

IN THE UNITED STATES DISTRICT COURT FOR THE  
WESTERN DISTRICT OF PENNSYLVANIA

ESTATE OF ANTONIO J. PALUMBO, )  
DECEASED, PNC BANK, NATIONAL )  
ASSOCIATION, EXECUTOR, )

Plaintiffs, )

v. )

UNITED STATES OF AMERICA, )

Defendant. )

Civil No. 2:10-cv-0760-AJS

**MEMORANDUM IN SUPPORT OF  
THE UNITED STATES' MOTION FOR SUMMARY JUDGMENT**

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## INTRODUCTION

This is a suit for the refund of \$11,721,141 in federal estate tax brought by the Estate of Antonio J. Palumbo (the “Estate”) after the Commissioner of Internal Revenue disallowed a charitable deduction for the amount given to the A.J. and Sigismunda Palumbo Charitable Trust (the “Trust”). The deduction was disallowed because it was effectively made by the *decedent’s son*, Antonio J. Palumbo Jr. (“Palumbo Jr.”), (as a result of a settlement agreement between the decedent’s son and the Trust), and not by the *decedent* in his last will and testament, dated July 6, 1999 (the “Final Will”). Furthermore, the Estate was not entitled to the deduction as the result of a *bona fide* dispute because, under Pennsylvania law, the Trust never had an enforceable right to the residue of the Estate.

It is undisputed that the decedent’s will contained no residuary clause bequeathing the residuary estate to the Trust. As a result, the residuary estate passed to the decedent’s son outside of his will under the laws of intestacy. The Trust, which did not object to the will or the distribution of the residuary estate in court, entered into a “settlement agreement” with the decedent’s son in which Palumbo Jr. agreed that the Trust would receive a portion of the residuary estate, even though the will contained no residuary clause.

This Court must determine whether the Trust had an enforceable right to the residue of the decedent’s estate apart from the settlement in this case. Because Pennsylvania law looks to the “four corners” of the will to determine whether a

prospective beneficiary had an enforceable right to a bequest, and because there was no residuary clause for the benefit of the Trust in the decedent's will, summary judgment should be entered in favor of the United States in this tax refund suit.

### STANDARD OF REVIEW

Summary judgment is appropriate "if the pleadings, depositions, answers to interrogatories and admissions on file . . . show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(c). To defeat summary judgment, the non-moving party must demonstrate a genuine factual dispute between the parties. A dispute is genuine where a reasonable jury, based on the evidence presented, could return a verdict for the non-moving party with regard to that issue. See Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 247-48 (1986) ("the mere existence of some alleged factual dispute between the parties will not defeat . . . [a] motion for summary judgment; the requirement is that there be no genuine issue of material fact"). The disputed fact must be "material" – i.e., a fact that might affect the outcome under the substantive law applicable to the claims at issue. See Boyle v. County of Allegheny, 139 F.3d 386, 393 (3d Cir. 1998). Because there are no disputed facts, and the deductibility of the charitable deduction claimed by the Trust turns on the proper application of Pennsylvania law, summary judgment is appropriate in this case.

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## ARGUMENT

Because tax deductions are matters of legislative grace, the Estate is entitled to a charitable deduction only if it demonstrates that its claim is legitimate. See Knight v. Commissioner, 552 U.S. 181, 192 (2008). In assessing whether the Estate's claim is legitimate, the Court is required to determine, under Pennsylvania law, whether the Trust had an enforceable right to the residuary estate, independent of the settlement between the decedent's statutory heir and the Trust. In this case, because the Trust did not have an enforceable right to the residuary estate under Pennsylvania law, the Estate is not entitled to a charitable deduction.

### **I. THIS COURT MUST DETERMINE WHETHER THE TRUST HAD AN ENFORCEABLE RIGHT TO THE RESIDUARY ESTATE**

The Supreme Court has held that "where the federal estate tax liability turns upon the character of a property interest held and transferred by the decedent under state law, federal authorities are not bound by the determination made of such property interest by a state trial court." See Commissioner v. Estate of Bosch, 387 U.S. 456, 465 (1967). Here, the Estate is only entitled to a charitable deduction if the donation to the Trust passed directly from the decedent to the Trust under the terms of the decedent's will. See 26 U.S.C. § 2055(a); Treas. Reg. § 20.2055-1(a). The validity of the charitable deduction, therefore, turns on the answer to the question of whether the residuary of the decedent's estate passed directly from the decedent to the Trust apart from any "settlement" between the Trust and the decedent's statutory heir.

**A. The Estate May Claim A Charitable Deduction Only If The Trust Had An Enforceable Right To The Residuary Estate Under State Law.**

In the absence of a ruling by the state's highest court on the issue, a federal court must determine whether the party acquiring an estate's property pursuant to a settlement had enforceable rights in the estate under state law and must ensure that such a claim is valid. See Bosch, 387 U.S. at 465 ("federal authorities must apply what they find to be the state law after giving 'proper regard' to relevant rulings of other courts of the State.") (citation omitted); Ahmanson Foundation v. United States, 674 F.2d 761, 774 (9th Cir. 1981) ("the majority [in Bosch] concluded that the test of 'passing' for estate tax purposes should be whether the interest reaches the spouse *pursuant to state law, correctly interpreted* – not whether it reached the spouse as a result of good faith adversary confrontation") (emphasis added). In this respect, the federal court "may be said to be, in effect, sitting as a state court." Bosch, 387 U.S. at 465.

This analysis is also required in settlements, including those involving charitable deductions. See Ahmanson, 674 F.2d at 775 ("either 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") (emphasis added); Terra Haute First National Bank v. United States, 67 A.F.T.R. 2d 91-1217, at \*91-1223 (S.D. Ind. 1991) ("the parties to a settlement should not be able to disregard or misapply state law and receive favorable federal estate tax benefits[, therefore] this court cannot automatically accord the same tax benefits to the estate as if the settlement was originally reflected in the decedent's will").

Consequently, for a settlement agreement to be a *bona fide* recognition of enforceable rights, which passes property from the decedent rather than from the intestate heir, the settlement must be based on an enforceable right under state law, properly interpreted. The Court, therefore, must determine, under Pennsylvania law, whether the Trust had an enforceable right to the residuary estate independent of the fact that the Trust and Palumbo Jr. settled the distribution of the residuary estate.<sup>1</sup>

**B. The Holding In Bosch Applies In Charitable Deduction Cases.**

The Estate argues that the analysis articulated in Bosch, Ahmanson, and Terra Haute, does not apply here. The Estate interprets the Supreme Court's decision in Bosch as being limited to cases involving *marital*, and not *charitable*, deductions. The Estate also attempts to distinguish this case from others by pointing out that there was no split interest in the amount of the residuary estate. The Estate contends that the only relevant factor is that the settlement resolved a *bona fide* dispute between the Trust and Palumbo's sole statutory heir. This argument erroneously limits the holding of Bosch and curtails the Court's ability to enforce federal law.

*First*, nothing in the Bosch opinion limits its application to cases involving marital deductions. The Supreme Court stated that the issue to be determined in the case was "[w]hether a federal court or agency in a federal estate tax controversy is

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<sup>1</sup>Lyeth v. Hoey, which predates Bosch is inapplicable here, because that case concerned how a party's interest in property should be dealt with under federal tax law, not whether a party actually had an interest, under the state's estate law, in the property at issue. Compare 305 U.S. 188, 196-97 (1938) with Bosch, 387 U.S. at 457, 465.

conclusively bound by a state trial court adjudication of property rights or characterization of property interests when the United States is not made a party to such proceeding.” Bosch, 387 U.S. at 456-57. In answering that question, the Court held that “where the federal estate tax liability turns upon the character of a property interest held and transferred by the decedent under state law, federal authorities are not bound by the determination made of such property interest by a state trial court.” Id. at 457. This holding, therefore, applies to federal estate tax case where the character of a property interest is at issue.

In addition, while Bosch involved a marital deduction, the Court did not limit its opinion to marital deduction cases. It is not surprising, therefore, that courts have applied the holding in Bosch to cases that do not involve the marital deduction. See, e.g., Hunter v. United States, 597 F. Supp. 1293, 1297 (W.D. Pa. 1984) (citing Bosch in support of holding that the federal court was not bound by a previous lower state court decision because the Pennsylvania Supreme Court had “never considered the extent of power granted by authority to invade [estate] principal in an ‘emergency’”); Berger v. United States, 487 F. Supp. 49, 51 (W.D. Pa. 1980) (citing Bosch for the proposition that the federal court must “independently review state law to determine if the state trial court followed the applicable state doctrines” in a case involving the tax effects of an irrevocable trust); Rudin v. United States, 285 F. Supp. 901, 904 (E.D. Pa. 1968) (citing Bosch for proposition that a state trial court decision did not bind a federal court in a case involving whether the proceeds of an *inter vivos* trust for the benefit of decedent’s

daughter were taxable); Terra Haute, 67 A.F.T.R. 2d 91-1217, at \*91-1223 (citing Bosch denying charitable deduction to Estate where the charity did not have an enforceable right to the amount received by charity pursuant to a settlement agreement).<sup>2</sup>

*Second*, the Estate's distinction between split interests and other interests held by charities is a red herring, because the only relevant concern is whether the Trust had an enforceable right to receive any portion of the residuary estate under the terms of the Final Will. Bosch, therefore, applies in this charitable deduction case.

**C. The Settlement Did Not Give The Trust An Enforceable Right To The Residuary Estate.**

Under Bosch, a party should not obtain the benefit of a federal tax deduction where, absent a state court decision or settlement of a dispute, it would not otherwise be entitled to take the deduction. Here, the settlement cannot bind this Court because the Trust had no enforceable right to any part of the decedent's residuary estate in the first place. Because the Trust had no enforceable right to any portion of the residuary estate under Pennsylvania law, there was no settlement of a *bona fide* dispute that could support the charitable deduction claimed by the Estate of its tax return.

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<sup>2</sup>The Fifth Circuit has held that, because the Bosch decision focuses on the legislative history regarding the marital deduction provision, the holding of Bosch is limited to marital deduction cases and does not apply to charitable deduction cases. See Estate of Warren v. Commissioner 981 F.2d 776, 779-82 (5th Cir. 1993). Warren, however, does not explain why the Supreme Court failed to state that the Bosch holding was limited to marital deduction cases, if in fact, it is so limited. In addition, while Bosch did involve the marital deduction, and necessarily had to discuss the provision itself, the general holding applies to all cases "where the federal estate tax liability turns upon the character of a property interest held and transferred by the decedent under state law," as is the case here. Bosch, 387 U.S. at 457.

The Third Circuit has held that where a charity received a donation pursuant to a settlement agreement, but would not have received anything absent that agreement, an estate cannot claim a charitable deduction for the donation. See Bach v. McGinnes, 333 F.2d 979, 983-84 (3d Cir. 1964). There, the decedent's wife elected to take against the will, which meant that under the operation of the will the charity was not entitled to anything. See id. at 983. The Third Circuit, therefore, held that because the will gave nothing to the charity, the amount actually received under the settlement agreement cannot be considered to have passed from the decedent to the charity. See id. at 984.

The Trust was entitled to nothing under the Final Will. (See Ex. 1.) In the absence of any valid objection, the decedent's son would have received the entire residuary estate under Pennsylvania intestacy laws as the decedent's sole statutory heir. Had the Estate disputed the distribution of the residuary estate to the decedent's son in the Pennsylvania courts (which it did not), Palumbo Jr. would have received the entire amount of the residuary estate pursuant to state intestacy laws. (See infra at 11-14.) But Palumbo Jr. chose to relinquish a portion of his rightful claim to the residuary estate rather than litigate in court. This choice – in a dispute where the United States was neither a party nor involved in any way – does not give the Trust an enforceable right to the residuary estate. See Bosch, 387 U.S. at 465; Bach, 333 F.2d at 984.

## **II. THE CHARITABLE TRUST NEVER HAD AN ENFORCEABLE RIGHT TO THE AMOUNT OF THE RESIDUARY ESTATE**

Palumbo Jr.'s choice to settle with the Trust rather than litigate his claim to the residuary estate does not change the fact that, under Pennsylvania law, the Trust never

had an enforceable right to the residuary estate, because the Final Will does not contain a residuary clause and such a clause cannot be read into the Final Will.

There is no dispute that the Final Will is clear and unambiguous. The Final Will does not contain a residuary clause. There was no provision for a charitable bequest of the residuary estate to the Trust. As a result, no state court could have properly applied Pennsylvania law, which looks to the “four corners” of the will to construe its provisions, to determine that the Trust had *any* right, let alone an *enforceable right*, to the residuary estate. To hold otherwise would effectively rewrite the Final Will.

Under Pennsylvania law, where a court can, with reasonable certainty, determine the intent of the testator through examination of the will itself, a court may not consider matters external to the will. See Estate of Schwenk, 507 Pa. 409, 415 (1985) (“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”) (citations omitted). Where the language of the will is clear, courts may not search for the testator’s intent beyond the “four corners” of the will itself. See id.; In re Jacobsen’s Estate, 460 Pa. 118, 122 (1975) (“Extrinsic evidence . . . cannot be received as evidence of testator’s intention independent of the written words employed”).

Moreover, all property not disposed of by will passes according to the intestacy law. See In re Jacobs Estate, 343 Pa. 387, 393-94 (1941). The intestacy law operates as a matter of law and applies at the moment of the decedent’s death. See In re Verner’s Estate, 358 Pa. 280, 286 (1948). The intestacy law even applies to property not *effectively*

*disposed of by will.* See 20 Pa. Cons. Stat. Ann. § 2101(a). Therefore, although Pennsylvania has a presumption that a testator intended to dispose of his entire estate and avoid intestacy, an intestate heir cannot be disinherited except by plain words or necessary implication. See In re Estate of Vandergrift, 406 Pa. 13, 27 (1962).

Because the intestacy law is so fundamental, Pennsylvania courts cannot read into a will provisions that are not part of the will itself. See Jacobs Estate, 343 Pa. at 393-94 (“interpretation [of a will] . . . is confined to the meaning of what the testator had said [in the will], and does not extend to the consideration of what he might have said [in the will] but did not.”). Whether those provisions are intentionally or unintentionally omitted is immaterial. See id. For example, in In re Estate of Schmidt, the Pennsylvania Supreme Court held that a residuary estate, after the death of the decedent’s wife, was to be distributed under the intestacy law where the will only provided that the residue of the Estate was to be given to the decedent’s wife for life. See 183 Pa. 641, 647 (1898). The Court held that the general presumption that a testator intended to dispose of the entire estate only applies to determine the meaning of the actual words in the will itself. See id. at 643. The rule is entirely inapplicable, however, “where the meaning of the words is clear,” because “there is no doubt” as to the testator’s intent. See id. at 643-44.

Similarly, the Pennsylvania Supreme Court refused to read a residuary clause into a decedent’s will where the will contained no evidence of any intention to make a testamentary disposition of the estate’s remainder. See In re Butler’s Estate, 364 Pa. 279,

281-82 (1950). The Court held that no court may “insert into a will a substantive disposition of property which the testator, whether by design or inadvertence, failed to make.” Id. at 282. The Court held that “[i]n seeking the intent of the testator, the test is not what the testator may have meant but rather the meaning of the words which he used.” Id. at 281 (citing In re Morrison’s Will, 261 Pa. 419, 421 (1949)).

In this case, the omission of a residuary clause from the last will does not create an ambiguity, because its language is otherwise clear. The Final Will made several bequests to various family members totaling several million dollars. (See Ex. 1.) It did not, however, contain any provisions for disposing of the residuary estate. (See id.) The operation of the Final Will, therefore, is completely clear; after the bequests were made, whatever was left over would be distributed according to the state intestacy law. This meant that the residuary estate would go to the decedent’s son as his statutory heir. Because there is no confusion regarding the operation of the Final Will, there is no need to look beyond the “four corners” of the will. See Estate of Schwenk, 507 Pa. at 415; In re Jacobsen’s Estate, 460 Pa. at 122. The Trust, consequently, did not have an enforceable right to the residuary estate.<sup>3</sup>

Because under Pennsylvania law the Trust did not have an enforceable right to

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<sup>3</sup>The Estate has argued that under the “armchair” theory of will interpretation extrinsic evidence regarding Palumbo’s intent to distribute the residue to the Trust can be read into the will. This theory, which applies where the court construing the construction of the will cannot feel confident distributing the estate by reference to the will alone, see Soles Estate, 451 Pa. 568, 574 (1973), cannot be applied here because the operation of the will is unambiguous and does not need interpretation.

the residuary estate, the settlement received by the Trust did not “pass” from the Estate to the Trust. Instead it passed from the decedent’s son to the Trust. As a result, the Estate is not entitled to a charitable deduction, and summary judgment should be entered in favor of the United States.

### CONCLUSION

It is undisputed that the residuary estate of the decedent, Antonio J. Palumbo, did not pass to the Trust by virtue of the Final Will. Furthermore, the Estate was not entitled to a charitable deduction for the amount the Trust received under the settlement because the Trust did not have an enforceable right to the residuary estate. The Estate’s refund claim, therefore, must be denied and summary judgment should be entered in favor of the United States.

DATED: February 22, 2011.

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I hereby certify that on this day, February 22, 2011, I filed with the Court the foregoing Memorandum in Support of the United States' Motion for Summary Judgment using the Court's CM/ECF procedures and served by United States Postal

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