OPINION NO. 1091

SUPERIOR COURT OF THE DISTRICT OF COLUMBIA
TAX DIVISION

FILED
APR 2 1 1971
Superior Court of the District of Columbia Tax Division

FRANCES H. CLAYTOR, Petitioner,	)	
v.	)	DOCKET NO. 2115
DISTRICT OF COLUMBIA, Respondent.	)	

FINDINGS, CONCLUSIONS and OPINION

This case involves D. C. income taxes for the calendar year 1968. Petitioner claimed as an offset to her other income for that year a "non-business expense", or "loss" deduction of $17,090.57 arising from an excess of deductions from the estate of E. M. Hammond (the late father of the petitioner) for its final taxable year (ended December 11, 1968) over the estate's income for the same period. During that year the estate paid out the executor's fees and other expenses that had accrued against the estate from the date of decedent's death.

Petitioner recognizes that an estate and the individual beneficiary of an estate are ordinarily two separate taxable entities, each of which files its own separate tax return, and neither of which gets the deductions of the other. However, under current Federal income tax law, the situation is different as to deductions incurred during the final taxable year in which the estate is liquidated and terminated. Under the Federal law, during that year, the estate is regarded as a mere conduit through which items of tax consequence pass and are absorbed by the distributees, or beneficiaries of the estate. Thus, tax deductions are reflected in the individual tax returns

of such distributees or beneficiaries. The estate is for that year in the position of a partnership for federal income tax purposes, i.e., it files an information return but all of its operations having income tax consequences are reflected on the tax returns of the distributees or beneficiaries.

This "conduit" theory specifically applies, for federal income tax purposes, to the excess of deductions over the estate's gross income for its final year. Section 642(h) of the 1954 Internal Revenue Code provides as follows --

> 642(h) - If on the termination of an estate or trust, the estate or trust has -
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> * * *
>
> (2) for the last taxable year of the estate or trust deductions * * * in excess of gross income for such year, then such * * * excess shall be allowed as a deduction * * * to the beneficiaries succeeding to the property of the estate or trust.

Petitioner accordingly had the benefit of the estate's $17,090.57 excess deductions as an offset against her other income for purposes of her 1968 Federal income tax return. Until such time as Congress sees fit to enact "conformity" legislation, however, the situation under the 1954 I.R.C. does not necessarily govern taxpayer's situation under the D. C. income tax law.

The D. C. income tax law was enacted July 16, 1947, and in general (with some important but not presently relevant exceptions) conforms to the 1939 Internal Revenue Code as amended to that date. The District of Columbia income tax law does not contain any provision similar to Internal Revenue Code section 642(h) quoted above. However, the D. C. law does contain a general provision allowing a deduction for <u>losses</u> "incurred in any transaction entered into for the production or collection of income subject to tax * * *, or for the management, conservation or maintenance of property held for

the production of income" (D. C. Code section 47-1557b(a)(4)(B)) and also for expenses incident to the "production or collection of income, or for the management, conservation or maintenance of property held for the production of income", D. C. Code 47-1557b(a)(12). Petitioner's theory is, that the $17,090.57 excess of estate deductions over income for its final tax year is either a loss incurred in the management, conservation or maintenance of the estate, or an expense incident to such management, conservation or maintenance, and that it is petitioner's loss or expense as sole beneficiary of the estate.

Discussion

There is no question but that for federal tax purposes, in its last year, the estate is treated as a mere "conduit" of any excess deductions to the beneficiary -- as is always the case, in every taxable year, with regard to proper current income distributions. See 714 CCH Federal Tax Rep. par. 3628.05. But we are not dealing with the law as it exists after the new section 642(h) was built into the 1954 Internal Revenue Code. We are dealing with the 1947 D. C. income tax law. The real issue is whether new section 642(h) simply codifies and restates the existing rule under the 1939 Internal Revenue Code -- which had provisions for the deductions of losses and expenses comparable or identical in part with the D. C. Code subsections cited above -- or whether on the contrary new section 642(h) brings into existence a new and different allowable deduction for beneficiaries during the year when the estate is wound up and distributed with an excess of deductions over income. Federal cases and authorities under the 1939 Internal Revenue Code are relevant and applicable because the 1947 D. C. income tax law is pari passu with that Code.

Cases and authorities under the 1954 Internal Revenue Code on the particular point now at issue are not relevant because the D. C. income tax law does not "track" the new provisions of that Code. Our question, restated, is whether new section 642(h) of the I.R.C. (a) expresses, or (b) changes the pre-existing Federal law regarding deductions against the beneficiary's income.

Legislative history. The report of the Ways and Means Committee (H.R. 1337, 83d Cong., 2d Sess.) on the 1954 I.R.C. generalizes as follows (p. 61) -

> The bill adheres to the conduit theory of the existing law. This means that an estate or trust is in general treated as a conduit through which income passes to a beneficiary. In order to implement this theory in a satisfactory manner, it is necessary to include in the measure items of income and deductions which are not reflected in taxable income. * * *

The House Report then adds this very pertinent comment (p. 62) -

> Upon termination of the trust (or estate) any of its net operating loss or capital loss carryovers which have not been used are to be made available to the distributees. At present these loss carry-overs are wasted.

The Senate Finance Committee Report (S.Rep. 1622, 83d Cong., 2d Sess.), p. 82, also generalizes with regard to estates and trusts (separate entities but "regarded as conduits through which income passes to the beneficiary") and then becomes specific (p. 83). In relevant part that Report there states -

> (2) Changes made by committee. Your committee has made the following changes in sections 642 and 643:
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> * * *
>
> (b) Subsection (h) of section 642 appeared in substance in the House bill as section 662(d), relating to excess deductions on termination available to beneficiaries.

> Under this provision unused loss carryovers and deductions in excess of gross income in the year of termination of the estate or trust are made available to the remainder man to whom the property is distributed. Under existing law these unused carryovers and excess deductions are wasted when the estate or trust terminates. (Emphasis added.) * * *

The Conference Report (Rep. 2543, 83d Cong. 2d Sess.) shows that the Senate rewrite of the original House provision (Section 662 in the House version) "makes clear that the excess of deductions over gross income of the estate or trust to be allowed to the succeeding beneficiaries is only the excess for the last taxable year * * *", which the House Conferees accepted.

The legislative history accordingly indicates clearly that section 642(h) changes, rather than expresses, preexisting law.

Other authorities. It is, of course, elementary that deductions are given to taxpayers as a matter of legislative grace -- they are privileges to be narrowly construed. Mertens, Law of Federal Income Taxation, sec. 3.08 and many cases cited.

According to Mertens, op. cit., discussing the allowance of "deductions in excess of the gross income" to the beneficiaries in the year of termination of estates, "A contrary rule prevailed under prior law", i.e., before the 1954 I.R.C. sec. 642(h)(2) provision. (Section 36.106 text and footnote 65.) The author cites Mellot v. U. S., 156 F.Supp. 253 (E.D. Pa.), affd. 257 F.2d 798 (C.A.3), disallowing the carryback of a 1950 net operating loss sustained by an estate to the 1949 personal income tax returns of the heirs. The lower court there reasoned -- (1) that the taxpayer sustaining the loss "is the estate and not the heirs"; (2) "there was no provision in the 1939 Code, as amended, which would have

allowed" the heirs the carryback; (3) deductions must be based on specific provisions of the law. 156 F.Supp. at 255. See also, opinion of Judge Kalodner on appeal, stressing the statutory nature of deduction provisions and the non-applicability of equitable considerations (257 F.2d at 800 - 801); and 5 Mertens, op. cit., 1953 and 1956 editions, par. 29.10.

It being reasonably clear that I.R.C. section 642(h) does not express prior law under the 1939 Internal Revenue Code as to the reach of the provisions covering losses and expenses, a comparable interpretation must be made with regard to our D. C. income tax provisions on the same subjects, and decision will be entered for respondent.

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