tee listed in its report the types of powers and interests that Congress meant to be included within the scope of the term. S. Rep. No. 1631, 77th Cong., 2d Sess. 235 (1942), 1942-2 C.B. 504, 677. The powers and interests there listed are virtually the same as those now included in section 20.2042-1(c)(2) of the regulations.

In *Connelly,* the Court of Appeals held that the decedent's sole power to select a settlement option and thereby alter the time of enjoyment of the insurance proceeds by the beneficiary did not give the decedent a substantial degree of control sufficient to constitute an incident of ownership and this power gave the decedent no rights to the economic benefits of the policy. The Court of Appeals declined to follow the Fifth Circuit in *Lumpkin v. Commissioner,* 474 F.2d 1092 (5th Cir. 1973), which involved the same employer and the same master group insurance policy found in *Connelly.* In *Lumpkin,* the Fifth Circuit held that the decedent's right to alter the time of enjoyment of the insurance proceeds was an "incident of ownership" within the meaning of section 2042 of the Code, despite the fact that such right could not benefit the decedent or the decedent's estate. This is consistent with the earlier decisions of the Supreme Court in *Lober v. United States,* 346 U.S. 335 (1953), and *United States v. O'Malley,* 383 U.S. 627 (1966), Ct. D. 1910, 1966-2 C.B. 526, holding that similar powers to affect the timing of actual enjoyment by the designated beneficiaries constituted significant powers of sufficient substance to require inclusion of the property in the decedent's estate under the statutory predecessors to sections 2038 and 2036.

The court in *Connelly* did not follow the Fifth Circuit's decision in *Lumpkin* and relied instead on a 1937 decision of the Board of Tax Appeals in *Billings v. Commissioner,* 35 B.T.A. 1147 (1937). In *Billings,* the Board stated that the mere right to say when insurance proceeds should be paid to the beneficiary does not amount to a control of the proceeds and therefore the proceeds were not includible in the gross estate. The Service acquiesced in the decision, 1937-2 C.B. 3; however, this acquiescence was withdrawn and non-acquiescence was substituted, 1972-1 C.B. 3, when the Service concluded, based on section 20.2042-1(c)(4) of the regulations and the Supreme Court decisions in *Lober* and *O'Malley,* that the right to elect among settlement options was an incident of ownership within the meaning of section 2042. Furthermore, the Tax Court has also departed from its position in *Billings.* In *Schwager v. Commissioner,* 64 T.C. 781, 791 (1975), the Tax Court cited with approval the holding in *Lumpkin,* commenting that "[b]y viewing the power to select a settlement mode as a substantial right, it follows that such a power constitutes an incident of ownership within the meaning of section 2042(2)."

Therefore, the conclusion of the Service is that the right to elect optional modes of settlement of proceeds of life insurance on a decedent's life is an incident of ownership within the meaning of section 2042. *See* Rev. Rul. 76-261, 1976-2 C.B. 276. The holding in *Connelly,* that the right to select such optional settlement modes is not an incident of ownership within the meaning of section 2042 if the option merely allows the decedent to alter the time of enjoyment of the insurance proceeds, will not be followed by the Service except in the Third Circuit.

HOLDING

In cases that involve factual situations similar to the one presented in *Connelly* and that arise in all circuits other than the Third Circuit, the Service will take the position that the insurance proceeds are subject to inclusion in the decedent's gross estate under section 2042 of the Code. In cases involving factual situations identical to the one presented in *Connelly* and that arise in the Third Circuit, the Service will not take the position that the insurance proceeds are subject to inclusion under section 2042.

Part IV.—Taxable Estate

Section 2053.—Expenses, Indebtedness, and Taxes

26 CFR 20.2053-3: Deduction for expenses of administering estate.
(Also Sections 6601, 6651; 301.6601-1, 301.6651-1.)

Administration expenses; penalties; interest. The failure to file and pay penalties are not deductible as administration expenses under section 2053 of the Code even if allowable under local law. The interest on a federal estate tax liability is a deductible administration expense to the extent allowable under local law regardless of the reason incurred.

Rev. Rul. 81-154

ISSUE

1) For purposes of section 2053(a)(2) of the Internal Revenue Code, is the amount paid as a penalty for the late filing of a federal estate tax return and the late payment of the federal estate tax allowable as a deduction from the gross estate?

2) For purposes of section 2053(a)(2), is the interest incurred as a result of the late payment of the federal estate tax allowable as a deduction from the gross estate?

FACTS

The decedent, *D,* died on August 1, 1978. Due to the executor's willful neglect, the federal estate tax return was filed more than four months after the time for filing had passed and the federal estate tax was paid at that time. Therefore, late filing and late payment penalties were assessed in accordance with section 6651 of the

Code. In addition, because the tax was not timely paid, statutory interest was assessed in accordance with section 6601.

LAW AND ANALYSIS

Section 2053(a)(2) of the Code provides that the value of the taxable estate is determined by deducting from the value of the gross estate such amounts for administration expenses as are allowable under the laws of the jurisdiction in which the estate is being administered. Section 20.2053-3(a) of the Estate Tax Regulations provides that deductible administration expenses are those expenses that are actually and necessarily incurred in the administration of the decedent's estate. Expenditures not essential to the proper settlement of the estate, but incurred for the individual benefit of the heirs, legatees, or devisees, may not be taken as deductions.

Section 6651 of the Code imposes a penalty for the failure to file a federal estate tax return and for the failure to pay the federal estate tax, unless the failure is due to reasonable cause and not due to willful neglect.

Under general fiduciary rules, an executor must act in good faith to preserve and protect the assets of the estate for distribution to the beneficiaries. As part of this duty, the executor is responsible for the timely payment of taxes chargeable against the estate. 33 C.J.S. *Executors and Administrators,* sections 184, 235 (1968). In this case, the willful failure to file the estate tax return is a breach of the executor's fiduciary duty and the resulting penalty would not be an expense necessarily incurred in the administration of the decedent's estate. Thus, the penalty payment is not deductible under section 2053(a)(2) of the Code, even if allowable under local law. However, interest incurred on a federal estate tax liability which is a charge for the use of money, rather than a penalty, is a necessary administration expense under section 2053 (a)(2) and is deductible to the extent allowable under local law. The interest expense is allowable under section 2053 without regard to the manner in which it was incurred. See *Estate of Bahr v. Commissioner,* 68 T.C. 74 (1977), *acq.,* 1978-1 C.B. 1; Rev. Rul. 78-125, 1978-1 C.B. 292, Rev. Rul. 79-252, 1979-2 C.B. 333. Thus, the interest incurred as a result of the late payment of tax is deductible under section 2053(a)(2), to the extent it was allowable under local law.

HOLDINGS

1) The penalty imposed on the failure to pay or the failure to file is not deductible as a necessary administration expense under section 2053 of the Code even if the expense is allowable under local law.

2) The interest incurred because of a late payment of tax is deductible under section 2053(a)(2) of the Code to the extent it is allowable under local law.

Section 2055.—Transfers for Public, Charitable, and Religious Uses

26 CFR 20.2055-2: Transfers not exclusively for charitable purposes.

Charitable deduction; residue; executor's discretion. A decedent's will provides for a legacy of specific dollar value to the decedent's adult child and for distribution of the estate's residue to a qualified charitable organization. The executor has absolute power to satisfy the legacy in cash, in property valued at fair market value on the date of distribution, or a combination of both, and to select the date for distribution of the estate's assets. Applicable state law requires the executor to act impartially with respect to the beneficiaries. A deduction is allowable under section 2055 of the Code for the bequest of the residue.

Rev. Rul. 81-20

ISSUE

Is a deduction allowable under section 2055 of the Internal Revenue Code with respect to the transfer of the residue of a decedent's probate estate to a charitable organization if the executor is granted absolute discretion (1) in the selection of assets, to be valued at fair market value on date or dates of distribution, with which to satisfy a general legacy and (2) in the timing of the distribution of the assets of the estate?

FACTS

The decedent, a resident of State *X*, died on November 5, 1977. The will of the decedent provides for $4x$ dollars to be paid to the decedent's adult child. The residue of the estate passes, after payment of all taxes and debts and other expenses, to a charitable oranization that qualifies as such under section 2055(a) of the Code.

The will empowers the executor to satisfy the $4x$ dollar legacy in cash or in kind or by a combination of both. The executor is required to use the fair market value, as of the date of distribution, of any assets selected to satisfy the legacy. The will also empowers the executor to select the date for distribution of assets from the estate.

Under the law of State *X*, in the absence of an expression in the will to the contrary, an executor must not favor one beneficiary over another or otherwise behave in a manner that deviates from strict impartiality as between beneficiaries.

LAW AND ANALYSIS

Section 2055 of the Code allows a deduction from the value of the gross estate for the amount of property bequeathed to charity.

Section 20.2055-2(b)(1) of the Estate Tax Regulations provides the rules for transfers subject to a condi-