DON'T ROCK THE SECTION 2053 BOAT—
YOU'LL TIP THE 706 OVER

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I. RECENT CASES DEALING WITH ADMINISTRATIVE EXPENSES

A. *Turner v. U.S.*, 306 F.Supp.2d 668 (January 30, 2004), Deductions for Interest Paid on Delayed Pecuniary Bequest

The will of Sally Jackson will left $10 million to a charity, the Juliette Fowler Homes, Inc., provided that the charity was an organization described in IRC §2055(a). The decedent's independent administratrix delayed satisfying the bequest until she received a closing letter from the IRS. Pursuant to § 378B(f) of the Texas Probate Code, statutory interest began to accrue at six percent on the bequest one year after letters testamentary were issued. The IRS conducted an audit of the estate, and issued a closing letter accepting the return as flied. The administratrix satisfied the bequest promptly after receiving the closing letter, and also sent the beneficiary over $1 million in interest. The administratrix filed a claim for refund based on an estate tax deduction under IRC § 2053(a) for the interest. The IRS denied the refund, arguing that the interest was not deductible for estate tax purposes.

The U.S. District Court granted the estate summary judgment, allowing an estate tax deduction for the interest. The court noted that the regulations allow a deduction for any administrative expense only if the expense is: (1) incurred in the administration of the decedent's estate, (2) actually and necessarily incurred, and (3) allowable by the laws of the jurisdiction under which the estate is being administered, Treas. Reg. § 20.2053-3(a).

The IRS first claimed that statutory interest payments were not actually expenses incurred in the administration of the estate, but rather a legal mechanism by which the estate income was allocated among its beneficiaries. The court disagreed, and accepted the estate argument that interest paid on a delayed bequest is no different from interest paid to another creditor. The IRS next argued that the interest was not "necessarily" incurred, because the administratrix "unreasonably" waited two and one-half years to satisfy the bequest. The court disagreed and held that the expense was necessary, because the will required that the administratrix ascertain the tax-exempt status of the charity before satisfying the bequest. Fowler Homes was a subordinate organization that claimed tax-exempt status through its affiliation with a charitable organization, the Christian Church (Disciples of Christ). The administratrix did receive from Fowler Homes three documents in support of its relationship with the Christian Church, but none of these documents were sufficient to prove conclusively the necessary relationship between Fowler Homes and the Christian Church. The administratrix, therefore, prudently withheld funding the bequest until the estate received an IRS closing letter and resolved any estate tax audit.

B. *Klein v. Hughes*, WL 838198, Cal. App. 1 Dist. (April 20, 2004), Borrowing to Pay Estate Taxes; Interest as Deduction.

Mark Hughes died in May 2000 with an estate of more than $300 million. The federal estate tax return showed estate taxes of more then $200 million. The Hughes estate had substantial tax liability but, due to the nature of the trust's investments, did not have sufficient liquid assets to pay this liability. Most of the trust's assets were in limited liability companies from which the trust had no power to compel cash distributions, and the trust's interests were subject to stringent restrictions on transfer. Thus, through a settlement with the IRS, the trustees agreed to borrow $49 million from a third party using a zero coupon loan transaction to pay the federal and state tax liabilities. The loan would carry a rate of 8.75 percent, with all unpaid principal interest due on December 31, 2027. Aside from a $10 million payment due September 9, 2005, no interim interest payments would be required for the loan. The trust would incur a total of approximately $309 million in deductible interest expense by the due date of the loan because prepayment of the loan was prohibited. Because IRC § 2053 permits a current estate tax deduction for all interest payable throughout the term of the 25-year loan, with no present-value discount of this sum, the trustees calculated this financing arrangement would reduce the trust's liability for estate tax by more than $166.5 million.

Absent any loan transaction, the trust owed $212,460,485 in estate taxes, due immediately. However, by using IRC § 2053 to deduct the full amount of interest paid on a $49 million loan, the trust court successfully reduce its estate taxes to approximately $49 million, for a savings of $166.5 million in estate taxes paid to the IRS. The trial court approved the trustees entering into a loan to pay its estate taxes over the objections of the guardian of the estate's principal beneficiary. The appeals court affirmed the lower court's decision.

C. *Dorothy L. Rupert v. U.S.*, 358 F.Supp.2d 421 (D.C. Pa. 2004), Estate had Burden of Showing that Interest Expense was Necessary

Dorothy Rupert's estate sued the government for a partial refund of estate tax based upon its claim that interest on a loan taken out to pay estate tax was deductible under IRC § 2053(a)(2). The estate moved for summary judgment. The central issue for the court was whether the loan was necessarily incurred to preserve the estate; if so, the interest was deductible from the gross estate and the amount of estate tax would be reduced correspondingly.

The estate claimed the loan was necessary because the estate did not have sufficient liquid assets to pay the estate tax and was not required to sell any assets. While the court determined that the estate could sell the right to receive the lottery payments, that ability to sell did not mean that the loan was unnecessary. Instead, the estate had the burden of showing that the interest expense was necessary. Thus, because no factual details were provided by the estate, the summary judgment was denied.

D. TAM 200444021 (October 29, 2004), Income Taxes on Post-Death IRA Distributions Not Claim Against Estate or Administration Expense

The estate claimed that the amount of income taxes paid by an estate on IRA distributions were deductible under IRC § 2053 to the extent they exceeded the IRC § 691(c) deduction. After the payment of all debts and expenses, the estate did not contain sufficient cash to pay the estate taxes. As to a claim deduction, the ruling noted that Treas. Reg. § 20.2053-6(f) limited a deduction for income taxes to income received prior to death and Treas. Reg. § 20.2053-4 limited claim deductions to those representing personal obligations of the decedent.

In regards to administration expenses, the court relied on *Turner v. U.S.*, 306 F.Supp.2d 668 (D.C. Tex. 2004). The court held that even if the estate had not claimed a §691(c) deduction, the income taxes paid on the IRAs distributions would not be deductible under §2053. The court explained that Congress had recognized the problem of income tax inherent in certain assets included in a decedent's gross estate. Thus, Congress determined that the property relief was to allow an income tax deduction under §691(c) to the estate or beneficiary reporting the income. The estate had already availed itself of this deduction and any additional benefit beyond what Congress intended would be unwarranted.

E. *Estate of Howard Gilman*, TC Memo 2004-286; Deductibility of Interest.

In the *Estate of Gilman*, the court held an estate could deduct interest on a loan to obtain funds to pay estate taxes and proper administration expenses. These expenses included $1.8 million for necessary administration services and legal fees. Interest to pay salaries and for periods arising after the payment of taxes, plus consulting fees for the business were non-deductible. The Court felt the major factors in determining deductibility was whether the amount and the duration of the loan were needed for proper estate administration.

F. Letter Ruling 2005 13028; Deductibility on Loan to Pay Estate Taxes.

The Service disallowed an upfront interest deduction on a loan to pay estate taxes. In this case, the estate owned an FLP with significant liquid assets. The Service ruled that the loan was not needed to administer the estate. It held that the FLP could have easily distributed cash, which would have relieved the estate from borrowing from a third party lender. Sufficient funds otherwise existed and hence the loan was not necessary.

G. *Estate of Hughes v. Commissioner*, TC Memo. 2005-296

A promissory note was not deductible as a claim against a decedent's gross estate under IRC § 2053(a)(3) because the underlying stock subscription agreement was not bona fide and the decedent did not receive full and adequate consideration in the transaction. Apparently, at the time the decedent's husband died, the value of stock in a used car dealership was valued at zero because the company's liabilities exceeded its assets. Subsequently, the decedent executed a promissory note under which the decedent agreed to pay

the company on demand $400,000 in exchange for an additional 4,000 shares of stock. After the decedent's death, $400,000 was transferred to the company, which in turn repaid a limited partnership in which the decedent's children and grandchildren held a 99.419 percent interest. On the decedent's estate tax return, the estate deducted the $400,000 promissory note. The court held that the estate could not deduct the $400,000 because the stock subscription was not bona fide nor was it for full and adequate consideration. The court concluded that the 4,000 shares were worthless because the company had no value at the time the promissory note was executed. Further, the court found that the decedent's children and grandchildren received the $400,000 as a substitute for a testamentary disposition.

H. *A. Gottesman*, D.C.N.Y., 2007-1 USTC, Deduction Denied

The estate of Muppets creator Jim Henson was not entitled to an IRC § 2053 deduction because Henson's surviving spouse did not have an enforceable claim against the estate.

The surviving wife had previously transferred her entire interest in Henson Associates, Inc. to Jim Henson. Henson then agreed to pay a percentage of the proceeds from any merger or sale of the corporation if he received "value" during her lifetime. After the transfer to Henson, the surviving wife's shares of the corporation were placed in escrow to secure this agreement.

Henson died, and his children received all the shares of the corporation. The children subsequently sold the corporation, and paid the surviving wife $10 million, believing she was entitled to this sum under the escrow agreement. The estate then sought an estate tax refund.

After the shares were bequeathed to the children, the estate ceased to have any interest in the corporation, and did not receive any "value" from the sale by the children. Further, the escrow agreement did not give the wife a right to proceeds from a subsequent sale or merger. The court ruled that the estate was not entitled to a deduction under IRC § 2053 because the wife did not have an enforceable claim against the estate.

I. *Estate of Hicks v. Commissioner*, TC Memo. 2007-182, Loan to Trust Was Deductible from Gross Estate

A loan made by a minor decedent's father to a trust for the decedent's benefit was deductible from her gross estate under § 2053, the Tax Court has held. Decedent was severely disabled when the family minivan collided with a locomotive engine, resulting in a $4.65 million settlement. A plan was developed involving the creation of two trusts to provide for the decedent's health care needs. The first trust was intended to comply with applicable Medicaid law and was funded with $1 million from the settlement. The second trust was a support trust that was funded in part by $450,000 from the settlement and a $1 million loan from the decedent's father, consisting of funds allocated to him from the settlement. The family's attorneys suggested that the loan be used because the second trust would be considered in determining the decedent's Medicaid eligibility. Pursuant to Ohio law, the local probate court approved the settlement, allocation of funds, and the creation of the trusts.

The court rejected the Service's argument that the father never had control over the funds because the probate court approval effectively transferred the funds from the decedent's interim financial holding account to the trustee. The father had control over the funds, because the probate court determined the ownership of the funds. Thus, the court ruled that the loan was bona fide. The court did not determine whether the allocation of the funds was a sham, and limited its review as to whether the loan was bona fide. The loan was bona fide because the parties intended that the loan would be repaid upon either the decedent's death or her need to qualify for Medicaid. The court also found that the loan did not lack economic substance, citing the following: (1) the decedent's death was not imminent at the time of the allocation; (2) the loan provided for the decedent's care while she was a minor and if she needed to be on Medicaid; (3) the father could have predeceased the decedent, causing the present value of the note to be includible in his estate; and (4) the allocation was approved by the Ohio probate court having familiarity of applicable family law. Therefore, the loan was deductible from the decedent's gross estate under § 2053. However, the estate was not entitled to deduct administrative expenses incurred by the trusts for the years 2001-2004 because those expenses were unsubstantiated. Furthermore, the parties were directed to reach an agreement on the deductibility of the estate's expenses with respect to the estate tax litigation.

J. J. Keeler, Admr., DC Cal., 2007-1 USTC, Attorneys' Fees Not Proven to Be Improper

A U.S. District Court in California has held that the government was not entitled to summary judgment because it failed to establish that attorneys' fees for all parties to a will contest were improperly claimed as administrative expenses under IRC § 2053. A decedent executed a will in 1994, naming her cousin as executor (Executor 1) and as a beneficiary. Other beneficiaries under the 1994 will were the decedent's predeceased husband's two children and his grandchildren. In 2000, decedent executed a second will, modifying the distribution of her estate among the same beneficiaries and naming one of her husband's children as executor (Executor 2). The 2000 will was admitted to probate upon decedent's death and was challenged by Executor 1. The county court issued a tentative decision that the decedent lacked capacity beginning in 1999 and invalidated the 2000 will. Prior to trial of the remaining issues, the parties reached a court-approved settlement agreement. The stipulated order provided that legal services were performed on behalf of the estate that were for the benefit of, and necessary to, the proper administration of the estate. The order further stated that the legal fees were properly payable out of the estate and directed the administrator to file an amended estate tax return deducting the attorneys' fees and costs as an administration expense.

Because the will contest did not involve preserving or increasing estate assets and the grandchildren and the non-executor child were only beneficiaries, the fees of those parties were not allowable as administrative expenses in accordance with California law. However, the court declined to grant partial summary judgment with respect to the legal fees of the nonexecutor-beneficiaries because the conclusion that those beneficiaries' fees were not properly charged to the estate was a conclusion of law and the IRS did not specify what amount of the claimed refund would be affected by that conclusion.

Because Executor 2 was a named executor under the 2000 will and did not offer the will in bad faith, the court explained that there was some basis for arguing that her fees were properly charged to the estate. The court rejected the Service's argument that Executor 1 could not recover fees when only he stood to benefit from the admission of the 1994 will to probate, finding that Executor 1 had a duty to offer the 1994 will for probate and to defend it. In addition, although the only issue that went to trial was Executor 1's contest of the 2000 will, the court concluded that Executor 1's challenge to the 2000 will was integral to the defense of the 1994 will. Accordingly, the Service failed to establish that Executor 1's attorneys' fees were improperly charged to the estate as administration expenses.

II. PROPOSED REGULATIONS UNDER § 20.2053-4, REGARDING DEDUCTIONS FOR CLAIMS AGAINST THE ESTATE

In the proposed regulations under § 20.2053-4, issued April 23, 2007, the Service adopted the position taken by the Eighth Circuit in *J. Jacobs, et al*, 34 F.2d 233 (1929), that an estate's IRC § 2053(a)(3) deduction is to be limited to amounts actually paid (i) to satisfy deductible claims and expenses; and (ii) in settlement of claims against the estate. Further, post-death events are not to be considered when determining the amount deductible under IRC § 2053. Contrary to judicial rulings issued by a majority of the circuits (all which have ruled except the 8th) and the Supreme Court itself; these proposed regulations also impose on the fiduciary the obligation to file a protective refund claim before the statute runs to attempt to preserve the deductibility of any item not paid in full at the time the return was filed.

A. Why the New Proposed Regs Under Section 20.2053-4 Should Not be Adopted

1. Introduction

Under Internal Revenue Code ("IRC") §2053(a)(3), an estate tax deduction is allowed for "claims against the estate . . . as are allowable by the laws of the jurisdiction." In analyzing whether post-death events affecting the valuation and/or validity of a claim should impact a taxpayer's ability to deduct any such claim, one has to wade through a couple lines of cases. The Internal Revenue Service ("IRS") position in these cases has been inconsistent, as they have invariably taken the position that will generate the most revenue.

On the premise that the courts' inconsistency and a split in authority caused problems regarding deductions dealing with post-death events, on April 23, 2007, the IRS rejected decisions of the Supreme Court and a majority of the Circuit Courts of Appeal and issued proposed regulations under IRC §2053, including Treasury Regs. §20.2053-4. The new proposed regulations limit the availability of any deduction on the estate tax return to amounts actually paid by the estate. In essence, if no payment is made, no deduction is permitted.

Since many such expenses and claims remain pending at the time the statute of limitations for assessment and collection of the estate tax is due to expire, under the proposed regulations, in lieu of being allowed to claim a deduction on the estate tax return (Form 706), the executor will need to file a protective claim for refund to preserve its right to claim any such deduction under IRC §2053(a), outlining the reasons

why actual payment has not been made. The IRS will then act on that claim only after it has been paid and any and all contingencies have been resolved. The new, additional filing requirements, disclosures and payments (any/all of which can adversely affect the fiduciary's liability exposures and litigation positions with respect to the underlying claims) contemplated under the proposed regulations impose an unreasonable hardship on fiduciaries.

Finally, the proposed regulations will not work properly with certain elections and estate planning clauses.

2. Brief Background

IRC §2053(a)(3) states, in relevant part, that, "[f]or purposes of [the federal estate tax], the value of the taxable estate shall be determined by deducting from the value of the gross estate such amounts . . .for claims against the estate . . .as are allowable by the law of the jurisdiction . . . under which the estate is being administered."[1]

Interestingly, while § 2053(a)(3) is silent as whether and, to what extent, if any, post-death events should be considered for purposes of determining the validity and/or value of claims against an estate, the Treasury regulations under that section, which have not been amended since 1958, provide guidance. Treasury Reg. §20.2053-4 states, in relevant part, that "[t]he amounts that may be deducted as claims against a decedent's estate are such only as represent personal obligations of the decedent *existing at the time of his death, whether or not then matured* . . ."[2] This regulation further states that "[o]nly claims enforceable against the decedent's estate may be deducted;" and that "[l]iabilities imposed by law or arising out of torts are deductible."[3]

Treasury Reg. §20.2053-1(b)(3) allows deductions attributable to claims even though the exact amount of any such claim is not known on the date the estate tax return is filed, provided it was ascertainable with reasonable certainty at that time and will be paid.[4]

While Treasury Reg. § 20.2053-4 contains a temporal reference in the words "at the time of his death," the "reasonable certainty" and "will be paid" provisions of Treasury Reg. §20.2053-1(b)(3) appear to allow post-death events to be considered. These regulatory provisions have contributed to the unsettled nature of this issue.

Over the years, two lines of case law have developed with respect to the analysis of whether and to what extent, if any, post-death events should be considered in determining the validity and/or value of claims under §2053. One line of cases, following *Jacobs v. Commissioner*,[5] concludes that post death events are relevant and only amounts actually paid are deductible. The other, better reasoned, more widely accepted line, which follows *Ithaca Trust Co. v. U.S.*,[6] concludes that post death events are irrelevant and deductions under §2053 should be based on the value of the pertinent claims at the date of death, rather than being based on those amounts which actually happen to have been paid before the estate tax return (or a claim for refund with respect thereto) is filed.

a. Summary of Proposed Regulations

On April 23, 2007, the IRS issued proposed regulations amending the existing regulations under Treasury Reg. §20.2053.[7] Part of the IRS' explanation of why, after 50 years, they felt compelled to amend the regulations under §2053, states the proposed regulations were enacted, "[t]o clarify that events occurring after a decedent's death are to be considered when determining the amount deductible under all provisions of §2053 and that deductions under §2053 are limited to amounts actually paid by the estate in satisfaction of deductible expenses and claims."[8] Further, if a claim is "potential, unmatured or contested at the time that the return is filed," the executor may not claim a deduction.[9] Rather, the personal representative must wait until the eve of the expiration of the statute of limitations to make a protective refund.[10]

Ignoring the fact that the Supreme Court has addressed the issue, the IRS suggests that the 50 year old regulations under §2053 needed amendment because of a purported split in authority. Contrary to the IRS' assertion, however, the majority of the circuits (Fifth, Seventh, Ninth, Tenth and Eleventh[11]) apply the principles the Supreme Court adopted in Ithaca Trust—that valuation of claims against an estate is to be determined at date of death, post-death events are not to be considered.[12] The only cases adopting the rule that only amounts actually paid are deductible are cases in the Eighth Circuit and the Court of Claims.[13]

Thus, the proposed regulations are clearly adopting a "bright line" test that, if no payment is made, no deduction is allowed. Unfortunately, among the problems associated with making claims deductible only when paid is the statute of limitations. If the claim remains unresolved when the statute of limitations is due to expire, the executor may, under the proposed regulations, file a protective claim for refund to preserve the right to claim a deduction under Treasury Reg. §20.2053-4(b). In this claim for refund, the executor must explain the reasons and contingencies delaying actual payment. The IRS will only act on the claim after the executor notifies them that the contingency has been resolved and payment has been made. The estate must also notify the IRS and pay additional taxes or file a refund claim for overpaid taxes if, after the filing of the estate tax return, the estate receives a tax refund or other adjustment to a paid claim.[14]

Proposed Treasury Reg. §20.2053-4(b)(4) goes on to establish "a rebuttable presumption that claims by a family member of a decedent, a related entity, or a beneficiary of the decedent's estate or revocable trust are not legitimate and bona fide and, therefore, are not deductible."

b. The Standard of Review for IRS Regulations

In analyzing the validity of proposed regulations, the first step is to analyze whether the plain meaning of the statute only supports one interpretation. If so, the statute is not ambiguous. If the statute is not ambiguous, the IRS has no discretion to issue regulations contrary to that unambiguous statute. Instead, the plain meaning of the unambiguous statute must be implemented. In this regard, if a court has declared the statute unambiguous or it has specified what the Congressional intent is, the IRS has no discretion to issue regulations contrary to that court ruling or court declaration of Congressional intent.[15]

If the pertinent code section is ambiguous or silent, regulatory review must then focus on the issue of whether the proposed regulation is based on a permissible construction of the statute. A permissible construction must be reasonable. Hence, the regulation must be rejected if it is unreasonable, arbitrary, capricious or manifestly contrary to the statute.[16] In other words, the proposed regulation cannot embellish the statute, make law, or add something that Congress has overlooked.

For the reasons outlined below, the proposed regulations on the treatment of claims against the estate under §2053 are not valid.

3. Analysis of Proposed Treasury Regulations Section 20.2053 4

a. The Proposed Regulations are Contrary to Section 2053

In general, §2053 does not require claims to have been paid in order to be deductible—an exception to that general rule was enacted in 2001, with respect to payment of foreign estate taxes.[17] The fact that Congress did not include actual payment as a requirement to deductibility under the general rule of §2053 when it made this particular amendment evidences a rather clear intent that actual payment was not intended as a requirement to deductibility under §2053. The proposed regulations are to the contrary. Thus, they are invalid.

No court has declared IRC §2053 to be ambiguous. Thus, the IRS has no discretion to issue regulations contrary to the statutory intent.

b. The Proposed Regulations are Contrary to the Fundamental Theory of Estate Tax

IRC §2001 imposes an estate tax on the net estate "transferred" by the decedent.[18] The Supreme Court has analyzed and determined that, because the estate tax is levied at the moment of death, the net value of the property transferred should be determined as nearly as possible as of that time.[19] For estate tax purposes, this should encompass the valuation of both the assets and liabilities.[20] In effect, the proposed regulations tax the property received, but ignore the claims, deductions and burdens on the assets taxed. Thus, they are inconsistent, uncertain, unpredictable and invalid.

c. The Proposed Regulations are Contrary to Case Law in the Overwhelming Majority of Circuits

When analyzing the IRS' argument that the deduction of claims should be limited to those allowed and paid, most courts have stated that this goes beyond what Congress intended, and they have refused to go beyond the clear and unambiguous statute.[21] Case law makes abundantly clear that the statute requires that the deduction for claims be based on date-of-death value, not on actual payment. The proposed regulations are contrary to this well-developed body of case law. Thus, they are void.

The Supreme Court has clearly stated that valuation is to be determined as of the date of death. In *Ithaca Trust Co.*,[22] the Supreme Court refused to consider post-death events in the valuation of the estate's deduction for a charitable bequest (a sum certain based on the applicable actuarial calculations), opting to value the charitable remainder interest after a surviving spouse's life estate based on the appropriate actuarial factors instead of recognizing that the widow actually died before the filing of the decedent's estate tax return. Significantly reducing the amount of the charitable deduction allowable to the decedent's estate, the Ithaca Trust Court stated: "[t]empting as it is to correct uncertain probabilities by the now certain fact, we are of the opinion that it cannot be done . . ."0[23] Thus, as a matter of law, the Ithaca Trust holding requires sum certain claims that are valid and enforceable at the time of the decedent's death to be valued without consideration of post-death events.

In *Propstra v. U.S.*,[24] the Ninth Circuit analyzed, in great detail, the 1954 amendment to IRC §2053(a) which changed the language authorizing a deduction for claims "allowed by the laws of the jurisdiction" to the current "allowable by the laws of the jurisdiction." The *Propstra* court concluded "that enforceability was to be determined at date of death . . . [and] claims based on legally recognized and enforceable rights were deductible; claims that were unenforceable because they lacked legal foundation were not deductible, even if actually paid. Congress lent support to this . . . construction when . . . it replaced "allowed" with "allowable." *[Id.* at 1254-1255.] Precluding consideration of post-death events in valuing a lien that was attached to one of the decedent's real properties on the decedent's date of death, even though the decedent's estate had the lien extinguished for a lesser amount, *Propstra* followed the Ithaca Trust approach: "we think that various indicia show that Congress intended that post-death events be disregarded when valuing the claims against the estate." [*Id.* at 1254.] As *Propstra* ruled on Congressional intent when §2053 was amended, the IRS cannot issue regulations contrary to that expression of Congressional intent. As the proposed regulations are contrary to that expression of Congressional intent, they are invalid.

Estate of *Smith v. Commissioner*,[25] the leading Fifth Circuit case, also follows the Ithaca Trust line of cases with respect to contingent liabilities and other claims for amounts uncertain as of the decedent's date of death. The Smith case involved a lawsuit against the decedent brought by an energy company over disputed royalty payments. The claim was eventually settled by the executors of the decedent's estate for significantly less than the amount of the original claim. Notwithstanding this fact, the Fifth Circuit 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."[26]

In response to the IRS' "no pay, no deduction" approach, the Fifth Circuit, stated, "[w]e decline the Commissioner's invitation to rewrite the law."[27] In remanding the case to the Tax Court, the Fifth Circuit prohibited the consideration of post-death evidence and analogized the valuation of the claim to that of an interest in a closely-held business in which each party presents "evidence of pre-death facts and occurrences supporting the value of the [claim] advocated by that party."[28]

The Tenth and Eleventh Circuits also follow the Ithaca Trust line of cases and cite *Propstra* in refusing to consider post-death events for purposes of determining the amount of the §2053 deduction. The leading cases in these circuits, respectively, are *Estate of McMorris v. Commissioner*[29] and *Estate of O'Neal v. U.S.*[30]

The Tenth Circuit's *Estate of McMorris* decision is notable for its thorough examination of the cases and promotion of the virtues of certainty for the taxpayer and the taxing authority alike. It also recognizes that any resulting benefits to be derived from refusing consideration of post-death events are dependent upon the facts of each particular case.[31] Thus, a rule refusing to consider post-death events does not, per se, favor either party.

In *Estate of McMorris*, the Tenth Circuit refused to consider post-death events that reduced an estate tax deduction for income tax liabilities after independent events caused the income taxes in question to become refundable to the decedent's estate. The Tenth Circuit focused on whether the deduction was properly calculated as of the date of death, and did not place reliance on the enforceability issue in its holding. It found that the deduction was properly calculated because the post-death events that triggered the refund were of independent origin and not relevant. Hence, the full amount of the originally claimed deduction was allowed.

In *Estate of O'Neal*, an Eleventh Circuit case following the Ithaca Trust holding, the claim was enforceable, but the amount of the claim was uncertain as of the date of death. The *Estate of O'Neal* court ultimately valued the claim under the strict date of death approach adopted by the *Smith* court. It refused to consider post-death events or allow such facts to be determinative of the IRC §2053 deduction.

In *Kyle Estate v. Commissioner*,[32] the Tax Court made a clear distinction between the issues of valuation and enforceability of a claim. In *Kyle*, the claim at issue was filed post-death against the decedent's estate and, like the Smith case, was unresolved at the time of her death. The *Kyle* court determined that, in cases where the enforceability of a claim is an issue, post-death events are relevant for purposes of determining the validity/enforceability of the claim. Where validity/enforceability is not an issue and the matter is merely one of valuation, post-death events are not considered. Based on this case law, *Kyle* held that post-death events must be considered only in determining whether a claim is valid and enforceable. Thus, the *Kyle* court denied the estate's §2053 deduction for a claim that was dismissed because it was not enforceable.

The Eighth Circuit is the only circuit that has taken the position that a deduction is allowed only for amounts actually paid. In *Jacobs v. Commissioner*,[33] the widow of the decedent never enforced her right to receive $75,000 under the terms of an antenuptial agreement with the decedent. Instead, she elected to receive her statutory share of the estate under state law. Thus, the *Jacobs* court refused to allow a $75,000 deduction for funds otherwise due to the widow under an antenuptial agreement which was enforceable at the time of the decedent's death.

Similarly, in *Sachs v. Commissioner*,[34] the Eighth Circuit denied a deduction under IRC §2053 because an income tax liability of the decedent (that was paid prior to his death) was reduced post-death as the result of new legislation which resulted in a refund of a portion of the income tax claimed by the decedent's estate. The *Sachs* court affirmed that, in the Eighth Circuit, the date of death principle of claim valuation set forth in Ithaca Trust does not apply to the deductibility of claims under IRC §2053. Thus, the estate lost its deduction because, as a legal matter, the claim ceased to exist without regard to whether the nullification of the claim

was foreseen.[35] However, the *Sachs* court acknowledged that, in the context of a tort action filed against the decedent after his death, "…it would be absurd to deny the estate a deduction for the settlement of the lawsuit on the ground that the decedent was unaware of the potential claim on the date of his death."[36]

Under the case law, which is replete, the courts have routinely found §2053 to be unambiguous. In fact, numerous courts have stated the Congressional intent is clear. As the proposed regulations are contrary to the unambiguous statutory language, they are invalid.

d. The Proposed Regulations are Unreasonable and Difficult, if not Impossible, to Administer

The proposed regulations are difficult, if not impossible, to administer, and impose unreasonable new requirements and burdens on fiduciaries. For example, with respect to contingent claims, the proposed regulations require the executor to: (i) file a protective claim prior to the expiration of the statute of limitations; then (ii) notify the IRS when the contingency affecting the claim has been removed.[37] No such post-return obligations are contained in or otherwise contemplated under §2053(a).[38]

In addition, many statutory elections will not work under the proposed regulations. For example, to determine whether an estate qualifies for installment payments under IRC §6166, deductions allowable under §2053 must be considered. As IRC §2057 has a similar requirement for qualified family owned businesses, certain estates could be precluded from utilizing these special relief provisions, further thwarting Congressional intent.

The statute of limitations, which was intended to clearly delineate the timeframe within which an audit and assessment would be allowed, can become virtually inconsequential in situations where a protective claim has to be filed as the protective claim must, necessarily, effectively extend the statute, at least until the date the claim is resolved. When a claim for refund is filed and the statute of limitations has expired, the IRS can review the whole estate tax return and make new determinations on previously reported items. If the IRS determines there should be an increase in valuation, that increase in valuation can be used to offset any claimed deduction. While a deficiency cannot be assessed, the refund can be denied, effectively leaving the estate open to litigation with the IRS for years longer than contemplated by the current statute of limitations framework.

Other complexities and unreasonable difficulties created by the proposed regulations relate to the use of "formula clauses" for purposes of establishing values to be funded into marital trusts and/or credit trusts under certain estate planning documents. Because there will be no ability to determine what can/should be funded into any marital trust or credit trust until resolution of the final amount of a claim, the proposed regulations simply do not work with certain formula clauses (or, alternatively, they impose yet another delay in attempting to administer the estate in a timely fashion). One could argue that this issue just extends funding and taxation until the "second death". But, if one (still) cannot ascertain the marital deduction amount on the second death, determination of the taxable estate and/or filing of an estate tax return on the second spouse's death would appear to be an administrative impossibility.

Notwithstanding all of the above, assuming a reviewing court could determine (i) that §2053 is ambiguous; (ii) that no court has stated that the statute is clear; and (iii) that the proposed regulations are not difficult or impossible to administer, the proposed regulations under §2053 should not be upheld because they are unreasonable, arbitrary and capricious. The following examples from a recent article in the California Trusts & Estates Quarterly illustrate why the proposed regulations are unreasonable or arbitrary and capricious:

> *Example 1,* Claim Against All Assets, Generally: Jane files a lawsuit against Jon, alleging that Jon owes Jane $1 million. Jane and Jon die the next day, and the sole asset of Jane's estate is the claim and Jon's estate owns one asset worth $1 million. Assume further that no other deductions or assets exist, the value of Jane's claim at date of death is $500,000, and ignore each decedent's applicable exclusion amount. Assume that at the time of the filing of the estate tax return, the claim is still pending.
>
> *Example 2,* Claim to a Particular Asset: Assume the same facts as Example 1, except that Jane alleged that Jon stole a particular asset worth $1 million and that asset is the sole asset of Jon's estate.
>
> *Example 3,* Claim as Business Liability: Assume the same facts as Example 1 except Jon's sole asset is an interest in a wholly owned business and Jane's suit named Jon and that business as co-defendants.

In all three examples, Jane's estate is subject to tax on the value of the claim as of the date of death [see IRC §2031] and Jane's taxable estate would be $500,000. By contrast, the tax on Jon's estate changes in each of these three examples.

In Example 1, under these proposed regulations, $1.5 million would be subject to estate tax because Jane would have a taxable estate of $500,000 and Jon would have a taxable estate of $1 million and Jon's estate would have no deduction for the contingent claim.

In Example 2, only $1 million would be subject to estate tax because Jane would have a taxable estate of $500,000 and Jon would have a taxable estate of $500,000, because the fair market value of the $1 million asset would be reduced by the $500,000 contingent liability to Jane's estate. [See *Id.*]

In Example 3, by contrast, on Jon's death, the business would be subject to the claim for $500,000, and Jon's estate would value that business, and thus the estate's interest in that business, subject to its share of the liability under the claim. [See *Id.*] Thus, in Example 3, under these proposed regulations something less than $1.5 million but more than $1 million would be subject to estate taxes.

Logically, the results in Example 1 and Example 2 and Example 3 should be the same—the type of Jane's claim and the type of Jon's assets should not determine the estate tax consequences. Nothing in the IRC provides any basis to conclude that the taxes should change based on the nature of the claim or the nature of the estate-defendant's assets. Rather, §2053 provides a deduction for "claims" without any qualifications; so all claims should be treated equally.

Moreover, the proposed regulations benefit Jane's estate and are detrimental to Jon's estate. The representative of Jane's estate would know that under the regulations, Jon's estate has to pay estate taxes currently, without deducting the uncertain claim. If the representative of Jane's estate knew that Jon's estate needed to take advantage of the tax deduction currently, instead of waiting possibly years, the representative of Jane's estate could use that information to bargain for a larger, earlier settlement. Also, Jane's estate could take that deduction into account when settling its claim, because in essence Jon's estate is saving, roughly, 45 cents in taxes on every dollar paid in the settlement. [See IRC §2001(c)(2)(B).] Thus, these proposed regulations provide an artificial incentive for Jon's estate to pay more than actually is owed or due, and to settle claims prematurely, just to take advantage of an estate tax deduction.[39]

Webster's Third New International Dictionary defines "arbitrary" and "capricious" as follows:

> Arbitrary: "1: depending on choice or discretion… 2 a (1) : arising from unrestrained exercise of the will, caprice, or personal preference… 2 b : based on random or convenient selection or choice rather than on reason or nature…"[40]

> Capricious: "1: marked or guided by caprice… not guided by steady judgment, intent, or purpose… 2: lacking a standard or norm : marked by variation or irregularity : lacking predictable pattern or law..."[41]

Notwithstanding the fact that beneficiaries' motivation to settle claims and compromise litigation positions to accelerate deductions and reduce taxes could subject fiduciaries to unreasonable additional, unintended liability exposures, the fact that the proposed regulations require the estate tax to change based not on the value, but on the nature or character of the assets and/or claims in the estate unequivocally demonstrates that the proposed regulations are arbitrary or capricious. Thus, the proposed regulations should not be adopted, they should be withdrawn.

4. Conclusion

The proposed regulations under IRC §2053 cause multiple problems. They are contrary to express statutory language; they do not interplay well with the estate tax provisions of the IRC; and they are unreasonable, arbitrary and capricious. Furthermore, they are in direct conflict with rulings from the Supreme Court and the Fifth, Seventh, Ninth, Tenth and Eleventh Circuit Courts of Appeal. Finally, implementation of the proposed regulations places unreasonable burdens and uncertainties on fiduciaries, a result which is, itself, contrary to Congressional intent. For these reasons, the proposed regulations should be withdrawn. Alternatively, they should be rewritten to conform with the United States Supreme Court's Ithaca Trust

decision and the conclusions of the vast majority of the Circuit Courts of Appeal which have addressed the issues of whether and to what extent, if any, post-death events should be considered in determining the validity and/or value of claims under §2053.

III. CIRCULAR 230/IRC SECTION 6694 (PREPARER PENALTIES)

A. § 10.35 Requirements for "Covered Opinions"

- A "covered opinion" is written advice (including electronic communications) concerning any federal tax issue(s) regarding … transactions with "the principal purpose of tax avoidance," and transactions with "a significant purpose of tax avoidance" if the written code advice is (a) a "reliance opinion…."

In evaluating the significant federal tax issues addressed, the practitioner must not take into account the possibility that a tax return will not be audited, an issue will not be raised on audit, or if raised, that an issue will be resolved through settlement.

- **Overall Conclusion**. The opinion must provide the practitioner's overall conclusion as to the likelihood that the federal tax treatment of the transaction or matter that is the subject of the opinion is the proper treatment and the reasons for that conclusion. If the practitioner is unable to reach an overall conclusion, the opinion must state that the practitioner is unable to reach an overall conclusion and describe the reasons for the practitioner's inability to reach a conclusion. In the case of a marketed opinion, the opinion must provide the practitioner's overall conclusion that the federal tax treatment of the transaction or matter that is the subject of the opinion is the proper treatment at a confidence level of at least "more likely than not."

B. § 10.37 Requirements For Other Written Advice

1. Requirements

A practitioner must not give written advice (including electronic communications) concerning one or more federal tax issues if the practitioner:

a. Bases the written advice on unreasonable factual or legal assumptions;

b. Unreasonably relies upon representations, statements, findings or agreements of the taxpayer or any other person;

c. Does not consider all relevant facts that the practitioner knows or should know; or

d. In evaluating a federal tax issue, takes into account the possibility that:

i. a tax return will not be audited;

ii. an issue will not be raised on audit;

iii. that an issue will be resolved through settlement if raised.

All facts and circumstances, including the scope of the engagement and the type and specificity of the advice sought by the client will be considered in determining whether a practitioner has failed to comply with Circular 230. In the case of an opinion the practitioner knows or has reason to know will be used or referred to by a person other than the practitioner (or the practitioner's firm) in promoting, marketing or recommending to one or more taxpayers an entity or arrangement a significant purpose of which is the avoidance or evasion of any tax imposed by the Code, the determination of whether a practitioner has failed to comply with Circular 230 will be made on the basis of a heightened standard of care because the greater risk caused by the practitioner's lack of knowledge of the taxpayer's particular circumstances.

C. Preparer Penalties.

1. Background On Small Business Act Changes To IRC § 6694.

For returns prepared after May 25, 2007, Small Business and Work Opportunity Act of 2007 (the "Small Business Act") dramatically changed the scope and breath of the preparers' penalty by:

a. Expanding the tax return preparer penalties to apply to all types of tax returns, including estate and gift tax, employment tax, and excise tax returns.

b. Raising the penalties imposed on return preparers for understatements due to unreasonable positions from $250 to the greater of $1,000 or 50% of the income derived (or to be derived) by the preparer with respect to the return or claim.

c. Raising the penalties for understatements due to willful or reckless conduct from $1,000 to the greater of $5,000 or 50% of the income derived by the preparer with respect to the return or claim.

d. Establishing a higher standard of conduct for preparers to avoid imposition of penalties when IRS alleges that the preparer knew or reasonably should have known of an unreasonable position. For undisclosed positions, the old standard required the position taken on the return to have a "realistic possibility of being sustained on its merits," which Reg § 1.6694-2(b) translated as a one in three or greater likelihood of being sustained on its merits. The new standard for undisclosed positions requires "a reasonable belief that the position would more likely than not be sustained on its merits," which translates to

approximately 51% or greater likelihood. This is significantly higher than the substantial authority standard that applies to taxpayers who don't use preparers.

e. Establishing a higher standard of conduct for disclosed unreasonable positions. Under the old standard, a preparer could avoid penalties on disclosed unreasonable positions if the position wasn't frivolous. The new standard requires a preparer to have a reasonable basis for the disclosed position – the same standard for disclosed positions as for taxpayers who don't use preparers.

2. Proposed Regulations under IRC § 6694

The proposed regs released June 17, 2008, would have conformed existing regs to the changes made by the Small Business and Work Opportunity Act of 2007 (the "Small Business Act").

a. Who is Responsible Within The Firm?

The proposed regs would replace the "one preparer per firm" rule under current Reg § 1.6694-1(b)(1) (in which only the signing tax return preparer associated with a firm is generally treated as a tax return preparer) with a position-by-position approach in which generally the person (or persons) within a firm primarily responsible for each position giving rise to an understatement would be responsible and subject to the penalty. (Prop Reg § 1.6694-1(b)(1)).

b. Reliance on Information Provided to the Preparer.

The proposed regs would allow preparers to rely in good faith without verification on information furnished by the taxpayer, another advisor, another tax return preparer, or another party (even when the advisor or tax return preparer is within the tax return preparer's same firm). A preparer could similarly rely on a tax return that has been previously prepared by a taxpayer or another tax return preparer. However, the proposed regs won't allow the preparer to rely on information provided by taxpayers with respect to legal conclusions on Federal tax issues. (Prop Reg § 1.6694-1(e)).

c. Firm's Liability.

With one exception, the proposed regs would follow the rules in current Reg § 1.6694-2(a)(2) and Reg § 1.6694-3(a)(2) with respect to when a firm is liable for the Code Sec. 6694(a) or Code Sec. 6694(b) penalty. Under the proposed regs, a firm would also be subject to the penalty when its review procedures were disregarded through willfulness, recklessness, or gross indifference in the formulation of the advice or the preparation of the return or claim for refund, that included the position for which the penalty was imposed. (Prop Reg § 1.6694-2(a)(2)(iii), Prop Reg § 1.6694-3(a)(2)(iii)).

d. Reasonable Belief or More-Likely-Than-Not.

The proposed regs would provide that the "reasonable belief that the position would more likely than not be sustained on its merits" standard would be satisfied if the preparer analyzes the pertinent facts and authorities and, in reliance on that analysis, reasonably concludes in good faith that the position has a greater than 50% likelihood of being sustained on its merits. Whether a tax return preparer meets this standard would be determined based on all facts and circumstances, including the preparer's due diligence. (Prop Reg § 1.6694-2(b)(1)).

e. Reasonable Basis Standard.

Under the proposed regs, the "reasonable basis" standard that must be met for disclosed positions would be the same standard as in current Reg § 1.6662-3(b)(3) (which provides that no negligence penalty is imposed for a return position that has a reasonable basis) or any successor provision. To meet the "reasonable basis" standard, a tax return preparer could rely in good faith, without verification, on information furnished by a taxpayer, advisor, another tax return preparer, or other party (even when the advisor or tax return preparer is within the tax return preparer's same firm). (Prop Reg § 1.6694-2(c)(1), Prop Reg § 1.6694-2(c)(2)).

f. Adequate Disclosure.

Under the proposed regs, to satisfy the disclosure standards when the position isn't disclosed on or with the return, each return position for which there is a "reasonable basis" but for which the tax return preparer doesn't have a "reasonable belief that the position would more likely than not be sustained on the merits" would have to be addressed by the tax return preparer. Advice to the taxpayer for each position would have to be particular to the taxpayer and tailored to his or her facts and circumstances--boilerplate disclaimers would not suffice. (Prop Reg § 1.6694-2(c)(3)).

g. Reasonable Cause.

The proposed regs generally would maintain the rules in the current regs on reasonable cause and good faith. However, whether a position is supported by a generally accepted administrative or industry practice would be an additional factor to consider in determining whether the tax return preparer acted with reasonable cause and good faith. (Prop Reg § 1.6694-2(d)).

h. Definition of a Tax Return Preparer.

The proposed regs would add the definitions of "signing tax return preparer" and "nonsigning tax return preparer" that are included in current Reg § 1.6694-1 to the regs under IRC § 7701. In determining whether an individual is a nonsigning tax return preparer, the proposed regs would provide that any time spent on advice that is given with respect to events that have occurred, which is less than 5% of the aggregate time incurred by the person with respect to the position(s) giving rise to the understatement, wouldn't be

taken into account in determining whether an individual is a nonsigning tax return preparer. (Prop Reg § 301.7701-15(b)).

In applying the proposed regs, IRS said that it would attempt to avoid a heavy handed approach and implement a "balanced enforcement program" for tax return preparers. IRS intends to modify its internal guidance so that a referral by revenue agents to the IRS Office of Professional Responsibility (OPR) will not be per se mandatory when IRS assesses an IRC § 6694(a) tax return preparer penalty against a tax return preparer who is also a practitioner under Circular 230 (i.e., the final regs governing the rules of practice before IRS). In matters involving non-willful conduct, IRS will generally look for a pattern of failing to meet the required IRC § 6694(a) penalty standards before making an OPR referral, although any egregious conduct subjecting a tax return preparer to penalty may form a basis for such a referral. (Preamble to Prop Reg, 06/16/2008).

The IRS intended to finalize these proposed regs by the end of 2008, with the expectation that the final regs would apply to returns, refund claims and advice given after they're published, but in no event sooner than Dec. 31, 2008.

3. Proposed Changes to Circular 230

The IRS has issued proposed regulations to eliminate the disparate treatment of tax advice and tax return positions between Circular 230 and IRC § 6694 as amended by the Small Business Act. The IRS has proposed to raise the standards in Section 10.34(a) of Circular 230 to the same "more likely than not" standard of IRC § 6694.

Presently Section 10.34(a) of Circular 230 provides that the standard for taking a position on a tax return or signing a tax return is the "realistic possibility" standard, i.e., one chance in three. A practitioner may not advise a client to take position on a tax return, or sign a tax return as a preparer, if the practitioner determines that the tax return contains a position that does not have a realistic possibility of being sustained on its merits unless the position is not frivolous and is adequately disclosed on the return.

The proposed regulations raise the "realistic possibility" standard to "more likely than not," i.e., more than 50 percent, and they also raise the standard for adequate disclosure from "not frivolous" to "reasonable basis," i.e., more than "not frivolous" but less than one chance in three. Under the proposed regulations, a practitioner may not (i) advise a client to take a position on a tax return; or (ii) sign a tax return as a preparer; unless the practitioner has a reasonable belief that the tax treatment of each position on the return would more likely than not be sustained on

4. IRS Memo

A memo from IRS's Large and Mid-Size Business Group ("LMSB") apprised IRS auditors of the new LMSB procedures for tax return preparer penalty cases.

a. Exam and Penalty Violations Are Distinct.

Examiners are reminded that each income tax examination is separate and distinct from a potential return preparer violation case relating to the income tax examination. Therefore, examiners are told not to propose or discuss conduct penalties per se in the presence of the taxpayer.

b. Taxpayer Interviews.

The memo informs examiners that taxpayer interviews should serve a dual purpose: (1) to further the tax examination; and (2) to identify violations by a tax return preparer. During the initial interview and throughout the examination process, the examiner should ask questions regarding the return preparation as appropriate to the case and issues being developed. Whether through the interview process or other documentation, the examiner will need to determine whether tax violations may have been committed by a person who prepared all or a substantial portion of a return for compensation.

c. Documentation of the Facts.

The examiner is instructed to document the case file following the conversation with the taxpayer and/or Power of Attorney. However, all the information on the return preparer's activities and the applicability of any penalties relating to the return preparer should be separated from the taxpayer's case file, and included in the return preparer penalty case file.

d. Finish Income Tax Case.

Generally, no return preparer penalty will be proposed until the income tax examination is completed at the group level. If the income tax case is unagreed, the examiner may pursue the preparer penalty after the unagreed income tax case is closed at the group level. The determination and settlement of the income tax examination should be at all times proceeding without regard to the return preparer penalty issue.

The House of Representatives passed H.R. 4318, which would reduce the reporting standard for tax professionals back down to a "reasonable basis" standard.

5. Emergency Economic Stabilization Act of 2008

On October 3, 2008, Congress passed and President Bush signed the Emergency Economic Stabilization Act of 2008("Economic Stabilization Act").

In addition to the "stability" that law has provided the economy in general and the financial and lending markets in particular, the Economic Stabilization Act included a number of significant tax provisions including the AMT "patch," and language replacing the "more likely than not" language under IRC § 6694(a) with "substantial authority" language. This change is retroactive to the effective date of the Small Business Act.

a. Impact on Proposed Regs.: The IRS was expected to issue final resolutions reflecting the "more like than not" standard under Code § 6694(a) before the end of 2008. Clearly, the new law makes that portion of those regs unnecessary.

> **Note:** The new law retains the "more likely than not" standard for tax shelters and reportable transactions.

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[1] IR.C. §2053(a).

[2] Treasury Reg. §20.2053-4 (emphasis added.)

[3] *Id.*

[4] Treasury Reg. §20.2053-1(b)(3).

[5] *Jacobs v. Commissioner,* 34 F.2d 233 (8th Cir. 1929), cert. den'd 280 U.S. 603 (1929).

[6] *Ithaca Trust Co. v. United States* (1929) 279 U.S. 151.

[7] 72 F.R. 20080.

[8] *Id.* at 20081.

[9] *Id.*

[10] *Id.*

[11] *Commissioner v. Lyne* 90 F.2d 745 (1st Cir. 1937); *Commissioner v. State Street Trust Company* 128 F.2d 618 (1st Cir. 1942); *Helvering v. O'Donnell* 94 F.2d 852 (2d Cir. 1938); *Estate of Shivley* 276 F.2d 372 (2d Cir. 1960); *Estate of Smith* 198 F.3d 515 (5th Cir. 1999); *Commissioner v. Strauss* 77 F.2d 401 (7th Cir. 1935); *Helvering v. Northwest National Bank & Trust Company of Minneapolis* 38 F.2d 553 (8th Cir. 1937); *Propstra v. United States* 680 F.2d 1249 (9th Cir. 1982); *Estate of McMoriris* 243 F.3d 1254 (10th Cir. 2001); *Estate of O'Neal* 258 F.3d 1265 (11th Cir. 2001); *Fehrs v. United States* 45 AFTR 2d (RIA) 1695 (Ct. Cl. 1979); *Estate of Sachs* 88 T.C. 769 rev'd on other grounds, 856 F.2d 1158 (8th Cir. 1988); *Estate of Lester* 57 T.C. 503 (1972); *Estate of Theile* 9 T.C. 473 (1947); *Russell v. United States* 260 F. Supp. 493 (N.D. Ill. 1966); *Greene v. United States* 447 F.Supp 885 (N.D. Ill. 1979); *Wilder V. Commissioner* 581 F.Supp. 86 (N.D. OH. 1983).

[12] *Ithaca Trust Co. v. United States* 729 U.s. 151 (1929)

[13] *Jacobs v. Commissioner*, 34 F.2d 233 (8th Cir. 1929), cert. den'd 280 U.S. 603 (1929); *Estate of Sachs* 856 F.2d 1158 (8th Cir. 1988); *Estate of Chesterton* 551 F.2d 278 (Ct. Cl. 1977), cert. den'd, 434 U.S. 835 (1977).

[14] Proposed Reg. § 20.2053-4.

[15] *National Cable & Telecomm. Assn. v. Brand X Internet Servs.* (2005) 545 U.S. 967, 982; *Chevron USA v. Natural Resources Defense Counsel* (1984) 467 U.S. 837, 843; *Estate of Gerson* (206) 127 T.C. 139, aff'd 507 F.3d 435 (6th Cir. 2007).

[16] *Chevon USA,* 467 U.S. at 845.

[17] IRC § 2053(d).

[18] *See US v. Manufacturers Nat'l Bank of Detroit*, 363 U.S. at 194.

[19] See *Estate of Smith*, 198 F.3d at 524; *Burnet v. Guggenheim* 288 U.S. 280, 285 (1933) ("Congress did not mean that the [estate] tax should be paid twice, or partly at one time and partly at another.").

[20] Basic accounting method concepts of consistency, certainty and predictability dictate that assets and liabilities must be valued at the same time in order to ensure that any "netting" of the assets less the liabilities fairly reflects the difference. Neither the IRC nor the Treasury regulations define what a "method of accounting" is.

Congress and the Treasury apparently assume that a method of accounting is an understood concept of financial accounting . . . However, certain elements are critical in defining a method of accounting: . . . consistency, certainty, and predictability. ***Once a method of a tax accounting has been adopted, it is assumed that the method will be consistently applied to a taxpayer's activities. Otherwise, there is no "method," only arbitrary procedures whose inconsistent application makes impossible the logical determination of income and expense during any particular period. [Citing *Walter H. Potter*, 44 T.C. 159 (1965), acq. 1966-1 CB 3, and *Holt Co. v. United States*, 368 F.2d 311 (5th Cir. 1966).] The use of a method of accounting lends certainty and predictability to the recognition and recording of financial transactions and events. Thus, any particular method of accounting, as opposed to an arbitrary practice, should so be defined that any person applying that method to a particular set of facts will reach the same result. Gertzman, Federal Tax Accounting (1988) §2.01.

[21] *Chevron USA v. Natural Resources, supra,* 467 U.S. at 844; *Boeing Co. v. United States* 537 U.S. 437 (203).

[22] *Ithaca Trust Co. v. U.s.,* 279 U.S. 151 (1929).

[23] *Id.* at 155.

[24] *Propstra v. U.S.,* 680 F.2d 1248 (9th Cir. 1982).

[25] *Estate of Smith v. Comm'r,* 198 F.3d 515 (5th Cir. 1999).

[26] *Id.* at 517.

[27] *Id.* at 524-525.

[28] *Id.* at 526.

[29] *Estate of McMorris v. Comm'r.,* 243 F.3d 1254 (10th Cir. 2001).

[30] *Estate of O'Neal v. U.S.,* 258 F.3d 1265 (11th Cir. 2001).

[31] *Estate of McMorris,* 243 F.3d at 1262-63 (10th Cir. 2001), citing *Estaet of Lester v. Comm'r,* 57 T.C. 503, 507 (1972).

[32] 94 T.C. 829 (1990).

[33] *Jacobs v. Comm'r.,* 34 F.2d 233 (8th Cir. 1929), cert. denied, 280 U.S. 603 (1929).

[34] 856 F.2d 1158 (8th Cir. 1988).

[35] *Id.* at 1160-61.

[36] *Id.* at 1162.

[37] Proposed Regs. §20.2053-4(b).

[38] Compare, for example, the post return-filing obligations imposed under IRC §§ 2013, 2031A, 2053(d), 2057 and 6166.

[39] Michael C. Gerson, Trusts & Estates Quarterly, Vol. 13, Issue 2, Summer 2007, "You Can Lead the IRS to the Law, But You Can't Make it Think: Why Section 2053 Proposed Regulations are Wrong," pp. 21-30.

[40] Webster's Third New International Dictionary (1961) p. 110.

[41] Webster's Third New International Dictionary (1961) p. 333.