

INTERNAL REVENUE SERVICE  
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

September 15, 2009

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Third Party Communication: None  
Date of Communication: Not Applicable

Index (UIL) No.: 2055.09-02  
CASE-MIS No.: TAM-130665-09

Taxpayer's Name:

Taxpayer's Address:

Taxpayer's Identification No  
Year(s) Involved:  
Date of Conference:

LEGEND:

Decedent	=
Son	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=
Date 5	=
Date 6	=

Year 1 =  
State 1 =  
State 2 =  
Charitable Trust =

a =  
b =  
c =  
d =  
Citation 1 =

Citation 2 =  
Citation 3 =  
Citation 4 =

Citation 5 =

Citation 6 =

Citation 7 =

Citation 8 =

Citation 9 =

#### ISSUE:

Whether Decedent's estate is entitled to a charitable deduction under § 2055(a) of the Internal Revenue Code for the amount paid to Charitable Trust pursuant to the settlement agreement.

#### CONCLUSION:

Decedent's estate is not entitled to a charitable deduction under § 2055(a) for the amount paid pursuant to the settlement agreement to Charitable Trust.

#### FACTS:

Decedent died on Date 6, a resident of State 1. Decedent's will was executed on Date 2. The will was subsequently amended by three separate codicils, dated Date

3, Date 4 and Date 5, respectively. The Date 5 codicil made certain amendments to the prior documents, and in all other respects confirmed and republished the Date 2 will and the Date 3 and Date 4 codicils. The Date 2 will specifically revoked Decedent's prior wills.

Paragraph First of Decedent's will, as amended by the codicils, provides that all of Decedent's just and lawful debts are to be paid as soon after Decedent's death as can properly be done consistent with the orderly management of Decedent's estate and without sacrifice of its assets. The executor is authorized to pay out of the residuary estate all inheritance, legacy, estate or other death taxes of whatsoever nature on the Decedent's estate or on the devolution of any portion thereof, levied by reason of the Decedent's death, as part of the expenses of the administration thereof with no right of reimbursement from any recipient.

In Paragraph Third, Decedent declares that he established Charitable Trust on Date 1.

In Paragraph Ninth Decedent devised a parcel of real property situated in State 2 in trust to be held for the use of Son and Son's wife during their lifetimes. Upon the death of the last to die of Son and Son's wife, the trustee is to sell the property and add the proceeds to Charitable Trust.

Under the terms of Paragraph Tenth, Decedent bequeathed \$a to be held in trust for the benefit Son. The trustee is to pay income from the trust in monthly or in other convenient installments, at least quarterly, to Son for his life. The trustee may also invade the principal of the trust, up to \$b, to pay for medical expenses. Upon Son's death, the trust income is to be paid to Son's wife. Upon Son's death if he is unmarried, or upon the death of Son's wife, the accrued interest and principal is to be paid over to Charitable Trust.

The will also provides for the establishment of similar trusts for the benefit other relatives. These trusts all provide income to the beneficiary for life with the remainder to be paid on termination to Charitable Trust.

Paragraph Twentieth, contains an in terrorem clause providing that if any person contests the will or elects to take against the will, that person will be considered to have predeceased the Decedent. Any share of the estate which such person or entity would otherwise receive would then be distributed to Charitable Trust.

The will as originally executed on Date 2 did not address the disposition of Decedent's residuary estate. Further, the Date 3, Date 4 and Date 5 codicils did not address the disposition of the residuary estate.

Son claimed that as Decedent's sole intestate heir, he alone was entitled to the residuary estate. The Charitable Trust claimed that it was the lawful beneficiary of Decedent's residuary and that the omitted residuary clause was the result of a scrivener's error. In this regard, the attorney that drafted the Date 2 will and the three codicils, has stated in an affidavit prepared in conjunction with state court proceedings that Decedent told him that he intended that the residue pass to the Charitable Trust. In addition, the Charitable Trust asserted that other extrinsic evidence indicated that Decedent intended that the residuary pass to Charitable Trust, including: previous wills of the Decedent executed prior to Date 2 identifying Charitable Trust as the residuary beneficiary; Decedent's history of making a large number of lifetime charitable transfers.

After several months of negotiations, Son and Charitable Trust settled the dispute and executed a settlement agreement. The settlement agreement provided that Son would receive \$c outright and free and clear of all expenses and taxes. The amount remaining after the \$c payment to Son and after payment of expenses and taxes (including taxes on the \$c distribution to Son) totaling \$d and was paid to Charitable Trust. The settlement agreement was approved by the local state court, without an evidentiary hearing.

#### LAW AND ANALYSIS

Section 2055(a) provides that the value of the taxable estate shall be determined by deducting from the value of the gross estate the amount of all transfers for charitable purposes.

Section 20.2055-1(a) of the Estate Tax Regulations provides, in part, that a deduction is allowed under § 2055(a) from the gross estate of a decedent who was a citizen or resident of the United States at the time of his death for the value of property included in the decedent's gross estate and transferred by the decedent during his lifetime or by will for charitable purposes.

Section 20.2056(c)-2(d)(2), applicable in the case of the estate tax marital deduction, provides that, if as a result of the controversy involving the decedent's will, or involving any bequest or devise thereunder, a property interest is assigned or surrendered to the surviving spouse, the interest so acquired will be regarded as having passed from the decedent to the surviving spouse only if the assignment or surrender was a bona fide recognition of enforceable rights of the surviving spouse in the decedent's estate. If the assignment or surrender was pursuant to an agreement not to contest the will, it will not necessarily be accepted as a bona fide evaluation of the rights of the spouse.

In Ahmanson Foundation v. United States, 674 F.2d 761 (9th Cir. 1981), the court considered whether an amount paid to a surviving spouse pursuant a settlement agreement involving a will controversy qualified for the estate tax marital deduction

under section 2056. The court noted that in Commissioner v. Estate of Bosch, 387 U.S. 456 (1967), the Supreme court had determined that an amount passing to the spouse pursuant to a state lower court judgment is treated as passing for estate tax purposes if “the interest reaches the spouse pursuant to state law, correctly interpreted – not whether it reached the spouse as a result of a good faith adversary confrontation.” Ahmanson Foundation v. United States, 674 F.2d at 774. The Ninth Circuit concluded that the same test applies in the case of amounts passing pursuant to the settlement of a bona fide controversy. “[E]ither a good faith settlement or a judgment of a lower state court must be based on an enforceable right, under state law properly interpreted, in order to qualify as ‘passing’ pursuant to the estate tax marital deduction.” Ahmanson Foundation v. United States, 674 F.2d at 775. See also Estate of Hubert v. Commissioner, 101 T.C. 314, 319 (1993), aff’d on another issue, 63 F.3d 1083 (11<sup>th</sup> Cir. 1995), aff’d on another issue, 517 U.S. 1166 (1996) (holding that a good faith settlement of an issue is not binding for estate tax purposes; rather, “[i]n deciding whether a surviving spouse has enforceable rights in a decedent’s estate, courts must look behind any settlement agreement to ensure that the claim on which it is based is valid.”

This principle has been found to be equally applicable in determining whether an amount passing to charity pursuant to a settlement agreement is deductible under section 2055. See Terre Haute First Nat’l Bank v. United States, 1991 U. S. Dist. Lexis 5771 \*24, note 7 (Dist. Ct. S.D. Ind. 1991). In Terre Haute First Nat’l Bank, the court concluded, in a case involving a dispute over the allowance of a deduction for an amount passing to charity pursuant to a settlement:

This court is persuaded, as the Ninth Circuit was in *Ahmanson Foundation*, that the holding in *Bosch* would apply to cases of settlement -- even following a bona fide will dispute and arm's length negotiations. In other words, the parties to a settlement should not be able to disregard or misapply state law and receive favorable federal estate tax benefits. The parties to a settlement are only entitled to federal estate tax deductions to the extent that they have an enforceable right under properly applied state law.

Terre Haute First Nat’l Bank v. United States, 1991 U. S. Dist. Lexis 5771 at \*25.

Therefore, in the instant case, we must determine whether Charity had an enforceable right under properly applied state law to receive the payment under the settlement agreement.

The estate argues that State 1 law does not favor property passing by intestacy if there is a will. If possible, a will should be construed to avoid an intestacy. Citation 1. The estate argues that because the will in this case lacks a residuary clause, a court cannot ascertain with certainty Decedent’s intent from the four corners of the will. Therefore, it is necessary to consider the circumstances at the time of execution of his will and other evidence which bears on intent. The estate further argues that other

provisions of the will designating Charitable Trust as the remainder beneficiary of several trusts evidence that that Decedent intended to designate Charitable Trust as the residuary beneficiary entitled to receive the primary benefit of his estate. Similarly, the in terrorem clause designates Charitable Trust as the taker in the event the clause becomes operative.

For example, the estate cites Citation 2. In this case, the Decedent's will did not contain a residuary clause. Several beneficiaries argued that the omission of the residuary clause was a scrivener's error and that it was the decedent's intent to divide residuary estate equally among those beneficiaries. The court admitted the testimony of the attorney that drafted the instrument. He testified that the failure to include a residuary clause was not an omission. Rather, at the time the decedent executed the instrument, she had not yet determined who should receive her residuary estate. Thus, the residuary clause was omitted intentionally. Accordingly, the court concluded that the residue passed by intestacy.

Furthermore, the estate argues that the amount paid to Charitable Trust pursuant to the settlement demonstrates that Charitable Trust would have prevailed in a state court proceeding. If Son really believed that he would win his case, argues the estate, he would have sought to adjudicate the case to conclusion and not agree to settle his dispute for \$c.

However, we disagree that the Charitable Trust had an enforceable right under State 1 law to the settlement proceeds in this case. Under State 1 case law, although, it is presumed that a testator who has executed a will intended to dispose of his entire estate and avoid intestacy, "[s]uch presumption, however, is met by an equally potent presumption that an heir is not to be disinherited except by plain words or necessary implication." Citation 8.

In addition, it is well settled that, where a court can with reasonable certainty ascertain the intent of a testator through examination of the will itself, resort to consideration of matters external to that document is not generally proper. When a will as written is clear and unambiguous, it is error for the court to consider external evidence tending to impute an intent to the testator different from that appearing on the face of the will. Citation 3. Courts will not search for the testator's intent beyond "the four corners of his will" when the language of that document is sufficiently clear and unambiguous so as to lead the court to believe it can with reasonable certainty effect a distribution in accordance with the testator's desires. Extrinsic evidence and collateral sources are always competent to show that a latent ambiguity exists in the will. However, extrinsic evidence of surrounding facts cannot be received as evidence of testator's intention independent of the written words employed. Citation 4. See generally, Citation 9.

In several cases, the courts have declined to supply a missing residuary beneficiary. For example, in Citation 5, the residuary clause did not effectively dispose of the residue and the court declined to interpret the clause in a manner that would have avoided the resulting partial intestacy. The court stated, “[a]lthough it is true, . . . , that we must construe the will where possible in order to avoid intestacy, we may not do so by ignoring the testatrix’s intent or by ascribing to her an intent which is nowhere evidenced in the will.” (Emphasis added.)

Similarly, in Citation 6, the court stated: “If, as is probable, a residuary bequest in the will of [testator] was an accidental omission, it is an omission we cannot supply. We may conjecture that it was intended after the liberal provision made to his widow the residue should go to his next of kin, but it would only be conjecture.” See also, Citation 7 (“As we have said, it is more than likely [the testator] intended that the heir should take the undisposed of portion of the income; but, at all events, if it was an oversight, the courts have no authority to insert a provision disposing of such income under the assumption that it was the intention of the testator. It is only when the language of the will expressly or by clear implication discloses the intention of the testator that the courts may carry it out. It will not do for the courts to undertake to guess at the intention of a testator and declare that to be his will.”)

In this case, the extrinsic evidence indicates that the residuary clause was erroneously omitted from the Decedent’s will. However, the omission of the residuary clause does not create an ambiguity. Rather, the will is silent regarding the disposition of the residuary estate and under State law, in the absence of the residuary bequest, the residue passes by intestacy. No language in the will conflicts with the distribution of the residue under the State 1 intestacy statute. Thus, we do not believe that the absence of the residuary clause can properly be characterized as an ambiguity that would justify reference to extrinsic evidence. If this was the case, every invocation of the intestacy provisions would be considered an ambiguity. In this regard, we note that in Citation 2, although the court admitted extrinsic evidence, the evidence confirmed that the residue passed by intestacy. The court did not use the extrinsic evidence as justification for inserting a residuary beneficiary that was not named under the will.

Further, there is no evidence in the will that Decedent intended that the residuary pass to the Charitable Trust. The will does provide for the distribution of certain trust remainders to Charitable Trust, and the Charitable Trust is the taker in the event the in terrorem clause becomes operative. However, we can not conclude that these provisions addressing bequests other than the residue, “expressly or by clear implication discloses the intention of the testator that the courts may carry it out.” Citation 7.

We also note that the relative amounts Son and Charitable Trust received under the Settlement is not indicative of whether Charitable Trust had an enforceable right under Decedent’s will. Arguably, Son may have settled for \$    in order to avoid lengthy

litigation and the additional expense litigation would entail. Even assuming the amount paid to Charitable Trust is indicative that Son believed Charitable Trust would prevail at the trial court level, the standard is whether State 1's highest court, no Son, would conclude that Charitable Trust had an enforceable right under State 1 law.

Accordingly, Decedent's estate is not entitled to a charitable deduction under § 2055 for the settlement proceeds paid to Charitable Trust.

**CAVEAT:**

A copy of this technical advice memorandum is to be given to the taxpayer(s). Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.