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July 23, 2007

CC:PA:LPD:PR (REG-143316-03)
Room 5203, Internal Revenue Service
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Washington, DC 20044

Via electronic mail to http://www.regulations.gov (IRS REG-143316-03).

The attached comments regarding the proposed regulations under Internal Revenue Code Section 2053 are being submitted on behalf of the American Bar Association Section of Real Property, Probate and Trust Law (the “Section”). They have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and should not be construed as representing the position of the American Bar Association.

The comments were prepared by members of the Estate and Gift Tax Committee of the Probate and Trust Division of the Section. Although the members of the Section who prepared these comments have clients who are affected by the Federal tax principles addressed, or have advised clients on the application of such principles, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a submission with respect to, or otherwise influence the development or the outcome of, the specific subject matter of these comments.

If you have any questions, please do not hesitate to contact Julie K. Kwon, McDermott Will & Emery LLP, 227 W. Monroe Street, #4400, Chicago, IL 60606, 312.984.7725, jkwon@mwe.com.

Very truly yours,

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18th Annual Spring CLE and Council Meeting · April 25-29, 2007 · Washington, DC
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COMMENTS OF THE
REAL PROPERTY, PROBATE AND TRUST LAW SECTION
OF THE
AMERICAN BAR ASSOCIATION

REG--143316-03
(Guidance Under Section 2053 Regarding Post-Death Events)

July 23, 2007

The following comments address issues raised by proposed regulations relating to the determination of the amounts deductible under § 2053 of the Internal Revenue Code (the "Code"). They are submitted on behalf of the American Bar Association Section of Real Property, Probate and Trust Law (the "Section"). These comments have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and should not be construed as representing the position of the American Bar Association.

The comments were prepared by members of the Estate and Gift Tax Committee of the Probate and Trust Division of the Section. Julie K. Kwon, Chair of the Estate & Gift Tax Committee of the Section, supervised the preparation of these comments and participated in their preparation with Kate M. H. Kilberg, Stephanie Loomis-Price, Edward Manigault, Carlyn S. McCaffrey, John McCaffrey, James V. Roberts and Alex Tanouye. These comments were reviewed by Carlyn S. McCaffrey on behalf of the Section's Committee on Governmental Submissions.

Although the members of the Section who prepared these comments have clients who are affected by the Federal tax principles addressed, or have advised clients on the application of such principles, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a submission with respect to, or otherwise influence the development or the outcome of, the specific subject matter of these comments.

I. EXECUTIVE SUMMARY.

These comments generally address the sections of the Proposed Regulations in the order in which they appear, regardless of the relative significance of the issues raised, but reserve for the end our comments regarding two issues that are relevant to multiple sections of the Proposed Regulations, protective claims for refund and the executor's duty to report to the Commissioner and pay additional tax.

Although we believe all of our comments relate to important issues, except for a few comments on technical matters, we are particularly concerned with the rules regarding the following six issues:

1. **Credible Evidence of Consistency With Local Law.** Proposed Regulation § 20.2053-1(b) permits the executor to rely on certain judicial decrees and settlement agreements that are consistent with local law and provide for payment of claims or expenses to deduct such claims and expenses. (We assume that the omission of this consistency requirement from Proposed Regulation § 20.2053-1(b)(ii), dealing with consent decrees, was an oversight that will be remedied in the Final Regulations.) To minimize the retrial of substantive local law issues with the IRS, we recommend that the Final Regulations provide that the existence of a judicial decree, including a consent decree, or settlement agreement that otherwise satisfies the requirements of Proposed Regulation § 20.2053-1(b) will constitute "credible evidence" within the meaning of Code §7491 of the fact that the expense or claim is allowable as a matter of local law, thereby placing the burden of proof as to this issue on the IRS.

2. **Deduction for Unpaid Determinable Amounts.** Generally, the Proposed Regulations limit deductions to claims and expenses that are actually paid. Proposed Regulation § 20.2053-1(b)(4) provides a limited exception for claims the exact amounts of which are unknown. We believe that these rules should not favor claims unknown in amount over claims that are definite in amount and that both should be deductible. Consequently, we request that the Final Regulations clarify that this exception applies equally to future payments of claims for which the exact amounts are known.

3. **Deduction for Claims Substantially Related to Estate Asset.** Proposed Regulation § 20.2053-4(a)-1 repeats the general rule limiting deductions to claims that are actually paid. The amount of a claim against the estate may depend upon the valuation of an estate asset which must be valued as of the date of death, such as counterclaims based on the same subject matter. We are concerned that the general rule requiring actual payment to deduct such claims may operate unfairly as post-death events may reduce the deductible claim that also would have reduced the corresponding value of the related estate asset. We suggest that the Final Regulations permit an exception to allow deduction of a claim as of the date of death if its amount is substantially related to the value of an asset included in the taxable estate, including a counterclaim based on the same subject matter.

4. **Rebuttable Presumption Based on Family Relationship.** Proposed Regulation § 20.2053-4(b)(4) creates a rebuttable presumption that claims by, or settlements among, certain related individuals and entities are not legitimate and bona fide and, therefore, not deductible. We suggest that these rules should not subject related persons to a different standard when the

other requirements will suffice to prevent abuse and recommend that the Final Regulations entirely eliminate these provisions. Alternatively, if the Final Regulations maintain the rebuttable presumption, we request that they provide further guidance regarding the kind of evidence sufficient to rebut the presumption.

5. **Protective Claims for Refund.** We expect that the limitation of deductions to claims that are actually paid will significantly increase the occasions when protective claims for refund are necessary to preserve the deduction. The Proposed Regulations specify that taxpayers should seek relief through such protective claims when the claim against the estate is not sufficiently certain to be deductible. Accordingly, we recommend revisions to the Instructions to United States Estate (and Generation-Skipping Transfer) Tax Return Form 706 to address the need for protective claims for refund if the estate must postpone deduction of a claim. We also recommend the revision of the Form 706 to incorporate a form to submit a protective claim for refund, or to make an election indicating the taxpayer's submission of a protective claim for refund. In addition, we request that the Final Regulations incorporate a waiver of the doctrine of variance that the Treasury and the IRS otherwise may assert to deny such refunds for lack of specificity.

6. **Executor's Reliance on Closing Letter.** The Proposed Regulations impose upon the executor the duties to notify the Commissioner and pay additional tax in certain instances where the claim or expense was deductible but ultimately is not paid. We are concerned that these provisions extend the executor's obligations to pay tax and report to the Commissioner for an indefinite period. However, after the issuance of a closing letter on the federal estate tax return, the IRS still may recover estate tax from an executor who distributed the estate assets in bad faith or from transferees receiving distributions from the estate for ten years after the decedent's death. Therefore, we request that the Final Regulations provide that upon receipt of a closing letter regarding the federal estate tax return, the executor may distribute property subject to payment of estate tax without personal liability and thereafter must notify the Commissioner and pay additional tax only at such time when the executor actually knows, or knows facts that would lead a reasonable person to inquire as to whether, the deducted claim will be waived or unpaid.

II. BACKGROUND.

By notice of rulemaking in Guidance Under Section 2053 Regarding Post-Death Events, REG-143316-03 (I.R.B. 2007-21), issued on May 21, 2007, the Department of the Treasury ("Treasury") and the Internal Revenue Service (the "IRS") proposed new regulations (the "Proposed Regulations") to address the effect of post-death events on the amount of claims deductible from a decedent's gross estate for estate tax purposes under Internal Revenue Code ("Code") § 2053(a)(3). The goal of the Proposed Regulations is the consistent application of Code § 2053(a)(3) to similarly situated estates, regardless of jurisdiction, and the resolution of a lack of consistency in the case law addressing this issue.

The federal estate tax is generally imposed upon the portion of a decedent's gross estate that is actually transferred to the decedent's beneficiaries, heirs and legatees. The fair market value of the gross estate is determined under Code § 2031(a) "at the time of [the decedent's] death (subject to the alternate valuation date under Code § 2032).

Code § 2053 permits deductions for amounts payable out of assets included in the gross estate and allowable by the law of the jurisdiction under which the estate is being administered for debts, expenses and certain taxes. In particular, Code § 2053(a) provides a deduction against the gross estate for funeral expenses, administration expenses, claims against the estate and certain unpaid mortgages and debts related to property included in the gross estate. Unlike Code § 2031, Code § 2053(a) does not direct that the amounts of the deductions under Code § 2053(a) must be determined with reference to their fair market value "at the time of [the decedent's] death." The focus of the section is on the amount payable rather than on the value of such amounts as of the date of death. In fact, as noted in the preamble to the Proposed Regulations, the amount of some of the deductions permitted under Code § 2053(a) (notably funeral and administration expenses) are determinable only after the decedent's death.

The method for determining the amount of the deductible claims against the estates of decedents has been the subject of litigation between taxpayers and the government. As described in the Proposed Regulations, one line of cases has essentially followed the decision of *Ithaca Trust v. Commissioner,*[1] so that such claims are valued as of the date of death of the decedent. This "snapshot" approach is similar to the method for calculating the gross estate pursuant to Code § 2031. Another line of cases has generally followed the decision of *Jacobs v. Commissioner*,[2] Unlike the snapshot approach, decisions following the *Jacobs* approach have taken into account post-death events and have generally permitted deductions only for claims that were actually paid by the estate.

The proposed these new regulations reflect the determination of Treasury and the IRS that the snapshot approach would result in an inefficient use of taxpayer, IRS and court resources because , in their view, it would require the taxpayer and the IRS to "retry" the substantive issues underlying the claims against an estate. Instead, the Proposed Regulation adopt an approach based on the Jacob rationale – limiting deductions under Code § 2053(a)(3) to those amounts actually paid in settlement of claims against the estate. If a claim cannot be resolved prior to the expiration of the estate tax statute of limitations, taxpayers must preserve the estate's right to the deduction for future payments of such claims by filing protective claims for refund.

In addition to resolving the conflict in the case law dealing with the effect of post-death events on the amount of the claims deductible by an estate, the Proposed Regulations address a number of related issues, including the effect on amounts deductible under Code § 2053 of court decrees, consent decrees and settlements, the deductibility of unmatured claims, the deductibility of claims by certain related persons, and the deductibility of recurring payments.

We appreciate the thought and effort expended by individuals at Treasury and the IRS in formulating the Proposed Regulations and, on balance, believe that they have addressed the relevant issues in a fair and reasonable manner.

[1] 279 U.S. 151 (1929).
[2] 34 F.2d 233 (8th Cir. 1929), *cert. denied*, 280 U.S. 603 (1929).

III. COMMENTS ON PROPOSED REGULATIONS.

A. Proposed Regulation § 20.2053-1. Deductions for Expenses, Indebtedness, and Taxes; in General.

1. Proposed Regulation § 20.2053-1(b)(2)(i). Effect of Court Decree; In General.

a. Deductibility When There Is No Court Decree.

Proposed Regulation § 20.2053-1(b)(2)(i) permits the executor to rely on certain final judicial decisions regarding expenditures for expenses and claims to determine the deductible amount. Many states authorize informal probate or independent probate administration where the court never or rarely reviews or approves aspects of the estate administration. In addition, the wills of many testators recite the preference for independent administration, if available. Although the last sentence of Proposed Regulation § 20.2053-1(b)(2)(i) appears to contemplate independent administration, unfortunately many practitioners have interpreted this Proposed Regulation as denying deductions for estates administered without judicial supervision. To alleviate the concern of these practitioner, we suggest that the last sentence be changed to read as follows:

> An estate will not be denied an otherwise allowable deduction under section 2053 solely because a local court decree has not been entered with respect to that amount if the amount would be allowable under local law and if no court decree is required under applicable law for payment as would be the case, for example, if an estate undergoes independent (or similar) administration pursuant to local law.

b. Necessity for Consistency With Local Law.

The Proposed Regulations contain a requirement as to a decree's consistency with local law that is almost identical to the consistency requirement under the existing regulations. They provide that "if the decision reached by the court is inconsistent with local law, the estate may not rely on the court's decree to establish the amount deductible for estate tax purposes." This requirement is not surprising because Code § 2053(a) permits deductions for expenses and claims only if they are "allowable by the laws of the jurisdiction . . . under which the estate is being administered." The Supreme Court has ruled that when the application of a substantive rule of federal tax law depends on state law principles, the IRS is not bound by a state court's determination as to what the state law provides unless the decision is a decision of the state's highest court.[3] A lower court decision, even if binding on the estate claiming the deduction, is merely a factor to be given proper regard by the IRS or by the federal court that is making a determination as to what claims and expenses the state law permits.

Nevertheless, the consistency requirement effectively renders illusory the regulation's permission to executors to rely on court decrees. If it were clear that the allowance of a particular expense or claim was consistent with local law, it would not be necessary to rely on a

[3] *Commissioner v. Estate of Bosch,* 387 U.S. 456 (1967).

decree except in those jurisdictions that impose a court decree as a requirement for the allowance of a claim or expense.

The power of the IRS to substitute its judgment for the judgment of a local court will, when exercised, require the executor to retry the local law substantive issues with the IRS – the very result that the Proposed Regulations seek to avoid in connection with contested claims. To minimize retrials of local law issues with the IRS, we suggest that the Final Regulations confirm that entry of a local court decree allowing a particular expense or claim will constitute "credible evidence" within the meaning of Code §7491 of the fact that such expense or claim is allowable as a matter of local law, thereby placing the burden of proof as to this issue on the IRS.

2. Proposed Regulation § 20.2053-1(b)(2)(ii). Consent Decree.

a. Necessity of "Local" Decree.

Proposed Regulation § 20.2053-1(b)(2)(ii) permits the executor to establish a deductible amount in certain cases by relying on a "local court decree rendered by consent." The meaning of the word "local" in this context is ambiguous. It could refer to the situs of the administration of the estate, the situs of the dispute or its adjudication, or the location of the executor or other parties. We suggest that this regulation refer instead to the court with appropriate jurisdiction over the administration of the estate or the subject matter of the dispute.

b. Bona Fide Recognition of the Validity of the Claim.

The Proposed Regulation requires consent that is "a bona fide recognition of the validity of the claim." Consent given "by all parties having interests adverse to that of the claimant will be presumed to be recognition of the claim's validity." Because the consent of all parties is typically required to issue a consent decree, this requirement of the Proposed Regulation will generally not be difficult to meet. However, parties seeking to resolve litigation will often consent to entry of an agreed order disposing of the matter without affirmatively conceding the validity of any other party's claim. An executor may conclude that entry of the consent decree best preserves the estate for its beneficiaries, after evaluating the likelihood and potential amount of any recovery on a claim and the costs of defending against the claim. An executor may violate her fiduciary duty to the takers of the estate if she refuses reasonable offers to settle the dispute and, instead, exhausts the estate in continued litigation to defend against the claim. Thus, an executor may consent to a decree to resolve the dispute while declining to acknowledge the validity of the claim. To preclude the IRS from taking the position during an estate tax return audit that the failure of a consenting party to concede the validity of the claim overcomes the presumption of the decree's validity, we suggest that the second sentence of Proposed Regulation § 20.2053-1(b)(ii) be changed to read as follows:

> Consent given by one or more parties having interests adverse to that of the claimant will be presumed to be recognition of the claim's validity whether or not any such party affirmatively concedes the validity of the claim.

c. Necessity for Consistency With Local Law.

Unlike the existing regulations, the Proposed Regulations do not impose a requirement that a consent decree that can be relied on must be consistent with local law. We assume this omission was an oversight and suggest the addition of the following language at the end of Proposed Regulation § 20.2053-1(b)(ii):

> If the consent decree is inconsistent with local law, the estate may not rely on it to establish the amount deductible for estate tax purposes. The existence of the consent decree, however, will constitute "credible evidence" within the meaning of Code §7491 of the fact that such expense or claim is allowable as a matter of local law, thereby placing the burden of proof as to this issue on the Commissioner.

3. Proposed Regulation § 20.2053-1(b)(3). Settlements.

a. Range of Reasonable Outcomes Requirement.

Proposed Regulation § 20.2053-1(b)(3) permits the executor to rely on certain settlements to establish deductible amounts. This Proposed Regulation requires that a settlement that may be relied upon must be "within the range of reasonable outcomes under applicable state law" and provides that this requirement will be satisfied if the settlement "results in a compromise between the positions of . . . adverse parties' and reflects the parties' assessments of the relative strengths of their respective positions." It will often be impossible for the executor to obtain any evidence from the parties whose interests are adverse to the estate that the estate's position had any validity at all, much less that the settlement reflected any concession by such parties that the executor's position had any strength. We believe that the settlement between adverse parties, by itself, should be adequate evidence that the settlement is within the range of reasonable outcomes and that any requirement based on the state of mind of the parties should be eliminated.

b. Arm's Length Negotiation Requirement.

This Proposed Regulation also requires that the settlement be the product of arm's length negotiations. Contested claims and expenses will often result from disputes among family members. Parties to such disputes may have difficulty establishing that a settlement results from arm's-length negotiations. Even where family members are engaged in a genuine dispute regarding a bona fide issue and motivated to actively protect their respective interests, they may seek resolution with as little apparent acrimony as possible to maintain family harmony. The requirement of arm's length negotiations may be particularly difficult to establish when the executor and family members agree that a valid claim of a family member should be paid by the estate. If parties are uncertain that a private settlement will suffice under this regulation, they are more likely to seek judicial review to safeguard the deductions in order to obtain the protection of a court decree established by consent or otherwise, which do not require evidence of arm's-length negotiations under Proposed Regulations §§ 20.2053-1(b)(2)(i) and (ii). We do not believe that the Proposed Regulations should create incentives for parties to seek court participation when they otherwise would settle the matter among themselves, if they fulfill the other requirements of this Proposed Regulation, including the resolution of a bona fide issue. We suggest that the "arm's length negotiation" requirement be omitted.

c. Necessity for Consistency With Local Law.

The Proposed Regulation requires that the settlement be consistent with local law and, similarly, denies deductions for amounts paid in settlement of an unenforceable claim. As discussed above in addressing court decrees and consent decrees, both requirements are understandable because Code § 2053 permits deductions for expenses and claims only if they are "allowable by the laws of the jurisdiction . . . under which the estate is being administered." Application of this principle to settlement agreements, however, is likely to be particularly troublesome because settlement agreements often include a recital specifying that none of the parties acknowledges the merits of any other party's claims or representations. In addition, as discussed above with respect to Proposed Regulation § 20.2053-1(b)(2)(ii) regarding consent decrees, an executor may believe that a claim has little merit, but may decide that prudence requires settlement as the best means of preserving the estate for its beneficiaries. Further, whether a claim is enforceable almost always remains an open question. Even in a court action, an executor cannot be certain that a claim will be determined to be unenforceable unless the executor litigates the claim to final judgment, exhausting all appeals and other procedural remedies. The resulting costs of such litigation and delay in estate administration would undermine the goal of promoting administrative and judicial efficiency.

To minimize the retrial of local law issues with the IRS, we suggest that the Final Regulation § 20.2053-1(b)(2)(iii) confirm that the existence of a settlement agreement that satisfies the other requirements of this provision and provides for payment of a particular expense or claim will constitute "credible evidence" within the meaning of Code §7491 of the fact that such expense or claim is allowable as a matter of local law and that such claim is an enforceable claim, thereby placing the burden of proof as to this issue on the IRS..

4. Proposed Regulation § 20.2053-1(b)(4). Estimated Amounts.

a. Unpaid Determinable Amounts.

The preamble notes that the major purpose in issuing the Proposed Regulations is to require that post-death events be considered in determining the amounts deductible under Code § 2053. This portion of the Proposed Regulations, however, do not actually include this requirement. Instead, to implement this change, Proposed Regulation § 20.2053-1(b)(1) establishes the general rule that deductions under Code § 2053 are limited to amounts actually paid.

Proposed Regulation § 20.2053-1(b)(4) creates a limited exception to the actual payment rule for claims the exact amounts of which are unknown, "provided that the amount is ascertainable with reasonable certainty and will be paid." Logically, the exception to the actual payment rule should apply equally to future payments of claims, the exact amounts of which are known. We suggest that this Proposed Regulation confirm the deductibility of such unpaid amounts. The change could be accomplished by changing the caption from "Estimated amounts." to "Unpaid amounts" and by inserting the following sentence at the beginning of the paragraph:

> A deduction will be allowed for a claim or expense that satisfies all applicable requirements if the exact amount of such claim or expense is known.

b. Unpaid Estimated Amounts.

The Proposed Regulations permit a deduction for a "claim that satisfies all applicable requirements even though its exact amount is not then known, provided that the amount is ascertainable with reasonable certainty, and will be paid."

We assume this provision is intended to apply to expenses as well as claims and suggest that the addition of the words "or expense" after the word "claim" in the phrase quoted above.

Additional guidance in the Final Regulations as to the criteria to be used to determine whether an amount is "ascertainable with reasonable certainty" would be helpful. For example, the Final Regulations might provide that the "ascertainable with reasonable certainty requirement" is satisfied if the unknown amount can be calculated by applying a formula provided by local law to an amount that can be determined with reasonable certainty. Executors' commissions that are calculated under local law by multiplying the value of the probate estate by a statutory percentage is an example of the use of such a formula. Additionally, the Final Regulations might provide that if the total amount of a claim or expense is not ascertainable but a portion of it is, the determinable portion will be immediately deductible.

B. Proposed Regulation § 20.2053-3. Deductions for Expenses of Administering Estate

1. Executors' Commissions and Attorney's Fees.

Proposed Regulation § 20.2053-3(b)-(c) permits deductions for executor's commissions and attorneys' fees. Both subsections state that the deduction (in the case of executor's commissions, if the amount has not been fixed by court decree, and, in the case of attorney's fees, if the fees have not been awarded by the proper court and paid) is limited to amounts that are paid in accordance with local practice for estates of similar size and character. In our experience, the determination of commissions and fees often also takes into account the particular skill and expertise of the executor or attorney. We suggest that the Final Regulations add the skill and expertise of the executor or attorney as relevant factors in determining the deductible amount.

2. Expenses Incurred in Defending the Estate Against Claims.

Proposed Regulation § 20.2053-3(d)(3) provides that "[e]xpenses incurred in defending the estate against claims described in section 2053(a)(3) are deductible as provided in § 20.2053-1 if the expenses are incurred incident to the assertion of defenses to the claim available under the applicable law, even if the estate is not ultimately victorious." This provision is limited to Code § 2053(a)(3), dealing with claims against the estate. Because estates may legitimately incur costs of litigating the other amounts deductible under Code § 2053(a), such as funeral expenses and administration expenses, we request the expansion of Proposed Regulation § 20.2053-3(d)(3) to include the costs of defending or prosecuting claims relating to all amounts described in Code § 2053(a).

Proposed Regulation § 20.2053-3(d)(3) allows a deduction for expenses incurred "incident to the assertion of defenses." It is unclear whether this provision includes expenses incurred in connection with the assertion of an affirmative claim or counterclaim or other strategies that a litigant may deploy in defense against a claim or whether it includes expenses incurred in connection with the prosecution of the estate's legitimate claims against others. To avoid any negative implication that may be drawn from the omission of such expenses, we request the expansion of this phrase to include them.

C. Proposed Regulation § 20.2053-4. Deduction for Claims Against the Estate.

1. Relationship Between Proposed Regulation 20.2053-4 and Current Regulation 20.2053-7.

Proposed Regulation § 20.2053-4, addressing the deduction for claims against the estate, substantially changes current Regulation § 20.2053-4. The Proposed Regulations do not make similar changes to current Regulation § 20.2053-7, addressing the deduction for claims in respect of any property included in the gross estate. We see no reason why requirements applicable to unsecured claims should not apply to secured claims. Accordingly, we suggest that the Final Regulations clarify that the same requirements apply to both secured and unsecured claims by amending Regulation 20.2053-7 to incorporate the requirements of Proposed Regulation 20.2053-4.

2. Proposed Regulation § 20.2053-4(a)(1) – In General.

Proposed Regulation § 20.2053-4(a)-1 repeats the requirement initially set forth in Proposed Regulation § 20-2053-1(b) that deductions for claims are not permitted unless the claim is actually paid. Although we agree that this rule is generally appropriate, we are concerned about the unfair results of this rule when a contested claim against a decedent's estate is interdependent with the valuation of an asset included in the estate, which must be valued as of the date of death.

This conflict is clearest in comparing valuations of a claim owned by the estate and a claim against the estate (though the resulting unfairness applies to any property that directly underlies the valuation of the claim). Lawsuits often include counterclaims, such that the estate may make a counterclaim once a party brings a claim against the estate, or *vice versa*. Claims owned by the estate are assets of the estate and must be valued under the general valuation principles (the "snapshot" rule) as of the date of death. In contrast, the Proposed Regulations postpone the valuation of the claim against the estate until it is finally determined and paid. However, intervening events may diminish the value of the claim against the estate which also would have reduced the value of the claim owned by the estate.

For example, assume that A is the primary manufacturer of widgets. Competitor C sued A for patent infringement. A responded with a general denial and a counterclaim against C for theft of trade secrets. A died while such litigation remains ongoing. A's counterclaim against C is included in A's gross estate at its estimated value as of the date of A's death. C's claim against A was not paid or sufficiently ascertainable prior to the due date for filing the federal estate tax return to take a deduction under the Proposed Regulations. Accordingly, A's executor E did not take a deduction for it on A's estate tax return and files a protective claim for refund describing the claim. Several years later, after a trial in which neither A's estate nor C was able to prove the validity of their respective claims, the claim and the counterclaim were dismissed As a result C's claim and A's counterclaim are worthless. Because no payment will be made on C's claim, no deduction for it will be available to offset the value of A's counterclaim as of the date of death which was included in A's gross estate.

This mismatch in valuation methods unfairly subjects the taxpayer to estate tax on the estimated value of a claim, counterclaim or asset without a corresponding deduction for a separate claim *against* the estate, even when the same property interest underlies both items or both are based on the same subject matter. Moreover, the different valuation methods applicable to the same property interest likely will increase the complexity of estate administration. We suggest that if the Final Regulations adhere to the *Jacobs* approach, that they provide an exception to allow deduction of a claim valued as of the date of death if the amount of the claim is substantially related to the value of an asset included in the taxable estate, including a counterclaim based on the same subject matter as the claim.

3. **Proposed Regulations §§ 20.2053-4(a)(1)(ii) and (b)(5) – Limitation of Deduction to Amounts Paid for Legitimate and Bona Fide, Enforceable Claims.**

Code § 2053 and the current regulations impose a requirement of bona fides to deduct a claim only when the claim is founded on a promise or agreement. The Proposed Regulations extend the bona fides requirement to all claims and impose a new requirement of legitimacy. If a claim is enforceable (and, if the claim is founded on a promise or agreement, based on full and adequate consideration in money or money's worth) we are not sure what additional factors will establish that the claim is "legitimate and bona fide." We agree, of course, that no deduction should be permitted for claims based on sham debts or collusive lawsuits.[4] If the purpose of the bona fides and legitimacy requirements is to preclude deductions for such claims, we request that the Final Regulations confirm such purpose. If the prevention of deductions for sham debts and collusive claims was not the sole purpose of such requirements, then we request that the Final Regulations include examples of the kinds of enforceable claims that these additional bona fides and legitimacy requirements are intended to encompass.

Our concerns with the enforceability requirement are discussed above in connection with our comments with respect to Proposed Regulations § 20.2053-1(b) (3) regarding settlements

[4] For example, we agree that deductions are not appropriate for claims based on sham debts like the debts that the decedent owed to his children who loaned him the amounts that were prior gifts from the decedent described in *Flandreau's Estate v. Commissioner* 994 F.2d 91 (2d Cir. 1993), or for collusive lawsuits like the one recommended by the decedent's financial planner described in Revenue Ruling 83-54 1983-1 C.B. 229.

4. Proposed Regulation § 20.2053-4(b)(1) – Potential and Unmatured Claims.

The Proposed Regulations state that no deduction may be taken on the estate tax return for a "potential or unmatured claim." We understand this rule as it applies to potential claims. A potential claim should be treated in the same way as a claim the amount of which is not ascertainable with reasonable certainty. We believe the term "unmatured claim" means claims that are actual (not potential) claims which are required to be paid at a later date. We do not understand why this Proposed Regulation should disallow unmatured claims, unless "unmatured claims" means claims the amounts of which are not ascertainable with reasonable certainty. We request clarification regarding the meaning of "unmatured claim."

5. Proposed Regulation § 20.2053-4(b)(4) – Claims by Family Members, Related Entities, or Beneficiaries.

Proposed Regulation § 20.2053-4(b)(4) creates a rebuttable presumption that claims by, or settlements among, the decedent's family members, a related entity, or a beneficiary of the decedent's estate or revocable trust are not legitimate and bona fide and, therefore, such claims or claims payable pursuant to such settlements are not deductible. Treasury has previously abandoned attempts to implement family attribution rules that impose different and more onerous rules on related family members for transfer tax purposes after meeting judicial resistance.[5] We suggest that Treasury should not resurrect distinctions that subject related persons to a greater burden under these Proposed Regulations when the other requirements applying similarly to all taxpayers will suffice to prevent abuse. Accordingly, we recommend that the Final Regulations entirely omit the provisions of Proposed Regulation § 20.2053-4(b)(4).

If the Final Regulations maintain this rebuttable presumption, we request that they recognize that in many intra-family claims, the kind of evidence that suffices to rebut the presumption under the Proposed Regulations ("evidence that the claim arises from circumstances that would reasonably support a similar claim by unrelated persons or non-beneficiaries") may not be available. In many intra-family disputes, the claim arises from circumstances or rights unique to the claimant's status as a family member, heir, or beneficiary. This is certainly the case in will and trust contests, claims for tortious interference with an expectancy, ademption of gifts, and the like. Therefore, the Proposed Regulations may offer no way for an executor effectively to rebut the presumption in such cases. If the Final Regulations maintain the rebuttable presumption, we request that they provide further guidance regarding the kind of evidence sufficient to rebut the presumption..

6. Proposed Regulation § 20.2053-4(b)(7) – Recurring Payments.

This Proposed Regulation distinguishes between contingent and noncontingent recurring obligations. Proposed Regulation § 20.2053-4(b)(7)(i) requires that recurring payments on non-contingent obligations likely to continue beyond the final determination of the estate tax liability be deducted with a discount to present value. In contrast, Proposed Regulation § 20.2053-4(b)(7)(ii) allows recurring payments on contingent obligations to be deducted in the amounts

[5] *See, for example,* Rev. Rul. 93-12, 1993-1 CB 202

actually paid. Thus, contingent obligations are not required to be deducted with a discount to present value. Consequently, the non-contingent obligation required to be paid must be deducted at a lower amount than the less certain, contingent obligation to pay the same amount. This difference in valuation seems unwarranted. Moreover, this disparity may motivate taxpayers to include remote contingencies in their obligations that are unlikely to occur but secure a deduction at the full, undiscounted value of payments. We recommend that a consistent valuation rule apply to all obligations to make recurring payments in the Final Regulations.

Example 7 of Proposed Regulation § 20.2053-4(b)(7) describes an estate owing 7 non-contingent annual payments under a divorce decree after a decedent's death that makes the initial payment before the estate tax return is filed. The example states that the estate may deduct "these payments" at discounted present value, without excepting the first payment as deductible at the full amount of the payment. We request clarification in the Final Regulations as to whether this example indicates that payments due to a non-contingent obligation that are made prior to the date of filing the federal estate tax return must be deducted at their discounted present value.

In addition, it is unclear how Proposed Regulation § 20.2053-4(b)(7)(ii) applies to the deduction of alimony payments subject to a contingency. Under the Proposed Regulations, if payments on a recurring obligation are subject to a contingency, or if there is a reasonable likelihood that the payments will not be made, the deduction will be limited to the amounts actually paid. It is unclear whether the death of the payee – a common termination event in the case of alimony or support payments required to be made after the payor's death – will constitute a contingency for this purpose. In Example 8, the estate owes seven non-contingent annual payments under a divorce decree after the date of death, and one of the annual payments is made before the estate tax return is filed. The example concludes that "[t]he estate may take a deduction for the present value of these payments." In Example 9, however, the estate has a contingent obligation to make payments over the same period of time as in Example 8, but the obligation ceases if the ex-spouse remarries or dies during the term. In Example 9, the estate can only deduct the additional payments as they are made.

There are two contingencies, death and remarriage, in Example 9 and it is unclear whether the presence of one, or both, of the contingencies prohibits the deduction under the Proposed Regulations. The IRS previously has permitted deductions for future alimony payments for an individual's lifetime based on the same method for valuation of annuities for inclusion purposes, using the actuarial value of the present value of such payments.[6] If either (1) a contingency based upon the payee's death alone (without regard to remarriage), or (2) a contingency based upon the payee's remarriage alone (without regard to death), constitutes a contingency for purposes of the Proposed Regulations, we suggest that additional examples be added to illustrate this point in the Final Regulations.

[6] *See, e.g., Lester v. Commissioner*, 57 T.C. 503(1972). For purposes of inclusion in the gross estate, the IRS has referred to the American Remarriage Table to value annuities that terminate on the sooner to occur of death or remarriage. See, e.g., Rev. Rul. 78-282, 1978-2 C.B. 235 (valuation for purposes of Section 2039 and obsoleted on other grounds); Rev. Rul. 71-67, 1971-1 C.B. 271 (valuation of alimony payments payable for individual's lifetime or remarriage).

Finally, we note that the only option under the Proposed Regulations for satisfaction of a recurring obligation (whether contingent or non-contingent) is the purchase of a commercial annuity. See Proposed Regulation § 20.2053-4(b)(7)(iii). The profit margin included in the pricing of such annuities, however, will make this an expensive proposition and might distort or alter the parties' relative economic interests in the estate. Accordingly, we recommend that the Final Regulations provide an alternative for the executor to negotiate in good faith with parties interested in the estate to pay a lump sum in satisfaction of a recurring payment that is deductible under Code § 2053(a)(3).

D. Protective Claims for Refund.

If the Final Regulations maintain the restriction of amounts deductible under Code § 2053(a)(3) to amounts actually paid by the estate, then the circumstances in which taxpayers must rely upon protective claims for refund will increase significantly. A claim for refund must be filed within the later of three years after the return is filed, or two years from the time the tax is paid.[7] Although a taxpayer may file a claim and sue for a refund for overpayment of taxes, it has always been possible that such an overpayment might not exist (or be known) until after the expiration of the relevant tax period of limitations. The likelihood of such overpayment will increase by reason of the Proposed Regulations. As even the Treasury points out (thirteen different times in the Proposed Regulations), there are a variety of instances in which the personal representative will need to file a "protective claim for refund" within the period for filing the claim for refund. We expect that many taxpayers and their advisors may not be aware of the need to file such protective claims or the proper procedures for preparing and filing them under the new standards described in the Proposed Regulations.

1. Current Elements of an Estate Tax Protective Claim for Refund.

A personal representative should file a Claim for Refund and Request for Abatement Form 843 ("Form 843") to file a protective claim for refund. A claim for refund must put the Service on notice, and therefore "must set forth in detail each ground upon which a … refund is claimed and facts sufficient to apprise the Commissioner of the exact basis thereof."[8] A claim that does not comply with this requirement "will not be considered for any purpose as a claim for refund or credit."[9] While "'crystal clarity and exact precision are not demanded,' … 'at a minimum the taxpayer must identify in its refund claim the 'essential requirements' of each and every refund demand.'"[10] Also, the taxpayer must "'state the exact basis' of his refund claim" and "'[n]o refund will be allowed except on a ground clearly stated and supported by facts sufficient to apprise the Commissioner of the exact basis of the taxpayer's claim.'"[11]

The Proposed Regulations note that protective claims for refund submitted to preserve deductions for amounts under Code § 2053(a)(3) "need not state a particular dollar amount or

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[7] Code § 6511(a). The amount of tax that can be refunded is limited to the amount of tax paid within that same period. Code § 6511(b)(2).

[8] Treas. Reg. § 301.6402-2(b)(1).

[9] Id.

[10] *Ryan v. United States*, 64 F.3d 1516, 1521 (11th Cir. 1995) (internal citations omitted).

[11] *Id. See also* Treas. Reg. § 301.6402-2(b)(1).

demand an immediate refund" but "must identify the outstanding liability or claim that would have been deductible under Code § 2053(a) had it already been paid." Proposed Regulation § 20.2053-1(b)(4), § 20.2053-4(b)(1). With respect to potential and unmatured claims, the protective claim for refund also "must describe the reasons and contingencies delaying actual payment of the liability or claim." Proposed Regulation § 20.2053-4(b)(1).

We believe that the primary pitfall in preparing a Form 843 to preserve a refund based on a Code § 2053(a)(3) deduction will be the failure to sufficiently detail the nature of the claim. The executor may lack comprehensive information regarding the potential or unmatured claims or claims that cannot be estimated in amount with reasonable certainty that require a protective claim for refund under the Proposed Regulations. In addition, the executor will be reluctant to disclose information that may be discoverable in litigation and may prejudice the executor's defense against the claim. This tension always exists in preparing claims for refund based on a litigated claim. However, the rejection of the snapshot rule requires the executor to rely exclusively on the claim for refund to preserve the deduction for unmatured or uncertain claims, exacerbating and increasing the incidence of this problem.

2. Problems with Forms 843 and 706.

The Form 843 and the United States Estate (and Generation-Skipping Transfer) Tax Return Form 706 ("Form 706") both have deficiencies that may hinder the proper preparation of protective claims for refund.

Form 843 currently is a cumbersome form used to seek refunds of a variety of unrelated income taxes, transfer taxes and excise taxes. Although Form 843 clearly contemplates use to recover a refund of estate taxes (including a convenient reference to Form 706), the "Purpose of the Form" portion of the Instructions for Form 843 does not clearly include a refund of estate taxes as a permitted use. The Form 843 Instructions also only mention "estate taxes" once, and then only in the indirect context of abatement or refund of interest. Form 843 Instructions makes no mention of protective claims for refund. However, to use the Form 843 for a protective claim for refund, taxpayers should label it "PROTECTIVE CLAIM FOR REFUND."

The Form 706 Instructions only mention "claim for refund" once, and then only in the context of the state tax deduction. Although the Form 706 Instructions refer to protective elections, there is no mention of a protective claim for refund. Form 706 does mention on the Schedule F Instructions a claim for refund, but only in the context of a claim for refund for income taxes. Neither Form 706 nor the Form 706 Instructions refers to Form 843.

3. Recommendations.

Given the likely increase in the need for protective claims for refund, Treasury and the IRS can and should take several relatively easy steps to alert taxpayers to the need for such protective claims and facilitate the proper preparation and filing of such protective claims.

Treasury and the IRS have asserted the variance doctrine as a defense against refunds based on grounds that allegedly were not described in sufficient detail in the original claims for those refunds.[12] When the government successfully asserts the defense of variance, the claim is barred for lack of judicial subject matter jurisdiction over theories or claims that were not adequately described in the claim. However, the Proposed Regulations specifically direct taxpayers to seek relief by filing protective claims when the amount of the claim cannot be estimated with reasonable certainty or when potential or unmatured claims have not yet ripened sufficiently to be determined. Thus, the executor will be filing protective claims for refund that attempt to describe claims against the estate due to the very fact that they could not be identified or determined with certainty. For example, the executor may not know the specific theory of recovery or parties who may receive the refund as proper takers in the executor's place upon the ultimate resolution of the claim against the estate. As a result, the protective claims for refund may not be as specific as most claims for refund in the normal course of estate administration.

Accordingly, we recommend that the Final Regulations expressly waive the doctrine of variance that the government otherwise may assert when the executor attempts to recover on a protective claim for refund such that the actual payment of the claim secures the deduction under Code § 2053(a)(3). We also recommend that the Final Regulations include examples of how a taxpayer would file a protective claim for refund (referring either to Form 843, or if added, the requested new portion of the Form 706), and what information a taxpayer should include in a protective claim for refund so that it will not later be argued to be insufficient.

We also recommend that Treasury should expand the Form 706 Instructions to cover the issues raised by the Proposed Regulations generally, and to address specifically why taxpayers should consider filing protective claims for refund, and how to prepare and file protective claims for refund. Treasury will not adequately educate taxpayers by merely reciting the possible need for a protective claim for refund (as done in the Proposed Regulations) and will not properly advise taxpayers on how to file a protective claim for refund merely by referring to Form 843.

Finally, recommend that the Form 706 be revised to incorporate or add a new form that will serve the same purpose as Form 843 currently does, at least for a protective claim for refund. The information that would need to be added would not take up much space and would not be complicated. We suggest a "check-the-box" marker added to Schedule K so that a taxpayer can make a protective claim for refund on the Form 706, along with a box in which taxpayers can provide information about the nature of the claim.

E. Executor's Duties to Report and Pay Additional Tax.

The Proposed Regulations impose upon the executor the duties to notify the Commissioner and pay additional tax in several cases in which a deduction under Code § 2053 is allowed in advance of payment and the payment is thereafter waived or otherwise unpaid. See Proposed Regulations § 2053-1(b)(4) (reasonably certain estimated amounts), § 2053-3(b)(3) (executor's commissions),[13] § 2053-6(g) Example 2. Final determination of a claim against the estate may occur after the IRS issues a closing letter regarding the federal estate tax return.

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[12] The variance doctrine is based on Code § 7422(a).

[13] The Section notes that Proposed Regulations § 2053-3(c) regarding attorney's fees does not include a provision requiring notification and payment of additional tax parallel to such provision under Proposed Regulations § 2053-3(b)(3) regarding executor's commissions.

Under § 3713 of Title 31 of the United States Code ("§ 3713"), a fiduciary can be personally liable for payment of taxes to the extent that estate assets are insufficient. This § 3713(b) by its plain terms imposes absolute liability on the executor if a debt is later determined to be due to the United States. However, courts have limited such liability to fiduciaries who knew that an unpaid debt to the United States existed or knew facts that would lead a reasonable person to inquire as to the existence of the debt.[14] Consequently, an executor typically distributes the estate to appropriate takers upon receipt of the closing letter from the IRS when the executor reasonably may conclude that no additional estate tax remains due. However, the Proposed Regulations indicate that the executor could remain liable for payment of estate tax for an indefinite period. This uncertainty may discourage executors from making distributions that facilitate proper, efficient estate administration.

We believe that executors should be able to rely on closing letters to proceed with distributions necessary to administer the estate. Under § 3713(b), the IRS still may recover estate tax directly from an executor acting in bad faith who knows that additional estate tax remains due when distributing the subject property to third parties. Under Code § 6324, the IRS also may recover estate tax from the transferees receiving the distributions for ten years after the decedent's death, even after discharge of the executor. Thus, we recommend that the Final Regulations clarify that an executor may distribute property subject to payment of estate tax upon receipt of the closing letter without personal liability, and that any subsequent obligation to pay estate tax pursuant to the above-referenced provisions is limited to the property remaining in the executor's possession or control at the time when the obligation arises.

In addition, the Proposed Regulations referenced above may suggest that the executor bears an ongoing duty to actively monitor or seek facts verifying whether the deducted claim ultimately will be waived or unpaid. Thus, we recommend that the Final Regulations clarify that the executor must notify the Commissioner and pay additional tax after the issuance of the closing letter only at such time when the executor actually knows, or knows facts that would lead a reasonable person to inquire as to whether, the deducted claim will be waived or unpaid.

We believe that these clarifications to relieve the executor from indefinite liability for payment of estate tax and reporting obligations, will maintain consistency with current law regarding such fiduciary liability, promote expeditious estate administration, and will not prejudice the IRS unduly.

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We appreciate the opportunity to submit these written comments and would welcome the opportunity to offer any additional assistance that may be desired.

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[14] *See* Rev. Rul. 66-43, 1966-1 C.B. 291; Rev. Rul. 79-310, 1979-2 C.B. 404; *United States v. Coppola*, 85 F.3d 1015 (2d Cir. 1996); *Leigh v. Commissioner*, 72 T.C. 1105 (1979).