



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
ODELIA D. LYNN TRUST,)
LLOYD G. RAINEY, TRUSTEE)

Appearances:

For Appellants: Edward S. Renwick
Attorney at Law

For Respondent: Mark **McEvelly**
Counsel

O P I N I O N

This appeal is made pursuant to section 18593 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Odelia D. Lynn Trust, Lloyd G. Rainey, Trustee, against a proposed assessment of additional personal income tax in the amount of \$56,146 for the year 1975.

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Odelia D. Lynn died testate on September 25, 1971, leaving as the principal assets of her estate 4,200 shares of Coca-Cola Bottling Corporation of Bakersfield and 24 shares of Lynn Distributing Company. Pursuant to the terms of Mrs. Lynn's will, her two daughters were to receive all her personal effects, with the residue passing to a trust which had been established in 1951.

Beginning with the calendar year 1971, Lloyd Rainey, executor of Mrs. Lynn's estate, filed California fiduciary returns on behalf of the estate. On the fiduciary return for 1975, the estate reported the installment sale of the above-noted **stock** pursuant to the provisions of Revenue and Taxation Code section 17577. That sale resulted in cash of \$365,400 received and installment notes of \$965,000 payable in ten equal annual installments commencing on January 2, 1976. Later fiduciary returns reported as income the subsequently-received installments of the sale in the year received.

By **letter** dated April 25, 1979, respondent **asked the** executor why the estate continued to remain open. Replying by letter dated May 7, 1979, the executor stated in part:

Although at the time of filing, on July **31, 1975,** of the second account in the decedent's estate the estate was in a condition to be closed, to close it at that time would have resulted in a very substantial loss to the estate and those interested therein,, Such result would have been due to the provision of Section 453(d) of the Internal Revenue Code (counterpart to Revenue and Taxation Code section 17580, as in effect in the year at issue] which would have compelled the payment in the year of final distribution of the estate of the deferred portion of the capital gains income tax applicable to the installment notes received from the buyer of **said** corporate **stocks as** partial payment of the sale price thereof, which said notes would have been included in the assets distributable in accordance with the provisions of decedent's will.

(Resp. Ex. D at 1.)

Upon review, respondent determined that pursuant to Revenue and Taxation Code section 17731 and the

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regulations there applicable, the period of administration of the estate had been unduly prolonged and, therefore, respondent terminated the estate for income tax purposes in tax year 1975. As forewarned by the executor's May 7, 1979, letter, such termination resulted in the disposition of the installment notes which, in turn, resulted in the recognition of gain to the estate. Appellant protested this **determination and** respondent's denial led to this appeal.

Appellant contends that the administration of the estate was not unduly prolonged since it continued under the valid orders of the local probate court and those orders should be binding upon respondent. Respondent answers that the continuance of the proceedings in the local probate court is irrelevant in the absence of evidence that an issue as to whether the estate should have been closed was **raised**, contested and determined by the court.

Section 17731, subdivision (a)(3), of the Revenue and Taxation Code provides that income received by an estate of a deceased person during the period of administration or settlement of the estate is taxable to the estate. Estates in administration are, thus, separate tax-paying entities. Section 17731 is similar to section 641(a)(3) of the Internal Revenue Code of 1954. As there are now no regulations of the Franchise Tax Board interpreting section 17731,^{1/} pursuant to the authority of section 19253 of the Revenue and Taxation Code, regulations under the Internal Revenue Code would govern the interpretation of the conforming state statute. (Cal. Admin. Code, tit, 18, reg. 19253.) Moreover, cases interpreting section 641 are highly persuasive as to the proper application of section 17731. (Holmes v. McColgan, 17 Cal.2d 426 [110 P.2d 428] (1941); Union Oil Associates v. Johnson, 2 Cal.2d 727 (43 P.2d 291) (1935); Meanley v. McColgan, 49 Cal.App.2d 203 [121 P.2d 45], (1942).)

^{1/} During the appeal year former Cal. Admin. Code, tit, 18, reg 17731(g) (repealer filed June 25, 1981, Register 81, No: 26) was substantially the same as Treas. Reg. § 1.641(b)-3.

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Treasury regulation section 1.641(b)-3 provides:

(a) ' The income of an estate of a deceased person is that which is received by the estate during the period of administration or settlement. The period of administration or settlement is the period actually required by the administrator or executor to perform the ordinary **duties of** administration, such as the collection of assets and the payment **of debts, taxes, legacies, and bequests, whether** the period required is longer or shorter than the period specified under the applicable local law for the settlement of estates. For **example**, where an executor who is also named as trustee under a will fails to obtain his discharge as executor, the period of administration continues only until the duties of administration are complete and he actually assumes his duties as trustee, whether or not pursuant to a court order. However, the period of administration of an estate cannot be unduly prolonged. If the administration of an estate is unreasonably prolonged, the estate is considered terminated for Federal income tax purposes after the expiration of a reasonable period for the performance by the executor of all the duties of **administration**. Further, an estate will be considered as terminated when all the assets have been distributed except for a reasonable amount which is set aside in good faith for the payment of unascertained or contingent liabilities and expenses (not including a claim by a beneficiary in the capacity of beneficiary).

We have squarely addressed this issue in the past. In the Appeal of Mrs. Lydia J. Hansen, decided August, 3, 1965, we stated:

For income tax purposes, the period of administration of an estate may be considered terminated regardless of the date of formal distribution and final settlement in the probate court. (Chick v. Commissioner, 166 F.2d 337; Stewart v. Commissioner, 196 F.2d 397; Marin Caratan, 14 T.C. 934; Sidney N. LeFiell, 19 T.C. 1162.) Thus, the continuance of proceedings in the probate court is irrelevant, at least in the absence of evidence that

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'an issue as to whether the estate should have been closed was raised, contested and determined by the court. (Sidney N. LeFiell, supra.)

(See also, Appeal of Mary R. Encell, Cal. St. Bd. of Equal., April 21, 1959.)

Appellant contends, **however**, that the Hansen and Encell cases are distinguishable from the instant situation because there is no indication that the local probate-courts made any finding that these estates were not in a condition to be closed. However, in the Hansen case, the taxpayer argued that the probate court consented to the lengthy administration due to its acceptance and approval of each of the annual accountings which had been filed. While the language of those annual accountings is not recorded in our opinion, it is routine to recite in such accountings language to the effect that "the estate is not yet in a condition to be closed" There **is** no indication in Hansen that the probate court did not **make** such routine findings in the annual accountings. Nevertheless, we found that the estate's administration had been unduly prolonged, and, therefore, we terminated the estate for income tax purposes. **Moreover**, in Encell, inheritance tax objections had been filed and remained contested during the period at issue. In spite of the fact that under Probate Code section 1024, as in effect during that period, the estate could not have been closed nor final distribution made, we found that the estate was terminated for income tax purposes.

Accordingly, we have held that the continuance of proceedings in the local probate court is irrelevant with respect to termination issues under section 17731, except when an issue as to whether the estate should have been closed has been raised, contested and determined by the court. (Appeal of Mrs. Lydia J. Hansen, supra.) There is no evidence in the **instant** case that the issue of the **estate's** closure was in fact contested, but instead, **the** probate court's order appears to have been mechanically made. Therefore, under the rationale of the Hansen and Encell cases, the continuance of local probate proceeding is irrelevant in the instant matter,

Moreover, the underlying federal cases support **respondent's** arguments. While finding that an estate's administration was not unduly prolonged, the tax court noted that "the period for settlement of a decedent's estate under State law is not **conclusive.**" (Est. of

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Mary Z. Bryan, ¶ 63,182, at 63-191, P-H Memo T.C. (1963);
see also Marin Caratan, 14 T.C. 934 (1950).

Nevertheless, appellant argues that Frederich v. Commissioner, 145 F.2d 796 (5th Cir. 1944), supports its position. In Frederich, the Fifth Circuit stated on page 799:

In the absence of fraud, or conspiracy to evade taxes, it does not lie within the province of the Tax Court to say that the County Judge abused his discretion in ordering that the administration should be kept open, in compliance with the agreement and desire of all parties of interest that this should be done until such time as the business could be liquidated by an advantageous sale.

However, we find the Frederich case to be distinguishable from the instant case. One of the ordinary duties of administration is the collection and disposition of assets. As indicated above, the administration in Frederich was extended in order to liquidate assets by an advantageous sale. Clearly, the extension required there was for reasonable circumstances involving the ordinary duties of the estate's administration. On the other hand, in the instant case, appellant freely admits that the reason for prolonging administration was to reduce the payment of income taxes. The executor here did not have a bona fide purpose in holding the estate open as did the executor in Frederich,

In Carson v. United States, 317 F.2d 370 (Ct. Cl. 1963), a case favorably citing Frederich, the court of claims held that the lawful orders of the local probate court could not be disregarded or lightly weighed in determining the earlier termination of the estate for federal income tax purposes. However, that court indicated that it would have found for the commissioner and terminated the estate if the purpose in holding open the estate had been to avoid the payment of taxes. On page 378, the court stated:

There is no evidentiary basis for finding that plaintiff had any purpose to avoid payment of taxes at a higher rate, or that higher aggregate income taxes would have been payable as a consequence of an earlier closing of the estate.

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On the contrary, 'by appellant's own admission, higher aggregate income taxes' would be payable due to the earlier closing of the estate. Indeed, in **spite** of some minor and subsequently developed reasons, it is clear that **the root** reason for the prolonged administration of the estate was to reduce income taxes. We find, under these circumstances, this was not a bona fide purpose for holding the estate open. Indeed, if we were to find otherwise, we would completely emasculate section 17731, subdivision (a)(3), since the termination **of any** estate means the disappearance of a separate taxpayer and **frequently can** result in an increase in **the overall** tax burden borne by the beneficiaries (see Glassmoyer, Termination of Estates and Trusts, 17 N.Y.U. Institute on Fed. Tax. (1959).)

There is no evidence from which we could **justifiably** conclude that a 'reasonable period for the performance by the executor of all the duties of administration' extended beyond 1975. Consequently, we agree **with** respondent's determination that the Odelia Lynn Estate had **terminated for income** tax purposes at the end of that year.

