

## SUGGESTED PROCEDURE FOR FILING AND PERFECTING PROTECTIVE CLAIMS UNDER TREASURY REGULATIONS §20.2053-1

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### DISCUSSION

#### **I. 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 laws of the jurisdiction ... under which the estate is being administered.”<sup>1</sup> IRC §2053(a)(3) is silent as to whether post-death events should be considered for purposes of determining the validity and/or value of claims against an estate, and the prior Treasury Regulations (last amended in 1958) offered somewhat conflicting guidance.

Over the years, two lines of case law developed with respect to the analysis of whether 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*,<sup>2</sup> concluded that post-death events are relevant and only amounts actually paid are deductible. The other, more widely accepted line, follows *Ithaca Trust Co. v. U.S.*,<sup>3</sup> and concludes that post-death events are irrelevant and deductions under IRC §2053 should be based on the value of the pertinent claims at the date of death, rather than on amounts actually paid before the estate tax return (or a claim for refund with respect thereto) is filed.

On the premise that a split in authority among the various United States Circuit Courts of Appeal caused problems regarding consistency in deductions for claims involving post-death events, the IRS issued proposed regulations,<sup>4</sup> followed by final regulations,<sup>5</sup> which amended the existing regulations under IRC §2053. The new regulations require actual payment prior to any deduction on the estate tax return for a claim against the estate. The new regulations limit the availability of any deduction to amounts actually paid by the estate. In essence, the regulations state that deduction is equal to the amount actually paid to settle the claim.

Since many such claims (e.g., litigation claims, environmental liability, etc.) remain pending prior to the statute of limitations for filing a refund request, the executor of an estate will now need to file a protective claim for a refund to preserve the estate’s right to claim a deduction under IRC §2053(a). This filing will preserve the claim even if the statute of limitations has otherwise expired. In this protective claim the executor will need to outline the reasons and circumstances why actual payment has not been made, i.e. why the claim is not ripe for settlement and remains contingent. The IRS will then act on the claim and issue a refund only after the executor has notified the IRS that the claim has been paid and any and all contingencies have been resolved.

## **II. ANALYSIS OF PROTECTIVE CLAIM REQUIREMENTS UNDER FINAL TREASURY REGULATIONS §§20.2053-1 AND 20.2053-4**

As stated above, for purposes of determining estate tax liability, IRC §2053(a)(3) allows for a deduction from the value of the gross estate equal to the value of a claim against the estate. “To be deductible, a claim against a decedent’s estate must represent a personal obligation of the decedent existing at the time of the decedent’s death.”<sup>6</sup> While a claim may exist at the time of the decedent’s death, “no estate tax deduction may be taken for a claim against the decedent’s estate while it remains a potential or unmatured claim.”<sup>7</sup> The amounts that may be deducted as claims against a decedent’s estate are limited to claims that are actually paid by the estate in settlement or satisfaction of the claim.”<sup>8</sup> Accordingly, “[e]vents occurring after the date of a decedent’s death shall be considered in determining whether and to what extent a deduction is allowable under IRC §2053.”<sup>9</sup> Note there is an exception for claims not exceeding \$500,000; however, the authors assume for purposes of this discussion that this safe harbor cannot be met.

“In determining whether and to what extent a deduction under IRC §2053 is allowable, events occurring after the date of a decedent’s death will be taken into consideration (i) until the expiration of the applicable period of limitation on assessment prescribed in IRC §6501 (including without limitation at all times during which the running of the period of limitations is suspended); and (ii) during subsequent periods, in determining the amount (if any) of an overpayment of estate tax due in connection with a claim for refund filed within the time prescribed in IRC §6511(a).”<sup>10</sup> In many instances, claims (i.e. litigation claims, environmental claims, etc.) remain disputed after the statute of limitations period has expired. To preserve the estate’s right to claim a deduction for claims that mature after the statute of limitations period expires, the executor must file a protective claim generally described in Treasury Regulations §20.2053-1(d)(5)(i) prior to the expiration of the statute of limitations period.”<sup>11</sup>

“A protective claim for refund under this section may be filed at any time before the expiration of the period of limitation prescribed in IRC§6511(a) for the filing of a claim for refund to preserve the estate’s right to claim a refund by reason of claims or expenses that are not paid or do not otherwise meet the requirements of deductibility under Section 2053 and these regulations until after the expiration of the period of limitation for filing a claim for refund.”<sup>12</sup> The Treasury Regulations state that “the protective claim need not state a particular dollar amount or demand an immediate refund, a protective claim must identify each outstanding claim or expense that would have been deductible under IRC§2053(a) or (b) if such item already had been paid and must describe the reasons and contingencies delaying the actual payment of the claim or expense.”<sup>13</sup>

Although the Treasury Regulations provide some basic guidelines for the information that must be identified in a valid protective claim, the regulations do not articulate with enough specificity the extent to which a claim must be identified, nor do they specify the procedure or form for filing such a protective claim. Apparently, it is contemplated that more specific guidance will be provided “from time to time by publication in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(b)).”<sup>14</sup>

Thereafter, a claim for refund can be made by the executor of the estate by notifying the IRS “within a reasonable period that the contingency has been resolved and that the amount deductible under §20.2053-1 has been established.”<sup>15</sup> However, it is unclear when a “contingency has been resolved” for this purpose. Additionally, no guidance is given as to how to notify the IRS that the contingency has been resolved, or what constitutes a “reasonable period” for filing a claim for refund.

### **III. PROPOSED PROCEDURE AND DISCLOSURE OF INFORMATION WHEN FILING PROTECTIVE CLAIMS**

Prior to the issuance of the final regulations, when an estate fiduciary would complete a Form 706 federal estate tax return on behalf of the estate, a deduction for a contingent claim (i.e., a claim in litigation) under IRC §2053 could be made on Schedule K by indicating an appraised value of the claim as opined by a litigation expert. Under the recently issued final regulations, estate fiduciaries cannot claim a deduction under IRC §2053 for a pending claim; rather, the contingency must be “resolved” and the amount of the claim must be “established” in order for a deduction to be valid. As stated above, a protective claim must be filed by the executor prior to the expiration of the applicable statute of limitations period for claiming a refund in order to preserve the right to claim a deduction under IRC §2053 once a particular claim has been paid. Since the final regulations provide no procedural guidance for filing a protective claim and provide only limited guidance as to the information that must be contained in a protective claim to preserve an estate’s right to claim a refund in the future, additional guidance from the IRS is needed. Without additional guidance, executors run the risk of failing to adequately protect an estate’s right to a deduction under IRC §2053 for either failure to file a protective claim in an appropriate manner, or for failure to provide sufficient information about a particular claim to the satisfaction of the IRS.

#### **A. Proposed Procedure for Filing Protective Claims**

There are many unknowns with respect to the procedural aspects of filing a valid protective claim. Not only are the basics of filing a protective claim unclear (i.e. what form or other written document must be filed and where must an executor file the appropriate paperwork), but it is also unclear whether a protective claim filed by an estate fiduciary would be examined for validity such that if insufficient information is provided, an executor would have the opportunity to amend the protective claim to conform to the as yet unknown requirements. The authors suggest that the Treasury Department publish guidance detailing the procedural aspects of filing protective claims as soon as possible so that estate fiduciaries ensure they are protecting decedents’ estates in accordance with their fiduciary duties since the regulations are now finalized.

With respect to the document or format of a protective claim, the authors propose that the IRS revise the Form 706 to either include a new schedule specific to protective claims, or to revise Schedule K to include a section for protective claims. Making the protective claim process a part of the Form 706 affords many benefits to both the estate fiduciaries as well as the IRS.

First, making the protective claim process a part of the Form 706 makes it more likely that this additional requirement imposed on an estate fiduciary will be timely fulfilled thereby protecting the estate’s right to request a refund once the contingency has been removed. Although the estate fiduciary would

generally have a three year window (based on the statute of limitations for filing a claim for refund under IRC §6511(a)) after the Form 706 estate tax return is filed in which to file a protective claim, this deadline could be inadvertently missed. Accordingly, it is advisable that the executor file any protective claims at the same time that the Form 706 is filed. With either a revised Schedule K or an additional schedule added to the Form 706 specifically for protective claims, this would ease the burden imposed on estate fiduciaries established by the final regulations and facilitate IRS review.

Second, enacting a procedure whereby a protective claim is filed as part of the Form 706 would clarify the filing location for protective claims in order to protect an estate's right to file a refund once a claim has been paid. No further guidance would be necessary for that issue.

Third, the administrative burdens imposed on the IRS by this additional requirement would be reduced if the protective claim was part of the Form 706. If protective claims were to be filed on a form separate from the federal estate tax return, the IRS would have to implement a system to not only link the protective claim with the Form 706 for that estate, but to also track the protective claim with an eventual claim for refund. Because a claim for refund generally involves an amended federal estate tax return, making the protective claim a part of the federal estate tax return would make not only reviewing the protective claim easier on the IRS, but analyzing a refund request would be easier as well.

Finally, by enacting a uniform procedure, all taxpayers and practitioners would have certain guidance. This would also ensure that the procedures are applied uniformly and fairly.

Additionally, because the filing of a valid protective claim is essential to preserving the estate's right to file a claim for refund after the applicable statute of limitations period has run, the IRS should review all filed protective claims for validity. At that point, if the IRS believes the protective claim is insufficient, the IRS should notify the estate fiduciary and give him or her the opportunity to amend the protective claim. If the protective claim was part of the Form 706, the IRS could review the new schedule (or amended Schedule K) to determine the validity of the protective claim. If the IRS deems the protective claim to be insufficient, the estate fiduciary should be notified at that time and given the opportunity to amend the protective claim.

When the IRS determines that the protective claim is valid, that fact can be made part of the closing letter issued by the IRS to the estate fiduciary. This way the estate fiduciary has evidence that the claim was received and is valid. In typical protective claims, receipt is acknowledged by the IRS so the taxpayer has confirmation that the IRS acknowledged receipt of the claim. Alternatively, there needs to be another mechanism for the fiduciary to determine that the claim has been received.

While the deductible value of the majority of claims is known by the due date of the Form 706, a claim may come to the fiduciary's attention after the filing date. In this circumstance, a different procedure will need to be utilized. The authors suggest that the Form 706 be amended to merely include a revised Schedule K or to include an attachment outlining the claim. Once again, the IRS should acknowledge that the claim was received and is valid.

## **B. Disclosure of Information Necessary to Preserve Right to Refund Upon Payment of Claim**

No matter what procedure and format is created by the IRS for the purpose of filing protective claims, the estate fiduciary should only be required to disclose limited information in order for the protective claim to be considered valid. Along with the name of the decedent and taxpayer identification number, the estate fiduciary should only be required to provide the name of the creditor and a brief description of the nature of the claim(s) against the estate. As stated in the final regulations, identifying a particular dollar amount is not required.<sup>16</sup>

In most pending litigation matters (particularly those involving substantial sums of money), the claims being litigated could change during the natural course of the litigation. For example, a creditor may add an additional cause of action against the estate. If the executor was required to identify with specificity the actual causes of action being litigated by the estate, the protective claim would not cover causes of action added after the protective claim was filed. This is also true with environmental liability. As the clean up progresses, time frames and costs continue to change. Accordingly, the authors suggest that the estate fiduciary only be required to identify the basic nature of the claim(s) made against the estate without being required to provide specifics as to the substantive legal details and procedural aspects of the claim. If the Treasury Department determines that more specific information about a claim is required in order for a protective claim to be valid, the executor must be given the opportunity to timely amend and/or supplement the protective claim. Guidance should also be provided as to whether an amendment is necessary in the event additional claims are made against the estate relating to the same pending matter.

## **IV. SUGGESTED PROCEDURE FOR FILING A CLAIM FOR REFUND**

Once the amount deductible for a claim that is the subject of a valid protective claim has been established and the contingency has been “resolved,” the estate fiduciary may file a request for a refund based on a proper deduction under IRC §2053. Treasury Regulations §20.2053-1(d)(5)(i) states that “[a]ction on protective claims will proceed after the executor has notified the Commissioner within a reasonable period that the contingency has been resolved and that the amount deductible under §20.2053-1 has been established.”<sup>17</sup> The Treasury Department, however, has provided no guidance regarding how the estate fiduciary should request the refund, what constitutes a “reasonable period” in which a request for refund should be made, and when a contingency has been “resolved.”

Generally, when an estate fiduciary is seeking a refund of estate tax liability, he or she simply files an “amended” Form 706 with the IRS which provides updated information regarding asset values or deductions. The authors suggest that a similar procedure apply with respect to requesting a refund after a contingency affecting the IRC §2053 deduction has been resolved. Specifically, in order to request a refund, the estate fiduciary should file an “amended” Form 706 that consists of the first page of the Form 706 (identifying the amount of the refund), the recapitulation on page 3, as well as Schedule K or other new schedule specific to protective claims (identifying the amount of the deduction claimed). Said “amended” estate tax return documents should serve as the required notice to the IRS under Treasury Regulations §20.2053-1(d)(5)(i).

With respect to the time in which the estate fiduciary must notify the IRS that a contingent claim has been resolved and make a claim for a refund, the Treasury Regulations simply state that the IRS must be notified within a “reasonable period.”<sup>18</sup> Such a statement is too vague for fiduciaries. Thus, the Treasury Department should issue guidance as to what constitutes a “reasonable period.” The authors suggest that guidance issued by the Treasury Department should provide that a claim for refund should be filed within one year from the date on which the amount of the claim is satisfied or settled. This would provide a precise deadline for the estate fiduciary while giving the estate fiduciary ample time to prepare the paperwork to request a refund.

When discussing this with Treasury, the authors proposed a one-year period. The Treasury Department indicated that this may be too long. On the other hand, ninety (90) days could, in some circumstances, be difficult to meet. Therefore, the authors are hopeful that at least six (6) months will be provided.

Finally, the triggering event for when a claim for refund may be made is unclear. Treasury Regulations §20.2053-1(d)(5)(i) states that a refund may be requested when “the contingency has been resolved and that the amount deductible under §20.2053-1 has been established.” However, when a contingency is deemed to be “resolved” and the amount deductible is deemed to have been “established” could arise in different ways. For example, assume the parties to a civil lawsuit enter into a settlement agreement in principle. Does that trigger the right to claim a refund? Or does the execution of a final written settlement agreement? What if the parties want to obtain court-approval of the settlement agreement? Is the contingency not “resolved” until the court approves of the settlement? Because the estate fiduciary has only a “reasonable period” of time in which to claim a refund based on when the contingency has been removed, it is imperative that the Treasury Department issue guidance as to when a contingency has been removed such that a claim for refund can be made.

## **V. CONCLUSION**

The final regulations under IRC §2053 impose an additional burden on estate fiduciaries by requiring that a protective claim be filed to protect the deductibility of a contingent claim once the value of the claim becomes certain and has been paid. However, the final regulations provide no means or procedural guidance for filing a protective claim and provide limited guidance as to what information must be contained in a protective claim to preserve an estate’s right to claim a refund in the future.

In order to provide for efficient administration and review, the Form 706 should be revised to incorporate a protective claim for refund, either on a separate schedule or as an addition to Schedule K, so that a separate form need not be filed. This will not only ease the burden on fiduciaries, but will also ease the administrative burden on the IRS by making easier to track protective claims and subsequent refund requests filed with each estate. No matter what procedural method the Treasury Department selects to implement this new requirement for a protective claim, the information required to be provided by an estate to preserve a deduction under IRC §2053 should be general in nature, i.e. the name of the decedent, taxpayer identification number, the name of the creditor, and a brief description of the nature of the claim(s) against

the estate. Upon receipt, the IRS should then acknowledge receipt of the protective claim. Moreover, in order to make a claim for refund, the IRS should simply require that the estate fiduciary file an “amended” Schedule K which has been revised to show the amount of the deduction by stating the amount paid in satisfaction of the claim. Finally, the Treasury Department should also provide some guidance as to the triggering event(s) to make a claim for refund and what is considered a “reasonable period” within which the estate fiduciary must make a claim for refund. The authors propose a deadline that is one year after the contingency has been resolved.

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<sup>1</sup> IRC§2053(a).

<sup>2</sup> *Jacobs v. Commissioner*, 34 F.2d 233 (8th Cir. 1929), cert. den’d 280 U.S. 603 (1929).

<sup>3</sup> *Ithaca Trust Co. v. United States* (1929) 279 U.S. 151.

<sup>4</sup> Proposed Treasury Regulations were published in the Federal Register on April 23, 2007 (REG- 143316-03, 72 F.R. 20080)

<sup>5</sup> Final Treasury Regulations were issued on October 20, 2009. T.D. 9468.

<sup>6</sup> Treasury Regulations §20.2053-4(a)(1).

<sup>7</sup> Treasury Regulations §20.2053-1(d)(1).

<sup>8</sup> Treasury Regulations §20.2053-1(d)(1), §20.2053-4(a)(1).

<sup>9</sup> Treasury Regulations §20.2053-4(a)(2).

<sup>10</sup> Treasury Regulations §20.2053-4(d)(2).

<sup>11</sup> Treasury Regulations §20.2053-4(d)(1).

<sup>12</sup> Treasury Regulations §20.2053-1(d)(5)(i).

<sup>13</sup> Treasury Regulations §20.2053-1(d)(5)(i).

<sup>14</sup> Treasury Regulations §20.2053-1(d)(5)(i).

<sup>15</sup> Treasury Regulations §20.2053-1(d)(5)(i).

<sup>16</sup> Treasury Regulations §20.2053-1(d)(5)(i).

<sup>17</sup> Treasury Regulations §20.2053-1(d)(5)(i).

<sup>18</sup> Treasury Regulations §20.2053-1(d)(5)(i).