

R.L. & SAUNDRIA GARNER
P.O. Box 459
Winfield, AL 35594,

STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

Taxpayers,

DOCKET NO. INC. 99-342

v.

STATE OF ALABAMA
DEPARTMENT OF REVENUE.

FINAL ORDER

The Revenue Department assessed 1998 income tax against R.L. and Saundria Garner (ATaxpayers®). The Taxpayers appealed to the Administrative Law Division pursuant to Code of Ala. 1975, ' 40-2A-7(b)(5)a. A hearing was conducted on September 14, 1999. CPA Calvin Logan represented the Taxpayers. Assistant Counsel David Avery represented the Department.

One of the Taxpayers, Saundria Pate Garner, received income in 1998 as a beneficiary of the Estate of Sterling Pate. The Taxpayers reported the income on their 1998 Alabama income tax return. The issue in this case is whether the Taxpayers can deduct the estate tax paid by the Estate attributable to the income.

Sterling Pate died in 1992. When he died, he held a note receivable with a face value of \$3,662,790. The due date of the note was December 1998. His Estate valued the note at \$3,256,000, and paid estate tax on that amount. The IRS audited the Estate and increased the value of the note by \$81,475. The Estate paid additional estate tax on that amount.

The three beneficiaries of the Estate, including Saundria Pate Garner, formed a

limited liability company (ALLC®). The Estate transferred the note receivable to the LLC in January 1997. The note was paid on the December 1998 due date, with the proceeds going to the LLC. The LLC distributed the proceeds to the three beneficiaries.

The Taxpayers received \$1,210,531 from the Estate. They reported that amount on their 1998 Alabama return. They also deducted \$653,605, which was their pro rata share of the estate tax paid by the Estate attributable to the income. The Taxpayers deducted the estate taxes pursuant to 26 U.S.C. '691. The Department denied the deduction because Alabama has not adopted '691, and also because the Estate paid the taxes, not the Taxpayers individually.

Code of Ala. 1975, '40-18-6(3) provides that a beneficiary's basis in property acquired from a decedent shall be determined in accordance with 26 U.S.C. '1014. Section 1014 generally allows for a step-up in basis. However, a step-up in basis is not allowed for property which constitutes a right to receive an item of income in respect of a decedent under '691. See, '1014(c).

The note receivable constituted a right to receive income in respect of a decedent pursuant to '691. Consequently, the Taxpayers were not allowed a step-up in basis for the note proceeds.

Section 691(c) also allows, however, that if a beneficiary is required to recognize income with respect of a decedent pursuant to '691(a), the beneficiary shall also be allowed to deduct the estate taxes paid by the estate attributable to the income. The Taxpayers claim that pursuant to '691(c), they should be allowed to deduct their pro rata

share of the estate tax paid by the Estate on the note proceeds. I disagree.

Unfortunately for the Taxpayers, while Alabama has adopted by reference IRC ' 1014, which specifies that the income in question (as income in respect of a decedent) shall not be allowed a stepped-up basis, Alabama has not adopted ' 691. Consequently, the Taxpayers cannot deduct the estate taxes attributable to the income pursuant to ' 691(c).

The Taxpayers also cannot otherwise deduct the estate taxes because the Estate paid the taxes, not the Taxpayers individually. Estate taxes are levied on the estate, and are paid by the executor or the personal representative out of the estate property. See, Code of Ala. 1975, ' ' 40-15-2 and 40-15-18, respectively. Estate tax levied on and paid by an estate cannot be deducted by a beneficiary of the estate. State v. Kilborn, 340 So.2d 447 (1976).

The final assessment is affirmed. Judgment is entered against the Taxpayers for \$28,720.47, plus applicable additional interest.

This Final Order may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, ' 40-2A-9(g).

Entered October 6, 1999.