*, United States v. Pyne, 313 U.S. 127 (1941), the opportunity rarely arose for estates to take advantage of the possible double deductions. For this reason, the House of Representatives was not too concerned with the past use of double deductions. See Don A. Davis, 4 T.C. 329 (1944), *aff'd*, 151 F.2d 441 (8th Cir. 1945), where the court held that the 1942 amendment to the Code was not meant to disturb the traditional use of selling commission expenses as offsets.

cordingly, the House adopted a provision which said in effect that an expense taken as an estate tax deduction could not be allowed as a deduction under the new section 23(a)(2) on the income tax return[22] Although the Senate decided to broaden "the somewhat narrower provisions" formulated by the House by extending the coverage so as to include all deductions allowed under section 23 and not just those under section 23(a)(2),[23] all other language used by the House was adopted without change.[24] It is reasonable to assume, therefore, that the Senate did not intend to change the meaning of the House version, but sought only to include a greater number of statutory deductions under the prohibition of section 642(g); it did not intend, in the process, to include anything more than statutory deductions. This interpretation is, in fact, coincident with the way in which the Internal Revenue Service originally construed and administered the statute as is evidenced by several private rulings including a 1952 ruling which declared:

> Therefore, both commissions and stamp taxes are offset against gross sales in determining *gross income* from a sale of securities. . . . Accordingly, this office holds that where securities are sold at a gain, and the expenses of the sale are offset against the selling price, there is no Section 23 [212] deduction involved and hence no application of Section 162(e) [642(g)] of the Code.[25]

Since this construction of the predecessor to section 642(g) had long been established, reenactment of the section by Congress in 1954 may legitimately be interpreted as legislative sanction of that construction.[26] Although somewhat broader language is used in the section as reenacted,[27] it is unlikely that Congress meant to define more broadly the word "deduction," for not only does the section as reenacted still refer merely to deductions, but in addition, the Senate Committee reported that the two versions of the section were

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22. H.R. REP. No. 2333, 77th Cong., 2d Sess. 75, 76 (1942).

23. S. REP. No. 1631, 77th Cong., 2d Sess. 136 (1942).

24. Int. Rev. Code of 1939, § 162(e), as finally promulgated stated:

> (e) Amounts allowable under section 812(b) as a deduction in computing the net estate of a decedent shall not be allowed as a deduction under section 23 except subsection (w), in computing the net income of the estate unless there is filed, within the time and in the manner and form prescribed by the Commissioner, a statement that the items have not been claimed or allowed as deductions under section 812(b) and a waiver of the right to have such items allowed at any time as deductions under section 812(b).

25. Pincus, *supra* note 9, at 1006.

26. G.C.M. 15430, XIV-2 CUM. BULL. 59, 60 (1935) declares in pertinent part:

> It is well settled that where a statute has been construed for a long period of time as having a certain meaning, a reenactment of that statute without change indicates legislative sanction of the construction previously given it. (*National Lead Co.* v. *United States*, 252 U.S. 140; *New Haven R.R.* v. *ICC*, 200 U.S. 361; *Copper Queen Mining Co.* v. *Arizona Board*, 206 U.S. 474).

27. Section 642(g) of the present Code (note 4 *supra*) provides that an expense taken as an estate tax deduction "shall not be allowed as a deduction *in computing the taxable income of the estate*," while § 162(e) of the 1939 Code (note 24 *supra*) stated that such expenses "shall not be allowed as a deduction *under section 23*." (Emphasis added.)

"comparable."[28] Furthermore, as the court in the principal case pointed out, substantially the same process is used to compute gain for income tax purposes under both the present Code and the 1939 Code, and it is unlikely Congress meant to treat offsets as deductions in section 642(g) of the present Code if they were not so treated in its predecessor.[29] The reason for the minor change in language is not entirely clear, although it probably was added to extend the application of the section so as to cover all income tax deductions.[30]

The Commissioner's broad interpretation of section 642(g) in Revenue Ruling 56-43 was properly repudiated by the court in the principal case, and technically it would be difficult to quarrel with the decision. The Commissioner, however, presented what appears at first blush to be an interesting practical argument against the outcome by claiming that it would result in inequitable treatment of taxpayers.[31] It is a well-established policy that taxpayers in similar situations should be treated equally, if possible, unless there is an express provision in the Code to the contrary.[32] The Commissioner claimed that if the brokerage commission expenses were allowed to be treated as both an income tax offset and an estate tax deduction, a disparity of treatment would result between two similarly situated taxpaying estates if one realized a capital gain and the other suffered a capital loss. Since a capital loss under section 165(c) is considered a "deduction" for income tax purposes,[33] the Commissioner maintained that if brokerage commissions were used as an offset against the gross receipts of a sale, the effect in a loss situation would be that the amount of the offset would be "added" to the capital loss and immediately become part of the allowed statutory "deduction." Since it would thus be included as a part of an income tax "deduction," section 642(g) would apply and would require that the use of the commission expense as a deduction from the taxable estate be disallowed. Therefore, the Commissioner concluded, if Revenue Ruling 56-43 were not followed, section 642(g) would disallow the double use of brokerage expenses when there is a capital loss, while the estate which realizes a capital gain would obtain a greater tax

28. S. REP. No. 1622, 83d Cong., 2d Sess. 340 (1954).

29. Principal case at 582.

30. For example, it would now be impossible to claim that a distribution from the income of an estate, which is deductible under § 661, is not within the coverage of § 642(g). See Bard, *supra* note 9, at 456.

31. First Brief for Respondent, pp. 16-17.

32. *E.g.*, Charles Ilfeld Co. v. Hernandez, 292 U.S. 62, 68 (1934).

33. INT. REV. CODE OF 1954, § 165 provides in pertinent part:

> (a) GENERAL RULE—There shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.
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> . . .
>
> (c) LIMITATION ON LOSSES OF INDIVIDUALS—In the case of an individual, the deduction under subsection (a) shall be limited to—
>
> . . .
>
> (2) losses incurred in any transaction entered into for profit, though not connected with a trade or business; and . . . .

advantage by being effectively able to use the expense twice.[34] Such dissimilar treatment of taxpayers, it was argued, should not be permitted.

The fallacy of the Commissioner's argument is that when a brokerage expense is used as an offset, it is not subtracted from the gross receipts of a sale in order to determine the deduction, but rather is added to the basis of the property sold in order to determine the extent of gain or loss resulting from the sale.[35] Thus, in the case of a capital loss, it is from the combined total of the basis plus the brokerage expenses that the selling price is substracted to determine the amount of the loss. Although the amount of the brokerage expense may be reflected in the total loss as a result of its having been added to the basis, the expense is in no way "added" to the capital loss in such a way that it becomes a part of the statutory deduction.[36] Since it is not a part of the loss deduction, there is not a double deduction when the selling expense is claimed as a deduction from the gross estate. A court, therefore, would be consistent if it were to decide a case involving an estate which suffered a capital loss the same way as it has decided the principal case.

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34. If this can be said to be an inequity, it is no more so than the inequity existing between persons selling their own homes for a gain and those selling for a loss. The selling expenses associated with selling a home may be used to offset the purchase price received in determining the amount of recognized gain on the transaction. On the other hand, although selling expenses will increase the amount of loss which may be sustained in selling the house, none of the loss is deductible under any section of the Code.

35. Federal Income Tax Form 1040, Schedule D, Part I—Capital Assets, item 1-f.

36. Even if selling expenses are thought of as being subtracted from the total receipts of the sale rather than as being added to the basis, it is arguable that the selling expenses do not become a part of any loss deduction. A loss is computed under § 1001 by subtracting the amount realized on the sale from the adjusted basis of the property sold. Although the selling expenses may be used to determine the amount of the loss, § 1001 does not provide that this loss is deductible. The net loss, so computed, will be allowed as a deduction in determining an individual's taxable income only if it meets the requirements of § 165(c). Thus, the selling expenses will merely become part of the net loss which, depending on the character of the loss, may or may not be taken as a deduction.