***Estate of Bailly v. Commissioner, 81 T. C. 246 (1983)***

Unaccrued interest on deferred estate taxes cannot be deducted as an administration expense due to the inability to estimate it with reasonable certainty.

**Summary**

In Estate of Bailly v. Commissioner, the Tax Court held that an estate could not deduct unaccrued interest on deferred federal and state estate taxes as an administration expense under IRC § 2053(a)(2). The estate of Pierre L. Bailly elected to defer estate tax payments over 10 years under IRC § 6166. The court reasoned that due to fluctuating interest rates and the possibility of prepaying or accelerating the tax liability, a reasonable estimate of unaccrued interest could not be made, distinguishing this case from Bahr v. Commissioner. The decision necessitates that estates deduct interest as it accrues, requiring annual supplemental filings.

**Facts**

Pierre L. Bailly died on November 24, 1976. His estate elected to defer payment of federal and Florida estate taxes under IRC § 6166. The estate filed a federal estate tax return on February 17, 1978, and made several payments on the federal estate tax liability from 1978 to 1982. The interest rates for federal estate taxes fluctuated significantly during this period, ranging from 6% to 20%. Similarly, Florida estate tax interest rates were adjusted from 6% to 12% in 1977. The estate sought to deduct an estimate of the interest to be accrued over the 10-year deferral period on its initial return.

**Procedural History**

The Commissioner of Internal Revenue determined a deficiency in the estate's federal estate tax, leading the estate to petition the U. S. Tax Court. The case was submitted fully stipulated, and the court issued its opinion on September 6, 1983.

**Issue(s)**

1. Whether an estate that elected to defer payment of its estate tax liability under IRC § 6166 can deduct unaccrued interest on that liability and on state estate tax liability as an administration expense under IRC § 2053(a)(2).

**Holding**

1. No, because due to the fluctuating interest rates and the possibility of prepaying or accelerating the tax liability, a reasonable estimate of unaccrued interest cannot be made. Therefore, unaccrued interest is not deductible as an administration expense under IRC § 2053(a)(2).

**Court's Reasoning**

© 2025 SCOTUSreports.com. All rights reserved. 

The Tax Court distinguished this case from Bahr v. Commissioner, noting that Bahr did not address the issue of estimating interest with fluctuating rates. The court emphasized that under IRC § 6621(b), the interest rate for federal estate taxes adjusts semi-annually, making it impossible to estimate with reasonable certainty the interest that would accrue over the deferral period. Additionally, the estate could choose to prepay or accelerate the tax liability under IRC § 6166(g), further complicating any estimation. The court concluded that the estate could only deduct interest as it accrues, requiring the filing of annual supplemental returns. The court also addressed the estate's concerns about the statute of limitations, asserting that the IRS procedure allows for overpayments to be applied to future installments, with any remaining overpayment refundable after the final installment.

**Practical Implications**

This decision impacts how estates handle deferred estate tax liabilities. Estates must now file annual supplemental returns to deduct interest as it accrues, rather than estimating unaccrued interest upfront. This ruling necessitates careful financial planning and ongoing communication with tax authorities. The decision also underscores the importance of understanding the variability of interest rates and the flexibility of payment schedules under IRC § 6166. Subsequent cases, such as Estate of Thompson v. Commissioner, have cited Bailly to reinforce the principle that only accrued interest on deferred estate taxes is deductible.

© 2025 SCOTUSreports.com. All rights reserved. 