

## Debts Under a Prenuptial Agreement'-Creative Contracting

**Take-Away:** An obligation created under a prenuptial agreement may not be deductible on one spouse's death.

**Background:** A prenuptial agreement is generally enforceable upon one spouse's death, although any blanket statement regarding the binding effect of a prenuptial agreement is a bit presumptuous when it comes to what a Michigan court might do these days, considering the recent string of *Allard* court decisions finding a divorce court is not bound to adhere to the terms of a prenuptial agreement.

**EPIC:** Under MCL 700.2204 the rights of a surviving spouse to a share under intestate succession, homestead allowance, widow's election, exempt property, or family allowance may be waived, before or after the marriage, by a written contract. A waiver of '*all rights*' in the property or the estate of a present or prospective spouse or a complete property settlement entered into after, or in anticipation of, separate maintenance is a waiver of *all rights* and is a renunciation by the surviving spouse of all benefits that would otherwise pass to the survivor from the other spouse by intestate succession *or by virtue of a Will* executed before the waiver or property settlement. This waiver of rights by a surviving spouse does not extend, however, to a child or children who are entitled to receive exempt property from their deceased parent. *In re Estate of Jajuga*, 312 Mich App 706 (2015).

**Debt:** A prenuptial agreement may contain provisions for the benefit of the surviving spouse, which commitments or obligations if unfulfilled on the promisor's death, could constitute enforceable *debts* of the decedent's estate. The *debts or obligations* incurred under a prenuptial agreement can lead to interesting questions when those debts are deducted under IRC 2053(a)(3) when it comes to calculating the deceased spouse's federal estate tax liability, if the obligation is to someone other than the surviving spouse.

**IRC 2053:** The Regulations under this Tax Code section identify five factors that guide an evaluation of whether an intrafamily transfer at death is contracted *bona fide*, and thus a deductible expense. Those factors are: (i) the transaction occurs in the ordinary course of business, is negotiated 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 consistent with the claim's nature. Consequently, the determination of whether a deduction for a claim paid by an estate is allowed is fact-intensive and made on a case-by-case basis. In sum, the *bona fide* requirement bars a deduction if the claim is based on a transfer that is essentially donative in character. This was the result in a recent federal appeals decision.

***Estate of Spizzirri v Commissioner, No. 23-24049 (11<sup>th</sup> Circuit, 2025)***

**Facts:** Richard and his fourth wife, Holly, entered into a prenuptial agreement that required Richard's estate to transfer \$6.0 million to Holly and \$3.0 million to Holly's children on Richard's death. Holly had three children from her marriage, while Richard had four children from his prior marriages. Over their 18-year marriage their prenuptial agreement was modified five times. In one of those amendments, Holly waived any right to a marital trust and residency rights in Richard's home, or under his Will, in exchange for which Holly negotiated the right to receive a \$9.0 million bequest on Richard's death, \$6.0 million to Holly and \$3.0 million to Holly's children. Subsequent amendments to the agreement confirmed that each of Holly's children were to receive \$1.0 million. Richard, however, never updated his estate planning documents to reflect these required pecuniary bequests, so that after his death Holly's children filed claims against Richard's estate to force the payment of their respective \$1.0 million bequests. Richard's estate paid these claims in addition to penalties for late-payment, and then filed Form 1099-MISC reporting the payments.

**Disputed Deduction:** After Richard's death his estate ultimately distributed the funds to Holly's children and then promptly claimed that the payments to Holly's children were deductible under IRC 2053(a)(3) as a 'claim against the estate' for estate tax deduction purposes. The IRS denied the deduction on the basis that the distributions to the children were neither contracted *bona fide*, nor was there any adequate and full consideration in money or money's worth provided by Holly's children. Accordingly, a Notice of Deficiency was issued to Richard's estate.

**Tax Court:** The Tax Court disallowed the deduction under IRC 2053(c)(1)(a), which conditions a deductible debt of the decedent on “a *bona fide* contract for an adequate and full consideration in money or money’s worth.” This condition is included in IRC 2053 to prevent gifts and testamentary transfers from being transformed into deductible claims against the decedent’s estate through ‘collaboration and creative contracting.’

**Court of Appeals:** The federal Circuit Court started its decision with the predictable judicial observation that “transactions between family members are subject to particular scrutiny,” because a testator is more likely to be making a bequest.

**Burden of Proof:** While the decedent’s estate can shift the burden of proof onto the IRS [IRC 7491(a)] if the estate introduces credible evidence, and complies with the substantiation and recordkeeping requirements, in this case the Court found that Richard’s estate failed in shifting the burden of proof to the IRS.

**Gratuitous Bequests, Not Debts:** The Court concurred that the estate’s transfers of \$3.0 million to Holly’s children were donative in character, and therefore they were not deductible as claims against the decedent’s estate, because they were neither: (i) contracted *bona fide*; nor (ii) “for an adequate and full consideration in money or money’s worth.” [Regulation 2053(a)(3)(c)(1)(A.)]

**No Consideration:** The payments to Holly’s three children were contracted in lieu of Holly’s expectation or claim for an inheritance, and thus the payments lacked the other characteristics of a *bona fide* transaction. In other words, the children’s claim against Richard’s estate did not originate from any transaction between Holly’s children and Richard; his stepchildren had no obligations to perform under the prenuptial agreement that would act as consideration or Richard’s pecuniary bequests.

**Conclusion:** The *Spizzirri* decision is a good reminder that the Tax Code provides strict conditions before a claim can be deducted from the gross estate when it pertains to family agreements or prenuptial agreements, that look more like testamentary arrangements, and as such ‘creative contract’ provisions in a prenuptial agreement will probably not produce a beneficial deductible debt of the decedent’s estate.

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