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The IRS's Flawed Solution to the Controversy over Deductible Claims Against the Estate and the Necessity for a Date-of-Death Standard, 42 J. Marshall L. Rev. 789 (2009)

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THE IRS'S FLAWED SOLUTION TO THE CONTROVERSY OVER DEDUCTIBLE CLAIMS AGAINST THE ESTATE AND THE NECESSITY FOR A DATE-OF-DEATH STANDARD

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I. INTRODUCTION

Does it matter *where* you die? Under the current law, tax professionals and the Internal Revenue Service ("Service") would answer the question in the affirmative: that where one dies can make a significant difference in the amount of assets that remains in the decedent's estate. As the law stands, differing standards across the country lead to inconsistent valuations of decedents' estates.[1] To some estates, this difference could mean millions.

Current estate tax law imposes a tax on the transfer of the taxable estate upon death.[2] The taxable estate, defined by Internal Revenue Code (the "Code") section 2051,[3] is the decedent's "net" estate, a separate concept from the "gross" estate.[4] Pursuant to sections 2031 through 2045 of the Code, the gross estate includes the value of all property in which the decedent had an interest at the time of death.[5] The Code also provides for a

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1. Jeffrey M. Loeb, *Crossed Circuits on Estate Tax Deductibility of Disputed or Contingent Claims*, 12 CAL. TR. & EST. Q. 6, 6 (2006) (discussing the complex history of the split among the circuit courts of appeals regarding deductible claims against the estate).

2. I.R.C. § 2001(a) (2006). This section provides that "[a] tax is hereby imposed on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States." *Id.*

3. I.R.C. § 2051.

4. REGIS W. CAMPFIELD ET AL., TAXATION OF ESTATES, GIFT AND TRUSTS ¶ 25,001 (23d ed. 2006).

5. I.R.C. §§ 2031-2045. According to Treasury Regulation 20.2033-1(a), "the gross estate of a decedent [includes] . . . the value of all property, whether real or personal, tangible or intangible, and wherever situated, beneficially

number of deductions[6] that reduce the gross estate to a net figure, known as the taxable estate.[7] This net amount is then subject to the federal estate tax. Despite the purpose of the Code to ensure the uniform application of estate tax laws throughout the nation, the inconsistent interpretations of section 2053[8] of the Code have led to the disparate treatment of similarly situated estates.

Internal Revenue Code section 2053(a) permits estate tax deductions for "claims against the estate" that are "allowable by the laws of the jurisdiction . . . under which the estate is being administered."[9] Notably, section 2053(a) does not reference the date for valuing such claims against a decedent's estate.[10] The

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owned by the decedent at the time of his death." Property is included in the gross estate at its fair market value (subject to exceptions) upon the decedent's date of death under section 2031 unless the executor of the decedent's will elects to value the property on the alternative valuation date under section 2032. I.R.C. §§ 2031-32.

6. I.R.C. § 2053, the topic of this Comment, allows a deduction for claims against the estate. I.R.C. § 2054 allows a deduction for casualty and theft losses incurred during the settlement of the estate. I.R.C. § 2055 allows a deduction for charitable transfers. I.R.C. § 2056 allows a deduction for marital transfers. I.R.C. § 2057 allows a deduction for the adjusted value of the qualified family-owned business interests of the decedent. I.R.C. § 2058 allows a deduction for state death taxes.

7. The rationale for the deductions allowable under sections 2051 through 2058 is to eliminate from estate taxation those portions of the gross estate that are expended in paying expenses of the estate. Because these expended portions are not transferred to the decedent's beneficiaries or heirs, they are intended to be excluded from the estate transfer tax. *See* Prop. Reg. § 20.2053(1-9), 72 Fed. Reg. 20080-87 (2007) (explaining the new provisions of section 2053 under the proposed amendments); *see also* Propstra v. United States, 680 F.2d 1248, 1250 (9th Cir. 1982) (holding that:

> [b]ecause the estate tax is a tax on the privilege of transferring property upon one's death, the property to be valued for estate tax purposes is that which the decedent actually transfers at his death rather than the interest held by the decedent before death or that held by the legatee after death).

8. I.R.C. § 2053(a)(3).

9. *Id.* The entire language of section 2053(a) includes:

> [f]or 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 on, or any indebtedness in respect of, property where the value of the decedent's interest therein, undiminished by such mortgage or indebtedness, is included in the value of the gross estate, as are allowable by the laws of the jurisdiction, whether within or without the United States, under which the estate is being administered.

I.R.C. § 2053(a).

10. *See* Anthony Vecino, *Section 2053 and the Extent to Which Post-Death Events Should Be Considered in Determining the Value of a Taxable Estate*, CAL. TAX LAW., Winter 2007, at 14 (explaining that the current statutory

applicable Treasury regulation explains that deductible claims against the estate must "represent personal obligations of the decedent existing at the time of his death, whether or not then matured."[11] Another Treasury regulation, however, provides that an item may be deducted even though its exact amount is not then known, provided it is ascertainable with reasonable certainty and will be paid.[12] These two regulations are arguably contradictory[13] and, therefore, offer little guidance regarding the date on which claims should be valued.[14] This lack of direction has led to inconsistencies among the circuit courts of appeals and two vastly different schools of thought on the matter.[15]

To better understand the consequences of the conflicting judicial interpretations, consider the following illustration. Pamela Patient files a malpractice lawsuit against Donald Doctor for three million dollars. Shortly thereafter, Donald dies unexpectedly, leaving the dispute unresolved. Using expert appraisals of the claim, Donald's executor takes a two million

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authority gives very little guidance on whether to consider postmortem events in determining the value of the taxable estate); *see also* Fran M. DeMaris, *IRS Issues Proposed Regs. Regarding Estate Tax Deductions Under I.R.C. § 2053*, CANNON FIN. INST., INC., May 15, 2007, http://www.cannonfinancial.com/news/newsDetail.cfm?ID=134 (discussing the history leading to the inconsistent treatment of estates under section 2053).

11. Treas. Reg. § 20.2053-4 (1958).

12. Treas. Reg. § 20.2053-1(b)(3) (as amended in 1972); *see also* Estate of Hester v. United States, No. 5:06-cv-00041, 2007 U.S. Dist. LEXIS 14834, at *14 (W.D. Va. Mar. 2, 2007) (holding that no deduction was allowed under section 2053(a) because the estate had neither an actual or expected claimant nor a cognizable claim).

13. Section 20.2053-4 seems to favor a date-of-death valuation, while section 20.2053-1(b)(3) appears to require courts to consider postmortem events. *See* Benjamin Clark Brown, *Life After Death? The Role of Postmortem Events in Calculating Deductions for Claims Against Estates*, 60 WASH. & LEE L. REV. 579, 584 (2003) (analyzing the components of the debate regarding postmortem events that should play a role in valuing deductions).

14. *Id.* at 583.

15. *See* Roger McEowen, *IRS Issues Proposed Regulations Providing Guidance on How Post-Death Events Impact Taxable Estate Value*, AG DECISION MAKER, Iowa St. Un., 2007, http://www.extension.iastate.edu/AgDM/articles/mceowen/McEowCIApr07b.html (discussing the history behind the two lines of reasoning that developed in the circuit courts). As a result of the silence by the regulations, executors lack a definite rule controlling the value of such deductions. Consequently, this leads to litigation that "drains precious IRS resources that are already severely strained." *See* Brown, *supra* note 13, at 583 (discussing the problems resulting from the regulations' lack of clarity relating to deductible claims against the estate); *see also* Albert B. Crenshaw, *IRS Lacks Resources it Needs, Departing Commissioner Says*, WASH. POST., Oct. 11, 2002, at E4 (commenting on the tight budgets preventing the Service from hiring professionals to find unreported income and over-stated deductions).

dollar estate tax deduction under section 2053 as a claim against the estate. Donald's estate eventually settles with Pamela for one million dollars.

If Donald's estate was administered within the jurisdiction of the Fifth Circuit, the two million dollar deduction would be permissible as a date-of-death valuation of the claim against the estate.[16] But if the estate was administered within the Eighth Circuit,[17] the estate would not be permitted to take a deduction for the amount of the disputed liability. Instead, the estate would be permitted to take a deduction only for the one million dollar amount that was actually paid. This illustration demonstrates that the differing standards among the circuit courts promote inconsistent applications of estate tax law.

Recognizing the issue, in April 2007, the Treasury Department and the Internal Revenue Service issued Proposed Regulations,[18] which seek to clarify section 2053.[19] The Proposed Regulations attempt to resolve the problem by setting rules that would govern situations where the precise amount of the estate's liability is uncertain at the date of death.[20]

This Comment seeks to analyze the Proposed Regulations and offers an alternative method for valuing deductible claims against the estate. Part II will explore the judicial history of relevant case law and identify reasons for the split decisions from the circuit courts of appeals. Part III will discuss the relevant sections of the Proposed Regulations and analyze their potential shortcomings. More specifically, it will examine the effects of the Proposed Regulations and their failure to adequately address the problems of the current Code. Part IV will propose that a date-of-death valuation approach will create a more efficient and equitable solution to the current inequities in the estate tax system.

II. BACKGROUND

There are two leading, but considerably different, views among the circuit courts of appeals as to the deductibility under I.R.C. § 2053(a) of disputed or contingent claims against the

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16. The deduction of the appraised amount of two million dollars is permissible regardless of the fact that Donald's estate actually paid only one million dollars. *See infra* text accompanying notes 50-57 (discussing the Fifth Circuit's adherence to the date-of-death valuation standard).

17. *See infra* text accompanying notes 36-41 (discussing the Eighth Circuit's consideration of postmortem events in valuing claims against the estate).

18. *See* Prop. Regs. §§ 20.2053(1-9), 72 Fed. Reg. 20080-87 (explaining the new provisions of § 2053 under the Service's proposed amendments).

19. I.R.C. § 2053.

20. Prop. Regs. §§ 20.2053(1-9), 72 Fed. Reg. 20080-87.

decedent's estate.[21] One side of the split follows the policy that a decedent's estate may not deduct the date-of-death value of a disputed or contingent claim, but must pay the full estate taxes, await resolution of the claim, and then seek a tax refund.[22] On the other side, a decedent's estate may deduct the date-of-death value of a disputed or contingent adverse claim,[23] leaving the Service with the opportunity to challenge the amount of the deduction in the event that postmortem events significantly alter the deduction.[24]

The discrepancies in the circuit court rulings have led to an unseemly lack of consistency among tax courts, resulting in disparate treatment of similarly situated estates.[25] In certain circuits, the date-of-death value of the deduction allowable to taxpayers for disputed or contingent claims may end up being greater than the amount actually paid to resolve the claim.[26] Conversely, in circuits that allow postmortem events to be considered, the amount of the taxpayer's deduction is based entirely on the amount ultimately paid postmortem to resolve the disputed or contingent claim.[27] The discrepancy has prompted one court to assert that the issue "is so readily susceptible to and so obviously yearning for legislative clarification."[28]

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21. Steve R. Akers, *Proposed Regulations Limiting Estate Tax Deductions for Uncertain Claims Against Decedents and Other Administration Expenses under § 2053*, ILL. ST. B. ASS'N SEC. TR. & EST., Sept. 2007, at 1, *available at* http://www.isba.org/Sections/ trustsestates/9-07.pdf.

22. Loeb, *supra* note 1, at 6.

23. *Id.*

24. I.R.C. § 6501 provides that the Service has three years from the date the estate tax return is filed to assess a tax on an estate. If an estate remains unsettled beyond this date because of disputed or contingent claims, the Service must issue a notice of deficiency to preserve any claim for underpayment it may have. I.R.C. § 6501(a).

25. *See* Akers, *supra* note 21, at 2 (describing discrepancies in circuit court rulings); *see also* Jay Cloud, *Proposed Regulations Under 2053: The IRS Proposed Changes to the Method for Determining Deductions for Claims Against an Estate*, TENN. B. ASS'N SEC. EST. PLAN. & PROB., May 2007, *available at* http://www.tba.org/sections/EstateLaw/newsletters/estate_05_21_07.htm#Anchor-Fourth-35882 (summarizing the Service's proposed amendments to § 2053); DeMaris, *supra* note 10 (noting the inconsistencies that have developed as a result of the lack of direction from the applicable regulations).

26. Akers, *supra* note 21, at 2.

27. *Id.*

28. Green v. United States, 447 F. Supp. 885, 894 (E.D. Ill. 1978). Others have suggested that "this is an area ripe for litigation with the IRS." Francis J. Antonucci & Robert Whitman, *After Death Tax Planning: Minimizing Tax Liabilities*, 2004 A.L.I.-A.B.A. 118.

The split among the circuit courts of appeals stems from the seminal case on the subject of deductibility of claims[29]—*Ithaca Trust v. Commissioner*,[30] a 1929 United States Supreme Court decision. In *Ithaca Trust*, the decedent made a gift to his wife of a life estate in the residue of his estate with the remainder passing to charity.[31] The issue before the Court was whether the amount of the testator's charitable deduction should be calculated by valuing the gift to charity on the decedent's date of death, reduced by the value of the wife's estate (to be determined upon her death) or by mortality tables showing the probabilities as they stood on the day when the testator died.[32] The Court ruled that "the value of the thing to be taxed must be estimated as of the time when the act is done."[33] This ruling established a clear rule that postmortem events were not to be considered in the valuation of deductions for charitable contributions.[34] But *Ithaca Trust* did not expressly extend its reasoning to every case involving deductions from the taxable estate, thereby opening the issue of whether its narrow holding should apply to deductions for claims other than charitable contributions against estates.[35]

Only months after the decision in *Ithaca Trust*, *Jacobs v. Commissioner*[36] was brought before the Eighth Circuit. In *Jacobs*, the widow elected to receive money from the decedent's will in lieu of her prenuptial agreement amount.[37] The estate wanted to

29. Loeb, *supra* note 1, at 6.

30. Ithaca Trust v. United States, 279 U.S. 151 (1929).

31. *Id.* at 154.

32. The wife died only six months after the decedent; consequently, it was feasible to calculate the deduction based on the actual facts in the case. *Id.* at 155. However, the Court noted in its decision that "[t]he first impression is that it is absurd to resort to statistical probabilities when you know the fact. But this is due to inaccurate thinking . . . . Tempting as it is to correct uncertain probabilities by the now certain fact, we are of the opinion that it cannot be done." *Id.* One theory suggests that *Ithaca Trust* was decided on the principle that "[a] call for absolute certainty would doom the charitable deduction in all cases, for there is no such thing." Leo L. Schmolka, *Income Taxation of Charitable Remainder Trusts and Decedents' Estates: Sixty-Six Years of Astigmatism*, 40 TAX L. REV. 1, 21-22 (1984).

33. *Ithaca Trust*, 279 U.S. at 155.

34. Brown, *supra* note 13, at 588. It is important to note that *Ithaca Trust* involved a deduction under I.R.C § 403(a)(3) of the Revenue Act of 1918 (the predecessor to I.R.C. § 2055) and not a deduction under I.R.C § 403(a)(1) (the predecessor to I.R.C. § 2053). Vecino, *supra* note 10, at 15. Consequently, some courts declined to extend the holding of *Ithaca Trust* beyond deductions under § 2055. *Id. See, e.g.*, Comm'r v. Shively, 276 F.2d 372, 374 (2d Cir. 1960) (asserting that the ruling in *Ithaca Trust* was very narrow and therefore only controlled cases concerning charitable deductions).

35. *Shively*, 276 F.2d at 374.

36. Jacobs v. Comm'r, 34 F.2d 233 (8th Cir. 1929).

37. *Id.*

deduct the prenuptial agreement amount in accordance with the reasoning of *Ithaca Trust* because it was a date-of-death claim against the estate.[38] The Eighth Circuit acknowledged *Ithaca Trust,* but distinguished the case before it by claiming that *Ithaca Trust* only applied to charitable deductions.[39] The court held that the language of the Code[40] allowed for postmortem events to be taken into consideration.[41] Following the Eighth Circuit's refusal in *Jacobs* to apply *Ithaca Trust* beyond the scope of charitable deductions,[42] a split of authority quickly developed among several circuits, each aligning itself with the decision in either case.[43]

More than fifty years after *Jacobs* caused the split, *Propstra v. United States*[44] complicated the issue further.[45] *Propstra* considered whether a taxpayer was entitled to deduct the full amount he owed a real estate organization as of his date of death despite having later settled the claim for a lesser amount.[46] The Ninth Circuit ruled unequivocally that "as a matter of law, when claims are for sums certain and are legally enforceable as of the date of death, postmortem events are not relevant in computing the permissible deduction."[47] The court went on to note, however, that postmortem events would be relevant for disputed or

38. *Id.* at 236.

39. *Id.*; *see* Estate of Sachs v. Comm'r, 856 F.2d 1158, 1161 (8th Cir. 1988) (reiterating its assertion in *Jacobs* that *Ithaca Trust* only governs in cases relating to charitable deductions).

40. The Court specifically referenced I.R.C. § 403(a) of the Revenue Act of 1918, which was the predecessor to I.R.C. § 2053(a).

41. *Jacobs*, 34 F.2d at 236. The rationale was based on the fact that "claims against the estate" were deductible under the same section as funeral and administration expenses, which do not exist at the time of death and thus need to be determined by postmortem events. *Id.* Interestingly, the Supreme Court ultimately denied certiorari in *Jacobs*. Jacobs v. Comm'r, 34 F.2d 236 (8th Cir. 1929), *cert. denied*, 280 U.S. 603 (1929). Some found that this supported the notion that *Ithaca Trust* did in fact only apply to charitable deductions and not to claims against the estate (as the *Jacobs* court reasoned). McEowen, *supra* note 15.

42. Brown, *supra* note 13, at 590.

43. *See* Comm'r v. Strauss, 77 F.2d 401, 405 (7th Cir. 1935) (allowing deduction of date-of-death balance due from decedent on promissory note and ignoring lender's postmortem failure to present a state court claim for payment). *But see* Comm'r v. State St. Trust Co., 128 F.2d 618, 622 (1st Cir. 1942) (disallowing deduction for present value of monthly amounts due to former spouse under divorce decree because of a postmortem compromise of amount due); *Shively*, 276 F.2d at 375 (disagreeing with "cases that state that subsequent events are to be ignored even when they render the claim entirely unenforceable in the probate proceeding settling the estate").

44. Propstra v. United States, 680 F.2d 1248 (9th Cir. 1982).

45. Vecino, *supra* note 10, at 15.

46. *Propstra*, 680 F.2d at 1253.

47. *Id.* at 1254.

contingent claims.[48] This assertion broadened the scope of the issue and drew a distinction between sums "certain" and sums "uncertain" at the date of death.[49]

The Fifth Circuit's leading case,[50] *Estate of Smith v. Commissioner*,[51] also adheres to the *Ithaca Trust* line of cases but distinguishes itself from *Propstra's* treatment of sums "uncertain." In *Smith*, the decedent's estate ultimately settled a claim brought against it for less than the original amount of the claim.[52] The court nonetheless held that the claim must be valued as of the date of death and "must [be] appraised on information known or available up to (but not after) that date."[53] In its decision, the *Smith* court explicitly rejected the distinction drawn by the Ninth Circuit in *Propstra* between sum certain and sum uncertain claims, holding that no distinction is drawn in I.R.C. § 2053(a)(3) or *Ithaca Trust*.[54] As part of its reasoning, the Fifth Circuit noted that "since *Ithaca Trust*, Congress has thrice reenacted the entire Internal Revenue Code[55] and has made countless other modifications to the statute, but has never seen fit to overrule *Ithaca Trust* legislatively."[56] *Smith* is significant because it "extends the reach of the *Ithaca* line of case law" to cases where

48. *Id.* The court relied on *Estate of DuVal v. Comm'r* to justify its position. 4 T.C. 722 (1945), *aff'd*, 152 F.2d 103 (9th Cir. 1945), *cert. denied*, 328 U.S. 838 (1946). *DuVal* denied a deduction of a contingent liability because it had become unenforceable when the bank agreed to look only to the primary debtor and not the decedent. *Id.* at 725. Some have suggested, however, that because *Duval* lacks any "real precedential value," the court's assertion in *Propstra* that postmortem events are relevant regarding disputed or contingent claims "appears to be nothing more than judicial contrivance." Loeb, *supra* note 1, at 10.

49. Vecino, *supra* note 10, at 15. In just over a year after *Propstra*, the Ninth Circuit addressed the question of whether a spousal support obligation was a "sum certain" in *Estate of Van Horne v. Commissioner*, 720 F.2d 1114 (9th Cir. 1983). The court reiterated its support for *Ithaca Trust* and provided the rule that a "claim that is actuarially valued is not uncertain for estate tax purposes." *Van Horne*, 720 F.2d at 1116.

50. Vecino, *supra* note 10, at 15.

51. Estate of Smith v. Comm'r, 198 F.3d 516 (5th Cir. 1999).

52. *Id.*

53. *Id.* at 517.

54. Loeb, *supra* note 1, at 11. In *Smith*, the court stated "[t]here is only a semantic difference between a claim that may prove to be invalid and a valid claim that may prove to have a value of zero." *Smith*, 198 F.3d at 525. The *Smith* court tried to reconcile its decision with *Propstra* by labeling its assertion relating to uncertain claims as "dicta." Loeb, *supra* note 1, at 12.

55. *Ithaca Trust Co.*, 279 U.S. 151 (1929) (deciding *Ithaca Trust* under the Revenue Act of 1918). The tax statutes were recodified by Acts of Congress in 1939, 1954, and 1986.

56. *Smith*, 198 F.3d at 524.

the claim is uncertain.[57] Other circuits that follow the *Ithaca Trust* line of reasoning include the Tenth[58] and Eleventh Circuits,[59] both of which cite to *Propstra*.

On the other side of the split are the circuits that follow the *Jacobs* line of reasoning. In 1988, the Eighth Circuit again addressed the *Jacobs* rule in *Estate of Sachs v. Commissioner*.[60] In *Sachs*, after the decedent had made net gifts of stock to irrevocable trusts, the estate paid the income tax and deducted the amount as a claim against the estate.[61] Subsequently, Congress forgave the income tax liability under the Tax Reform Act of 1984.[62] The Eighth Circuit denied the deduction on the ground that the new legislation made the claims "disappear,"[63] and therefore the deductions were no longer valid.[64] The court reasserted its reasoning in *Jacobs* by emphasizing that *Ithaca Trust* only applies to the valuation of charitable bequests, and the public policy of providing certainty in situations involving charitable bequests exists to stimulate charitable giving, but no such reason exists in valuing claims against the estate.[65] The Eighth Circuit is joined by the First Circuit,[66] the Second Circuit,[67] and the Service[68] in

57. Loeb, *supra* note 1, at 11.

58. *See* Estate of McMorris v. Comm'r, 243 F.3d 1254 (10th Cir. 2001) (refusing to consider postmortem events that reduced a deduction for income tax liabilities after the income taxes were refunded to the estate as a result of unrelated events). The court also discussed that policy reasons prompt the adoption of the date-of-death line of reasoning because "this principle provides a bright line rule which alleviates the uncertainty and delay in estate administration." *Id.* at 1261.

59. *See* O'Neal v. United States, 258 F.3d 1265 (11th Cir. 2001) (aligning with the cases that follow *Ithaca Trust*). Notably, *O'Neal* was remanded for a recalculation of the date-of-death values, suggesting that the courts are not bound to Form 706 values as filed. *See* Larry Maples, *Post-Death Events and Valuation of Claims*, CPA J., Nov. 2003, *available at* http://www.nysscpa.org/cpajournal/2003/1103/dept/d115003.htm (discussing the background relating to the judicial split).

60. *Sachs*, 856 F.2d at 1160.

61. The estate filed the deduction under I.R.C. § 2053(a)(3). *Id.* at 1159.

62. The Tax Reform Act of 1984 provided that the income tax paid by the donees on a net gift is not includible in the taxable income of the donor. Tax Reform Act of 1984, Pub. L. No. 98-369, § 1026, 98 Stat. 494, 1031 (1984).

63. *Sachs*, 856 F.2d at 1160.

64. The Eighth Circuit reversed the Tax Court's decision, which upheld the taxpayer's position that the tax liability was deductible as a claim against the estate despite the fact that subsequent legislation forgave the tax liability. *Id.*

65. *Sachs*, 856 F.2d at 1160. The *Sachs* holding directly contradicts the Tenth Circuit's holding in *McMorris*, despite their similar fact scenarios. Vecino, *supra* note 10, at 16; *see also* John Zimmerman, *Claims Against the Estate: A Continuing Controversy*, 10 TAX MGMT. EST. GIFTS & TR. J. 65, 66 (1985) (observing that certain courts distinguish *Ithaca Trust* because it involved charitable deductions).

66. *See* State St. Trust v. Comm'r, 128 F.2d 618 (1st Cir. 1942) (allowing

support of the *Jacobs* line of reasoning.[69]

In the almost eighty years since *Ithaca Trust* and *Jacobs*, the Supreme Court has declined to rule on the issue despite the discrepancies among the circuits.[70] In order to finally resolve the circuit courts of appeals' seemingly unfair disparate applications of tax laws relating to claims against the estate, the Service issued Proposed Regulations as a complement to section 2053.[71] The goal of the Proposed Regulations is to create a fair and effective administration of the tax laws.[72] Despite their objectives, the

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postmortem events to be taken into account in valuing the deductible claim). In *State Street Trust*, the wife filed a claim against the estate of her deceased husband for payment of the amounts due to her under the divorce decree. *Id.* at 619. Later, the probate court approved a compromise agreement for the liquidation of the claim by paying a sum in cash and monthly payments as long as she lived and remained unmarried. *Id.* The First Circuit held that the Tax Board should consider the possibility of the wife's remarriage when determining the value of the deduction by the decedent's estate. *Id.* at 622.

67. *See Shively*, 276 F.2d at 375 (disagreeing with "cases that state that subsequent events are to be ignored even when they render the claim entirely unenforceable in the probate proceeding settling the estate").

68. The Service aligns itself with the *Jacobs* line of reasoning in advocating for postmortem events to be used to value contingent and contested claims. *See* Maples, *supra* note 59 (discussing the arguments for both sides of the issue). One reason for the Service's position is that permitting estates to deduct claims that will not be paid "constitutes windfall in certain cases." William L. Raby & Burgess J.W. Raby, *Post-Death Events and Claims Against Estates*, 91 TAX NOTES 105, 106 (2001).

69. Another significant case on the issue is *Kyle v. Commissioner*, 94 T.C. 829, 850 (1990). In *Kyle*, the court drew a distinction between the issues of valuation and enforceability of a claim. The court held that there "appear[ed] to be two broad categories of cases that have considered post-death events: (1) [c]ases concerning the valuation of claims that are certain and enforceable at the time of death and (2) cases concerning the enforceability of disputed or contingent claims against the estate." *Id.* at 849. Thus, the court blended the elements in the two lines of reasoning and offered the position that courts should consider postmortem events in determining validity of claims but not in determining their valuation. *Id.*

70. *See, e.g.*, *Jacobs*, 34 F.2d at 236; *DuVal*, 4 T.C. at 725-26; *Van Horne*, 78 T.C. at 736. In 2001, Congress passed legislation that phases out the estate tax and ultimately eliminates the tax in 2010. *See* Economic Growth and Tax Reconciliation Act of 2001, Pub. L. No. 107-16 § 501(a), 115 Stat. 38, 69 (eliminating the estate tax through annual reductions). The Act will abolish the estate tax as of 2010, but unless it is extended by an act of Congress, the estate tax will automatically be reinstated in 2011. *See id.* § 901 (expressing the "sunset" provisions for the estate tax repeal). Consequently, it is not likely that the Supreme Court will address the issue of deductions involving claims against the estate until the future of the estate tax is more certain. *See* Brown, *supra* note 13, at 584 (discussing probable judicial or congressional action).

71. Prop. Regs. §§ 20.2053(1-9), 72 Fed. Reg. 20080-87; *see also* Cloud, *supra* note 25 (discussing the rationale behind the Proposed Regulations).

72. Prop. Regs. §§ 20.2053(1-9), 72 Fed. Reg. 20080-87.

Proposed Regulations fail to address the issues fully, leaving the door open to further discussion on the topic.

III. ANALYSIS

A. The IRS Takes Action

The Proposed Regulations lay out basic rules that would govern the deductibility of expenses and claims against the estate under section 2053.[73] In general, the Proposed Regulations purport that events occurring after a decedent's death are to be considered when determining the deductible amount.[74]

The most significant change under the Proposed Regulations is the limit on the deductibility of claims against the estate. Essentially, deductions under section 2053 are limited to amounts actually paid by the estate in satisfaction of deductible expenses and claims.[75] In order to be deductible, the claim must: (A) represent personal obligations of the decedent existing at the time of the decedent's death, (B) be enforceable against the decedent's estate at the time of payment,[76] and (C) actually be paid by the estate in settlement of the claim.[77]

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73. The Proposed Regulations amend multiple provisions of section 2053. This Comment will only address the segments of the Proposed Regulations that govern the deductibility of claims against the estate. *See* Prop. Reg. § 20.2053-1(b)(2), 72 Fed. Reg. 20082 (stating that final court decisions as to the amount and enforceability of the claim will be accepted in determining the amount deductible as long as the amount is paid or meets the requirements for estimated expenses); Prop. Reg. § 20.2053-1(b)(3), 72 Fed. Reg. 20083 (stating that settlements will be accepted if they are reached in bona fide negotiations between adverse parties with valid claims recognizable under applicable law, and if they are not inconsistent with applicable law); Prop. Reg. § 20.2053-1(b)(5), 72 Fed. Reg. 20083 (stating that a deduction is not allowed to the extent the expense or claim is compensated for by insurance or is otherwise reimbursed).

74. Despite the recent trend by the circuit courts to favor date-of-death valuations of claims against the estate, the Service rejected the reasoning behind such cases. In the preamble to the Proposed Regulations, the Service asserts that the date-of-death approach is inefficient and expensive for both the taxpayer and the government. 72 Fed. Reg. 20081; *see also* Akers, *supra* note 21, at 2 (discussing the rationale behind the Proposed Regulations).

75. Prop. Reg. § 20.2053-1(b)(1), 72 Fed. Reg. 20082.

76. Decidedly, the term "enforceable" is ambiguous, creating a potential debate as to its precise meaning. *See* Jonathan G. Blattmachr & Diana S.C. Zeydel, *Prop. Regs. on the Deduction for Administration Expenses and Claims*, 34 EST. PLAN. 3, 12 (2007) (discussing the modifications under the Proposed Regulations and the potential consequences).

77. If the amount of liability is not ascertainable before the period of limitations for claims of refund expires, the estate may file a protective claim for refund in order to preserve its right to claim a refund. The protective claim must satisfy two requirements: (1) it must identify the outstanding liability or

The Proposed Regulations also assert that an estate may not take deductions on estate tax returns for claims that are potential, unmatured, or contested at the time the return is filed.[78] An estate may file a protective claim to preserve its right to receive a tax refund, but only to the extent the estate ultimately pays the pending claim.[79]

Another important modification by the Proposed Regulations is the new treatment of recurring payments that will extend beyond the period for final determination of the estate tax liability.[80] If an estate has an outstanding recurring payment that is not subject to a contingency, it may deduct the present value of the payments as of the date of the decedent's death.[81] As to recurring payments subject to contingencies, the Proposed Regulations limit the deduction to the amounts ultimately paid.[82]

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claim that would have been deductible under § 2053(a) had the liability already been paid, and (2) it must describe the reasons and contingencies delaying the determination of the liability or the actual payment of the claim. *See generally* Treas. Reg. § 301.6402-2 (1967) (stating the requirements for claims for a credit or refund).

It is important to note that the requirements for a protective claim under the Proposed Regulations need clarification. The Final Regulations would need to address "whether a protective claim would be filed in the same manner as any other claim for refund or whether a different procedure is contemplated." *Comments Concerning Proposed Regulations Relating to Deductions for Claims Against an Estate under Section 2053*, AM. B. ASS'N SEC. OF TAXATION, July 24, 2007, at 10 [hereinafter *Comments Concerning Proposed Regulations*]. The final Regulations must also offer guidance as to the time period in which the estate has to notify the Commissioner following the removal of the contingency. *Id.*

78. Prop. Reg. § 20.2053-4(b)(1-2), 72 Fed. Reg. 20084.

79. *See supra* note 77 (noting the two requirements for filing protective claims). Despite the availability of the protective claim to protect the estate's right to claim a later deduction, it is important to note that the Proposed Regulations also state that claims that are unenforceable prior to death or before they are actually paid are not deductible even though the estate pays the claim. Prop. Reg. §20.2053-4(b)(5), 72 Fed. Reg. 20085.

80. Prop. Reg. § 20.2053-4(b)(7), 72 Fed. Reg. 20085. Examples of recurring payments are loan repayments or divorce decrees.

81. *Id.* The present value of the payments would be measured through the valuation rules of I.R.C. § 7520. An example of a recurring noncontingent payment would be a divorce decree whereby the estate is obligated to make annual payments of $20,000 for a period of ten years. If the decedent dies two years later after making only two payments, the estate can take a deduction for the present value of the $80,000 remaining claim against the estate.

82. Prop. Reg. § 20.2053-4(b)(7), 72 Fed. Reg. 20085. An example of a recurring contingent payment would be a divorce decree whereby an estate is obligated to make annual payments of $20,000 for the sooner of a period of ten years or the death of the former spouse. Here, it is not certain that the estate will necessarily make ten payments. If the decedent dies after making only two payments, the estate would not be permitted to take a deduction for the remaining payment obligations.

A deduction is allowed only as each payment is made.[83]

A final significant change to section 2053 under the Proposed Regulations is the treatment of claims by family members,[84] related entities,[85] or beneficiaries. Proposed Regulation section 20.2053-4(b)(4) states that claims by family members, related entities, or beneficiaries of a decedent's estate will be strictly scrutinized to ensure that they are legitimate claims.[86] This Proposed Regulation suggests that there is a rebuttable presumption that claims by such parties are not legitimate or bona fide, and therefore not deductible. The estate is responsible for providing evidence to overcome the presumption against such claims before it can take a deduction.[87]

B. *Potential Shortcomings of the Proposed Regulations*

In the Preamble to the Proposed Regulations, the Service

Notably, a higher deduction may ultimately result for contingent claims because the amount will be deductible at face value, instead of the present value as of the date of death. Blattmachr & Zeydel, *supra* note 76, at 13. The Proposed Regulations also include a provision stating that if a commercial annuity is purchased to satisfy a recurring obligation on an enforceable claim, the estate can deduct the sum of the amount paid for the commercial annuity, regardless of whether the claim is contingent. Prop. Reg. § 20.2053-4(b)(7)(ii), 72 Fed. Reg. 20085.

83. Prop. Reg. § 20.2053-4(b)(7), 72 Fed. Reg. 20085. If the amount of the liability will not be paid or is not ascertainable with reasonable certainty by the expiration of the applicable period of limitations, the estate must properly preserve the claim for refund by filing a protective claim. *See supra* note 77 (noting the two requirements for filing protective claims).

84. Prop. Reg. § 20.2053-4(b)(4) states that family members include "the spouse of the decedent; the grandparents, parents, siblings, and lineal descendants of the decedent or of the decedent's spouse; and the spouse and lineal descendants of any such grandparent, parent, and sibling. Family members include adopted individuals." 72 Fed. Reg. 20084-85.

85. Prop. Reg. § 20.2053-4(b)(4) defines a related entity as:

> An entity in which the decedent, either directly or indirectly, had a beneficial ownership interest at the time of the decedent's death or at any time during the three-year period ending on the decedent's date of death. Such an entity, however, shall not include a publicly-traded entity nor shall it include a closely-held entity in which the combined beneficial interest, either direct or indirect, of the decedent and the decedent's family members, collectively, is less than thirty percent of the beneficial ownership interests (whether voting or non-voting).

72 Fed. Reg. 20084-85.

86. *Id.* The rationale behind the new provision is to prevent family members and beneficiaries from using the claim against the estate deduction to bypass the gift tax system.

87. "Evidence sufficient to rebut the presumption may include evidence that the claim arises from circumstances that would reasonably support a similar claim by unrelated persons or non-beneficiaries." Prop. Reg. §20.2053-4(b)(4), 72 Fed. Reg. 20084-85.

detailed its reasoning behind the changes to section 2053.[88] The Preamble states that the Treasury Department and the Service came to their conclusions after carefully considering the many judicial decisions on the issue,[89] the legislative history of section 2053,[90] and various methods to furthering its goal of "effective and fair administration of the tax laws."[91] The actual payment approach is generally more favorable to the Service's position[92] in that it "prevent[s] estates from arguing for a high date-of-death value of a claim against the estate despite an actual settlement and payment of a much lower amount."[93] However, an examination of the public policy considerations and practical consequences of the Proposed Regulations reveals many inconsistencies and inefficiencies resulting from the provisions.

A significant issue that may arise under the Proposed Regulations is that the estate may encounter liquidity problems.

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88. 72 Fed. Reg. 20080.

89. The Service reaffirmed its support for *Jacobs* and its progeny. 72 Fed. Reg. 20081-82.

90. Notably, the preamble does not explicitly reference the legislative history that it refers to in support of its "actual payment" approach. *See* Akers, *supra* note 21, at 2 (discussing portions of the preamble to the Proposed Regulations).

91. 72 Fed. Reg. 20081. The Service notes that § 2031(a) explicitly requires that the decedent's assets be valued as of the date of death, but that § 2053 is lacking such an instruction. However, "[t]he lack of a statutory requirement to value claims against the estate as of the date of the decedent's death may well be a result of the structure of I.R.C. § 2053(a), rather than some specific congressional intent that date-of-death values should not be used." Press Release, Am. Inst. of Certified Pub. Acct., Comments on Section 2053 Proposed Regulations (REG-143316-03) Regarding How Post-Death Events May Be Considered in Determining the Value of a Taxable Estate (Aug. 8, 2007), *available at* http://tax.aicpa.org/NR/rdonlyres/1982F8EB-99E7-485A-A94E-DC33D319BAA0/0/2053_regs_comments_08_08_07__final_to_IRS.doc.

Section 2053(a) states four categories of items that are deductible. I.R.C. § 2053(a). Two of the items, funeral expenses in § 2053(a)(1) and administrative expenses in § 2053(a)(2), cannot be valued at the date of death. Therefore, it would be impossible to impose by statute that all four categories should be valued at the date of death. It is important to note that funeral and administrative expenses could be valued within a short period of time following the death of the decedent, and usually within the time that it takes to complete administration of the estate.

92. The basis for the Service's argument is that using the date-of-death value requires the taxpayer and the Service to retry the substantive issues underlying the claims against the estate in the context of the tax issue. The Service argues that this approach is expensive in both appraisal and litigation costs. 72 Fed. Reg. 20081. Also, the date-of-death valuation frequently compels the taxpayer to take contradictory positions on the estate tax return and in the substance of the court pleadings. Prop. Reg. § 20.2053(1-9), 72 Fed. Reg. 20080-87.

93. Akers, *supra* note 21, at 6.

An estate involved in a claim that is contested, contingent, or unmatured is prohibited from taking a deduction for such a claim until the claim is actually paid.[94] Essentially, the estate would be required to pay the estate tax and later file for a refund in the amount that would have been deductible.[95] A problem arises when an estate does not have enough liquid assets to cover the judgment or settlement agreement amount after it has already paid the estate tax.[96] Estates may be forced to borrow funds to cover the amount required to settle the claim against it.[97] The estate would undoubtedly suffer significant administrative inconveniences and would endure prejudices from the timely and costly process.[98]

Another related problem with the Proposed Regulations is the potential unfairness that may result for estates involved in claims or counterclaims in the same or related litigation. The standard for the inclusion of assets under estate tax law[99] would be inconsistent with the standard for deducting claims against the estate under the Proposed Regulations. Estates would be required to value their contested claims against a third party as an asset of the estate at the date of the decedent's death.[100] The estate must report the value regardless of whether the dispute has been resolved by the due date for filing the estate tax form. In contrast to the inclusion standard, the deduction standard for claims against the estate under the Proposed Regulations prohibits the estate from deducting the value of the contested claim against it.[101] Instead, the estate must await the resolution of the lawsuit

94. Prop. Reg. § 20.2053-4(b)(1), 72 Fed. Reg. 20084; Prop. Reg. § 20.2053-4(b)(2), 72 Fed. Reg. 20084; *see supra* notes 76-79 and accompanying text (discussing the deductibility of contingent or contested claims under the new Proposed Regulations).

95. The estate must properly preserve the claim for refund by filing a protective claim. *See supra* note 77 (noting the two requirements for filing protective claims).

96. The Code does include certain provisions that allow for extensions to avoid liquidity problems. *See, e.g.*, I.R.C. § 6166 (governing extension of time for paying estate tax where the estate consists largely of interest in a closely held business). However, these extensions will not be applicable in every situation and may not be adequate to effectively protect against liquidity problems. *See id.* (allowing executor of estate to pay tax in subsequent years subject to certain restrictions).

97. *See Comments Concerning Proposed Regulations, supra* note 77, at 6 (discussing the liquidity concerns raised by the Proposed Amendments).

98. The estate may face problems securing loans from third party lenders or end up incurring excessive legal and administrative fees.

99. *See* I.R.C. § 2031(a) (defining value of gross estate to include all property, real or personal, tangible or intangible).

100. *Id.* The fair market value of the claim would be included as an asset of the estate.

101. Prop. Reg. § 20.2053-4(b)(2), 72 Fed. Reg. 20084.

before seeking a refund.[102]

Because it is quite common for modern lawsuits to have counterclaims,[103] this provision of the Proposed Regulations is particularly burdensome for the taxpayer. The potential liquidity problems will be even more severe in disputes involving counterclaims. Not only will the estate be barred from taking a deduction for the claim against the estate, but it will also be obligated to include the amount of its claim against the third party as an asset, regardless of whether the estate ultimately receives the estimated amount.[104] Without the benefit of a deduction for the claim, the estate may not have enough liquid funds to cover the estate tax for the potential claim against the third party.[105]

These inconsistent standards are unfairly burdensome for the estate. The Service asserts that the Proposed Regulations will reduce the retrying of cases in the tax court that result from inaccurate valuations.[106] Yet the Service requires the same type of valuations for the inclusion of assets in the estate.[107] These standards are ideologically irreconcilable and realistically unreasonable. While the Service asserts that the Proposed Regulations are based on administrative convenience and efficiency,[108] "this very common situation will result in even more complexity in light of the different approaches that will apply to the claim and counterclaim."[109]

The new provisions relating to recurring payments also create issues for the taxpayer. If an estate is obligated to make recurring payments and that obligation is "certain," the estate is permitted to take the deduction for the amount.[110] This is logical and equitable, as the estate can adequately assess the net estate. But estates are not permitted to deduct claims for contingent recurring payments and, instead, must deduct the payments as they are made.[111] Depending on the type of recurring payment obligation,

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102. The estate must properly preserve the claim for refund by filing a protective claim. *See supra* note 77 (noting the two requirements for filing protective claims).

103. *Comments Concerning Proposed Regulations, supra* note 77, at 6.

104. Blattmachr & Diana, *supra* note 76, at 11.

105. *Id.*

106. 72 Fed. Reg. 20081.

107. I.R.C. § 2033.

108. 72 Fed. Reg. 20081.

109. Akers, *supra* note 21, at 6.

110. Prop. Reg. § 20.2053-4(b)(7), 72 Fed. Reg. 20085; *see supra* notes 80-81 and accompanying text (explaining the rule under the Proposed Regulations regarding the deductibility of recurring claims for "certain" sums).

111. Prop. Reg. § 20.2053-4(b)(7), 72 Fed. Reg. 20085; *see supra* note 82 and accompanying text (explaining the rule regarding the deductibility of recurring contingent claims under the Proposed Regulations).

an estate may be forced to file for annual estate tax refunds for decades.[112] Such situations would be highly problematic, causing estates to possibly incur many additional costs and burdens in filing refund claims every year.[113] Furthermore, the requirement would prevent heirs and executors from obtaining the closure necessary to manage the estate effectively.[114]

Depending on the type of contingency, an accurate valuation of the potential claim can be assessed through methods often used by the Service under inclusion provisions.[115] In fact, the Service has consistently asserted that the actuarial tables must be used to value a stream of future payments to be included for tax purposes.[116] The Service's position on contingent recurring payments under the Proposed Regulations is inconsistent with its position taken elsewhere regarding the estate tax.

Another shortcoming under the Proposed Regulations is the provision regarding claims by family members and beneficiaries.[117] Proposed Regulation section 20.2053-4(b)(4) creates unnecessary burdens for the estate. The current regulations and pertinent provisions of the Proposed Regulations sufficiently guard against the manipulation of claims used to bypass the gift and estate tax systems.[118] For example, with regard to court decrees and

112. An important practical consequence of this provision is that claims not subject to a contingency will take the present or discounted value deduction. But claims subject to a contingency will receive a deduction of the full amount when the taxpayer files the deductions in the year of payment. Thus, "[t]he same payment stream would result in a lesser estate tax for the estate making payments subject to a contingency." Press Release, *supra* note 91, at 4.

An estate with recurring contingent payments pays established deductible liability if it purchases a commercial annuity. However, the estate would be subjected to an additional and unnecessary "expense to achieve the same result that applying the actuarial table achieves under other circumstances in the IRC." Please Release, *supra* note 91, at 3; *see also supra* note 82 (stating the deductibility of commercial annuities under the Proposed Regulations).

113. *See supra* note 77 (noting the two requirements for filing protective claims).

114. *Id.*

115. For example, life annuities are valued using actuarial tables. *See* Treas. Reg. § 20.2031-7 (2000) (requiring the use of actuarial tables for the valuation of ordinary annuities, as well as life and remainder interests in property to be included in the estate).

116. Press Release, *supra* note 91, at 4; *see, e.g.*, Cook v. Commissioner, 349 F.3d 850, 856 (5th Cir. 2003) (holding that a lottery prize was properly valued in accordance with annuity tables for estate tax purposes); Shackleford v. United States, 262 F.3d 1028, 1031-32 (9th Cir. 2001) (discussing the reasonableness of annuity tables used for valuation of noncommercial annuities for estate tax purposes).

117. Prop. Reg. § 20.2053-4(b)(4), 72 Fed. Reg. 20084-85.

118. *See Comments Concerning Proposed Regulations*, *supra* note 77, at 13

settlement of claims, the provisions of the Proposed Regulations require the agreements to resolve bona fide issues.[119] Furthermore, the current regulations adequately protect against fraudulent claims by explicitly stating that "consent to payment of a claim cannot be a cloak for a gift."[120]

Given that the Service's concern is adequately addressed by other regulations, it would create an unnecessary burden on the estate to provide evidence overcoming the presumption that the claim is not legitimate in cases involving family members or beneficiaries.[121] The estate must produce factual proof to validate the claim's validity. But the rule is incomplete in that it does not explicitly state the standard of proof required to overcome the presumption.[122] Moreover, this burden may be inconsistent with the burden of proof provisions of section 7591.[123] The Proposed Regulation provision extends beyond the burden of proof imposed on the taxpayer by section 7591,[124] thereby creating a problem of inconsistency within the Code.[125]

In general, the Proposed Regulations fail to adequately address the controversy over deductible claims against the estate in an equitable and efficient manner. The inconsistent standards created by the Proposed Regulations are likely to cause confusion for estate planners and administrators. Consequently, more liability issues may arise for such parties.[126] Furthermore, the

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(addressing the need to omit section 20.2053-4(b)(4) from the final regulations).

119. Prop. Reg. § 20.2053-1(b)(2)(ii), 72 Fed. Reg. 20082; Prop. Reg. § 20.2053-1(b)(3), 72 Fed. Reg. 20082; *see supra* note 77, at 13 (discussing the Proposed Regulations).

120. Prop. Reg. § 20.2053-1(b)(3), 72 Fed. Reg. 20082.

121. *See supra* notes 84-87 and accompanying text (discussing the burden on the estate in cases involving family members or beneficiaries).

122. Blattmachr & Zeydel, *supra* note 76, at 13.

123. Section 7491 states that the Service bears the burden of proof on a factual issue as long as

> [a] taxpayer introduces credible evidence with respect to any factual issue; . . . the taxpayer has complied with the requirements under this title to substantiate any item; [and] the taxpayer has maintained all records required under this title and has cooperated with reasonable requests by the Secretary for witnesses, information, documents, meetings, and interviews.

I.R.C. § 7491(a)(1-2).

124. *Id.*

125. *See Comments Concerning Proposed Regulations, supra* note 77, at 13 (addressing the need to omit section 20.2053-4(b)(4) from the final regulations).

126. Because the Proposed Regulations are likely to cause a great deal of uncertainty in estate administration, executors may begin to take advantage of I.R.C. § 2204. Section 2204 enables executors to better protect themselves against potential future personal liability. *Id.* The increase of petitions under

new provisions will cause many estates to remain open for years after a decedent's death. This will not only be costly for the estate, but it will also prevent the family and heirs of the decedent from obtaining closure. Additionally, the Service will face higher administrative costs in handling a drastic increase in the number of refunds and protective claims that are filed. In light of the many problems that may arise when the Proposed Regulations become effective,[127] the Service should re-evaluate and amend the regulations before they are published in the Federal Register as final regulations.

IV. PROPOSAL

The Service has appropriately identified the need for regulations in order to address the current disparate treatment of similarly situated estates. The final regulations must promote the fair and equitable administration of the tax laws by effectively balancing the interests of the government with those of the taxpayer. A reasonable solution must weigh the Service's legitimate concern that estate administrators will take unfair deductions based on overvalued claims[128] against the taxpayer's interest in a consistent rule that promotes the timely and just administration of the estate. Ultimately, the final regulations must present a feasible solution on a practical level and serve the best interest of the public from a policy standpoint.[129] The regulations should be amended to support the date-of-death valuation for all claims against the estate. A consistent date-of-death valuation standard promotes the most feasible system for estate tax administration.

A. *Practical and Public Policy Consequences*

The date-of-death valuation policy would require estates to use reasonable estimations[130] to value claims that are uncertain at

§ 2204 would undoubtedly increase the administrative burden for the government. Press Release, *supra* note 91, at 6.

127. The changes will apply only to estates of individuals who die after the publication of the Federal Register containing the Treasury's adoption of the final regulations. Prop. Reg. § 20.2053-1(e), 72 Fed. Reg. 20083.

128. *See* 72 Fed. Reg. 20081 (explaining the problems of the date-of-death valuation approach).

129. Both the taxpayer and the government agree that there is a considerable policy rationale for allowing estates to take estate tax deductions.

130. The Proposed Regulations would allow 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." Prop. Reg. § 20.2053-1(b)(4) (2007), 72 Fed. Reg. 20083 (2007). Yet the Proposed Regulations do not offer any guidance as to what is a "reasonable certainty." *See* Press Release, *supra* note 91 (discussing the

the time of death. One criticism of this standard is that inaccurate estimations have led to the overvaluation of deductions.[131] But estimates are an unavoidable mechanism for the effective administration of the estate tax.[132] When estate administrators file estate tax returns, they must value every asset in the estate in order to determine the total assets.[133] Administrators must frequently use estimations as the basis for values of items to be included in the estate.[134] There are a number of methods by which reasonable estimations can be calculated. The use of actuarial tables and experts has been a long-standing policy of the Service and administrators alike.[135]

Furthermore, while the Proposed Regulations prevent the estate from using estimates to value claims against the estate, the Service requires administrators to make the same type of estimated valuations when calculating claims to be included as assets in the estate.[136] Even where the estate has an interest in a contingent claim, it must nonetheless value the claim based on reasonable estimations as of the date of death, so it can be included as part of the estate's assets.[137]

In order to promote equitable public policy, this same standard should also be applied to the deductibility side of the estate tax.[138] The date-of-death valuation standard for both includable and deductible assets and claims is fair because both the taxpayer and the government are subjected to the same risk.

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problem of the Proposed Regulations' wording).

131. *See* 72 Fed. Reg. 20081 (explaining the problems of the date-of-death valuation approach).

132. *See* Press Release, *supra* note 91, at 6 (discussing the use of estimates throughout the estate tax regime). The facts and circumstances for each and every taxpayer should be analyzed using fair and reasonable estimates known at the time of death.

133. Treasury Regulation section 20.2031-1(b) (as amended in 1965) provides that "[t]he value of every item of property includible in a decedent's gross estate . . . is its fair market value at the time of the decedent's death." The fair market value, for purposes of the estate tax, "is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts." *Id.*

134. For example, in valuing family limited partnerships or closely held businesses, many similar contingencies will arise and the estate must value the asset based on estimates. Press Release, *supra* note 91, at 5.

135. *See supra* notes 115-116 and accompanying text (discussing the regular use of actuarial tables for federal income, gift, and estate tax purposes).

136. *See supra* notes 99-109 and accompanying text (discussing the inconsistent requirements for the valuation of includable and deductible claims).

137. *Id.*

138. *See Comments Concerning Proposed Regulations*, *supra* note 77, at 5 (addressing the need for consistent valuation standards).

In some situations, a date-of-death deduction value may be higher than the amount that the estate actually paid, and thus the taxpayer may receive a deduction greater than it is entitled to.[139] Yet the estate may also take a deduction for a value lower than the amount it ultimately pays, in which case the estate has lost the benefit of a higher deduction.[140] Certain assets and claims may be overvalued, while others may be undervalued. If the date-of-death valuation standard is applied consistently for both includable and deductible assets and claims, then all parties will share the risk and the benefits of an inaccurate estimation.

Moreover, there are practical safeguards that prevent the taxpayer from unreasonably inflating the claim against the estate in order to seek a higher deduction. Through an audit, the Service has the opportunity to dispute the value of a deduction.[141] Because administrators know that they may face such a challenge if the values are unreasonable, administrators have a strong incentive to report accurate estimates. Additionally, an estate that is actively involved in defending a claim will not want to increase its potential liability by overvaluing the claim on its estate tax return.[142] These considerations are likely to deter estates from overvaluing deductible claims against the estate.

The date-of-death valuation approach will reduce delay and uncertainty in estate administration,[143] as well as provide family members and heirs with necessary closure. The practical consequences of preventing an estate from handling its affairs in a timely manner are significant. Certain estates will be forced to

139. For example, an estate may value an adverse claim at one million dollars and consequently take a one million dollar estate tax deduction. If, however, a judgment is rendered against the estate for two million dollars, the estate cannot later amend the deduction to two million.

140. This example can also be applied to the valuation of includable assets. *See* DeMaris, *supra* note 10, at 2 (noting that claims may be undervalued, resulting in lower deductions for taxpayers).

141. During an audit, the Service can contest the accuracy of a valuation. The value can then either be amended, if all parties agree upon a value, or the parties can resolve the discrepancy in the tax court. *See supra* note 92 (noting the Service's argument that the taxpayer and the Service must retry the substantive issues in the tax court).

142. The Service highlights this issue as a shortcoming of the date-of-death valuation approach because the taxpayer may be forced to take contradictory positions. 72 Fed. Reg. 20080. Yet this will force estates to make fair assessments of their claims.

143. *See McMorris*, 243 F.3d at 1261-62 (commenting that definitive rules bring "more certainty to estate administration, an ideal which has long been promoted by judge and commentator alike"). *See also* Brown, *supra* note 13, at 604 (arguing that a "hard and fast" rule applicable to valuation determinations is a more efficient solution).

remain open for decades,[144] significantly increasing the costs for the estate administration. Further, the Service will likely become burdened by the increase in the number of refunds and protective claims that are filed on an annual basis.[145] This will create additional costs and administrative inconveniences for the Service.[146] A date-of-death valuation approach will avoid unnecessary delays and promote the efficient administration of estates.

There is also a strong public policy argument that favors the timeliness of the date-of-death valuation standard. Heirs and family members need to have closure, and it is overly burdensome for heirs to wait years before knowing the final value of their inherited assets.[147] Family members also need to have emotional closure. Most people do not want to be troubled with the estate administration process after the loss of a loved one, and it would be unreasonable to prevent families from moving on with their lives.

B. Language of the Statutes and Regulations

Not only do the practical and public policy consequences favor a date-of-death valuation standard, but the language of the statutes and regulations makes a persuasive argument for the date-of-death valuation standard. The language of nearly every section relating to the gross estate[148] expresses that the asset valuation is appropriate at the date of death.[149] It appears from this explicit language that Congress determined date-of-death valuations to be an equitable and efficient method of estate administration.

Opponents of the date-of-death standard argue that because

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144. *See supra* note 111 and accompanying text (discussing the potential problem of serious delays in estate administration).

145. Press Release, *supra* note 91, at 7.

146. *Id.*

147. *See id.* (suggesting that it would be inequitable to force heirs into a position where they are not able to determine the estate tax until decades have passed after the testator's death).

148. *See* I.R.C. §§ 2031-2046 (governing the valuation of a gross estate). I.R.C. § 2032, which governs alternate valuation elections, is the exception to the date-of-death valuation standard for the determination of the value of the gross estate. *See infra* note 155 (commenting that section 2032 explicitly allows for the consideration of postmortem events).

149. *See, e.g.*, I.R.C. § 2031 (stating in part that "[t]he value of the gross estate of the decedent shall be determined by including to the extent provided for in this part, the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated.") (emphasis added). *See also* Brown, *supra* note 13, at 614 (suggesting that the language of the Code is the strongest argument against considering postmortem events when valuing assets).

the deduction provision for claims against the estate is included in the same Code section as other provisions mandating consideration of postmortem events, Congress intended postmortem events to be a factor in valuing deductions for claims.[150] Specifically, section 2053 permits the deduction of funeral and administration expenses,[151] which cannot be definitively valued upon death.

This "guilt by association"[152] approach is a flawed interpretation of the Code. Section 2053 also contains a provision for the deduction of unpaid mortgages, a value that is ascertainable without considering postmortem events.[153] As such, this attempt to interpret Congress's intent using other provisions of the same Code section is unpersuasive.[154] Congress also expressly manifested its intent that the postmortem events should be considered in other provisions of the Code.[155] One may infer that if Congress had intended that postmortem events be considered in the valuation of claims against the estate, it would have been clear in expressing such an intention.[156]

150. *See supra* note 41 and accompanying text (discussing the rationale used by the *Jacobs* court in determining that postmortem events should be considered in valuing claims).

151. *See* I.R.C. §§ 2053(a)(1)-(2) ("[T]he value of the taxable estate shall be determined by deducting from the value of the gross estate such amounts (1) for funeral expenses, [and] (2) for administration expenses.").

152. *See* Raby & Raby, *supra* note 68, at 106 (discussing the logical inferences leading to the "guilt by association" argument). The Eighth Circuit, in *Jacobs*, was the first court to adopt this "guilt by association" interpretation. *Jacobs*, 34 F.2d at 236; *see also supra* note 41 and accompanying text (noting the court's analysis of the legislative intent with regard to deductions allowable under section 2053).

153. *See McMorris*, 243 F.3d at 1261 (remarking that "we find it insignificant that Congress placed funeral and estate administration expenses, which are calculated after death, with claims against the estate in section 2053(a), because that section also contains a deduction for unpaid mortgages, which may be calculated without reference to postdeath events").

154. *See* Brown, *supra* note 13, at 614 (suggesting that the argument against the "guilt by association" approach is the more reasonable interpretation).

155. *See Propstra*, 680 F.2d at 1256 (commenting that "except with regard to matters like funeral and administrative expenses, which by their very nature require valuation after a decedent's death, Congress has been explicit in providing for consideration of post-death events"); *see, e.g.*, I.R.C. § 2013 (requiring consideration of postmortem events in the calculation of credit for tax on prior transfers); I.R.C. § 2032 (requiring consideration of postmortem events when electing the alternate valuation of asset provision); I.R.C. § 2054 (requiring consideration of postmortem events in calculation of deductions for casualty and theft losses during estate administration).

156. Some argue that allowing postmortem events to be considered in claim valuation is contrary to the purpose of the estate tax, which is to tax the estate upon death. *See* RICHARD B. STEPHENS ET AL., FEDERAL ESTATE AND GIFT TAXATION ¶ 5.03(5)(b) (7th ed. 1997) (claiming that approaches rejecting a

V. CONCLUSION

The Service's attempt to create a uniform standard by which to determine the deductibility of claims against the estate is inequitable and inconsistent with the positions taken elsewhere by the Service regarding the estate tax, creating practical and public policy concerns. The Proposed Regulations should be amended to reflect a more feasible approach that better serves the best interest of the public. A date-of-death valuation standard is an appropriate means by which to value claims against the estate because it will reduce the practical inequities and create a consistent method for both the inclusion and deduction of assets and claims. Date-of-death valuations will also reduce unnecessary delay in the administration of the estate and prevent additional costs that would likely occur if estates were forced to remain open until all claims were finalized. Additionally, because family members and heirs are entitled to attain closure after their loved one has passed, there is a strong public policy argument that favors timely estate administration. Lastly, the language of the Code itself is a powerful argument in favor of the date-of-death standard. Accordingly, the final regulations should incorporate the date-of-death approach to effectuate an efficient and equitable estate administration process.

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date-of-death standard "fly in the face of early precedent and are inconsistent with the obvious purpose of the estate tax to measure the taxable estate at death, except where Congress clearly elects to recognize post-death events.").