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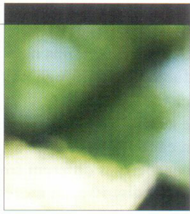
Final Regs. on Deducting Expenses and Claims Under Section 2053-Part 1

Jonathan G. Blattmachr

Mitchell M. Gans
Maurice A. Deane School of Law at Hofstra University

Diana S.C. Zeydel



Final Regs. on Deducting Expenses and Claims Under Section 2053—Part 1

Only bona fide expenses and claims against the estate may be deducted under Section 2053, and the regulations provide guidance on how this applies to claims by related parties and court-ordered payments.

JONATHAN G. BLATTMACHR, MITCHELL M. GANS, AND DIANA S.C. ZEYDEL, ATTORNEYS

As a general rule, expenses incurred in administering a decedent's estate, if not deducted for income tax purposes, and claims against a decedent's estate are deductible for estate tax purposes under Section 2053. That is, such expenses and claims reduce the amount subject to estate tax. (Under Section 2054, losses incurred during the settlement of estates arising from fires, storms, shipwrecks, or other casualties, or from theft, when such losses are not compensated for by insurance or otherwise, are also deductible.)

The IRS recently issued certain final regulations[1] under Section 2053 (reserving certain parts for later regulations) dealing with the estate tax deduction of claims against a decedent's estate and costs of administering the estate, which amend the prior regulations. Proposed regulations were issued in 2007.[2]

Overview of Section 2053

Before beginning a discussion of the final regulations, it is appropriate to discuss some of the basic provisions of Section 2053 itself and some of the previous regulations promulgated under that section.

Section 2053 sets forth four categories of items that may be deducted in determining a decedent's taxable estate on which estate tax may be imposed. These are:

1. Funeral expenses.
2. Administration expenses.
3. Claims again the estate.
4. Unpaid mortgages on (and other debt with respect to) property included in the decedent's gross estate.

Section 2053(b) allows a deduction of "other administration expenses" incurred in administering property that is not subject to claims against the decedent's estate—essentially, non-probate assets, such as a QTIP trust that qualified for the estate or gift tax marital deduction, which the decedent's spouse created for the decedent (which will be included in the decedent's gross estate under Section 2044).

Deductions are also permitted by other Code provisions when calculating the taxable estate. For instance, Section 2054 permits a deduction for certain losses. Sections 2055 and 2056 permit deductions for transfers to or for charity or the decedent's surviving spouse. In addition, a tax credit (known

JONATHAN G. BLATTMACHR is a retired partner in the New York City office of Milbank, Tweed, Hadley & McCloy, LLP. He is also a co-developer of Wealth Transfer Planning, a software system published by Interactive Legal Systems, LLC. MITCHELL M. GANS is a professor at Hofstra Law School in Hempstead, New York, and co-author with Jonathan Blattmachr of The Circular 230 Deskbook published by the Practising Law Institute. DIANA S.C. ZEYDEL is a shareholder in the Miami office of Greenberg Traurig, P.A. Ms. Zeydel is also a Regent of the American College of Trust and Estate Counsel.

as the unified credit or the applicable credit amount) provided by Section 2010 is subtracted from the estate tax calculated on the gross estate reduced by applicable deductions before the allowance of that credit. Other credits are permitted under Sections 2011, 2012, 2013, and 2014.

Conditions for deduction. Section 2053(a) provides that, in order for such items to be deducted, they must be "allowed by the laws of the jurisdiction ... under which the estate is being administered." In the case of expenses incurred in administering non-probate property, Section 2053(b) requires that two conditions must be satisfied:

1. The expense would have been deductible had it been incurred in administering probate property.
2. Payment must be made while the statute of limitations under Section 6501 is still open.

The deductions set forth under Section 2053(a) cannot exceed the estate tax value of the property included in the gross estate subject to claims *unless* they are paid before the due date (including extensions granted) for the filing of the Form 706 for the decedent's estate.[3] "Property subject to claims" means property (reduced by Section 2054 deductions) includable in the gross estate that under applicable local law bears the burden of payment of the deductions described in Section 2053(a). Two important points should be mentioned with respect to that rule:

1. The rule, by its terms, does not apply to the administration expenses with respect to non-probate property that is not subject to claims against the estate. Hence, administration expenses paid with respect to non-probate property that is not subject to claims may be deducted even though paid after the due date.
2. The general rule that the deduction cannot exceed the value of the property is different from the rule, discussed in more detail below, that a claim is deductible only if enforceable.

Under Section 642(g), administration expenses that are deducted under Section 212 (see, e.g., Reg. 1.212-1(i)) may not also be deducted for estate tax purposes.[4] Regs. 1.642(g)-1 and -2 provide that before an estate is allowed an income tax deduction, the executor must file a statement that the items claimed as deductions for income tax purposes have not been allowed under Section 2053 or 2054 and that the executor waives any right to deduct them under either of those sections.

A claim or expense that is contested or contingent is not ascertainable with reasonable certainty and, therefore, may not be deducted.

Ten-part regulations. The Section 2053 regulations have long been divided into ten parts. Reg. 20.2053-1 through Reg. 20.2053-10 provide details, respectively, about:

1. General rules relating to the section.
2. Funeral expenses.
3. Estate administration expenses.
4. Claims against the decedent's estate.
5. Charitable pledges.
6. Unpaid taxes.
7. Unpaid mortgages.
8. Expenses of administering property, which expenses are not subject to claims against the decedent's probate estate.
9. State death taxes.
10. Foreign death taxes.

Much of the new regulations deals with Reg. 20.2053-1, which provides the general rules that govern all deductions allowed under Section 2053.

Overview of the final regulations

The final regulations apply to estates of decedents dying after 10/19/2009. Of course, unless the federal government adopts new legislation to change the result, there will be no estate tax during 2010, meaning the regulations will not apply to individuals dying that year.

The final regulations adopt the general thrust of the proposed regulations: Expenses and claims are deductible only when and to the extent paid. They do, however, make certain changes that will help avoid prolonged administration of estates in several situations.

The final regulations retain the provision contained in the proposed regulations that expenses and claims that are ascertainable in amount and will be paid may be deducted before they are paid—essentially, meaning they may be deducted on the Form 706. A deduction may not be taken for a claim or expense (at least prior to its payment) based on a "vague or uncertain estimate." The regulations further provide that a claim or expense that is contested or contingent is not ascertainable with reasonable certainty and, therefore, may not be deducted (again, at least prior to the time it is paid). The final regulations add provisions that permit up the $500,000 in value of

1 TD 9468, 10/20/2009.

2 See, generally, Blattmachr and Zeydel, "Proposed Regs. on the Deduction for Administration Expenses and Claims," 35 Estate Planning 3 (October 2007).

3 See Section 2053(c)(2).

4 See, however, Section 691(b) with respect to "deductions with respect to a decedent."

claims, unpaid when the Form 706 is filed, to be deducted on the return if they meet certain criteria. The final regulations also permit certain recurring payments to be deducted on the Form 706 even as to those payments that will extend beyond the period during which the IRS may assess additional tax and, unlike the proposed regulations, the deduction is not limited to the present value of payments.

It should be noted that while both Section 2053 and its regulations deal with both claims against a decedent's estate and costs of administering the estate, some regulatory provisions apply only to claims and some only to expenses. For example, the $500,000 amount that may be deducted without being paid applies only to claims and not to expenses.

It is surprising that the regulations appear to create a more favorable rule for claims against a trust that is includable in the gross estate—at least where the decedent had no personal liability. In such a case, the estate apparently need not satisfy the new rule making post-death events determinative. Instead, in determining the inclusion amount with respect to the trust, the claim is taken into account (i.e., because the claim appears to be considered in determining the net value of the inclusion with respect to the trust, no deduction is taken and the new rules, therefore, do not apply).[5]

Example. A trust is included in the gross estate under Section 2036 or a QTIP trust is included in the decedent's gross estate under Section 2044, and there is an outstanding claim against the trust for which the decedent is not personally liable. In determining the net inclusion with respect to the trust, the claim apparently is to be taken into account even though it is the subject of a dispute and may indeed never be paid.

In contrast, if the contested claim were asserted against the decedent's estate, no deduction could be taken on the U.S. estate tax return (unless it fell under the exception for amounts up to $500,000 or offsetting claims) and post-death events would be determinative. The Preamble does not offer any justification for this discrimination; nor, does the Preamble even acknowledge the existence of this discrimination.

Parenthetically, while claims against a trust apparently enjoy this advantage under the new regulations, disadvantages may also be encountered where a trust is present. As indicated, where the total of the Section 2053 deductions exceed the value of the probate estate, a deduction can be denied under Section 2053(c)(2) for a claim or expense if not paid by the due date for filing the estate tax return. Even in the case of a revocable trust, the IRS has argued that a claim against the trust could not be deducted because it was not paid before the due date for filing the return.[6] Although the argument failed, it remains possible that the IRS will reassert it. Such an argument should not be successful when a state statute expressly makes the revocable trust liable for expenses and obligations of the estate.[7]

Penalty potential. It is important to be familiar with and to follow the final regulations. If, on Form 706, a claim or expense is taken that may not be deducted, the taxpayer could be charged with negligence. This could subject the taxpayer to a nondeductible penalty of 20% of the tax underpaid under Section 6662 and the return preparer to the preparer penalty under Section 6694. If the deduction ultimately is allowed, however, presumably no penalty would be imposed on the taxpayer or the return preparer, as neither penalty can apply without an underpayment of tax.

Even so, not following the regulations may be risky. In fact, when eligibility to claim the deduction on Form 706 is in doubt, the best course for those choosing to claim the deduction may be to make a disclosure on the return. That may pre-

5 See Reg. 20.2053-7.

6 See Snyder, 84 AFTR2d 99-5963 (Fed. Cl. Ct., 1999) (unpublished). The court allowed the claim because it found "[t]he Revocable Trust's assets are subject to and bear the burden of the payment of the EPA claims under Ohio law."

7 See, e.g., F.S. 736.05053 (a trustee of a revocable trust is required to pay to the personal representative any amounts the personal representative certifies in writing to the trustee are required to pay expenses of administration and obligations of the settlor's estate).

vent the imposition of the penalty under Section 6662 and may protect the return preparer from a penalty under Section 6694. Bear in mind, however, that sanctions could nonetheless possibly be imposed under section 10.34 of Circular 230 against the preparer if, for example, a deduction is taken on the return for a claim that is being contested at the time of filing even if no underpayment results because the claim is actually settled and paid by the time of audit.

Bona fide expenses and claims only

Reg. 20.2053-1(b)(2) sets forth the general rule that an expense or claim is deductible only if "bona fide." After setting forth the bona fide condition, that regulation states that no deduction is allowable under Section 2053 for an expense or claim to the extent it is founded on a transfer "that is essentially donative in character (a mere cloak for a gift or bequest)" except for certain charitable pledges.[8] It is uncertain whether the denial of the deduction for "cloaked gifts," apparently disguised as deductible claims and expenses, is an additional condition to the bona fide requirement. In any event, it may be prudent to consider taking a deduction for a claim or expense only if it was incurred and paid in good faith and it is certain that it is not a cloak for a gift or bequest.

Some recent estate tax cases have concluded that "bona fide," at least for purposes of Section 2036(a), means it was done for a significant and legitimate non-estate-tax reason.[9] Whether a similar type of meaning is contained in the new Section 2053 regulations is uncertain.[10]

Family member claims and expenses

As mentioned above, the regulations deny a deduction for the payment of a claim of expense that is a cloaked gift. Perhaps, in connection with this requirement, the proposed regulations contained a rebuttable presumption that claims of family members, beneficiaries, and related entities were not "legitimate and bona fide." The final regulations drop the "legitimate" requirement and the presumption but provide a non-exclusive list of factors indicative of the bona fide nature of a claim or expense involving a family member, related entity, or beneficiary of the decedent's estate.

A claim or expense that is contested or contingent is not ascertainable with reasonable certainty and, therefore, may not be deducted.

Relevant factors. The first factor is that the transaction occurred in the ordinary course of business, was negotiated at arm's length, and was free of donative intent. This is similar to Reg. 25.2512-8 which provides, for gift tax purposes, that a sale, exchange, or other transfer of property made in the ordinary course of business (i.e., a transaction that is bona fide, at arm's length, and free from any donative intent) is considered as made for an adequate and full consideration in money or money's worth and, therefore, will not be a gift. Developments under that regulation, therefore, may serve as guidance for construing this new provision in the Section 2053 regulations.

The second factor is that the nature of the claim is not related to an expectation or claim of inheritance. This factor may be difficult to apply in practice. Perhaps, it covers a situation where an individual provides personal care for a relative from whom the care provider expects or hopes to receive an inheritance and then presents a bill for the services when he or she does not receive the inheritance he or she expected to receive. But that is uncertain and, in any case, may be difficult to establish.

The third factor is whether any claim or expense based on an agreement between the decedent, on the one side, and the family member, related entity, or beneficiary, on the other side, was "substantiated with contemporary evidence." The regulations may be indicating that a claim of a family member, related entity, or beneficiary that is not founded on an agreement but, perhaps, based on *quantum meruit* would likely be considered not bona fide. Substantiation almost certainly could be proved by a contemporaneous written contract between the decedent and the other party. It likely also could be proved by the withholding of taxes on payments made to the other party during the decedent's lifetime or some other factors, such as advising third parties about the relationship.

The fourth factor is that performance pursuant to the agreement with the decedent and the agreement can be substantiated. This seems to mean that the claimant must prove that the action he or she undertook was pursuant to the agreement. For example, a beneficiary had a written agreement with the decedent to paint her home. After the decedent died, the bene-

[8] Certain charitable pledges are deductible under Section 2053(c)(1)(A) even if not founded on consideration in money or money's worth.

[9] See, e.g., Estate of Bongard, 124 TC 95 (2005).

[10] See Strangi, 417 F.2d 468, 96 AFTR2d 2005-5230 (CA-5, 2005) (intimating that the contours of the bona fide exception in Section 2036 as applied in the context of a family limited partnership may be different in a different context).

ficiary rendered a bill for the house painting and also for repairs the beneficiary made to the decedent's automobile. That claim for house painting would meet the criteria of the fourth factor (i.e., the painting was pursuant to the written contract and the contract is substantiated by the writing). In contrast, if no written contract exists for automobile repairs and the beneficiary cannot otherwise substantiate it, the fourth factor would not be met as to those repairs.

In connection with both the third and fourth factors, especially perhaps a claim involving a transfer of cash or other asset to the decedent prior to death, the factors used by the courts to determine whether a transfer was a loan or something else (such as a gift) may be helpful in determining if the criteria of either or both of the third or fourth factors are met.[11]

The fifth and final factor listed in the final regulations to determine if the claim of a family member, related entity, or beneficiary is bona fide is whether the payment is reported by each party for federal income tax and employment purposes in a manner consistent with the reported position of the claim or expense. For example, a beneficiary contends that he or she is entitled to be paid for care giving provided to the decedent before she died because it was pursuant to an unwritten contract with the decedent. The beneficiary contends that the existence of the contract is established because he or she can show that the decedent during lifetime made regular payments to him or her. The failure to report those lifetime payments as income to the IRS would seem to indicate that the fifth factor has not been met.

On the other hand, with the payment of a claim for an alleged predeath loan to the decedent, the repayment of the principal of the loan would not be reportable for income (or employment) tax purposes. Nevertheless, interest paid (and, in some situations, even if it is accrued) on the note would be reportable for federal income tax purposes. Furthermore, even if no interest were payable under the loan arrangement, the "forgone" interest might nonetheless be reportable for income and gift tax purposes under Section 7872 (although certain "small" loans escape the reach of that section—see, e.g., Section 7872(c)(2)). In addition, interest may be accrued under the original issue discount rules under Section 1272.

Related parties defined. Reg. 20.2053-1(b)(2)(iii) provides definitions of family members, related entities, and beneficiaries. Family members "include" the decedent's spouse, grandparents, and their descendants, including adopted descendants, and their spouses. The use of the term "include" rather than "consist of" may mean that the IRS properly could contend that others (such as a child-in-law) could be included as family members in appropriate circumstances. In any case, the IRS likely will use the same or similar factors to establish that claims by others are not bona fide and, therefore, deductible. In fact, it is somewhat surprising that the IRS has limited the use of the five factors to family members, related entities, and beneficiaries.

A related party is one in which the decedent had at or within three years of death any "beneficial ownership" although not a publicly traded entity or one in which the decedent and family members, "directly or indirectly," hold less than a 30% interest (whether voting or non-voting in stock, capital, or profits). There is no explanation of "direct or indirect." It may be reminiscent of "direct or indirect" voting rights retained under Section 2036(b) (which includes in the decedent's gross estate stock transferred before death, other than in a bona fide sale for full and adequate consideration in money or money's worth, and over which the decedent directly or indirectly retained the right to vote). But it might mean something different. Indeed, it may develop that it is intended to encompass certain constructive ownership rules, such as under, among many other sections, Section 267, 318, or 4946.

Moreover, "beneficial interest" is not defined. Hence, whether it is intended to encompass only interests that are capable of being val-

[11] See Miller, TCM 1996-3, *aff'd* 113 F.3d 1241, 79 AFTR2d 97-2843 (CA-9, 1997) ("The mere promise to pay a sum of money in the future accompanied by an implied understanding that such promise would not be enforced is not afforded significance for federal tax purposes, is not deemed to have value, and does not represent adequate and full consideration in money or money's worth.... The determination of whether a transfer was made with a real expectation of repayment and an intention to enforce the debt depends on all the facts and circumstances, including whether: (1) there was a promissory note or other evidence of debt, (2) interest was charged, (3) there was any security or collateral, (4) there was a fixed maturity date, (5) a demand for repayment was made, (6) any actual payment was made, (7) the transferee had the ability to repay, (8) records maintained by the transferor or the transferee reflected the transaction as a loan, and (9) the manner in which the transaction was reported for federal tax purposes is consistent with a loan."). See also Santa Monica Pictures, LLC, TCM 2005-104; Estate of Rosen, TCM 2006-115.

ued actuarially also is unclear. It would not appear by its terms to cover a trust (or another decedent's estate in which the decedent or his or her family had an interest as a beneficiary) because an interest as a beneficiary in a trust or an estate would not seem to be a voting or non-voting in stock, capital, or profits interest. Perhaps, it would cover a situation where the decedent or family member was a trustee or executor, as such a fiduciary (as opposed to being a beneficiary) holds voting or non-voting interests in stock as well as interests in capital or profits of interests held by the trust or estate of which he or she is a fiduciary (again, as opposed to being a beneficiary).

In any case, if the decedent holds, directly or indirectly, any managing interest (e.g., as a general partner of a partnership or as a managing member of a limited liability company), apparently regardless of whether the aggregate beneficial ownership interests are at least 30%, the entity is a related entity. Thus, claims involving partnerships and limited liability companies in which the decedent was a general partner or a managing member will always be subject to testing under the factors. It is unclear whether this would also cover a controlling shareholder of a corporation.[12]

Reg. 20.2053-1(b)(4), Example 3 provides an illustration of a claim by a family member that is determined to be bona fide and, therefore, its payment deductible. It involves the rendering of predeath accounting services to the decedent by his niece who is a certified public accountant and charges others in the same manner she charged the decedent. There is no indication of whether the niece was a beneficiary of the decedent's estate. Nevertheless, under the facts of the case, the example's outcome apparently would be the same had she been one. Indeed, the facts of the example are so compelling to the conclusion that the niece's claim for her accounting services is bona fide that the example is of little, if any, help in discerning the scope of the family rules. The regulations offer no other illustrations applicable to the special factors relating to claims of family members, related entities and beneficiaries.

The facts of the example are so compelling to the conclusion that the example is of little, if any, help in discerning the scope of the family rules.

The final regulations provide that beneficiaries of a *decedent's* estate "include" beneficiaries of a trust of the decedent. As in the case of "family members, the word "include" suggests the scope of the term "beneficiaries" may be incomplete and might include others. There is no explanation of:

- The meaning of "trust of the decedent" creating some uncertainty as to which types of trusts must be considered.
- Whether the decedent must be a settlor or a beneficiary of the trust.
- Whether the trust must be included in the decedent's gross estate.

The first paragraph of Reg. 2053-1(b)(2)(ii), however, uses the phrase "beneficiaries of the decedent's estate or *revocable* trust" (emphasis added). Accordingly, perhaps only the beneficiary of a revocable trust was intended to be included.

As a general rule, federal courts are required to follow the proposed construction of a regulation by the agency that issued it.[13] This may mean that the IRS has significant flexibility in extending the scope of the regulations where they fail to provide an explicit rule, such as the *meaning* of "a trust of the decedent."

Payments pursuant to court order

Reg. 20.2053-1(b)(3) sets forth the rules about when a court order may be used to establish that the payments are deductible under Section 2053. Expenditures for funeral expenses, administration expenses, and claims against the estate that are allowed in a final judicial decision by a court of competent jurisdiction may be taken as a deduction if the court reviews and approves the expenditures and actually passed on the facts on which deductibility depends (assuming, of course, the deduction is not impermissible on some other ground).

The new regulations may represent a "relaxing" of prior law. In *Estate of Bosch*,[14] the Supreme Court held that neither the IRS nor federal courts are bound by a determination made by a state court (other than the highest court of the state) as to the property-rights matters.[15] Rather, the federal courts are to sit as a state court and determine what those property rights are. *Bosch* has been applied to the allowance of claims and administration expenses.[16] The federal court, in such a case, however, does not sit as a state court would but

12 *Cf.* Byrum, 409 U.S. 898 (1972).

13 See Auer v. Robbins, 519 U.S. 452 (1997). But see Robinson Knife Manufacturing Co., Inc., 105 AFTR2d 2010-1467 (CA-2, 2010).

14 387 U.S. 456, 19 AFTR2d 1891 (1967).

15 Note, however, that the IRS itself has limited the holding of Bosch to state court determinations that occur *after* the taxing event (e.g., death with respect to an estate tax matter) and held that it is bound by lower state court determinations that occur before the taxing event. See Rev. Rul. 73-142, 1973-1 CB 405.

16 See, e.g., First National Bank of Amarillo, 422 F.2d 1385, 25 AFTR2d 70-1539 (CA-10, 1970).

rather simply determines if the local court followed state law.[17]

A leading case is *White v. Sterling*,[18] where the Second Circuit held that neither the IRS nor the federal courts were precluded, in applying Section 2053, from reviewing the propriety of expenses that had been allowed by the state court. The Second Circuit made this determination in part because the regulations at that time provided: "The decision of a local court as to the amount and allowability under local law of a claim or administration expense will ordinary be accepted if the court passes upon the fact upon which deductibility depends. *** The decree will not be accepted if it is at variance with the law of the state...." The court stated, "In stating that a local court decree 'will not be accepted if it is at variance with the law of the State,' the regulation ... when read in conjunction with Bosch, makes it clear that the IRS is entitled to make an independent assessment of applicable state law...."

The new final regulations, however, change the language that determines the deductibility of an expense or claim based on a court decree. Specifically, the word "ordinarily" is eliminated. The regulations now provide: "If a court of competent jurisdiction over the administration of an estate reviews and approves expenditures..., a final judicial decision in that matter *may be relied upon* to establish the amount of the claim or expense that is otherwise deductible under section 2053 ... provided that the court actually passes upon the facts on which deductibility depends." (Emphasis added.) In addition, the portion of the regulations that provided "will not be accepted if it is at variance with the law of the State" also has been removed.

This seems to indicate that the IRS has abandoned the right to challenge a local court decree where the facts relating to the deduction were considered. Hence, it appears that the IRS has, in effect, overruled *Bosch*—at least in the Section 2053 context. As a result, in a case like *White*, the result would be different under the new regulations. That is, assuming the state court passes on the facts, the IRS would now be precluded from reexamining the court's decision.[19]

Where the court does not actually pass on the facts, the decree will not be binding on the IRS. The decree would be binding on the parties, however, possibly causing a nondeductible claim to nevertheless be enforceable against the estate. The regulation provides, however, a presumption that the court did in fact undertake such a review if there was an active and genuine contest.[20] Nonetheless, a court's decree that appears unreasonable will be used as evidence that there was no such contest (although the estate may provide other evidence to refute this). No example is provided to illustrate what would be an unreasonable decree. Perhaps, if a person submitted a claim for rendering household services to the decedent for two months prior to death (e.g., cooking and cleaning), an allowance by the court of a claim of

[17] *Id.*

[18] 853 F.2d 107, 62 AFTR2d 88-5972 (CA-2, 1988), *cert. granted and cert. denied* 110 S. Ct. 273 (1989).

[19] Although Reg. 20.2053-1(b)(4), Example 1 may suggest that the IRS could challenge a court decree as being inconsistent with controlling local law, the example involves a consent decree, not one where the court has reviewed and approved the expenditure.

[20] The regulations indicate that the court must pass on the claim. If there were a jury verdict, however, it likely would be accepted as evidence of an active or genuine contest over the claim. *Cf.* Cobb, TCM 1985-208.

$100,000 would appear, on its face, to be unreasonable.

If applicable law allows an expense or claim to be paid without a court decree, the failure to secure a decree does not preclude the deduction.[21] For example, where an executor's fee can be paid without a decree, a deduction will be allowed for the payment even though no decree is secured. This will, of course, have the salutary effect of easing the estate-administration burden.

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Consent decrees and settlement agreements

A consent decree may be relied on to establish deductibility under Section 2053 "provided that the consent resolves a bona fide issue in a genuine contest."[22] The consent of all parties having interests adverse to the claimant raises a presumption that there was, in fact, such a contest.[23] Similarly, a settlement agreement may be relied on to establish deductibility if it resolves a genuine contest and is the result of arm's-length negotiations by parties having adverse interests with respect to the claim/expense.[24] For instance, unlike the proposed regulations, the final regulations indicate that even if the settlement appears greater than the merits of the claim warrant, the amount agreed to be paid in the settlement may be deducted if the estate can establish that the cost of defending or contesting the claim or expense, or the delay associated with it, would impose a higher burden on the estate than the payment of the amount paid to settle the claim or expense.

Here, again, the regulations move away from *Bosch*. Under the prior regulations, the Service could have used *Bosch* to challenge the validity of a claim or expense even if it was the product of an arm's-length negotiation. In *Ahmanson Foundation*,[25] in the marital deduction context, the Service successfully argued that a deduction could be denied where it could be established that the settlement agreement was inconsistent with the rights of the parties *under state law*.[26] Although the Service had previously indicated that it would not question an arm's-length settlement following a claim made in good faith in Rev. Rul. 66-139, 1966-1 CB 225, the court entertained the Service's argument that the settlement did not accurately reflect state law. The court reasoned that, if under *Bosch*, a court decree is not binding, it would make little sense to treat a *settlement* agreement as having this effect. Having prevailed on this point in *Ahmanson*, the Service now retreats in these new regulations and in effect revitalizes Rev. Rul. 66-139. This is a welcome development in that it avoids the need to retry in federal court issues that the parties have already resolved in an adversarial context.[27]

Conclusion

Although the Code presently has no estate tax for 2010, the estate tax is scheduled to reappear in 2011. The return of the tax will revive a multitude of tax issues, among them is the treatment of expenses incurred in administering the estate and claims against the estate. Recently issued regulations continue the approach of tying the timing and amount of deductions to actual payments. Exceptions to this general rule, however, permit earlier deductions. Part 2 of this article will appear in the next issue of ESTATE PLANNING. It will provide further analysis of the final regulations, including the effect of post-death events on deductions, exceptions to the requirement that an expense or claim is deductible only to the extent it was paid, and the favorable treatment of certain contingent claims. ■

21 See Reg. 20.2053-1(b)(3)(ii).

22 See Reg. 20.2053-1(b)(3)(iii).

23 See *id.*

24 See Reg. 20.2053-1(b)(3)(iv).

25 674 F.2d 761, 48 AFTR2d 81-6317 (CA-9, 1981).

26 See also Estate of Brandon, 828 F.2d 493, 60 AFTR2d 87-6139 (CA-8, 1987).

27 For a further discussion of *Bosch*, *Ahmanson*, and the Revenue Ruling, see Gans, "Federal Transfer Taxation and the Role of State Law: Does the Marital Deduction Strike the Proper Balance?," 48 Emory L.J. 871 (1999).