Estate Tax Deductions for Claims Against the Estate

Two possibilities:

1. WAIT – Wait until the claim is actually paid, and deduct the amount actually paid. The estate can preserve the right to deduct the claim if paid after the normal estate tax statute of limitations has run; to do so, it must file a protective claim for refund before the statute expires (for example, on the estate tax return). Reg. § 20.2053-1(d)(5)(i).

2. DEDUCT NOW – Deduct the amount of the claim on the estate tax return based on an estimate as of the date of death.

   Transactions eligible for an immediate deduction:

   A. Any enforceable and certain claim as to which the amount to be paid is ascertainable with reasonable certainty. Reg. § 20.2053-1(d)(4). No deduction is allowed based on "a vague or uncertain estimate." *Id.* With recurring payments on an enforceable claim with no contingency other than death or remarriage, the estate may deduct the amount of the claim, measured according to the factors set forth in the valuation regulations. Reg. § 20.2053-4(d)(6)(i).

   B. Contested claims as to which a related counterclaim by the decedent is included in the decedent's gross estate, if the counterclaim's value exceeds 10 percent of the gross estate. The estate may deduct the "current value" of the claim, provided that a qualified appraisal is obtained supporting that value. Reg. § 20.2053-4(b)(1). The deduction is limited to the value of the decedent's counterclaim. Reg. § 20.2053-4(b)(2). If the claim is actually paid before the statute of limitations runs out on the estate tax, the deduction must be adjusted to the amount actually paid. Reg. § 20.2053-4(b)(3). The estate can preserve the right to increase the deduction to match actual payment of the claim after the normal estate tax statute of limitations has run; to do so, it must file a protective claim for refund before the statute expires. *Id.*

   C. Any claims whose aggregate "current value" does not exceed $500,000, provided that a qualified appraisal is obtained supporting that value. Reg. § 20.2053-4(c)(1). If the claim is actually paid before the statute of limitations runs out on the estate tax, the deduction must be adjusted to the amount actually paid. Reg. § 20.2053-4(c)(2). The estate can preserve the right to increase the deduction to match actual payment of the claim after the normal estate tax statute of limitations has run; to do so, it must file a protective claim for refund before the statute expires. *Id.*

Examples

1. Decedent agreed that he or his estate will pay his ex-spouse $10,000 per month for her life. Decedent dies when the ex-spouse is alive and 47 years old. The estate may DEDUCT NOW in category 2A. Under IRS actuarial tables, assuming a section 7520 rate of 2%, the current value of $120,000 per year for the life of a 47-year-old is $2,757,756. The estate may deduct this amount under IRC § 2053. No qualified appraisal is needed. Regardless of when the ex-spouse dies, there are no further estate tax consequences.

2. Decedent agreed that he or his estate will pay his ex-spouse $10,000 per month until she dies or remarries. Decedent dies when the ex-spouse is alive, 47 years old, and single. The estate may DEDUCT NOW in category 2A. To determine the amount of the deduction, an actuarial factor must be used that takes into account both the ex-spouse's life expectancy and the odds that the ex-spouse will remarry. (Actuaries do have such tables, although they're not posted anywhere obvious.) The amount will be less than $2,757,756 (see Example 1) because of the remarriage contingency. No qualified appraisal is needed. Regardless of when the ex-spouse dies, there are no further estate tax consequences.

3. At the time of her death, Decedent was being sued by Competitor for $2,000,000 in a proceeding for patent infringement. Decedent had a related counterclaim against Competitor for $1,800,000 for unfair competition. Assume that the fair market value of Decedent's claim against Competitor for purposes of inclusion in Decedent's gross estate is $1,200,000. Assume also that the current value of Competitor's claim against Decedent, determined by a qualified appraisal, is $1,350,000. Decedent's estate may DEDUCT NOW $1,200,000 for Competitor's claim, in Category 2B. If Decedent's estate eventually pays Competitor $900,000 on Competitor's claim, and if the statute of limitations has not run for assessing estate tax, the IRS can reduce the deduction from $1,200,000 to $900,000, and assess additional estate tax accordingly.

4. At the time of her death, Decedent was being sued by Competitor for $200,000 in a proceeding for patent infringement. Decedent had no related counterclaim against Competitor. Assume that the current value of Competitor's claim against Decedent, determined by a qualified appraisal, is $135,000. Decedent's estate may DEDUCT NOW $135,000 for Competitor's claim, in Category 2C. If Decedent's estate eventually pays Competitor $90,000 on Competitor's claim, and if the statute of limitations has not run for assessing estate tax, the IRS can reduce the deduction from $135,000 to $90,000, and assess additional estate tax accordingly.

5. At the time of her death, Decedent was being sued by Competitor for $2,000,000 in a proceeding for patent infringement. Decedent had no related counterclaim against Competitor. Assume that the current value of Competitor's claim against Decedent, if it were determined by a qualified appraisal, would be $1,350,000. Decedent's estate must WAIT to deduct Competitor's claim. If the estate is concerned that the estate tax statute of limitations might run before the claim is resolved, it must file a timely protective refund claim to extend the limitations period.