ARE ESTATE PAYMENTS MADE TO STEP-CHILDREN UNDER A PREMARITAL AGREEMENT A DEDUCTIBLE CLAIM AGAINST THE ESTATE

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In *Estate of Spizzirri v. Commissioner of Internal Revenue*, No. 23-14049 (11th Cir. 2025) the United States Court of Appeals for the Eleventh Circuit addressed whether payments made pursuant to a post-marital agreement, to a decedent's spouse's children, were deductible as claims against an estate.

CASE HISTORY:

On March 4, 1997, Richard Spizzirri ("Richard") and his fourth wife, Holly Lueders ("Holly"), entered into a prenuptial agreement ("Agreement"). At the time the agreement was entered into, Richard had a significant net worth and four children from a previous marriage, while Holly had a nominal net worth, in comparison, and three children from a previous marriage. At the time of the marriage, Richard had in place a Last Will and Testament that had been executed in 1997 ("1997 Will"). The 1997 Will, primarily benefited his children from his first marriage. Over their 18-year marriage, the prenuptial agreement was modified five (5) times.

The third modification of the Agreement occurred on November 3, 2005, and it specifically amended Article IV and the provisions for Holly after Richard's death. In this modification, Holly waived her right to a marital trust and residency rights. In exchange, Richard agreed to make and keep in effect a will providing for a $9 million cash payment upon his death, which included $6 million to Holly and $3 million to her adult children. This modification reiterated that Holly would accept these provisions "in lieu of any other rights which may be available to her as [Spizzirri's] surviving spouse". Subsequent modifications reaffirmed the agreement to pay $1 million to each of Holly's three children.

Beginning in 2014, Richard executed four codicils to his will. The first three codicils specified the inheritance rights of Richard's two children born outside of his marriage. The fourth codicil provided that his estate would satisfy the mortgage on the condominium he owned with his girlfriend and transfer his interest to her upon his death. None of the codicils incorporated the terms benefiting Holly or her children from Agreement. Richard and Holly became estranged before his death in May 2015.

After Richard's death, Holly's children filed claims in state court against the estate of Richard seeking payment of their $1 million dollars under the Agreement. In 2016, the estate paid the three children $1 million each, plus penalties. The estate then filed a Form 1099-MISC and deducted these $3 million in payments as "claims against the estate". The Commissioner of Internal Revenue (the "Commissioner") denied these deductions on the basis they were neither "contracted bona fide" nor "for an adequate and full consideration in money or money's worth."

U.S. Tax Court:

The estate petitioned for review of the Commissioner's denial of the deduction to the U.S. Tax Court. At trial, the estate presented witnesses who testified as to the enforceability of the agreement, the value of Holly's waived marital rights, and that Richard had agreed to the payments to keep Holly happy and preserve their marriage.

The tax court ruled that the estate did not produce the "credible evidence" necessary to shift the burden of proving entitlement to a deduction. 26 U.S.C § 7491(a). The Court further ruled that the payments to Holly's children were essentially donative in character, as they were made to keep Holly happy and maintain the marriage, rather than as part of an arm's length transaction.

<u>United States Court of Appeals</u>

The estate then appealed the ruling to the United States Court of Appeals for the Eleventh Circuit. First, the estate argued that it had introduced "credible evidence" of its entitled to a deduction and complied with the requirements to "substantiate any item" and "maintain all records required. 26 U.S.C. § 7491(a).

The court then noted that the determination of whether a deduction for a claim against an estate is allowed is fact-intensive and must be made on a case-by-case basis and focuses its analysis on the "bona fide" requirement.[1] Transactions between family members are subject to "particular scrutiny" as a testator is likely to be making a bequest to a family member.[2] The "bona fide" requirement contained in section 2053(c)(1)(A) bars a deduction for a claim "to the extent it is founded on a transfer that is essentially donative in character."

Contracted Bona Fide

Treas. Reg. § 20.2053-1(b)(2)(i) (2009) provides five factors for evaluation of whether an intrafamily transfer was contracted bona fide: (i) The transaction occurs in the ordinary course of business, is negotiated at arm's length, and is free from donative intent; (ii) The claim is not related to an expectation or claim of inheritance; (iii) The claim originates pursuant to an agreement between the decedent and the family member; (iv) Performance by the claimant stems from an agreement between the decedent and the family member; and (v) All amounts paid are reported by each party for Federal income and employment tax purposes consistently with the claim's nature. The court ultimately concluded that each factor weighed against finding the payments to the children were contracted bona fide as they related to Holly's expectation of inheritance, were not in the ordinary course of business, not free from donative intent, and the circumstance did not resemble an arm's length transaction.

Estate Tax

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[1] Treasury Regulation § 20.2053-1(b)(2)(i) clarifies that the bona fide requirement bars a deduction if the claim is based on a transfer that is "essentially donative in character (a mere cloak for a gift or bequest)".

[2] Holly's children were considered "family members" as lineal descendants of his spouse under Treas. Reg. § 20.2053-1(b)(2)(iii)(A).

The court explained that the estate tax is a tax on the transmission of wealth at death. *United States v. Stapf*, 375 U.S. 118, 134 (1963); 26 U.S.C. § 2001. The taxable amount is calculated by subtracting allowable deductions from the gross estate. 26 U.S.C. §§ 2051, 2053(a). A taxpayer may try to decrease the amount of their gross estate and corresponding estate tax by means which the law permits." Gregory v. Helvering, 293 U.S. 465, 469 (1935). However, § 2053 ensures that gifts and testamentary transfers are "not transformed into deductible claims through collaboration and creative contracting." Est. of Huntington v. Comm'r, 16 F.3d 462.

Estate Argument:

The estate cited to Estate of Kosow v. Commissioner in support of its position. However, Kosow involved a father's agreement, in anticipation of divorce, to "finance his sons' college educations and leave them two-thirds of his estate in exchange for his spouse's acceptance of reduced support payments and waiver of other rights." However, Kosow did not address the "bona-fide" issue and the estate's reliance on dictum was misplaced.

CONCLUSION

The Eleventh Circuit ultimately affirmed the Tax Court's judgment in favor of the Commissioner and held the burden had not been shifted to the Commissioner, and the payments to Holly's children were not deductible as "claims against the estate" under 26 U.S.C. § 2053(a)(3). This ruling underscores the strict requirements for both shifting the burden and deducting claims arising from agreements between family members, especially those tied to prenuptial agreements or testamentary arrangements. The five regulatory factors demonstrate the importance of evidencing that a transaction is genuinely commercial in nature, free from donative intent, and not merely a substitute for an inheritance or a mechanism to achieve estate tax avoidance through disguised gifts.