Overview

A decedent’s taxable estate is determined by deducting from the value of the gross estate certain deductions. That includes deductions for amounts paid for funeral and administration expenses, claims against the estate and unpaid mortgages. Specifically, the Internal Revenue Code (Code) provides that “the value of the taxable estate shall be determined by deducting from the value of the gross estate…claims against the estate.” As explained in the applicable Treasury Regulation, “[o]nly claims enforceable against the decedent’s estate may be deducted” from the gross estate. Under another Treasury Regulation, an item may be entered on the return for deduction even though its exact amount is not then known, provided it is ascertainable with reasonable certainty and will be paid. Other than that general guidance, neither the Code nor the Treasury Regulations provide any guidance on whether post-death events are relevant in determining the value of claims which may be deducted on an estate tax return. For almost 80 years, the courts have reached different conclusions on the matter through two different schools of thought.

In 2000, IRS gave notice that it would continue to litigate the issue. Then, in early 2007, IRS issued proposed regulations that provide guidance regarding the extent to which post-death events may be considered in determining the value of a taxable estate. Now, IRS has finalized the regulations.

I.R.C. §2053

I.R.C. §2053(a) allows a deduction in arriving at taxable estate for funeral and administrative expenses, claims, and unpaid mortgages, but is silent concerning whether deductible claims are to be valued at their date-of-death value. So that raises a question as to the extent to which post-death events are to be considered in valuing deductible claims. The IRS has reasoned that because funeral and administrative expenses are routinely incurred after death, the statute should be construed to include post-death events. But, as mentioned above, the statute is not clear on this point and the Regulations are not helpful, merely stating that deductible claims are those which represent personal obligations of the decedent existing at the time of death, whether or not matured. The Regulations go on to say that a claim is deductible even though “its exact amount is not then known, provided it is ascertainable with reasonable certainty, and will be paid.”

The Supreme Court’s Ithaca Trust Ruling

In a 1929 Supreme Court case, the decedent’s trust gave the residue of his estate to his wife for life. The trust gave her the power to use any amount of the principal necessary to “suitably maintain” herself. But, she died six months after the decedent with the residue then transferring to certain charities. Normally the actuarial value of the surviving spouse’s life expectancy at the time of the decedent’s death would be used to determine the amount the charity could expect to receive, but she died before the decedent’s estate tax return was
filed. So was the charitable deduction to be determined by using mortality tables or using the date of death of the surviving spouse? The Court first ruled that the provision for the wife’s maintenance did not make the charitable gifts so uncertain that they could not be deducted. The Court then ruled that the amount of the deduction was to be determined after reducing the amount of the charitable contribution by the wife’s probable lifespan as it existed at the time of the decedent’s death. Thus, the value of the wife’s life estate had to be estimated by using the mortality tables, not by her actual lifespan, and that value had to be deducted from the amount passing to the charities.

Two Schools of Thought

The Supreme Court’s *Ithaca Trust* decision dealt with a charitable deduction rather than a claim against the estate. That raised a significant question — did the Court’s ruling in *Ithaca Trust* establish a broad principle that a taxable estate should be determined by considering only information known as of the date of death, or are post-death events irrelevant only when actuarial tables define fair market value? Relatedly, does *Ithaca Trust* only apply to charitable bequests and not claims against the estate?

Just months after the Supreme Court’s *Ithaca Trust* decision, the U.S. Court of Appeals for the Eighth Circuit, in *Jacobs v. Comr.*, considered the applicability of the date-of-death valuation rule to claims against an estate. The case involved a widow who chose to take a life estate in a trust created by her pre-deceased husband’s estate rather than receive a fixed sum in accordance with a pre-marital agreement. The husband’s estate deducted the fixed amount in the pre-marital agreement as a claim against the estate on the basis that the pre-marital agreement was an existing, valid contract. The court disagreed, holding that only claims presented to and allowed or otherwise determined as valid against the estate and actually paid or to be paid could be deducted as a claim against the estate. The court specifically noted that the Supreme Court’s *Ithaca Trust* decision did not mean that claims against the estate must be determined solely by facts and conditions existing on the day of the decedent’s death. The Supreme Court ultimately denied certiorari in *Jacobs*. That seemed to lend support to the notion that the date-of-death valuation rule in *Ithaca Trust* did not apply to deductions for claims against an estate.

Clearly, *Ithaca Trust* didn’t settle the issue. Since *Jacobs*, some courts have interpreted *Ithaca Trust* as announcing a broad principle that a taxable estate should be determined by considering only information known as of the date of death. Others, however, believe that *Ithaca Trust* does not reach I.R.C. §2053 claims, but is instead limited to IRC §2055 charitable bequests. The IRS does not follow *Ithaca Trust* either. It is the IRS position that *Ithaca Trust* is not relevant because it involved an IRC §2055 charitable deduction, rather than an IRC §2053 claim deduction. In addition, the position of the IRS and those courts that don’t follow *Ithaca Trust* is that post-death events are irrelevant only when actuarial tables define fair market value.

Recent Litigation

Three recent circuit court opinions indicate that the basis for the IRS’ insistence on using post-death events may be eroding. In *Estate of McMorris v. Comr.*, the Tenth Circuit reversed the Tax Court and held that post-death events are not to be considered in valuing a claim against an estate under IRC §2053. During life, the decedent inherited stock. The corporation later redeemed the stock and the decedent paid taxes on the difference between the redemption proceeds and the stock value as reflected in the pre-deceased husband’s estate tax return. Upon audit of the estate tax return, IRS increased the valuation on the stock by an amount that was enough to eliminate the decedent’s income tax gain. The IRS agreed to offset the decedent’s income tax refund against the estate tax deficiency. The issue was whether the income tax refund reduced the I.R.C. §2053 deduction for the income tax liability on the estate tax return. The estate argued that the refund should not affect the tax liability deduction since it was based on a post-death audit. The IRS argued that the tax liability claim was contingent and thus should be adjusted to reflect post-death events. The court agreed with the estate.

In *Estate of Smith v. Comr.*, the estate was forced to repay some oil royalty payments to Exxon Corporation. Repayment was necessary because Exxon had been required to refund to the federal government amounts that had violated pricing
consider post-death events, the IRS (and some courts) appears to make a distinction between contested and contingent liabilities.\textsuperscript{27}

The Regulations

As proposed, the regulations would impact estates in which there are claims outstanding at the time of the decedent’s death. Under the proposed regulations, IRS rejected the date-of-death valuation approach as an inefficient use of resources for taxpayers, the IRS and the courts. Instead, the proposed regulations adopted rules based on the premise that an estate may only deduct amounts actually paid in settlement of claims against the estate. Thus, post-death events are to be considered when determining the amount deductible under \textit{all} provisions of I.R.C. \textsection{2053}, and such deductions are limited to amounts actually paid by the estate in satisfaction of deductible expenses and claims.\textsuperscript{28} The proposed regulations also provide that an estate may file a protective claim for refund for some contested or contingent claims that are unresolved.\textsuperscript{29}

Effective October 20, 2009, the final regulations adopt the proposed regulations with some changes. In general, the final regulations demonstrate that it is the view of the IRS that all estates should be similarly treated, regardless of jurisdiction. In doing so, the final regulations reject the date-of-death valuation approach – post-death events are to be taken into account in determining the deductible amount under I.R.C. \textsection{2053} - and specify that an estate may only deduct amounts that an estate actually pays to settle claims against the estate. The final regulations include an exception for claims against an estate for which there is an asset or claim that is included in the gross estate that is substantially related to the claim against the estate. Also included is an exception for claims against an estate that, collectively, do not exceed $500,000. However, while the exceptions do allow estates to claim a deduction on Form 706 (federal estate tax return), the deduction amount remains subject to adjustment to reflect post-death events according to the final regulations.

\textbf{Note:} Form 706 still must be timely filed. So, an estate that is subject to an outstanding claim (or multiple claims) that aren’t paid before the due date for Form 706 (nine months after the decedent’s date of death) will have to file Form 706, pay

regulations. Exxon sought reimbursement in part of $2.48 million from the decedent, who died with this claim outstanding. The $2.48 million was deducted on the decedent’s estate tax return, but nine months after the return was filed, the estate settled the claim for $681,840. The Tax Court agreed with the IRS that the deduction of $2.48 million was not certain at date of death, but that even if the estate were allowed the larger deduction, it would still be taxed on discharge of indebtedness income.\textsuperscript{21} The Fifth Circuit reversed, refusing to value a claim based on post-death events and holding that IRC \textsection{1341} does not require recognition of discharge of indebtedness income for disputed claims.

Two years after the Fifth Circuit’s opinion in \textit{Smith}, the Eleventh Circuit also ruled against using post-death events in valuing claims.\textsuperscript{22} The case involved a claim against the estate for reimbursement of gift taxes paid by the transferees of the gifts. The value of the gifts was in dispute at the date of death. Based on the IRS-assigned values, the claim against the estate was in excess of $9 million, but was eventually reduced to less than $600,000. The court held that the date-of-death value should apply in deducting the claim, and remanded the case for a recalculation of the deduction.\textsuperscript{23}

Most recently, the \textit{Ithaca Trust} rationale was followed by the Fifth Circuit in \textit{McCord v. Comr.}.\textsuperscript{24} The case involved gift tax, but the court referenced \textit{Ithaca Trust} for the “well-established legal precedent” that fair market value is determined on the date that the gifts were complete by execution of an assignment agreement.\textsuperscript{25}

\textbf{Planning Points}

There are basically three types of situations that could arise relating to the use of post-death events to value claims. One of those involves situations where the liability is fixed at the date of death, but changes due to post-death events. In that situation, post-death events should not matter - the liability is fixed as of the date of death. But, IRS and the courts are not clear on that point. Another situation is where the claim is contingent on the date of death – such as a post-death tax adjustment. The courts generally agree that only those facts known as of the date of the decedent’s death matter, and the IRS appears to have conceded the point.\textsuperscript{26} A third possible situation is where the claim is contested. Although the appellate courts generally do not
the estate tax and then later file a refund claim. That means that practitioners will have to consider the need to file a protective claim so that the statute of limitations does not run and bar the ability to file an amended return seeking a refund. The IRS position also means that the executor may have to consider means to provide liquidity for the estate in the event funds are necessary to pay estate tax which can only later be recovered (at least in part) via a refund claim.

The final regulations also clarify other associated issues and provide guidance on how to handle settlements, protective claims, final court decisions, reimbursed amounts, and various types of other claims against an estate - including unenforceable claims and recurring payments. In addition, the final regulations reflect the EGTRRA amendments in 2001 to I.R.C. Sec. 2053(d) and 2058 (concerning the deduction for state death taxes).

To reiterate, the practical effect of the final regulations is that they could require an estate that is dealing with litigated claims to remain open for a lengthy period of time. In those situations, the estate’s executor will have to make sure to file a protective claim to preserve the right to claim any possible refund of estate tax that was paid while the validity and/or amount of the claim was being judicially determined. Some types of claims could take many years to resolve. For example, there have been several cases filed against farm and ranch estates in recent years involving alleged environmental contamination. In those situations, the estate executor can’t distribute any assets until the claim is resolved. So, a protective claim would bar the statute of limitations from running that would prevent a claim for refund.

Note: Along with the final regulations, IRS issued Notice 2009-84. The Notice provides limited administrative exception to the ability of the IRS to examine Form 706 in connection with certain protective claims for refunds that are timely filed where the filing is made based on a deduction under I.R.C. Sec. 2053. According to the IRS, if a claim for refund ripens and becomes ready for consideration after the expiration of the period of limitations on assessment in I.R.C. Sec. 6501, IRS will limit its review of Form 706 to evidence relating to deduction under I.R.C. Sec. 2053 that was the subject of the protective claim.

Filing Protective Claims

As noted above, the impact of the regulations is that practitioners handling estates with outstanding claims may have to consider filing protective claims to prevent the statute of limitations from running which would result in the inability to file an amended return. In mid-October of 2011, the IRS provided guidance on the procedure for filing protective claims for refunds under I.R.C. §2053. In the guidance, IRS noted that a protective claim must be filed within three years after the time the return was filed or two years after tax was paid, whichever date is later. According to the regulations, a written declaration and evidentiary proof of the claim must be provided. In addition, a separate claim must be filed for each expense for which a deduction may be claimed in the future. IRS has the power to require the practitioner filing the protective claim to provide more detail as to outstanding claims, but is not required to do so.

For estates of decedent's after 2011, a protective claim can be made by attaching Schedule PC to Form 706, or by filing Form 843 (if the estate tax return has already been filed). The use of Form 843 is the only way to file a protective claim for estates of decedent's dying from October 9, 2009 through 2011.

In the guidance, IRS also stated that not following the procedures set forth in the guidance will have the effect of denying the estate the benefit of limiting the review by IRS of Form 706 just to evidence relating to the deduction under I.R.C. Sec. 2053 that was the subject of the protective claim. The IRS also noted in the guidance that executors need not provide detail on expenses such as attorney and appraisal fees associated with contested matters, and that estate settlement will not be delayed while an issue that is subjected to a protective claim is pending.

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1. I.R.C. §2051.
2. See I.R.C. §2053.
4. Treas. Reg. §20.2053-4. For instance, in Estate of Saunders v. Comr., No. 12-70323, 2014 U.S. App. LEXIS 4647 (9th Cir. Mar. 12, 2014), the court ruled that a $30 million malpractice claim against the pre-deceased spouse of the decedent that was outstanding at the time of the surviving spouse’s death was not deductible by the estate because the value of the claim was not certain enough as of the date of death. The court did allow, however, a $250,000 deduction for the amount that the estate paid to settle the claim.


6. AOD 2000-04 (May 9, 2000).


10. Rev. Rul. 77-274, 1977-2 C.B. 326 (where the right to claim an amount is not fixed by the deadline for filing the estate tax return, the taxpayer can protect the right to the claim the deduction by filing a protective claim on Form 843). But, no deduction is allowed for claims against the estate which have not been paid or will not be paid because the creditor waives payment, fails to file the claim within the prescribed time limit or otherwise fails to enforce payment. See Rev. Rul. 60-247, 1960-2 C.B. 272.


12. Id.

14. 34 F.2d 233 (8th Cir. 1929), cert. den. sub nom., Jacobs v. Lucas, 280 U.S. 603 (1929).
15. 280 U.S. 603 (1929).

16. The U.S. Courts of Appeal for the Fifth, Tenth and Eleventh Circuits have expressed this view. See Estate of Smith v. Comr., 196 F.3d 515 (5th Cir. 1999); Estate of McCord v. Comr., 461 F.3d 614 (5th Cir. 2006); Estate of McMorris v. Comr., 243 F.3d 1254 (10th Cir. 2001); Estate of O’Neal v. United States, 258 F.3d 1265 (11th Cir. 2001). But, both the Fifth and the Eleventh Circuits have ruled that post-death events are relevant when hypothetical liabilities are involved. See Estate of Hagmann v. Comr., 492 F.2d 796 (5th Cir. 1974); Estate of O’Neal v. United States, 258 F.3d 1265 (11th Cir. 2001).

17. The United States Tax Court and the U.S. Courts of Appeal for the First, Second, Eighth and Ninth Circuits follow this approach. See Estate of Kyle v. Comr., 94 T.C. 829 (1990); Comr. v. State Street Trust Co., 128 F.2d 618 (1st Cir. 1942); Comr. v. Estate of Shively, 276 F.2d 372 (2d Cir. 1960); Estate of Sachs v. Comr., 856 F.2d 1158 (8th Cir. 1988); public policy of providing certainty in situations involving charitable bequests exists to stimulate charitable giving, but no such reason exists in valuing claims; Propstra v. United States, 680 F.2d 1248 (9th Cir. 1982); (while the court held that when claims are for sums certain and are legally enforceable as of the date of death, post-death events are not relevant in computing the permissible deduction, the court did note in dicta that post-death events are relevant when computing the deduction to be taken for disputed or contingent claims); Estate of Van Horne v. Comr., 720 F.2d 1114 (9th Cir. 1983), cert. den., 466 U.S. 980 (1984) (legally enforceable claims valued by reference to an actuarial table meet the test of certainty for estate tax purposes; but, court noted in dicta that post-death events are relevant in cases where the claims are potential, unmatured, contingent or contested at the date of death).


19. 243 F.3d 1254 (10th Cir. 2001).
20. 98 F.3d 515 (5th Cir. 1999).
23. The remand very clearly instructed the district court to ignore post-death events when determining date-of-death value.
24. 461 F.3d 614 (5th Cir. 2006).
25. However, Treas. Reg. §20.2031-2(b)(1) states that the valuation of stocks and bonds, when no sale occurs on the valuation date, must be computed as a weighted average of the means between the highest and lowest sales on the nearest date before and the nearest date after the valuation date.
27. Id.
28. See, e.g., Gottesman v. United States, No. 05 Civ. 8212 (BSJ), 2007 U.S. Dist. LEXIS 15043 (S.D. N.Y.)
Jan. 12, 2007)(estate denied estate tax refund claim because ex-wife had no valid claim after death of decedent under express terms of separation agreement; court reasoned that if claim cannot be enforced because of post-death events, there can be no deduction under I.R.C. §2053(a)(3) for that claim).

The proposed regulations also update provisions regarding the deduction for some state death taxes to reflect 2001 statutory amendments under I.R.C. §2053(d) and 2058.


This could be a very arduous process that could give IRS the ability to deny the claim because it wasn't identified with enough particularity when the claim was filed.

The Form will be available with the 2012 Form 706.