“FORM 706 DEDUCTIONS FOR CLAIMS AGAINST AN ESTATE: NEW TREASURY REGULATIONS”

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PEP Meeting, Thursday, January 14, 2010

- IRC §2053 allows deductions from the gross estate for (a) funeral expenses, (b) claims against the estate, and (c) administration expenses.

- Due to inconsistent litigation with IRS, Treasury has promulgated new and final regulations concerning certain aspects of deductions for **“claims against an estate” under IRC 2053(a)(3).** Most of the litigation has centered on the extent post-mortem events are considered in determining claims against an estate.

- The new regulations[1] are effective for deaths after October 19, 2009.

- Claims Against the Estate. The deduction is usually limited to those claims that were “personal obligations of the decedent existing on the date of death.”

    - Examples of Various Claims Against an Estate.

        - Any income taxes owed pre-mortem are deductible as claims against the estate even if IRS assesses them post-mortem; income taxes on post-mortem income are nondeductible on the 706;

        - Post-mortem lawsuit against the estate by a victim alleging decedent caused injury or death; did decedent cause the injury or death? What if the estate settles the lawsuit post-mortem?

        - What if decedent was liable as a co-guarantor of a debt but the creditor hasn’t brought a claim against the estate?

- Here is a brief summary of the final regulations:

    - General Rule. Only claims actually paid by the estate are deductible on the 706.

        - Exceptions:
            - Deductions allowed to the extent that all claims against the estate do not exceed $500,000.

[1] Treas. Regs. §20.2053-1, 20.2053-3 through 6, 20.2053-9 through 10, and, IRS Notice 2009-84.

- Deductions allowed if the gross estate includes an asset substantially related to the claim against the estate.
- Both exceptions anticipate an amended estate tax return to adjust for actual post-mortem events.

- Claims and Counterclaims. Deduction allowed for claims against the estate if there are one or more assets included in the gross estate that constitute at least 10% of the gross estate and the claim against the estate is determined by a "qualified appraisal" performed by a "qualified appraiser." The deduction is limited to no more than the related asset included in the gross estate.

- Reimbursements. No deduction allowed if there is a reasonable prospect of being reimbursed via insurance or otherwise. Executor should certify that no reimbursement is available in order to deduct the claim.

- Executor and Attorney Fees to Administer Estate. Deductible (even if not yet paid) providing: (a) they will be paid after 706 is filed and (b) can be determined with reasonable certainty.

- Contingent Claims. Generally, no deduction. Must file amended 706 when and if claim is actually paid.

The new regulations are very detailed and complex. Therefore, make sure any contested or inchoate claims are thoroughly researched in the regulations to maximize deductions on the Form 706.

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1/12/2010