September 23, 2022

Ms. Melissa C. Liquerman
Chief, Branch 4 (Estate & Gift)
Office of Chief Counsel
Passthroughs and Special Industries
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20044

Ms. Karlene M. Lesho
Senior Technician Reviewer, Branch 4 (Estate & Gift)
Office of Chief Counsel
Passthroughs and Special Industries
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20044

CC:PA:LPD:PR (REG–130975–08)
Room 5205
Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

RE: Comments on Section 2053 Proposed Regulations (REG-130975-08) Guidance Regarding the Deduction for Interest Expense and Amounts Paid under a Personal Guarantee, Certain Substantiation Requirements, and Applicability of Present Value Concepts

Dear Ms. Liquerman:

The American Institute of CPAs (AICPA) is writing to provide to the Department of the Treasury ("Treasury") and the Internal Revenue Service (IRS) our comments on proposed regulations (REG-1390975-08) guidance under section 2053 regarding the deduction for interest expense and amounts paid under a personal guarantee, certain substantiation requirements, and applicability of present value concepts ("Proposed Regulations"), issued June 24, 2022.[1] These proposed regulations will affect estates of decedents dying on or after the date of publication of the final regulations in the Federal Register.

The AICPA previously submitted comments on August 8, 2007 on prior proposed regulations (REG- 143316-03, published April 23, 2007) regarding how post-death events may be considered in determining the value of a taxable estate.[2]

Our below comments focus on the following concerns with the 2022 section 2053 proposed regulations:

---

[1] Unless otherwise indicated, references to a "section" are to a section of the Internal Revenue Code of 1986, as amended (the "Code"), and references to a "Treas. Reg. §" are to the Treasury regulations promulgated under the Code.
[2] See AICPA comments, "Proposed Regulations (REG-143316-03, 2007-2 IRB 1292) Regarding How Post-Death Events May Be Considered in Determining the Value of a Taxable Estate," August 8, 2007.

1455 Pennsylvania Ave. NW, Washington, DC 20004-1081
T: +1 202.737.6600 F: +1 202.638.4512
aicpaglobal.com | cimaglobal.com | aicpa.org | cgma.org

1. Application of present value principles to amount deductible under section 2053,

2. Interest expense incurred in administering the estate, and

3. Deduction for claims against the estate.

Specific Comments

1. Application of Present Value Principles to Amount Deductible under Section 2053

Overview

Treasury proposes that deductible amounts for claims and expenses otherwise meeting the requirements for deductibility of a claim or expense under section 2053 but paid after a three-year grace period ("Grace Period") following a decedent's date of death are to be valued at the present value, as of the decedent's date of death, of that amount.

Recommendations

- Treasury and IRS should reconsider the proposed regulations net present value approach.

- If the Grace Period concept is retained, Treasury and IRS should provide that the Grace Period is harmonized with current Treas. Reg. § 20.2053-1(d)(2), which provides that in determining whether and to what extent a deduction under section 2053 is allowable, events occurring after the date of a decedent's death will be taken into consideration until the expiration of the applicable period of limitations on assessment prescribed in section 6501.

- If the present value requirements are retained, the *Hubert* regulations and the Proposed Regulations should be harmonized.

- Treasury and IRS should clarify Example 6 of Prop. Reg. § 20.2053-1(d)(7) and the exception of Prop. Reg. § 20.2053-1(d)(6)(vii).

Analysis

In the AICPA's opinion, there are potentially multiple concerns with this approach.

First, the Proposed Regulations may overreach the statutory language of section 2053. Section 2053(a) provides that "the *value* of the taxable estate shall be determined by deducting from the *value* of the gross estate such amounts for funeral expenses, for administration expenses, for claims against the estate, and for unpaid mortgages on, or any indebtedness in respect of, property where the value of the decedent's interest therein, undiminished by such mortgage or indebtedness, is included in the value of the gross estate" [emphasis provided]. In contrast, the Proposed Regulations would limit the deduction to the present value of the estate's expenses beyond the Grace Period. The effect is to decrease the deduction for expenses paid, and the statute would appear not to support such a reduction.

Second, setting the Grace Period at three years after the date of death appears arbitrary.[3] Treasury notes "that a significant percentage of estates pay most, if not all, of their ordinary estate administration expenses during the three-year period following the decedent's date of death." Nearly all taxable estates are examined by the IRS, and such examinations generally are still underway at the end of the defined Grace Period. The statute of limitations with respect to estate tax returns extends to three years after the date of the filing of Form 706,[4] rather than three years from the date of death. Thus, under the provisions of the Proposed Regulations, the taxpayer would face the detriment of a reduced deduction for a relatively large administrative expense related to examination, the timing of which is within the government's control. At a minimum, it seems reasonable that the Grace Period should be harmonized with current Treas. Reg. § 20.2053-1(d)(2), which provides that in determining whether and to what extent a deduction under section 2053 is allowable, events occurring after the date of a decedent's death will be taken into consideration until the expiration of the applicable period of limitations on assessment prescribed in section 6501.

We further note that the following types of estates generally have substantial administrative expenses after the defined Grace Period: estates that must be resolved in more than one jurisdiction (particularly foreign jurisdictions), estates subject to or embroiled in litigation, estates with closely held businesses meeting the requirements of section 6166 (which are statutorily permitted up to a 14-year deferral period for payment of estate tax), and estates experiencing liquidity hardships that permit such estate, under section 6161, an extension of time to pay for up to ten years. The administration for these complicated estates will exceed the applicable period of limitations on assessment prescribed in section 6501. Thus, the deduction for legitimate administrative expenses paid after the passing of the statute of limitations is, per se, the subject of a negotiated estimate. Subjecting such an estimate to further reduction under the net present value regime articulated in Prop. Reg. § 20.2053-1(d)(6)(ii) and Prop. Reg. § 20.2053-1(d)(6)(iv) is another form of an estimate.

---

[3] As we read the Proposed Regulations, it seems deliberate in that the Proposed Regulations make no changes to existing Treas. Reg. § 20.2053-1(d)(2) (which limits adjustments for post-death events only through the applicable statute of limitations on assessments or with respect to a deduction claimed pursuant to a claim for refund), but Prop. Reg. § 20.2053-1(d)(6)(iii) requires adjustment to any deduction claimed on the Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return, which is paid outside of the Grace Period subject to the statutory limit under existing Treas. Reg. § 20.2053-1(d)(2). Thus, the regulation anticipates an exercise where discounting all deductions incurred during the nine to fifteen months period that the statute of limitations exceeds the Grace Period while the estate is still under audit. Thereafter, the required precision imposed by Prop. Reg. § 20.2053-1(d)(6)(ii) is possible only with respect to deductions arising from a claim for refund.
[4] Section 6501(a).

Current regulations permit an estimated amount to be deducted which appears to account for the fact that all of the expenses of the estate cannot be known by the point at which Form 706 must be filed.[5] Similarly, the implementation of other regulatory provisions (such as the so-called *Hubert* regulations[6] which require an estimate of a subset of estate administrative expenses (so called transmission expenses) incurred over the entire administrative period in order to accurately determine the charitable or marital deduction) are, per se, based on estimates determined during the course of the IRS examination of the return. All such estimates are anticipated and currently permitted under Treas. Reg. § 20.2053-1(d)(4). At least with respect to costs incurred in the ordinary administration of an estate where the administrative period is likely to be extended, the AICPA requests that a negotiated estimate of such costs be mutually agreed to and the estate tax statute of limitations allowed to close without further speculation as to expense amount and timing.

Finally, the AICPA is concerned that the present value requirement might be construed to reduce a residuary marital or charitable deduction. As described above, the *Hubert* regulations, as a practical matter, require the reduction of the marital or charitable deduction for the amount of transmission expenses determined with respect to the estate. If transmission expenses are paid after the Grace Period, then the deductible amount of transmission expenses will, presumably, reduce the marital or charitable deduction. However, Treas. Reg. § 20.2055-3 and Treas. Reg. § 20.2056-4 require that the marital deduction be reduced by the amount paid - not the amount determined to be deductible under the Proposed Regulations. If the present value construction results in a reduced deduction on Form 706, Schedule J, it is not clear whether the actual amount of transmission expenses will nonetheless be required to calculate the marital or charitable residue, thus creating a phantom increase to the taxable estate equal to the difference between the actual amount paid for transmission expenses and their determined net present value under the Proposed Regulations. If the present value requirements as outlined are retained, the AICPA requests that the *Hubert* regulations and the Proposed Regulations be harmonized to prevent this outcome.

The AICPA also requests clarification regarding Example 6 of Prop. Reg. § 20.2053-1(d)(7) and the exception of Prop. Reg. § 20.2053-1(d)(6)(vii). The exception indicates that no mortgage or indebtedness deductible pursuant to Treas. Reg. § 20.2053-7 is subject to discounting under the net present value regime introduced in the Proposed Regulation. Treas. Reg. § 20.2053-7 applies if the value of property is wholly included in the estate and such property is encumbered by a mortgage or other indebtedness. It would appear then that Example 6 would apply only in those instances when the obligation is not collateralized or otherwise secured by specific property that is wholly included in the gross estate. If that is the proper interpretation of the exception, it would appear the exception would be easily invoked by securing the indebtedness with assets, the value of which must be included fully in the gross estate.

---

[5] Treas. Reg. § 20.2053-1(d).

[6] Reg. 20.2055-3 with respect to the estate tax charitable deduction and Reg. § 20.2056(b)-4(d) with respect to the marital deduction.

2. Interest Expense Incurred in Administering the Estate

Overview

Treasury provides a number of factors that collectively may support a finding that interest expense on a loan entered into by the estate to facilitate the payment of the estate's tax and other liabilities or administration of the estate may be deductible.

Recommendations

- Treasury and IRS should provide a safe harbor to clarify that loans with legitimate non-tax purposes, bearing adequate interest, for a reasonable period of time, given the likely administration of the estate should be respected as bona fide debt regardless of the listed factors.

- Treasury and IRS should clarify Prop. Reg. § 20.2053-3(d)(1)(iv)(C), Example 3 to point out, for purposes of the example, that the tax obligation (and related penalties and interest) was not a contested claim subject to Treas. Reg. § 20.2053-4.

- Treasury and IRS should broaden the fourth factor regarding use of the loan proceeds to properly settle the estate to indicate that the funds may be used to satisfy estate liabilities, administrative expenses and other obligations imposed by the testamentary documents.

- If the fifth factor related to the loan term and payment schedule is not removed, the regulation should indicate how the burden of proof is to be met in order to satisfy this requirement.

- Treasury and IRS should consider eliminating the requirements in the sixth and seventh factors, which would require that borrowing occur only if there are no practical alternatives or if the estate does not have control of an entity with sufficient liquidity to satisfy the estate liabilities.

- Treasury and IRS should rethink or reformulate the eighth factor concerning intent to create illiquidity in the estate plan.

- Treasury and IRS should not treat the ninth and tenth factors as relevant and should withdraw these factors. These factors would limit borrowing from a lender who is an estate beneficiary or an entity over which the beneficiary has control.

- If it is decided not to withdraw the ninth and tenth factors, Treasury and IRS should clarify in the Proposed Regulations that interest on loans from a decedent's irrevocable life insurance trust would continue to be deductible.

- With respect to the eleventh factor on the right of recovery of estate tax, Treasury and IRS should limit the prohibition to the amount of right of contributions or the right of recovery and permit the executor to borrow funds from the parties in excess of these rights.

- Treasury and IRS should provide positive and negative examples to support the factors ultimately retained.

Analysis

The AICPA agrees with the observation provided by Prop. Reg. § 20.2053-3(d)(1)(ii) that "when non-section 6166 interest accrues on unpaid estate tax deferred under section 6161 or section 6163, the interest expense is actually and necessarily incurred in the administration of the estate…because the extension was based on a demonstrated need to defer the payment." Thus, such interest is per se deductible under section 2053.

The AICPA generally agrees with the exception for non-deductibility of interest expense attributable to an executor's negligence (including situations with intent, and not including situations of inadvertently not being aware), intentional disregard of applicable rules or regulations or fraud with intent to evade tax. However, demonstration of negligence, intentional disregard or fraud must require a showing greater than a failure to pay when the resources to pay might otherwise appear to be available.

The AICPA is concerned that Treasury and IRS may routinely disallow post-mortem interest, and that such disallowance should require a showing that the postponed payment of the uncontested claim was a breach of fiduciary duty at the time the IRS alleges the payment should have been made. Prop. Reg. § 20.2053-3(d)(1)(iv)(C), Example 2 is problematic and should be revised. We suggest that Example 2 be clarified to explain that interest incurred due to legitimate disputes should continue to be deductible. Prop. Reg. § 20.2053-3(d)(1)(iv)(C), Example 3 should be further clarified to point out, for purposes of the example, that the tax obligation (and related penalties and interest) was not a contested claim subject to Treas. Reg. § 20.2053-4.

The AICPA is also concerned with the restrictions set forth in Prop. Reg. § 20.2053-3(d)(2). That section provides that the "interest on a loan entered into by the estate to facilitate the payment of the estate's tax and other liabilities or the administration of the estate may be deductible depending on all the facts and circumstances." It is logical that indebtedness should be evidenced by an instrument or contractual arrangement and that the indebtedness expense and related loan terms be actually and necessarily incurred in the administration of the estate. However, many of the factors listed that would support a finding that the interest expense is not deductible may be problematic.

We agree with Treasury's concern about the term of any loan, the interest rate applied to the loan amount and the expected terms of the note's repayment. However, the identity of the lending party and whether other liquidity alternatives exist are matters related to the proper discharge of the executor's fiduciary duty. The AICPA is concerned that placing conditions on liquidity options will increase fiduciary risk without providing greater assurance with respect to the government's interests.

The fourth factor should be broadened to indicate that the funds may be used to satisfy estate liabilities, administrative expenses and other obligations imposed by the testamentary documents.

Further, unlike contested claims that are the subject of Treas. Reg. § 20.2053-4, expenses falling under Treas. Reg. § 20.2053-3 are those that are estimated and are net present valued based on estimated timetables. So measured, they permit the estate to be closed within the normal time constraints of the estate tax statute of limitations. Even if the information were within the executor's control, the loan regime may extend for several years beyond the estate tax statute of limitations. If this fifth factor is not removed, then the regulation should indicate how the burden of proof is to be met in order to satisfy this requirement.

The sixth and seventh factors turn on subjective determinations – the existence of "practical alternatives" to the loan and a finding of "insufficient liquidity." The payment of debts, expenses, taxes and specific bequests is the penultimate role of the executor. Ultimately, the course of action taken to raise the funds necessary to satisfy these demands is a course of action that most reasonably fulfills the executor's fiduciary duty and limits fiduciary risk at the time of its execution. The facts and circumstances at the time may indicate that the loan is the best of available alternative, even when other practical alternatives are also available. Further, whether an executor should compel distributions from controlled entities, or to exercise put rights or other contractual rights, are decisions that may further increase fiduciary risk with respect to the entity itself (which likely has other designs on its working capital) or other equity owners that object to the loss of significant working capital. Forcing a controlled entity to distribute cash needed for ongoing operations contradicts the goal stated in the sixth factor to prevent a "financially undesirable course of action." The executor should have the latitude to take those considerations into account without government interference. Given that the courts have generally been unwilling to second guess the business judgement of an executor (e.g., *Estate of Ruby S. Sturgis*)[7], even regarding the estate's relative liquidity (e.g., *Estate of Lewis S. Thompson*)[8], the motivation for the loan should be less a concern than the rate charged and the loan's term. Consideration should be given to eliminating these requirements.

The eighth factor should be rethought or reformulated for several reasons. First, it assumes knowledge of the decedent's motivation for his estate plan. Second, it implies an importance to estate tax considerations that generally does not exist in the estates large enough to be taxed under the current regime. Third, it assumes a degree of control over liquidity that the executor seldom enjoys. In general, the demands on an estate's liquidity will generally outstrip its availability in the years following death. Most decedents borrowed because they were illiquid, making the

[7] *Estate of Ruby S. Sturgis*, TC Memo 1987-45. The Court stated that "we are not prepared to second guess the judgments of a fiduciary not shown to have acted other than in the best interests of the estate."
[8] *Estate of Lewis S. Thompson III, Deceased, Synovus Trust Company, Successor Executor to Security Bank and Trust Company v. Commissioner*, TC Memo 1998-325

satisfaction of existing debt a burden that is compounded by expenses and specific pecuniary bequests – often charitable. Further, as indicated above, facts and circumstances could indicate that a borrowing represents a prudent action to undertake given the executor's obligations in the whole. The AICPA recommends that the focus be more on the rate charged and the loan's term as opposed to the motivation for the loan

The ninth and tenth factors should not be relevant. The act of net present valuing the interest deduction precludes any real advantage to a related party lender who is paying income tax and net investment income tax on the interest, in full, as collected. This disadvantage is compounded when any estate tax savings is being shared with numerous beneficiaries other than the lender. Moreover, as written, this factor would deny the most prevalent source of borrowed capital: life insurance proceeds held by irrevocable life insurance trusts (ILITs) or key person life insurance held by business entities that was intended to help fund the estate tax liability. Whether those proceeds are borrowed or used to buy assets is a question of fiduciary duty and fiduciary risk. It would seem unfair to make this decision more complex due to estate tax complications. Lastly, Treasury should consider that the nature of estate administration doesn't lend itself to commercial loan products, which often are too inflexible relative to the estate's facts and circumstances or simply can't be made large enough to accommodate the liquidity needs. In addition, commercial lenders often want the executor or trustee to personally guarantee a loan, which is outside the scope of the executor and trustee's duties. For all of these reasons, borrowing from a related party would be "actually and necessarily incurred in the administration of the decedent's estate" and "essential to the proper settlement of the decedent's estate."[9] We would encourage the withdrawal of these factors.

It is a routinely accepted practice for a decedent's ILIT to lend funds to the decedent's estate to provide liquidity. In most cases, the beneficiaries of the ILIT would be similar to those of the estate. If Treasury and IRS do not withdraw the factors, they should clarify in the Proposed Regulations that interest on these loans should continue to be deductible.

With respect to the eleventh factor, the AICPA requests that the prohibition be limited to the amount of right of contributions or the right of recovery. The executor should be permitted to borrow funds from such parties in excess of these rights.

The AICPA requests that both positive and negative examples be provided to support the factors ultimately retained. A safe harbor should be provided to clarify that loans with legitimate non-tax purposes, bearing adequate interest, for a reasonable period of time given the likely administration of the estate should be respected as bona fide debt regardless of from whom borrowed. Such guidance will be critical for executors in administration of the estate. A denial of the estate tax deduction for interest payments would further increase fiduciary risk for the executor since the interest paid has been ruled by the IRS as wholly nondeductible for income tax purposes.

[9] Prop. Reg. § 20.2053-3(d)(2)

Further, if Treasury is concerned that the formality of the related-party loans is being disregarded (for example, that loans are being prepaid or forgiven rather than paid pursuant to the loan agreement), consideration could be given to expanding the scope of the regulations to include income tax reporting requirements imposed upon any related party lender corresponding to the payment schedule upon which the interest deduction was premised.

Finally, it should be clarified that interest paid under section 6161 outside the Grace Period should continue to be deducted in full and not subject to the present value regime. Section 6161 provides an estate tax deferral as an alternative to section 6166 for illiquid estates that are not comprised of closely held businesses. Though the interest incurred related to the section 6166 deferral is not deductible, it is calculated at a reduced, preferential interest rate. To provide equity with the section 6166 treatment, section 6161 interest should continue to be deductible in full.

3. Deduction for Claims Against the Estate

Overview

Treasury provides that, to be deductible, a claim founded on a promise must represent a personal obligation of the decedent existing at the time of death, and the claim must be enforceable against the decedent's estate. In general, such promise or agreement must also have been bona fide and in exchange for adequate consideration in money or money's worth.

Recommendations

- Treasury and IRS should broaden the rule to allow deductibility of payments made pursuant to a decedent's guarantee if the arrangement was made at arm's length with a fair market value guarantee fee paid.

- Treasury and IRS should provide an example confirming the deductibility of payments made pursuant to certain facts we discuss in the analysis below.

Analysis

The AICPA is concerned about the restriction on deductibility of payments made pursuant to a decedent's guarantee. The Proposed Regulations provide that a decedent's agreement to guarantee a debt of an entity in which the decedent had an interest at the time the guarantee was given satisfies the requirement that the agreement be in exchange for adequate and full consideration in money or money's worth if: (1) at the time the guarantee was given, the decedent had control of the entity; or (2) the maximum liability of the decedent under the guarantee did not exceed, at the time the guarantee was given, the fair market value of the decedent's interest in the entity.[10] The AICPA suggests Treasury and IRS broaden the rule to allow deductibility of payments made pursuant to a

[10] Prop. Reg. § 20.2053-4(b)(5)(ii)

decedent's guarantee if the arrangement was made at arm's length with a fair market value guarantee fee paid. This should apply even if the decedent did not have control of the entity. Treasury and IRS should provide an example confirming the deductibility of payments made pursuant to these facts.

* * * * *

The AICPA is the world's largest member association representing the CPA profession, with more than 421,000 members in the United States and worldwide, and a history of serving the public interest since 1887. Our members advise clients on federal, state and international tax matters and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America's largest businesses.

If you have any questions, please contact Irene Estrada, Chair, AICPA Trust, Estate, and Gift Tax Technical Resource Panel, at (703) 628-5243 or Irene.C.Estrada@pwc.com; Eileen Sherr, AICPA Senior Manager – Tax Policy & Advocacy, at (202) 434-9256 or Eileen.Sherr@aicpa-cima.com; or me at (601) 326-7119 or JanLewis@HaddoxReid.com.

Sincerely,

Jan Lewis, CPA
Chair, AICPA Tax Executive Committee

cc: Ms. Catherine Hughes, Estate and Gift Tax Attorney-Advisor, Office of Tax Legislative Counsel, Office of Tax Policy, Department of the Treasury
Ms. Holly Porter, Associate Chief Counsel, Passthrough & Special Industries, Internal Revenue Service