

WHERE TO DEDUCT ESTATE ADMINISTRATION EXPENSES

By **Bruce D. Steiner, Esq.**, *Kleinberg, Kaplan, Wolff & Cohen, P.C.*

Estate administration expenses can generally be deducted either on the estate tax return (Form 706) or on the estate's fiduciary income tax return (Form 1041), but not on both. For purposes of this article, state death taxes are ignored, and it is assumed that none of the unified credit was used during the taxpayer's lifetime.

Estates under \$600,000 are not subject to federal estate tax. In nontaxable estates, because the administration expenses will not provide any benefit on the estate tax return, they should be claimed on the income tax returns.

In large estates, absent the marital deduction, the administration expenses should generally be claimed on the estate tax return. This is because the lowest estate tax bracket (37%) is higher than the highest income tax bracket (31%).

The choice is more complicated if the will contains a formula marital deduction provision interrelated with the exemption equivalent. In such cases, to the extent that the administration expenses are claimed as income tax deductions, they count against the \$600,000 exemption equivalent. As a result, the marital share of the estate is increased, and the nonmarital share of the estate is decreased.

Time for an Illustration

This can be illustrated as follows, assuming that the estate is \$3,000,000 and that there are \$300,000 of expenses:

	If Expenses are Deducted on Form 706	If Expenses are Deducted on Form 1041
Total estate	\$ 3,000,000	\$ 3,000,000
Marital deduction	(2,100,000)	(2,400,000)
Expenses claimed on Form 706	(300,000)	-0-
Taxable estate	600,000	600,000
Expenses claimed on Form 1041	-0-	(300,000)
Nonmarital share	<u>\$ 600,000</u>	<u>\$ 300,000</u>

In the above example, if you deduct the expenses on the income tax return, the estate of beneficiaries is entitled to a \$300,000 income tax deduction. However, if you deduct the expenses on the estate tax return, you can shelter an additional \$300,000 (plus the growth thereon and possibly the income thereon during the spouse's lifetime) from estate tax in the spouse's estate.

In making the choice, the following factors should be considered:

1. Estimate whether the surviving spouse's estate will be subject to estate tax. If you expect the spouse to consume or give away enough assets so that the estate will not be subject to tax, consider taking the expenses as an income tax deduction.
2. Determine whether the income from the nonmarital share of the estate is payable to the spouse. This depends upon the terms of the will. The estate tax deduction is more valuable if the income from the nonmarital share (as well as the principal) can be sheltered from the spouse's estate, rather than merely the principal. However, if the will gives the spouse all of the income from the nonmarital share, he or she may be able to disclaim the income interest.
3. Consider the estate's income tax bracket in the year in which the expenses are paid. In addition, if the expenses are paid in the estate's final taxable year, consider the beneficiaries' income tax brackets, as well as the effect of the 2% floor on miscellaneous itemized deductions.

BRUCE D. STEINER
N.Y., N.J. AND FLA BARS

KLEINBERG, KAPLAN, WOLFF & COHEN, P.C.
522 FIFTH AVENUE
NEW YORK, NEW YORK 10036

TELEPHONE (212) 382-0080
FACSIMILE (212) 719-9054