Estate of Gertrude H. Saunders, Deceased, William W. Saunders, Jr. , and Richard B. Riegels, Co-Executors v. Commissioner of Internal Revenue, 136 T. C. 406 (2011)

In Estate of Saunders v. Commissioner, the U. S. Tax Court ruled that a $30 million claim against the estate was not deductible for estate tax purposes due to its uncertain value at the decedent's death. The case underscores the stringent 'ascertainable with reasonable certainty' standard for deducting contingent liabilities, impacting how estates value and report such claims for tax purposes.

Parties

Plaintiff: Estate of Gertrude H. Saunders, represented by co-executors William W. Saunders, Jr. , and Richard B. Riegels. Defendant: Commissioner of Internal Revenue.

Facts

Gertrude H. Saunders died on November 27, 2004. Prior to her death, her husband William W. Saunders, Sr. , had died on November 3, 2003. Saunders, Sr. had previously represented Harry S. Stonehill. Following Saunders, Sr. 's death, the Estate of Harry S. Stonehill made a claim against the Saunders estate for legal malpractice and related issues, asserting that Saunders, Sr. had acted as an IRS informant against Stonehill's interests. The Stonehill estate's claim, filed 73 days before Gertrude's death, sought over $90 million in damages. The Saunders estate claimed a $30 million deduction for this claim on its estate tax return. The IRS disallowed the deduction, leading to the present litigation.

Procedural History

The IRS issued a notice of deficiency to the Saunders estate, disallowing the $30 million deduction and determining a penalty under I. R. C. § 6662(h). The estate petitioned the U. S. Tax Court for a redetermination. The parties stipulated facts and submitted expert reports. The Tax Court, under its authority, bifurcated the issue of whether the claim's value was ascertainable with reasonable certainty at the date of death. The court's decision on this issue would determine if a full trial on the claim's value was necessary.

Issue(s)

Whether the value of the Stonehill estate's claim against the Saunders estate was ascertainable with reasonable certainty as of November 27, 2004, the date of Gertrude H. Saunders' death, thus qualifying for a deduction under I. R. C. § 2053 and Treasury Regulation § 20. 2053-1(b)(3)?

Rule(s) of Law

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Under I. R. C. § 2053, deductions are allowed for claims against an estate that are enforceable under the laws of the jurisdiction where the estate is being administered. Treasury Regulation § 20. 2053-1(b)(3) provides that an item may be deducted even if its exact amount is not known, provided it is ascertainable with reasonable certainty and will be paid. The regulation explicitly states that no deduction may be taken upon the basis of a vague or uncertain estimate.

Holding

The Tax Court held that the value of the Stonehill estate's claim against the Saunders estate was not ascertainable with reasonable certainty at the date of Gertrude H. Saunders' death, and thus, the claim was not deductible under I. R. C. § 2053 and Treasury Regulation § 20. 2053-1(b)(3).

Reasoning

The court's reasoning focused on the uncertainty inherent in the valuation of the Stonehill claim as presented by the estate's experts. The court reviewed the expert reports and found significant discrepancies and uncertainties in the valuations provided. John Francis Perkin, the estate's litigation counsel, initially valued the claim at $30 million but later reduced it to $25 million, acknowledging the wide range of possible outcomes from $1 to $90 million. Philip M. Schwab, a valuation expert, used a decision tree analysis but his valuation was over $10 million less than Perkin's initial estimate, relying on the same uncertain assumptions. James J. Bickerton, another expert, generalized about the likelihood of contingency fee lawyers taking the case but did not provide a concrete valuation. The court concluded that these reports demonstrated a lack of reasonable certainty, as required by the regulation, and that the estate's experts failed to show that any specific amount, let alone $30 million, would be paid. The court distinguished between valuing claims in favor of an estate and deducting claims against an estate, emphasizing the stricter standard for deductions under the regulation. The court also noted the procedural posture of the case, rejecting the estate's argument that the issue was akin to a motion to dismiss or for summary judgment, and clarified that the decision was based on applying the law to the stipulated facts and documents.

Disposition

The Tax Court's decision was entered under Rule 155, indicating that the amount actually paid during the administration of the estate may be deducted in accordance with Treasury Regulation § 20. 2053-1(b)(3).

Significance/Impact

The case reaffirms the high threshold for deducting contingent claims against an estate under the 'ascertainable with reasonable certainty' standard. It clarifies the

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distinction between valuing assets in favor of an estate and deducting liabilities against it, impacting estate planning and tax reporting practices. The decision underscores the importance of concrete evidence in supporting the deductibility of claims, potentially affecting how estates approach the valuation and reporting of uncertain claims in the future. The case also highlights the procedural flexibility of the Tax Court in managing complex valuation disputes, as seen in its decision to bifurcate the issue for preliminary determination.

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