Estate of Keith Wold Johnson, Deceased, Seymour M. Klein, Betty W. Johnson, and Robert J. Mortimer, Executors, Petitioner v. Commissioner of Internal Revenue, Respondent, 88 T. C. 225 (1987); 1987 U. S. Tax Ct. LEXIS 14; 88 T. C. No. 14

Closing agreements with the IRS are final and binding unless there is fraud, malfeasance, or misrepresentation of material facts.

Summary

In Estate of Johnson, the estate sought to adjust its basis in notes it held after its decedent's death, arguing it should be increased by $4. 2 million in life insurance proceeds. However, the estate had previously entered into a closing agreement with the IRS, setting the basis at $600,000. The Tax Court held that the estate was bound by the closing agreement and could not contradict its terms by later claiming an increased basis. Additionally, the court ruled that the estate's informal bookkeeping entries did not constitute valid income distributions to another estate, disallowing deductions for those amounts.

Facts

Keith Wold Johnson, the decedent, guaranteed a loan to American Video Corp. (AVC) and assigned life insurance policies as collateral. Upon his death, the bank collected $4. 2 million from the insurance policies and assigned AVC notes to the estate. The estate and the IRS entered into a closing agreement valuing the estate's interest in the notes at $600,000 for estate and income tax purposes. Later, the estate claimed the basis should be $4. 2 million, representing the insurance proceeds. The estate also claimed income distribution deductions based on informal bookkeeping entries to Willard's estate, another beneficiary.

Procedural History

The estate filed its tax returns and entered into a closing agreement with the IRS in 1979. After AVC repaid the notes in 1980 and 1981, the estate filed amended returns claiming refunds based on an increased basis. The IRS issued a notice of deficiency, rejecting these claims. The estate then petitioned the Tax Court, which held a trial and issued its opinion in 1987.

Issue(s)

1. Whether the estate was bound by the closing agreement and could not claim an increased basis in the AVC notes.
2. Whether the estate was entitled to deductions for income distributions to Willard's estate based on informal bookkeeping entries.

Holding

1. Yes, because the estate was bound by the terms of the closing agreement and could not later contradict its position by claiming an increased basis.
2. No, because the informal bookkeeping entries did not constitute valid distributions beyond the estate's recall.

Court's Reasoning

The court emphasized the finality of closing agreements under IRC section 7121, stating they cannot be set aside without fraud, malfeasance, or misrepresentation of material facts. The estate's claim for an increased basis contradicted its earlier position in the closing agreement, which the IRS had relied upon. The court found no evidence of fraud or misrepresentation, thus upholding the agreement's terms. Regarding the income distributions, the court applied the standard that amounts must be definitively allocated beyond recall to qualify as distributions under IRC section 661(a)(2). The informal workpapers and lack of actual fund transfers did not meet this standard, as the estate could still recall the funds if needed.

Practical Implications

This decision reinforces the binding nature of closing agreements with the IRS, cautioning taxpayers against attempting to alter agreed-upon tax positions without clear evidence of fraud or misrepresentation. Practitioners must carefully consider all facts and potential future implications before entering such agreements. The ruling also clarifies the requirements for valid income distributions from estates, emphasizing the need for clear allocation beyond recall, which impacts estate planning and administration practices. Subsequent cases have cited Estate of Johnson when addressing the enforceability of closing agreements and the criteria for estate distributions.

