Prop. Regs. on the Deduction for Administration Expenses and Claims

The new Proposed Regulations attempt to tie actual deduction of administration expenses and claims to actual payment. Although theoretically this appears generally desirable, it may increase the cost of administration for both the estate and the IRS.

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The federal estate tax is imposed under Section 2001 on the taxable estate determined under Section 2051. In determining the taxable estate, Section 2051 allows a deduction for (among others) funeral expenses, administration expenses, claims against the estate and unpaid mortgages on, or any indebtedness in respect of, property where the value of the decedent's interest in the property, undiminished by such mortgage or indebtedness, is included in the value of the gross estate, all as described in Section 2053. Section 2053 limits the deduction to amounts allowable by the laws of the jurisdiction, whether within or without the United States, under which the estate is being administered.

As is well known, property is included in the gross estate at its fair market value (“FMV”) (subject to exceptions [1]) upon the decedent's date of death under Section 2031 unless the executor of the decedent's will may and does elect to value the property on the alternate valuation date under Section 2032. Although courts, not infrequently, use post-death events to determine the property's value, [2] there is no exception to the rule that the value on the date of death (or on the alternate valuation date) must be used.

Certain categories of expenses deductible under Section 2053 cannot be known as of the date of death. Funeral expenses and administration expenses (such as attorney's fees incurred in administering the decedent's probate estate) are typical examples of expenses that are deductible under that section but are unknown when the decedent dies and, in fact, are not even payable as of the decedent's death. Claims against a decedent's estate also are not paid until after death, and their amount often cannot be determined with precision at that time. [3]

The law seems somewhat uncertain as to when post-death events are to be used to determine the amount of the claims. The Treasury Department recently issued Proposed Regulations to clarify when post-death events will be considered. [4] The Proposed Regulations, in some cases, would significantly change the amount deductible under

Section 2053 and, perhaps, more important, will prolong the administration of certain aspects of a decedent's estate.

This article analyzes certain parts of the Proposed Regulations. It seems appropriate for practitioners and advisors to be mindful of two factors that are not discussed in the Proposed Regulations. First, Section 2053 itself provides different rules for the deduction of claims and expenses that are payable from (1) property that is in the decedent's gross estate for federal estate tax purposes and is subject to such claims and expenses under local law (e.g., assets in the probate estate or, under the law of many states, a decedent's revocable trust), and (2) property that is so includable but is not subject to such claims and expenses, in which case the amounts are deductible only if paid within the period during the period of limitations for assessments under Section 6501. [5] Second, administration expenses (and certain claims) generally are deductible only for either estate tax or, where permitted, income tax purposes and not both. [6] The rules set forth in the Proposed Regulations would apply only for purposes of determining if the expense or claim is deductible for estate tax purposes and would not necessarily determine whether such claim or expense would be deducible for income tax purposes.

Background

According to the Preamble to the Proposed Regulations, but without citation to any case, some courts have held that post-death events may not be considered in determining the amount deductible for claims. It does appear that *Ithaca Trust* [7] may be read as consistent with the statement that post-death events cannot be considered in evaluating a claim, and instead, the amount must be evaluated as of the date of death, taking into account contingencies and the vagaries of litigation. On the other hand, the Preamble also points out that some courts do consider post-death events because claims allowable under Section 2053 are "actual not theoretical ones." [8] Indeed, some courts have held that no deduction is permitted for a claim where post-death events make the claim disappear. [9]

Overview of the Proposed Regulations

The Proposed Regulations essentially adopt rules based on the premise that an estate may deduct only amounts actually paid or those that will be paid in an amount that may be estimated with reasonable certainty. The Proposed Regulations provide that if the resolution of a contested or contingent claim cannot be reached prior to the expiration of the period to assess additional estate tax (normally, three years after the estate tax return (Form 706) is filed), no deduction for the claim will be allowed, but the Proposed Regulations also expressly authorize that the estate may file a protective refund claim to preserve its right to claim the deduction once resolution is reached. [10]

Filing a refund claim will prolong the administration of the estate and likely cause the estate to incur additional administration costs. If this procedure is adopted in final Regulations, [11] it will be important to include in the protective refund claim the costs of prosecuting any contingent or contested claim, as those costs themselves likely will be deductible in most cases.

Basic rule of the Prop. Regs.: Deduct only as paid

It appears the intention of new Prop. Reg. 20.2053-1 is to set forth fundamental rules for the deductibility of any expense (funeral, administrative, claim, or indebtedness)

described in Section 2053 and not just claims against the decedent—even though the Proposed Regulations, as discussed below, mention only "claims" in some cases.

In any case, the new basic rule that the Proposed Regulations would adopt is that, in general, the amount allowed as a deduction under Section 2053 "is limited to the total amount actually paid...in settlement or satisfaction of that item." However, that broad rule is subject to exceptions (such as certain "estimated expenses" and "recurring payments," discussed below). In addition, even the amount actually paid may be deducted only if certain conditions are met.

Court decrees. The Proposed Regulations would modify Reg. 20.2053-1(b)(2) (entitled "Effect of court decree") in certain respects. For example, the Proposed Regulations would not permit a deduction solely based on the decree of a local court permitting the expense or claim if the court's decision is "inconsistent" with local law. The current Regulations provide that the decree may not be used if it is at "variance" with local law. It is uncertain what such changes in phrasing are intended to represent. It would be helpful for at least the Preamble to the final Regulations to explain the scope and intent of the change.

For example, suppose the decedent was involved in protracted litigation before death, and a judgment is entered by the court having jurisdiction over the matter but the judgment is contrary to state law. It seems unwise to force the estate, in such a case, to appeal to have the judgment set aside. Even if the estate appeals, the appellate court may enter a judgment that is at variance with local law, or at least from the estate's perspective arguably so. In this regard, will the estate's pleadings in the matter be held against the estate? Presumably, only a judgment of the highest court of the state may be regarded as certainly consistent with local law. [12] The other side of the coin might be that unless there is a decision of the state's highest court to the contrary, the judgment of the local court should be respected. It would, after all, be enforced as binding on the estate.

In any case, under the Proposed Regulations, any court judgment against the estate will be deductible under Section 2053 only if paid by the estate or if it meets the requirements for estimated expenses.

As in the current Regulations, a consent decree may be relied upon by the estate to establish the amount deductible, but again apparently subject to the "new" requirement the Proposed Regulations would impose that it be paid or meet the requirements for estimated expenses. And the Proposed Regulations continue the statement that a court decree is not necessary for deductibility.

Settlements of claims. The Proposed Regulations would add an explicit rule for amounts paid or agreed to in settlement of a claim against the decedent. Prop. Reg. 20.2053-1(b)(3) provides that an executor may rely on a settlement if: (1) it resolves a bona fide issue in an active and genuine contest, (2) the settlement is the product of arm's-length negotiations by parties having adverse interests with respect to the claim, and (3) the settlement is within the range of reasonable outcomes under applicable law governing the issues resolved by the settlement. The Proposed Regulations, fortunately, provide some guidance as to what will be regarded as within that range: a settlement is within the range of reasonable outcomes if it is a compromise between the positions of such adverse parties and reflects the parties' assessments of the relative strengths of their respective positions. [13]

It would be appropriate for the final Regulations to clarify that a payment in the settlement of a nuisance claim will also be deductible under the new settlement rule.

Indeed, because the costs of administering the estate, including defense of even a nuisance claim (which, if not defended, could result in a judgment against the estate), normally are deductible under Section 2053, it would not be in the interests of the IRS to deny a deduction for a payment in settlement of a nuisance claim (where, for example, the costs of defense would be deductible and the additional expenses of keeping the administration of the estate open for a longer period of time than otherwise would occur are also deductible). [14]

Estimated amounts. The Proposed Regulations would permit a deduction for a claim that otherwise would be deductible even if not paid, provided the amount is "ascertainable with reasonable certainty and will be paid," although no deduction may be taken for a vague or uncertain estimate. [15] Although phrased in terms of a "claim," it seems that the estimated amount rule applies to administration expenses as well, such as an executor's commission. [16]

It seems appropriate for the final Regulations expressly to confirm that the rule covers estimated administration expenses. Assuming that the "ascertainable with reasonable certainty" rule does cover expenses, it seems that an unpaid executor's commission would be an example of an estimated expense. In New York, for example, the amount of an executor's commission is set as a percent of the assets received and paid by the fiduciary. [17] Normally, the "paid" commission is not allowable under New York law until the property in the estate is, in fact, paid over (e.g., distributed to the beneficiaries). If the estate has not been completely distributed (and it seems it will not have been where an estate tax return is filed), entitlement to the paid commission will not have arisen but normally may be estimated with reasonable certainty. This seems to be the type of "claim" that is covered by this Proposed Regulation. [18]

Prop. Reg. 20.2053-1(b)(4) adds, however, that if the payment is waived or otherwise left unpaid, the executor must notify the IRS and pay the resulting tax. A waiver of commission might arise where the executor initially serving as executor dies before distribution of the estate and the successor who effects the distribution waives entitlement to the paid commissions. Similarly, it may be that the executor is denied the commission under local law. [19] However, it seems the IRS could accept such payment only if made within the period that the tax could be assessed (generally, under Section 6501, within three years of the filing of the estate tax return). That is, a tax may be collected by the IRS only if the tax is assessed, and tax may be assessed only within the time frame(s) specified in the Code. If the assessment is not so timely made, it may not be collected by the Service. [20]

It seems that the deduction for an estimated payment applies only where the amount of the liability for the claim (or, apparently, an expense) is ascertainable with reasonable certainty and it will be paid—hence, the rule that if it is not paid, the executor is under a duty to so notify the Commissioner. The test seems to require an honest determination that it will be paid, but not that a subsequent development resulting in non-payment be foreclosed.

The Proposed Regulation apparently requires not only that the amount payable is reasonably certain but also that the claim (or expense) itself is reasonably certain to be paid. For example, suppose the decedent had a judgment entered against her in a fixed amount prior to her death. Assume that she timely appealed the decision which had not been finally determined at her death, contending that judgment should have been entered for her. The amount that will be paid—if it is paid—is certain, but a successful appeal may modify or eliminate the obligation. It seems that the Regulation means that a deduction for the claim may not be taken because of its uncertainty of payment, not

uncertainty of the amount. This rule is consistent with the rule on contested claims discussed below.

Estimates not adequately certain. To the extent the amount of the liability is "not ascertainable with reasonable certainty" at the time of the examination of the return (that is, at the end of the audit), or to the extent that it is not clear that the amount will be paid, the amount will not be allowed as a deduction. Nevertheless, if the amount of the liability is subsequently ascertained *and paid*, a protective refund claim may be filed before the expiration of the period to assess additional tax (normally, three years after the return was filed). [21] The final Regulations should specify in which cases the estate may seek a refund based on a protective refund claim where any contingencies for payment have been resolved but payment of the claim will be "recurring" within the meaning of Prop. Reg. 20.2053-4(b)(7), which, as discussed below, permits recurring payments that will extend beyond the period within which additional estate tax may be assessed to be deducted before all payments to be made.

According to Prop. Reg. 20.2053-1(b)(4), the protective refund claim need not state a particular dollar amount or demand an immediate refund, but must identify the outstanding liability or claim that would have been deductible had it been paid. The protective claim, according to the Proposed Regulations, must also describe the reasons and contingencies delaying the determination of the liability or the actual payment of the claim. Fortunately, the Proposed Regulations permit a protective refund claim to be filed if the amount of the liability "was or will not" be paid before expiration of the period of limitations. Presumably, this means the estate need not wait until the "last minute" to file its protective claim, but may file if the executor believes the matter will not be resolved in time.

Reimbursements and insurance. Prop. Reg. 20.2053-1(b)(5) provides that no deduction is allowed to the extent the expense or claim "could be" compensated for by insurance or otherwise reimbursed. "Could be" may be a very broad phrase. The Proposed Regulation fails to provide any guidance as to what is and is not covered by the rule. In some cases, the entitlement to reimbursement may be uncertain or, at least, uncertain in amount. The final Regulations should provide additional guidance about this matter.

Deduction for administration expenses [22]

Prop. Reg. 20.2053-3 deals with deductions for expenses of administering the decedent's estate. It maintains the same basic structure that the current Regulation has but changes some provisions. [23] The new Proposed Regulation does not impose a requirement, for example, that executor's commissions are allowed only if paid; rather, the Proposed Regulation would maintain the current requirement of the Regulation that the IRS (the Proposed Regulations say the "Commissioner" and the current Regulations say the "District Director") is reasonably satisfied the commissions claimed as a deduction will be paid.

It seems that the major change the Proposed Regulation would make is to provide expressly for the filing of a refund claim where the conditions for deductibility (which appear essentially to be the same as in the current Regulations) are not met. The requirement that the executor advise the IRS (again the Proposed Regulations say "Commissioner" and the current Regulations say "District Director") if the commissions are not paid and pay additional estate tax due is carried over from the current Regulation in the Proposed Regulation.

As with executor's commissions, it appears that the only significant change the Proposed Regulations would make with respect to the allowance of a deduction for attorney's fees is to provide expressly for the filing of a protective refund claim if the requirements for allowance of those fees are not met. Both executor's commissions and attorney's fees may be allowed when the IRS is reasonably convinced they will be paid in a certain amount. This is contained in the current Regulation and is carried over in the proposed one. In other words, despite the general rule adopted by the Proposed Regulations that items under Section 2053 are deductible only when and if paid, executor's commissions and attorney's fees would continue to be deductible under the "reasonably expected to be paid" provision of the current Regulations.

Although at least one commentator has stated that the Proposed Regulation would eliminate the provision in the current Regulations that attorney's fees incurred by beneficiaries incident to litigation as to their respective interests are deductible if the litigation is essential to the proper settlement of the estate, such a statement appears to be incorrect. That provision is contained in Reg. 20.2053-3(c)(3), which would not be amended by the Proposed Regulations.

A new provision would be added by the Proposed Regulations to Reg. 20.2053-3(d) (dealing with miscellaneous expenses of administering an estate), by the addition of Prop. Reg. 20.2053-3(d)(3). This new subparagraph would provide that expenses in defending the estate against claims against it are deductible if incurred incident to the defenses of the claim even if the estate is "not ultimately victorious." [24] However, under the Proposed Regulation, expenses incurred "merely for the purpose of unreasonably extending the time for payment, or incurred other than in good faith, are not deductible."

It seems that extending the time for payment means payment of the claim—not the payment of estate tax (as the payment of the claim would reduce the tax). However, the Proposed Regulation may fail to acknowledge that often in defense, "stalling" tactics are effective in reducing the claim. Perhaps, the term "unreasonably" means that expenses in effecting a delay for tactical reasons would be deductible. In any case, at least the Preamble to the final Regulations should explain this matter in more detail, and the Regulations themselves should contain examples of when the delay will and will not be regarded as unreasonable for purposes of this rule.

Deduction for claims against the estate

Perhaps, the most significant changes the Proposed Regulations would make to the existing Regs. apply to the deduction for claims against the estate. [25] Three changes made by the "in general" rules contained in Prop. Reg. 20.2053-4(a) seem appropriate to mention. First, the Proposed Regulations provide that only liabilities that are "legitimate and bona fide" are deductible. It is uncertain what those terms are designed to convey.

The current Regulations provide that claims based on a promise or agreement are deductible only if the "liability was contracted bona fide and for an adequate and full consideration in money or money's worth. See [Reg.] § 20.2043-1." These current requirements, which as indicated reflect requirements of Section 2043, continue to apply with respect to a claim founded on a promise, as discussed below. The final Regulations should explain what the additional requirements of "legitimate and bona fide" are intended to convey. Perhaps, they are intended to cover non-promise claims such as those arising from tort or from a statutory claim other than in contract.

Second, the Proposed Regulations would add that claims are deductible only if paid, although this requirement is "relaxed" at least in the case of certain "recurring payments," discussed below. [26]

Third, events occurring after death are to be considered when determining the amount deductible. Much of the balance of this new regulatory rule is dealt with under the heading "Special rules." [27]

Potential and unmatured claims. This "Special rules" Proposed Regulation prohibits deducting on the estate tax return a potential or unmatured claim. The Proposed Regulation goes on to provide that if the claim matures *and is paid* before the expiration of the period during which a claim for estate tax refund may be made, the estate may file a refund claim as provided in Section 6511. [28] As a practical matter, the Regulations should provide expressly that an adjustment for such a matured and paid claim may be made during audit of the estate return. The Proposed Regulation further provides that a protective refund claim may be filed before the expiration of the period to claim a refund. As indicated above, the protective claim need not state a specific dollar amount or demand an immediate refund, but must identify the outstanding liability or claim and describe the reasons and contingencies delaying actual payment of the liability or claim.

The type of unmatured or potential claim at which the Proposed Regulation may be aimed is, perhaps, a claim by the government for toxic waste. [29] This type of claim often takes considerable time to resolve. A standard litigation claim is likely also included. Appeals from a judgment may take years to be made final. And it seems the claim might be regarded as "potential" while on appeal. In any case, that may not be important on account of the additional requirement that a claim may be deducted (subject to the recurring payment rule) only when and to the extent paid (pursuant to a settlement or otherwise). [30]

Contested claims. The "Special rules" Proposed Regulation also provides that no deduction may be taken if the estate is contesting the decedent's liability. [31] That provision might seem unnecessary as a claim is permitted only if paid. Perhaps, however, the provision is intended to cover a case where the claim is paid but is contested. For example, the IRS itself may have assessed additional income tax against the decedent. To avoid running of interest and/or to have the claim resolved in federal district court or the U.S. Claims Court, the estate might decide to pay the claim and sue for a refund. Because the claim, in essence, is being contested, presumably it will not be allowed.

This might suggest that a taxpayer before death should pay claims that later could be contested. The amount so paid would not be included in the decedent's gross estate. Although the claim by the decedent to recover all or a portion of the amount paid would be an asset in the gross estate, the value of that claim to recover what the decedent paid during lifetime will be determined "as of" the decedent's death (or, if applicable, on the alternate valuation date) and there is no authority requiring that "[e]vents occurring after...death shall be considered" in determining the value of the decedent's claim to recover. [32] It would be interesting to see how the IRS examiner of the decedent's estate tax return would value the decedent's claim against the IRS for income tax.

That, in turn, raises a somewhat inconsistent treatment to the value of claims the decedent holds at death and of claims against him or her at that time. For example, suppose that a decedent is involved in litigation in which the decedent has made a claim and the other party has made a counterclaim against the decedent. Regardless of how the cross claims are resolved, there may well be inconsistency in valuation and deduction. For instance, suppose that the decedent's executor and other party ultimately

agree to drop the claims against each other. It seems only fair that nothing be included in the gross estate and nothing be deducted with respect to these cross claims. Yet no amount might be allowed for the claim against the decedent even if the claim of the decedent as of his or her death has some positive value (which it may well have as it was used to "pay off" the claim against the decedent), unless the estate could establish, as it might, that it "paid" the claim with the estate's claim against the other party. The final Regulations should address this important issue.

Claims against multiple parties. If a claim is against more than one party (including the estate), the estate may deduct only the portion due from and paid by the estate, reduced by any reimbursement received or that could have been collected from any other party (or insurer) where the estate declines or fails to attempt to collect. [33] However, if the estate establishes that the burden of collection efforts would outweigh the benefit from those efforts, the potential reimbursement will not reduce the amount deductible. Similarly, if the estate establishes that a party could pay only a portion of a potential reimbursement, then only that portion that could reasonably have been expected to be collected will reduce the estate's deduction. [34]

Claims by family members, related entities or beneficiaries. Prop. Reg. 20.2053-4(b)(4) provides that there will be a rebuttable presumption that claims by a family member of the decedent, [35] a related entity, [36] or a beneficiary of the decedent's estate or revocable trust are not legitimate and bona fide and, therefore, are not deductible. The Proposed Regulation goes on to provide that evidence sufficient to rebut the presumption "may" include evidence that the claim arises from circumstances that would reasonably support a similar claim by unrelated persons or non-beneficiaries.

The rule in the Proposed Regulation seems incomplete in not specifying what evidence will be considered and what standard of evidence (or proof) must be submitted to overcome the presumption. In any case, the imposition of a rebuttable presumption may be in conflict with Section 7491 which provides generally that the burden of proof on any factual issue in a court proceeding is shifted to the IRS where the taxpayer presents "credible evidence" as to the factual matter. [37] It seems the final Regulations should be consistent with this rule. Indeed, case law appears to support only the imposition of "heightened" or "close" scrutiny of claimed estate tax deductions in respect of claims based on transactions with family members. [38] In any event, the final Regulations should specify what evidence will be sufficient (such as an affidavit setting forth facts to support the contention that the claim is legitimate and bona fide) to rebut the presumption.

Unenforceable claims. Claims that are unenforceable prior to death would not be deductible under the Proposed Regulations even if paid. To the extent a claim becomes unenforceable after death, it would not be deductible to the extent it is paid after it becomes unenforceable. The Proposed Regulations should specify what is meant by "unenforceable." It may or may not be limited to circumstances where the decedent (or the estate) has an affirmative defense, such as the running of the statute of limitations or, perhaps, laches. For example, Prop. Reg. 20.2053-4(d), Example 7, contains an illustration of a time-barred claim but states that the expenses incurred in defending the claim may be deducted as an administration expense. However, the Proposed Regulations would appear to allow the claim, if paid, where (or, perhaps, to the extent) enforceability of the claim itself is at issue.

Claims founded on a promise. As indicated above, the current Regulations provide that a claim founded on a promise or agreement is limited to the extent that the liability was contracted bona fide and for an adequate and full consideration in money or money's worth. That provision would be retained by the Proposed Regulation. [39] But the Proposed Regulation "fleshes out" the meaning of "bona fide and for adequate and full

consideration in money or money's worth" by providing that the promise or agreement must have been made "in good faith" and the price must have been an adequate and full equivalent "reducible to a money value."

That "reducible to a money value" requirement seems largely a restatement of the "adequate and full consideration in money or money's worth" requirement. If it is intended to mean something different, the Preamble to the final Regulations or the final Regulations should specify that difference. It is uncertain what the "in good faith" requirement means. Reg. 20.2043-1(a) (second sentence) suggests that "good faith" is the same as "bona fide." However, some recent court cases suggest that "bona fide" means that there was a significant and legitimate non-tax reason for the arrangement. [40] In any case, the Preamble to the final Regulations or those Regulations themselves should clarify what the "good faith" requirement is intended to mean. Nevertheless, it seems that neither the "good faith" nor "reducible to a money value" requirement is new; these seem to be reflected, as indicated, in the current Regulations under Section 2043.

Recurring payments. Despite the fact that, as a general rule, a claim against the estate may be deducted only if paid, Prop. Reg. 20.2053-4(b)(7) allows certain recurring payments to be deducted before payments are made. For example, if the decedent is obligated to make recurring payments on an enforceable and certain claim that is not subject to a contingency, the present value of those payments may be deducted even with respect to payments that have not yet been made. As indicated, it is only the date of death *present value* (determined under Reg. 20.2031-7(d)—the Prop. Regs. also cite Reg. 20.7520-1 through Reg. 20.7520-4—which sets forth certain actuarial principles used in valuing income, annuity and unitrust payment streams and remainders and reversions) of such post-death payments. Nevertheless, this recurring payment rule (and the limitation to present value) seems to apply only if "the payments will continue for a period that will likely extend beyond the final determination of the estate tax liability."

It is uncertain what constitutes a non-contingent payment. An obligation of the decedent's estate to make fixed payments over time to her husband or his estate pursuant to a divorce decree seems to fall under this rule. [41] If the payments are to cease when the husband dies, these still might be regarded as non-contingent—the possibility of the husband's death is merely one of the factors that may be used to determine value pursuant to Reg. 20.2031-7(d).

However, Prop. Reg. 20.2053-4(d), Example 9, states that the present value of payments still due at the death of the decedent to her former spouse but that cease upon his death or *his remarriage* may be deducted only to the extent paid prior to the filing of the estate tax return and then only as the subsequently due payments are made. Perhaps the condition of remarriage produces that result, but this should be made clear. Interestingly, as one commentator has pointed out, the existence of a contingency will produce a higher deduction because the amounts will be deductible at face, not at present value on the date of death.

The Proposed Regulations contain a "corollary" rule that if the recurring obligation is subject to a contingency, the deduction is limited to amounts actually paid in satisfaction of the claim. Nevertheless, if the decedent had a recurring obligation "whether or not contingent" to pay an "enforceable and certain claim" and the estate purchases a commercial annuity from an unrelated dealer in commercial annuities in an arm's-length transaction to satisfy the obligation, the amount deductible by the estate is the sum of the amount paid for the commercial annuity and any amount actually paid prior to the purchase of the annuity. [42] Apparently, the notion is that the executor would be subject to a breach of fiduciary duty for purchasing an annuity to the detriment of the estate.

Interest on claims. The Proposed Regulations provide that interest on a deductible claim is deductible as a Section 2053 claim but only for interest accrued through the date of death (even if alternate valuation under Section 2032 is elected). But the Proposed Regulations also acknowledge that "[p]ost-death accrued interest may be deductible...as an...administration expense under section 2053 or as an income tax deduction." [43] Although this Proposed Regulation does not require that such interest be paid, presumably its actual deductibility will be tested under Prop. Reg. 20.2053-3, discussed above.

Impact on the marital or charitable deduction

One question is how the "delay" in the allowance of the deduction under Section 2053 for an expense or claim will affect the allowance of the marital or charitable deduction. For example, suppose a decedent dies and leaves a pecuniary bequest equal to her unused estate tax exemption to a non-marital deduction trust and the residue of her estate to her husband in a form qualifying for the marital deduction. Such a division of her estate means no estate tax should be payable. There is a claim against her estate which would not, under the Proposed Regulations, be deductible under Section 2053 until paid, and it is unpaid when the estate tax return is filed. The claim, if paid, would be charged against the residuary bequest to the husband and would reduce the marital deduction. But if it is allowed as a deduction under Section 2053, still no estate tax would be due because the deduction would offset the reduction in the marital deduction dollar-for-dollar.

In filing the estate tax return, may her executor ignore the potential claim against the estate and report the marital deduction without regard to the claim? The answer seems somewhat uncertain. [44] The issue should be addressed specifically in the final Regulations which should also deal with the allowance of the charitable deduction.

Conclusions

The Proposed Regulations attempt to tie actual deduction to actual payment. Although that appears, in general, to be desirable in a theoretical sense, denying the estate an ability to deduct on the estate tax return certain expenses and claims not actually paid by the time the return is filed will cause taxpayers to file amended estate tax returns and/or claims for refund. That will increase the cost of administration for both the estate and the IRS. As discussed above, several parts of the Proposed Regulations should be clarified to reduce disputes between taxpayers and the IRS with respect to many matters covered in the Regulations. Certain provisions, such as those that presume claims by family members are not deductible, should be substantially modified.

PRACTICE NOTES

The Proposed Regulations essentially adopt rules based on the premise that an estate may deduct only amounts actually paid or those that will be paid in an amount that may be estimated with reasonable certainty.

1

One of those exceptions is for real property described in Section 2032A, dealing with special-use valuation.

2

For example, a court may use the price at which property was sold after death as evidence of its value on the date of death. See Estate of Andrews, 73 AFTR 2d 94-2395, 850 F Supp 1279, 94-2 USTC ¶60170 (DC Va., 1994); Estate of Love, TC Memo 1989-

470, PH TCM ¶89470, 57 CCH TCM 1479 *aff'd* 67 AFTR 2d 91-1171, 923 F2d 335, 91-1 USTC ¶60056 (CA-4, 1991).

3

Certain unpaid claims may be due and the amount payable as of the decedent's death. For example, assume that the decedent dies on April 15. Her U.S. income tax return (Form 1040) has been completed and the amount of unpaid tax due already determined; it was anticipated that the return would be filed and the payment made on April 15 and, in fact, the filing and payment are made that day following her death.

4

See REG-143316-03, 72 Fed. Reg. No. 77, at 20080 (4/23/07). The IRS and the Treasury Department have requested comments "on the clarity of the proposed rules and how they can be made easier to understand." Although the IRS has not requested comments on the substance or scope of the Proposed Regulations, professional groups (such as the American College of Trust and Estate Counsel) have submitted or will submit comments on that as well as clarity and understanding matters.

5

See Reg. 20.2053-8.

6

See Section 642(g) and Reg. 20.2053-1(d).

7

7 AFTR 8856, 279 US 151, 73 L Ed 647, 1 USTC ¶386 (S.Ct., 1929).

8

Jacobs, 7 AFTR 9308, 34 F2d 233, 1 USTC ¶420 (CA-8, 1929), *cert. den.*

9

See, e.g., Estate of Sachs, 62 AFTR 2d 88-6000, 856 F2d 1158, 88-2 USTC ¶13781 (CA-8, 1988); Gottesman, 99 AFTR 2d 2007-1212, 2007-1 USTC ¶60536 (DC N.Y., 2007); but see Estate of Smith, 84 AFTR 2d 99-7393, 198 F3d 515, 2000-1 USTC ¶50147, 2000-1 USTC ¶60366 (CA-5, 1999) (evidence of post-death events is not admissible for purposes of determining the value of a claim on the date of death), *non-acq.* by AOD 2000-04, 2000 WL 799106 (this AOD says post-death events should be considered); Estate of McMorris, 87 AFTR 2d 2001-1310, 243 F3d 1254, 2001-1 USTC ¶60396 (CA-10, 2001); Estate of O'Neal, 88 AFTR 2d 2001-5245, 258 F3d 1265, 2001-2 USTC ¶60412 (CA-11, 2001).

10

A refund claim is made by filing IRS Form 843. If the claim for refund is uncertain, a protective claim may be filed. See, generally, Reg. 301.6402-2.

11

As a general rule, the changes will apply only to estates of decedents dying on or after the date of publication of the Treasury decision adopting final Regulations in the Federal Register. See, e.g., Prop. Reg. 20.2053-1(e).

12

Compare, Estate of Bosch, 19 AFTR 2d 1891, 387 US 456, 18 L Ed 2d 886, 67-2 USTC ¶12472, 1967-2 CB 337 (S.Ct., 1967), *with* Rev. Rul. 73-142, 1973-1 CB 405.

13

See also Prop. Reg. 20.2053-4(d), Example 3.

14

But see, e.g., Pennsylvania Bank & Trust Co., 42 AFTR 2d 78-6409, 451 F Supp 1296, 78-2 USTC ¶13248 (DC Pa., 1978), *aff'd* 43 AFTR 2d 79-1332, 597 F2d 382, 79-1 USTC ¶13299 (CA-3, 1979), *cert. den.* (payments made to decedent's cousins as a nuisance settlement were not deductible).

15

See Prop. Reg. 20.2053-1(b)(4).

16

See Prop. Reg. 20.2053-1(b)(6), Example 1. *Cf.* Prop. Reg. 20.2053-1(b)(5) denying a deduction for any "expense or claim" that could be compensated for by insurance or

otherwise.
17

See N.Y. Surr. Ct. Proc. Act ("SCPA") §2307.
18

In Florida, the statute provides only that certain levels of compensation for a personal representative are "presumed reasonable." F.S. 733.617(2). Query whether compensation not exceeding the amounts presumed reasonable would satisfy the requirements of the Proposed Regulations.
19

For example, under N.Y.Ct.Rules §207.42, an executor who fails to file a report with the Surrogate's Court explaining why the estate has not been distributed in full by a certain time may have commissions denied.
20

Although it is beyond the scope of this article to discuss the matter in detail, it seems that the requirement in the Proposed Regulation that the executor must advise the IRS about the non-payment of the claim and pay the tax liability resulting therefrom may be contrary to *Badaracco*, 53 AFTR 2d 84-446, 464 US 386, 78 L Ed 2d 549, 84-1 USTC ¶9150, 1984-1 CB 254 (S.Ct., 1984), which, in turn, raises the question of the degree to which the Treasury Department may issue a Regulation overturning a Supreme Court decision. See, generally, Blattmachr, Gans, and Rios, *Circular 230 Deskbook*, Ch. 1(PLI 2006).
21

Prop. Reg. 20.2053-1(b)(4).
22

The Proposed Regulations would make no change to Reg. 20.2053-2, dealing with funeral expenses.
23

Minor phrasing changes (e.g., rather than referring to commissions of the executor or administrator, the Proposed Regulation refers only to the executor). Presumably, the use of that term is intended to incorporate the definition of Section 2203. If any of these phrasing changes is intended to be significant, at least the Preamble to the final Regulations should specify which ones are and what the import of a phrasing change is. No explicit requirement for payment of an administration expense before the deduction is paid is mentioned in the Proposed Regulations. One commentator has concluded that the Proposed Regulations "do not seem to impact [*Estate of Graegin*, TC Memo 1988-477, PH TCM ¶88477, 56 CCH TCM 387] loans at all" for projected interest due on a loan by the estate to pay estate taxes which loan could be repaid only with a substantial prepayment penalty. See Akers, "Proposed 2053 Regs Limiting Estate Tax Deductions for Uncertain Claim," Steve Leimberg's Estate Planning Newsletter #1114 (5/15/07). Nevertheless, the question about certainty of payment will likely be raised under the general principle that expenses are deductible only if reasonably certain to the paid.
24

Although the phrase "not ultimately victorious" used in the Proposed Regulation may adequately convey the scope of the new rule, it seems a phrase such as "regardless of the outcome with respect to the claim" might be more appropriate.
25

See Prop. Reg. 20.2053-4.
26

Prop. Reg. 20.2053-4(a)(1)(iii).
27

Prop. Reg. 20.2053-4(b).
28

See Prop. Reg. 20.2053-4(d), Example 2.
29

See, e.g., Comprehensive Environmental Response, Compensation, and Liability Act ("CERCLA").
30

Cf. Prop. Reg. 20.2053-4(d), Example 6.
31

Prop. Reg. 20.2053-4(b)(2).
32

See Estate of Aldrich, TC Memo 1983-543, PH TCM ¶83543, 46 CCH TCM 1295 (value of gross estate includes proceeds of decedent's contingent fee arrangement received just prior to alternate valuation date).
33

Prop. Reg. 20.2053-4(b)(3).
34

See, e.g., Prop. Reg. 20.2053-4(d), Examples 4 and 5.
35

A family member "includes" the spouse and a grandparent, parent, sibling, and lineal descendant of the decedent or of the decedent's spouse and the spouse and descendants of any such grandparent, parent, and sibling.
36

A related entity "is" an entity in which the decedent, either directly or indirectly, had a beneficial interest at death or within three years of death, but not a publicly-traded entity or closely held entity in which the combined beneficial interests, direct or indirect, that the decedent and family members collectively own are less than 30% of the beneficial ownership interests (direct or indirect). This entity rule seems uncertain in many respects, including what "direct or indirect" means. The final Regulations should "flesh out" the entity rule if the presumption rule for such claims is retained.
37

According to Professor Mitchell M. Gans of Hofstra University School of Law, imposing a rebuttable presumption on the taxpayer is not necessarily inconsistent with Section 7491. As a matter of litigation, generally, one party can be made to bear the burden of proof while, at the same time, enjoying the benefit of a presumption. Rule 301 of the Federal Rules of Evidence states: "In all civil actions and proceedings not otherwise provided for by Act of Congress or by these rules, a presumption imposes on the party against whom it is directed the burden of going forward with evidence to rebut or meet the presumption, but does not shift to such party the burden of proof in the sense of the risk of nonpersuasion, which remains throughout the trial upon the party on whom it was originally cast." The Proposed Regulation may raise an interesting question under *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 US 837, 81 L Ed 2d 694 (S.Ct., 1984): whether the IRS has the authority by regulation to create such a presumption. In *RLC Industries Co.*, 76 AFTR 2d 95-5077, 58 F3d 413, 95-2 USTC ¶50328 (CA-9, 1995), the Ninth Circuit held that the IRS could not create by regulation an abuse-of-discretion standard. It may be argued that, by analogy, the IRS should not be able to create such a presumption. On the other hand, the courts have long contended, in the Section 2053 and other contexts, that they are required to scrutinize family claims carefully. Perhaps, the IRS will contend that the Proposed Regulation is in the nature of a codification of these cases. But, ultimately, there seems to be a significant difference between "scrutiny" and a presumption which, in turn, leads back to the *Chevron* question.
38

See, e.g., Estate of Flandreau, TC Memo 1992-173, RIA TC Memo ¶92173, 63 CCH TCM 2512 *aff'd* 72 AFTR 2d 93-6711, 994 F2d 91, 93-1 USTC ¶60137 (CA-2, 1993); Leopold, 35 AFTR 2d 75-1588, 510 F2d 617, 75-1 USTC ¶13053 (CA-9, 1975).
39

Prop. Reg. 20.2053-4(b)(6).
40

See, e.g., Estate of Schutt, TC Memo 2005-126, RIA TC Memo ¶2005-126, 89 CCH TCM 1353 *Cf.* Estate of Hughes, TC Memo 2005-296, RIA TC Memo ¶2005-296, 90 CCH TCM 630

41

See Prop. Reg. 20.2053-4(d), Example 8.

42

See Prop. Reg. 20.2053-4(d), Example 10.

43

Prop. Reg. 20.2053-4(c); *cf.* Prop. Reg. 20.2053-4(d), Example 1.

44

Compare Ahmanson Foundation, 48 AFTR 2d 81-6317, 674 F2d 761, 81-2 USTC ¶13438 (CA-9, 1981) (a discount in the value of the assets that would be available to satisfy a residuary charitable devise had to be taken into account for purposes of determining the estate tax charitable deduction) *with* Estate of Chenoweth, 88 TC 1577 (1987) (estate was entitled to show that a 51% majority block of stock passing to the surviving spouse is entitled to an additional value because of the control element).

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