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Please Address Reply to:

September 22, 2022

Submitted Electronically
IRS and REG-130975-08

CC:PA: LPD:PR (REG-130975-08)
Room 5205, Internal Revenue Service
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Washington, DC 20044

RE: Comments Regarding Proposed Regulations under Code Section 2053

The American College of Trust and Estate Counsel ("ACTEC") is pleased to submit its comments regarding Treasury Notice 87 Fed. Reg. 38331 (6/28/22) requesting comments on proposed regulations (the "Proposed Regulations") that would amend existing regulations issued under Code section 2053. The Proposed Regulations affect estates of decedents seeking to deduct funeral expenses, administrative expenses, and/or certain claims against a decedent's estate under section 2053. ACTEC commends Treasury and the IRS (collectively "Treasury") for their careful efforts in drafting the Proposed Regulations, and we appreciate the opportunity to comment on the Proposed Regulations.

ACTEC is a nonprofit association of lawyers and law professors. Its more than 2,400 members are called "Fellows" and practice throughout the United States, Canada and other foreign countries with extensive experience in the preparation of wills and trusts, estate planning, and administration of trusts and estates of decedents, minors and incompetents. Fellows of ACTEC are elected to membership by their peers on the basis of professional reputation and ability in the fields of trusts and estates and on the basis of having made substantial contributions to those fields through lecturing, writing, teaching, and bar association activities. Fellows of ACTEC have extensive experience in providing advice to taxpayers on matters of transfer tax planning. ACTEC offers technical comments about the law and its effective administration but does not take positions on matters of policy or political objectives.

ACTEC's comments regarding the Proposed Regulations are set forth in the attached memorandum. If you or your staff would like to discuss the contents of this memorandum with the ACTEC Fellows who created it, please contact Kevin Matz, Chair of ACTEC 's Business Planning Committee (212-745-9576 kevin.matz@afslaw.com), William I. Sanderson, Chair of ACTEC's Washington Affairs Committee (202-875-1743 wsanderson@mcguirewoods.com) or Deborah McKinnon, ACTEC Executive Director (202-684-8460 domckinnon@actec.org).

Respectfully submitted,

Robert W. Goldman
President of ACTEC
ACTEC President 2022-2023

Comments of the American College of Trust and Estate Counsel ("ACTEC") on Proposed Regulations under Code Section 2053

Treasury Notice 87 Fed. Reg. 38331 (6/28/22) requested comments on proposed regulations (the "Proposed Regulations") that would amend existing regulations issued under Code[1] section 2053.[2] The Proposed Regulations affect estates of decedents seeking to deduct funeral expenses, administration expenses, and/or certain claims against a decedent's estate under section 2053. ACTEC commends Treasury and the IRS (collectively "Treasury") for their careful efforts in drafting the Proposed Regulations, and we appreciate the opportunity to comment on the Proposed Regulations.

BACKGROUND

Under section 2053(a), for federal estate tax purposes, the value of the taxable estate is determined by deducting from the value of the gross estate the following amounts that are allowable by the laws of the jurisdiction, whether within or without the United States, under which the estate is being administered: (1) funeral expenses, (2) administration expenses, (3) claims against the estate, and (4) 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.

Final regulations amending the regulations under section 2053 (TD 9468) were published in the **Federal Register** (74 FR 53652) on October 20, 2009 (the "2009 Final Regulations"). The 2009 Final Regulations generally limit the deduction for claims and expenses to the amount actually paid in settlement or satisfaction of that item, with exceptions for certain ascertainable amounts, claims against the estate, and indebtedness. *See* § 20.2053-1(d)(1) and (4); § 20.2053-4(b) and (c); and § 20.2053-7. The 2009 Final Regulations also reserve § 20.2053-1(d)(6) to provide future guidance on the issue of the appropriate application of present-value principles in determining the amount deductible under section 2053. The Proposed Regulations address this issue. In addition, the Proposed Regulations provide or clarify rules under section 2053 addressing the deductibility of interest expense accruing on tax and penalties owed by an estate, the deductibility of interest expense accruing on certain loan obligations incurred by an estate, requirements for substantiating the value of a claim against an estate that is deductible under § 20.2053-4(b) or (c), and the deductibility of amounts paid under a decedent's personal guarantee.

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[1] Unless otherwise stated, references in these Comments to "section(s)" or to "Code" are to the Internal Revenue Code of 1986, as amended. References in these Comments to "§" are to relevant sections of the Treasury regulations promulgated under the Code.

[2] 87 Fed. Reg. 38331 (June 28, 2022), Guidance Under Section 2053 Regarding Deduction for Interest Expense and Amounts Paid Under a Personal Guarantee, Certain Substantiation Requirements, and Applicability of Present Value Concepts.

EXECUTIVE SUMMARY OF ACTEC'S RECOMMENDATIONS

ACTEC's comments address the following aspects of the Proposed Regulations and are briefly summarized below:

1. **Interest Expense on Certain Loan Obligations.** The Proposed Regulations express concern about perceived attempts by estates to produce illiquidity that can cause estates to enter into loan agreements with related parties to generate interest deductions under section 2053. Although Treasury's concern is understandable, the prescription that the Proposed Regulations offer goes beyond what is necessary to address this concern and, if adopted in its present form, would also penalize estate and other planning that is significantly motivated by non-tax considerations. ACTEC suggests an approach to balance these considerations that focuses in general on the presence of a significant non-tax purpose for entering into the loan, with certain carve-outs from limitations on deductibility of interest.

2. **Written Appraisal Document.** ACTEC recommends that there should be no requirement that a written appraisal document be signed under penalties of perjury. ACTEC further believes that the word "appraisal" itself is unnecessarily restrictive and recommends that it should not be used (except perhaps as an example of several options).

3. **Amounts Paid Pursuant to the Decedent's Personal Guarantee.** Under case law, the guarantor's right to subrogation constitutes adequate and full consideration if the guarantor had a bona fide expectation that the loan would be paid by the borrower or that the guarantor would be reimbursed if the guarantor were required to make payment on the loan guarantee. ACTEC believes that the regulations should reflect this case law and that any examples in the regulations should be expressly nonexclusive safe harbors.

DISCUSSION

1. Interest Expense on Certain Loan Obligations

The Proposed Regulations express concern about taxpayers' use of "*Graegin* Loans" (*Estate of Graegin v. Commissioner*, T.C. Memo. 1988-477) and perceived attempts by estates to produce illiquidity to be addressed through loan agreements with related parties that can generate interest deductions under section 2053. Although Treasury's concern is understandable, we respectfully submit that the prescription that the Proposed Regulations offer goes beyond what is necessary to address this concern, and if adopted in its present form, would also penalize estate planning that is significantly motivated by non-tax considerations. That would be especially problematic because a good deal of entirely legitimate estate planning,[3] especially in the context of family-owned and -operated businesses, includes the creation of safeguards to preserve family

[3] We refer here to how the term "estate planning" is used in the Preamble to the Proposed Regulations and the term "estate plan" is used in Prop. Treas. Reg. § 20.2053-3(d)(2)(viii).

ownership, which necessarily prevent or seriously limit transfers outside the family. The side effect could of course be viewed as "illiquidity." Estate planners would welcome some assurance that such resulting "illiquidity" is unquestionably "genuine" (as the preamble to the Proposed Regulations (the "Preamble") puts it), and that such legitimate business planning is not the target, and should not even be a collateral object, of these regulations.[4]

The Preamble acknowledges that some estates face genuine liquidity issues that make it necessary to find a means to satisfy their liabilities, and incurring a loan obligation on which interest accrues may be the only or best way to obtain the necessary liquid funds. The Preamble continues: "However, if illiquidity has been created intentionally (***whether in the estate planning***, or by the estate with knowledge or reason to know of the estate tax liability) prior to the creation of the loan obligation to pay estate expenses and liabilities, the underlying loan may be bona fide in nature but most likely will ***not*** be found to be actually and necessarily incurred in the administration of the estate." (Preamble at 15; emphasis added)

The Proposed Regulations provide that interest expense is deductible ***only if***, among other things, the loan is actually and necessarily incurred in the administration of the decedent's estate and is ***essential*** to the proper settlement of the decedent's estate. Further, the Proposed Regulations provide a nonexclusive list of factors to consider in determining whether interest expense payable pursuant to such a loan obligation of an estate satisfies the applicable requirements.[5] Among those

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[4] *See* Ronald D. Aucutt, Capital Letter No. 57 "A Surge of Administrative Guidance" (Aug. 11, 2022) (hereinafter "Capital Letter No. 57") (available at Capital Letter No. 57 | The American College of Trust and Estate Counsel (actec.org)).

[5] According to Prop. Treas. Reg. § 20.2053-3(d)(2), factors that collectively may support a finding that the interest expense also satisfies the additional requirements under § 20.2053-1(b)(2) and § 20.2053-1(a) include, but are not limited to, the following:

(i) The interest rate on and the terms of the underlying loan (whether between related or unrelated parties), including any prepayment penalty, are reasonable given all the facts and circumstances and comparable to an arms-length loan transaction;

(ii) The underlying loan is entered into by an executor of the decedent's estate acting in the capacity of executor or, if no executor is appointed and acting, the person accountable for satisfying the liabilities of the estate;

(iii) The lender properly includes amounts of paid and/or accrued interest (including original issue discount as determined under sections 1271 through 1275 and the regulations in this part under those sections, such as original issue discount attributable to stated interest that is treated as part of the stated redemption price at maturity because it is not payable at least annually) in gross income for Federal income tax purposes, particularly if the lender is a family member of the decedent, a related entity, or a beneficiary of the decedent's estate or trust (as defined in § 20.2053-1(b)(2)(iii));

(iv) The loan proceeds are used to satisfy estate liabilities that are essential to the proper settlement of the estate, including, but not limited to, the Federal estate tax liability;

(v) The loan term and payment schedule correspond to the estate's anticipated ability to make the payments under, and to satisfy, the loan, and the loan term does not extend beyond what is reasonably necessary;

factors is whether the loan obligation is entered into by the executor with a lender who is not a substantial beneficiary of the decedent's estate (or an entity controlled by such a beneficiary) at a time when there is no available alternative to obtain the necessary liquid funds to satisfy estate obligations and without requiring a sale of illiquid assets at significantly less than their fair market value.[6] But that is not clear.

The Preamble posits an example where either the need for the loan or any of the loan terms are contrived to generate, or increase the amount of, a deduction for the interest expense – in that case, the interest is not deductible. Further, if the loan obligation carried an extended loan term with a single balloon payment that does not correspond with the estate's ability to satisfy the loan, the Preamble states that the interest accruing on the loan is not necessarily incurred in the administration of the estate (and therefore is not deductible).

The Proposed Regulations are extending their scrutiny not only to actions taken after death that may create illiquidity, but also to estate planning during the decedent's lifetime which produces illiquidity post-death. We respectfully submit that this overlooks that there will often be significant non-tax reasons for taxpayers to structure their holdings in ways that may not be liquid, including to ensure that subsequent generations don't sell or otherwise dispose of their inherited business interests that the decedent has spent a lifetime building. We recommend that the following circumstances be expressly addressed by examples in the Proposed Regulations, and also in language in the Preamble:

(vi) The only practical alternatives to the loan are the sale of estate assets at prices that are significantly below-market, the forced liquidation of an entity that conducts an active trade or business, or some similar financially undesirable course of action;

(vii) The underlying loan is entered into when the estate's liquid assets are insufficient to satisfy estate liabilities, the estate does not have control (within the meaning of section 2701(b)(2)) of an entity that has liquid assets sufficient to satisfy estate liabilities, the estate has no power to direct or compel an entity in which it has an interest to sell liquid assets to enable the estate to satisfy its liabilities, and the estate's assets are expected to generate sufficient cash flow or liquidity to make the payments required under the loan;

(viii) The estate's illiquidity does not occur after the decedent's death as a result of the decedent's testamentary estate plan to create illiquidity; similarly, the illiquidity does not occur post-death as a deliberate result of the action or inaction of the executor who then had both knowledge or reason to know of the estate tax liability and a reasonable alternative to that action or inaction that could have avoided or mitigated the illiquidity;

(ix) The lender is not a beneficiary of a substantial portion of the value of the estate, and is not an entity over which such a beneficiary has control (within the meaning of section 2701(b)(2)) or the right to compel or direct the making of the loan;

(x) The lender or lenders are not beneficiaries of the estate whose individual share of liability under the loan is substantially similar to his or her share of the estate; and

(xi) The decedent's estate has no right of recovery of estate tax against, or of contribution from, the person loaning the funds.

[6] *See* Prop. Treas. Reg. § 20.2053-3(d)(2)(vi), (viii), (ix), and (x).

1. The option of borrowing from a family-owned entity, including an operating business, may be not only most convenient but also most protective of the viability of that entity or business whose owners are faced with tax liabilities that shareholders of public corporations, for example, could satisfy simply by sales of stock that do not affect the company. The Proposed Regulations would not prohibit the deduction of interest in such cases; they simply offer "factors" to be weighed. ACTEC would welcome some assurance in the Final Regulations that such weighing would indeed strike an "appropriate balance." [7]

2. Subdivision (vi) of Prop. Treas. Reg. § 20.2053-3(d)(2) states as follows (emphasis added):

   (vi) The only practical alternatives to the loan are the sale of estate assets at prices that are ***significantly*** below-market, the forced liquidation of an entity that conducts an active trade or business, or some similar financially undesirable course of action;

   What constitutes "prices that are ***significantly*** below-market" is undefined in the Proposed Regulations. Any attempt at such delineation moreover would be highly problematic as the executors of estates are fiduciaries under state law, and can be held liable by estate beneficiaries for wasting estate assets in a below-market sale to generate liquidity to pay estate taxes when loans (including from related parties) are available. This same consideration would apply not only to executors who are individuals, but also to corporate executors such as banks or trust companies who would generally be unwilling to engage in such below-market sales due to these liability concerns. We are concerned that a potential consequence of the Proposed Regulations could be to penalize a fiduciary's exercise of sound business judgment in determining whether to sell an interest in a closely-held business.

3. The Proposed Regulations could also be construed to penalize estate planning that involves the use of life insurance policies on a decedent's life that are owned by and payable to irrevocable life insurance trusts ("ILITs") to create a source of liquidity outside of one's taxable estate to help fund estate tax payment obligations through loans made by the ILIT's trustee to the estate's executor. An ILIT is commonly employed to create a source of liquidity outside of the decedent's taxable estate, with the trustee of the ILIT often lending the funds obtained through insurance proceeds to the executor to help fund the payment of estate taxes. We respectfully submit that the Proposed Regulations should be modified to expressly exonerate such pre-death funding arrangements (which can also be accomplished through business entities) from causing an estate's interest deductions to be denied.

[7] *See* Capital Letter No. 57.

We do, nevertheless, understand and appreciate the concerns that the Proposed Regulations express about a decedent's participation in estate planning transactions (particularly during the three-year period prior to the decedent's death) that produce illiquidity post-death where a significant non-tax purpose does not support the transactions (or where life insurance has not been used as a funding mechanism to create liquidity to help finance the payment of estate taxes). We believe that an appropriate balance can be struck through a focus on the estate's establishment of a significant non-tax purpose in the estate planning or other transactions that are undertaken within three years of the decedent's death that have the effect of producing illiquidity. (Transactions more than three years prior to death, in contrast, need not be subject to any such heightened scrutiny.) Those lifetime transactions within three years of the decedent's death that have produced illiquidity for which the estate is able to demonstrate a significant non-tax purpose should be conferred a presumption of validity for section 2053 deduction purposes, while those lifetime transactions within three years of death that produce illiquidity for which the estate is unable to demonstrate a significant non-tax purpose would not be conferred the benefit of such presumption. In addition, there should be an express and overriding "carve-out" that conclusively exonerates from such limitations on deductibility interest on loans that are made to the executor from an irrevocable life insurance trust (or through various other types of financing arrangements that could involve business entities) and are funded with proceeds of life insurance on the decedent's life.

2. Written Appraisal Document

The Proposed Regulations state that, for amounts deductible under § 20.2053-4(b) or (c), the expected date or dates of payment must be identified in a "written appraisal document" of "a person who is qualified by knowledge and experience to appraise the claim being valued." Prop. Treas. Reg. § 20.2053-4(b)(1)(iv), (b)(1)(iv)(F), (c)(1)(iv), and (c)(1)(iv)(F). The Proposed Regulations require that such a written appraisal document be "signed under penalties of perjury." Prop. Treas. Reg. § 20.2053-4(b)(1)(iv)(F) and (c)(1)(iv)(F).

The Proposed Regulations would remove the requirement that the written appraisal document comply with the rules for a "qualified appraisal," because, as the Preamble states, those rules were adopted to address charitable contributions and are not all appropriate under section 2053. 87 Fed. Reg. at 38335 (June 28, 2022). The qualified appraisal rules, however, do not require that the appraisal be signed under penalties of perjury, and no other provision of the Code or Treasury regulations includes such a requirement. *See* § 1.170A-17(a)(3). Furthermore, the Proposed Regulations provide that a written appraisal document may not be prepared by a related party, which makes it less likely that the person signing the written appraisal document will have firsthand knowledge of the underlying facts, further making a "penalties of perjury" requirement inappropriate. ACTEC therefore recommends that this requirement be deleted.[8]

ACTEC welcomes the removal of the "qualified appraisal" references from the section 2053 context and believes that that removal should also encourage reexamination of whether an "appraisal" as such should be required at all. The use of the term "appraisal document" implies that it must be formally prepared by someone who is an "appraiser" by profession. Unlike the value of a nonmarketable asset, a claim against the estate will often be grounded mainly in legal

[8] *See also* Capital Letter No. 57.

considerations and arguments. ACTEC believes, for example, that often an attorney overseeing the estate administration will be eminently, if not uniquely, qualified to weigh such legal considerations and arguments and estimate the likely amount and timing of the payment of such claims. ACTEC therefore recommends that § 20.2053-4(b)(1)(iv) and (c)(1)(iv) of the final regulations omit the use of the word "appraisal" (unless it is used only as an example of several options). The use of the word "statement" in Prop. Treas. Reg. §20.2053-1(d)(6)(iv) would be a good model. It may still be appropriate to require that the person preparing the statement is not a family member of the decedent, a beneficiary or family member of a beneficiary, or an employee or similarly related person, as in Prop. Treas. Reg. § 20.2053-4(b)(1)(iv)(F) and (c)(1)(iv)(F).

3. Amounts Paid Pursuant to the Decedent's Personal Guarantee

The Proposed Regulations state that an estate may deduct under section 2053 claims against a decedent's estate founded upon a decedent's agreement to guarantee a debt of another. Prop. Treas. Reg. § 20.2053-4(d)(5)(ii). As with other claims against a decedent's estate, the claim based on a guarantee must: (a) represent a personal obligation of the decedent existing at the time of the decedent's death; (b) be enforceable against the decedent's estate; (c) be a *bona fide* loan guarantee; and (d) have been entered into in exchange for adequate and full consideration in money or money's worth. Prop. Treas. Reg. § 20.2053-4(d)(5)(i) and (ii).

There must be consideration for a loan guarantee, but the courts have long held that the consideration need not be paid to the decedent. Rather, courts have held that a guarantor's obligation is contracted for adequate and full consideration in money or money's worth if there is a loan of money to a third party on account of a binding guaranty. The guarantor's right to subrogation constitutes adequate and full consideration if the guarantor had a *bona fide* expectation of repayment. No additional monetary consideration to the decedent is required for the loan guarantee. *See, e.g.* (in each of which no separate monetary consideration was paid for the decedent's loan guarantee), *Carney v. Benz*, 90 F.2d 747 (1st Cir. 1937) (decedent guaranteed loan to real estate investment company owned and operated by his wife and daughter, to enable it to open a stock-trading account; account lost all value after stock market crash of 1929; decedent's estate paid the claim and deduction allowed); *Commissioner v. Wragg*, 141 F.2d 638 (1st Cir. 1944) (deduction allowed where decedent was accommodation endorser of notes issued by son and son was bankrupt; at least some of the borrowed funds were used to finance a family corporation in which decedent owned an interest); *Commissioner v. Porter*, 34 B.T.A. 798 (1936), *aff'd*, 92 F.2d 426 (2d Cir. 1937) (decedent guaranteed loan obtained by son-in-law; guarantee was an ordinary business transaction, son-in-law was solvent when guaranty was given, decedent had a reasonable expectation of reimbursement if he were called upon to pay); *Estate of Hofford v. Commissioner,* 4 T.C. 542 (1945), *supp. opinion*, 4 T.C. 790 (1945) (decedent endorsed a note of a homeowners association; association became unable to repay the loan and decedent's estate was required to pay; deduction allowed because of the absence of "evidence that the decedent intended any gift to the association by his accommodation endorsement and … no reason to suppose that he intended any gift"); *Scofield v. Commissioner*, T.C. Memo 1980-470 (deduction allowed for lien on decedent's estate due to his guarantee of son's bank loans, because arrangements were commercially reasonable and there was no evidence of a hidden donative objective); *Dodge v. Gagne,* 23 F. Supp. 729 (D.N.H. 1938) (deduction allowed where decedent guaranteed brother's promissory notes, loan was used to operate corporation of which brother was president and major

stockholder, and there was no evidence that decedent abandoned any recourse against his brother, or that he intended to make a gift or testamentary distribution).

ACTEC recommends that the Proposed Regulations be clarified to state that consideration is required for the underlying indebtedness, but that consideration will be deemed to have been provided for the loan guarantee if a loan of money is made on account of the guarantee and the relevant facts and circumstances demonstrate a reasonable expectation of repayment.

The Proposed Regulations state that a loan guarantee will be deemed to have been entered into in exchange for adequate and full consideration in money or money's worth for this purpose, if, at the time the guarantee was given, either: (a) the decedent had control (within the meaning of section 2701(b)(2)) of the entity; or (b) 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." Prop. Treas. Reg. § 20.2053-4(d)(5)(ii). It is not clear whether this is intended as the only cases in which a loan guarantee will be deemed to have been entered into in exchange for adequate and full consideration in money or money's worth, and whether the absence of either of these factors precludes a finding that a loan guarantee was entered into in exchange for adequate and full consideration in money or money's worth.

ACTEC recommends that, even in the absence of both of the above factors, the estate should nevertheless be eligible to establish that the loan guarantee was entered into in exchange for adequate and full consideration in money or money's worth through evidence that the transaction was entered into with full expectation that the loan would be paid by the borrower or that the decedent would be reimbursed if required to make payment on the loan guarantee. This could be done by adding the following statement at the end of proposed Example 10: "The result would be the same if D did not have control of LLC and the fair market value of D's interest in the LLC on Date 1 was not at least $100x, if all relevant facts and circumstances reflect a reasonable expectation of repayment."

Although the situations described in the Proposed Regulations are helpful if viewed as nonexclusive ways of showing that a guarantee is bona fide, they are a significantly smaller set of circumstances than case law acknowledges and may be inconsistent with the practical realities of some business loans. Suppose two entrepreneurs start a business, owning equal shares. Neither owner controls the business. Because the business does not have a track record of earning profits, an appraisal would show only speculative value. However, the business owners may have a realistic budget that projects cash flows sufficient to repay loans in full and – after a few years – generate profits that reward the risk and effort they are undertaking. Because banks are being paid for the use of money rather than for taking entrepreneurial risks, these owners may need to have family members with more established credit guarantee the loans. If the family members had lent the money at the applicable federal rate, § 1.1273-1(c)(1)(ii) ignores "the possibility of nonpayment due to default, insolvency, or similar circumstances" unless "the lending transaction does not reflect arm's length dealing and the holder does not intend to enforce the remedies or other terms and conditions." In this business owner hypothetical, the commercial lender is documenting and administering the loan, ensuring that the loan reflects arm's length dealing, and the family member guaranteeing the loan fully expects the loan to be paid because the business owners have a realistic budget and the commercial lender will enforce the loan terms and any

accompanying covenants. Such a loan guarantee should be respected on the basis of case law and the principles underlying section 7872's use of the applicable federal rate.