



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR ASSOCIATE AREA COUNSEL (SBSE),
ATTN:

FROM: ASSOCIATE CHIEF COUNSEL
(PASSTHROUGHS AND SPECIAL INDUSTRIES)
CC:PSI

SUBJECT: ALLOWABLE DEDUCTION UNDER § 2053(a)(3)

This Chief Counsel Advice responds to your memorandum dated October 24, 2001. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

LEGEND

w =
Date 1 =
Decedent =
Driver =
Wife =
Daughter =
Date 2 =
Son =
State =
Public Highway =

Date 3 =
 x =
 State Agency 1 =

 State Agency 2 =
 Construction Contractor 1 =
 Construction Contractor 2 =
 Date 4 =
 Date 5 =
 Date 6 =
 y =
 Insurance Company 1 =
 z =
 Date 7 =
 Date 8 =

ISSUE

What is the allowable estate tax deduction under § 2053(a)(3) when the estate denied claims filed in probate for a wrongful death lawsuit and the estate ultimately settled its portion of the claim for \$w?

CONCLUSION

The estate may deduct \$w as a claim against the estate under § 2053(a)(3).

FACTS

On Date 1, Decedent was involved in a vehicular collision with another vehicle that was driven by Driver. The police report stated that Driver's vehicle was traveling 55 mph in an area with a posted speed limit of 45 mph. Wife and Daughter were passengers in Driver's vehicle. Decedent and Driver died as a result of injuries sustained in the collision. Wife and Daughter suffered non life-threatening injuries in the accident.

On Date 2, Wife, Daughter and Son (collectively "Family") served a written claim on certain State agencies alleging negligent maintenance and operation of Public Highway where the accident occurred. The claim was rejected by State. On Date 3, Wife, Daughter and Son each filed claims with the probate representatives of Decedent's estate totaling \$x, alleging economic loss and general damages caused by the wrongful death of Driver. The estate rejected these claims. Family then filed actions alleging wrongful death, negligence causing personal injuries, and emotional distress against State Agency 1, State Agency 2, the representatives of Decedent's estate, Construction Contractor 1, Construction Contractor 2, and other miscellaneous parties. The complaint alleged that each defendant was negligent in some manner toward Driver, proximately causing his death and Wife and Daughter's injuries. The claimants alleged that Public Highway was improperly maintained and that the construction zone was of improper width, lacked proper speed controls, lacked a center divider to prevent accidents of the sort at issue, failed to provide a recovery shoulder, and failed to comply with the industry standards for erecting a type-A dike so close to the westbound traffic lane. No specific amount was listed for damages in the complaint. On Date 4, Decedent's estate filed a complaint against Construction Contractor 2 alleging property damage, general negligence, and wrongful death seeking damages and punitive and exemplary damages. Cross-complaints were subsequently filed.

Family submitted an expert witness report stating that Construction Contractor 1 and Construction Contractor 2 created a dangerous condition at the scene of the accident. The expert testified that the situation fell below the standard of care for highway construction. The contractors alleged that State Agency 1 had authorized the specific construction of the dike and approved its location, although original specifications did not call for the construction of the dike. State filed a cross-complaint against Construction Contractor 1 and Construction Contractor 2 alleging that they created a dangerous situation contrary to construction specifications.

Construction Contractor 1 filed a motion for summary judgment on Date 5. The court denied the motion for summary judgment because it found that Construction Contractor 1 failed to negate its negligence and that a triable issue remained as to whether the contractor complied with construction specifications.

On Date 6, Decedent's estate agreed to an out-of-court settlement with Family. Decedent's estate agreed to pay Family \$y and pay Insurance Company 1 \$z in reparation for the damages caused to Family's vehicle. Family's complaint and Insurance Company 1's complaint with respect to Decedent's estate were dismissed with prejudice on Date 7.

Decedent's estate filed a Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return (the "Estate Tax Return") on or about Date 8. The

executor's address, as listed on the Estate Tax Return, is in State. On Schedule K of the Estate Tax Return, the executors claimed total deductions of \$x for the claims filed in probate by Wife, Daughter and Son. No deduction was claimed on the return for a claim from Insurance Company 1. The Service disallowed the deductions totaling \$x and limited the deduction to the actual amount paid to Family. In addition, the Service allowed a claim for the amount paid to Insurance Company 1 even though it was omitted on the Estate Tax Return as originally filed.

LAW AND ANALYSIS

Section 2001 of the Code imposes a tax on the transfer of the taxable estate, determined as provided in § 2051, of every decedent, citizen or resident of the United States. Section 2031 defines the property included in the decedent's gross estate. Section 2051 provides that the "taxable estate" is determined by deducting from the value of the gross estate deductions provided in chapter 11A, Part IV, which includes § 2053 deductions. Section 2053(a) provides

For purposes of the tax imposed by section 2001, the value of the taxable estate shall be determined by deducting from the value of the gross estate such amounts (1) for funeral expenses, (2) for administration expenses, (3) for claims against the estate, and (4) for unpaid mortgages ... as are allowable by the laws of the jurisdiction, whether within or without the United States, under which the estate is being administered.

Section 20.2053-1(b)(3) provides that an item may be entered on the return for deduction though its exact amount is not then known, provided it is ascertainable with reasonable certainty, and will be paid. No deduction may be taken upon the basis of a vague or uncertain estimate. If the amount of a liability was not ascertainable at the time of final audit of the return by the district director and, as a consequence, it was not allowed as a deduction in the audit, and subsequently the amount of the liability is ascertained, relief may be sought by a petition to the Tax Court or a claim for refund as provided by §§ 6213(a) and 6511, respectively.

The purpose of § 2051 is to define that part of the decedent's property that should be subject to the estate tax. Thus, the deductions allowed under § 2053 operate to eliminate from estate tax those portions of the gross estate that do not pass by gift, but rather, are expended in paying the claims and expenses of the estate. Those portions of the gross estate that are not transferred to the decedent's beneficiaries should not be subject to the transfer tax. It follows that the amount allowed as deductions under § 2053 should be limited to the amounts actually paid or reasonably expected to be paid by the estate. This ensures that

the taxable estate reflects the amount actually passing to the decedent's beneficiaries.

In Ithaca Trust v. Commissioner, 279 U.S. 151 (1929), the decedent bequeathed a life interest in property to his spouse with the remainder to charity. This remainder interest was intended to qualify for an estate tax charitable deduction under the predecessor to § 2055. The surviving spouse died within a year of the decedent. The estate deducted the amount actually passing to charity, valuing the charitable remainder interest based upon the spouse's premature death, rather than on the actuarial tables. The Supreme Court held that the value of the charitable remainder interest must be determined at the decedent's date of death based on the applicable actuarial tables prescribed by the regulations. Id. at 155. In support of its holding, the Supreme Court stated "[t]he estate so far as may be is settled as of the date of the testator's death." Id. Although this holding was applicable to the valuation of charitable remainder interests under the predecessor to § 2055, subsequent case law has relied upon it, we believe erroneously, in determining the amount of the deduction for claims against the estate under § 2053 and its predecessors.

Within months of the Supreme Court's decision in Ithaca Trust, the Eighth Circuit considered the applicability of the date-of-death valuation rule to claims against the estate in Jacobs v. Commissioner, 34 F.2d 233 (8th Cir. 1929). In Jacobs, on her husband's death, a widow chose to take a life estate in a trust rather than to receive a fixed amount pursuant to an antenuptial agreement. The estate claimed that it was entitled to a deduction for the fixed amount in the antenuptial agreement as claim against the estate because "the antenuptial agreement was a valid and subsisting contract." Id. at 233. The court held 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 "claims against the estate." Id. at 235. The Eighth Circuit reasoned that the "widow never claimed anything from the estate under the antenuptial contract, and the gross estate was not decreased one single cent by reason of the [fixed amount] stipulated in the antenuptial contract." Id. at 235. The court stated that "[t]he claims which Congress intended to be deducted were actual claims, not theoretical ones. Indeed, a claim without a claimant is a sort of legal figment, which has the tendency to produce intellectual dizziness." Id. The Eighth Circuit noted that the Supreme Court "has not said that claims against the estate must be determined solely by the facts and conditions existing on the day of the decedent's death, and we are confident that Court will never say so." Id. at 236.

Five months after the Eighth Circuit's opinion in Jacobs, the Supreme Court denied the taxpayer's petition for writ of certiorari. Jacobs v. Lucas, 280 U.S. 603 (1929). The fact that the same Court that issued Ithaca Trust refused to grant certiorari in Jacobs after the Eighth Circuit issued such a strong statement about

what the Court meant in Ithaca Trust supports the government's position that the date-of-death valuation rule in Ithaca Trust does not automatically apply to deductions for claims against the estate.

With respect to whether post-death events may be considered in determining the amount of a deduction under § 2053(a)(3), the Eleventh Circuit noted recently in Estate of O'Neal v. Commissioner, 258 F.3d 1265, 1271 (11th Cir. 2001), that this area of law is generally governed by "two distinct and irreconcilable lines of cases" namely, the cases that follow Ithaca Trust, and the cases that follow Jacobs. The Commissioner's published position is that post-death events are controlling in determining the amount that may be deducted as a claim against the estate whether or not the claim is contested or contingent. Revenue Ruling 77-274 states that where the right to claim an amount is not fixed by the deadline for filing the estate tax return, the taxpayer can protect his right to claim the deduction by filing a protective claim on Form 843. Rev. Rul. 77-274, 1977-2 C.B. 326. The Service has also ruled that regardless of the nature of the claim, no deduction will be allowed for claims against the estate which have not been paid or will not be paid because the creditor waives payment, fails to file his claim within the prescribed time limit and under the conditions prescribed by applicable local law, or otherwise fails to enforce payment. See Rev. Rul. 60-247, 1960-2 C.B. 272 (denying a deduction for an otherwise valid claim which became void and uncollectible after the date of death by virtue of noncompliance with a state statute of limitations on filing probate claims). See also Rev. Rul. 75-24, 1975 C.B. 306, and Rev. Rul. 75-177, 1975-1 C.B. 307.

Some courts, including the Ninth Circuit, have either held or noted that where the claim is contested, contingent, or unenforceable on the date of death, post-death events are considered in determining the allowable deduction. Propstra v. United States, 680 F.2d 1248, 1253 (9th Cir. 1982) ("The law is clear that post-death events are relevant when computing the deduction to be taken for disputed or contingent claims."), Gowetz v. Commissioner, 320 F.2d 874 (1st Cir. 1963), aff'g Taylor v. Commissioner, 39 T.C. 371 (1962) (denying a deduction for a contested claim for a marital settlement rendered unenforceable by a spouse's remarriage); Estate of Van Horne v. Commissioner, 78 T.C. 728, 734 (1982), aff'd, 720 F.2d 1114 (9th Cir. 1983), cert. denied, 466 U.S. 980 (1984) (noting in dicta that post-death events are relevant in cases where the claims are potential, unmatured, contingent, or contested at the date of death); Estate of Courtney v. Commissioner, 62 T.C. 317 (1974) (denying a deduction for mortgages that were never presented to the estate); Estate of Cafaro v. Commissioner, T.C. Memo. 1989-348 (limiting deductions for contested business debts existing at the date of death to amounts actually paid).

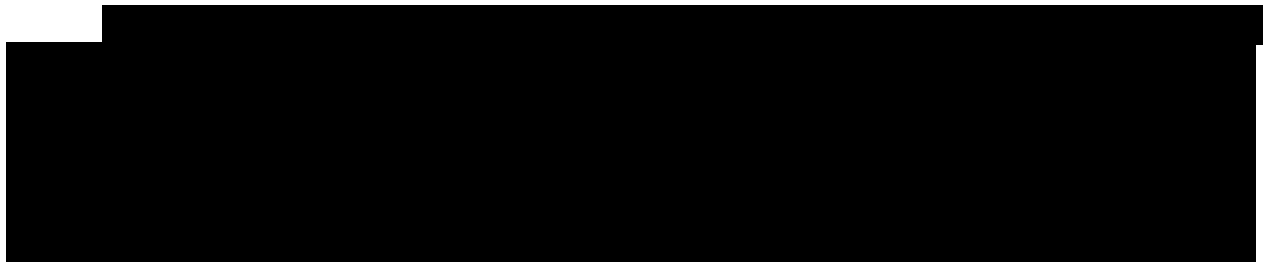
The Ninth Circuit decision in Propstra involved lien claims against an estate that had been compromised for a lesser amount. Although the government argued

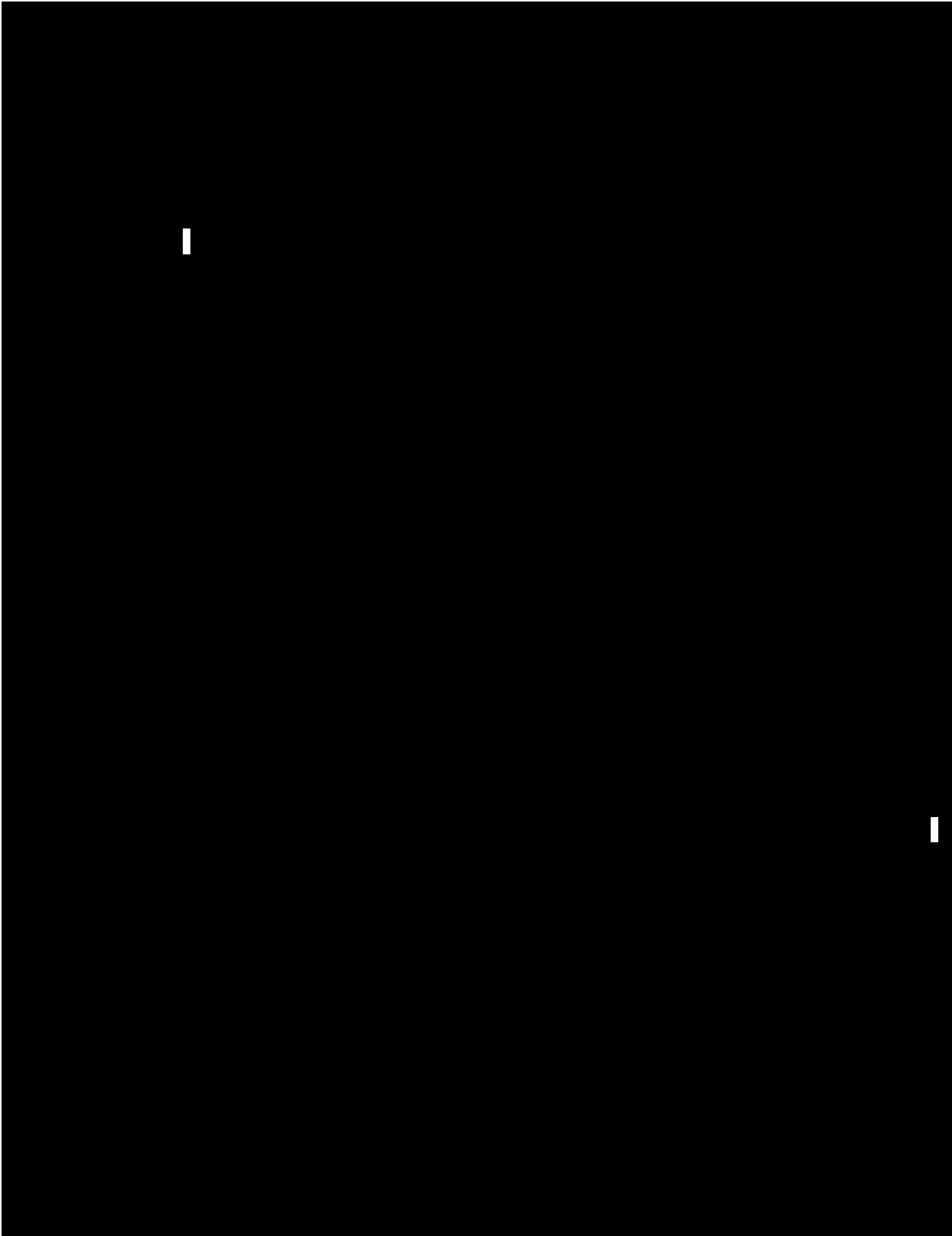
to the contrary, the court found that at the date of death, the estate had no colorable defense to the claims, and the claimant did not have the ability to compromise the claim. Propstra, 680 F.2d at 1254. The court, citing Treas. Reg. § 20.2053-1(b)(3), stated that the preliminary determination to be made was the nature of lien claims against the estate. Propstra, 680 F.2d at 1253. The court then held that “as a matter of law, 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.” Propstra, 680 F.2d at 1254. However, the court noted in dicta that “[t]he law is clear that post-death events are relevant when computing the deduction to be taken for disputed and contingent claims.” Id. at 1253. Based upon the facts, the court determined that the lien claims were certain and enforceable at the time of death, and therefore the post-death compromise of the claim could not be considered in determining the amount of the deduction.

Estate of Van Horne involved an undisputed spousal support obligation calculated by using actuarial tables. The obligation was terminated after four monthly payments when the recipient died. In Van Horne the Ninth Circuit makes clear that its holding is limited to “certain and enforceable” claims. The government argued that the spousal support obligations were not a “sum certain” and therefore should not be governed by the rule enunciated in Propstra. The court disagreed and held that, “legally enforceable claims valued by reference to an actuarial table meet the test of certainty for estate tax purposes.” Van Horne, 720 F.2d at 1117.

In the present case, appeal will lie to the Ninth Circuit. The claims filed by Wife, Daughter and Son with the executor of Decedent’s estate were denied by the estate. In addition, the estate actively contested the subsequent litigation. The estate appears to have had affirmative defenses to the suit filed by Family. We believe that, based upon the Ninth Circuit’s dicta in Propstra and Van Horne, the Ninth Circuit would hold in this case that post-death events are relevant in computing the permissible § 2053(a)(3) deduction because the claims in this case were disputed and contingent. Based upon published Service position and the Ninth Circuit’s guidance in this area, the estate’s deduction should be limited to the amounts eventually paid in settlement of the claims. The estate, accordingly, may deduct \$w as a claim against the estate under § 2053(a)(3).

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS







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Please call if you have any further questions.

By: MELISSA C. LIQUERMAN
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