

Internal Revenue Service

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Department of the Treasury

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Person to Contact:

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Refer Reply To:
CC:DOM:P&SI:7:PLR-117973-98

Date: February 15, 2000

RE:

LEGEND:

Decedent:

Niece:

Date 1:

Date 2:

Bank:

a:

b:

c:

w:

x:

y:

z:

State:

Dear

We received your letter, dated August 28, 1998, submitted on behalf of Decedent's estate, requesting a ruling concerning the deductibility of interest expense under § 2053 of the Internal Revenue Code. This letter responds to that request.

The represented facts are as follows: Decedent died on Date 1. Decedent's niece (Niece), also Decedent's conservator, is the principal beneficiary of Decedent's estate. Decedent's estate was initially administered by Bank. After the filing of the Estate (and Generation-Skipping

Transfer) Tax Return on Form 706 and prior to the issuance of the closing letter dated Date 2, Bank resigned and Niece succeeded Bank as the personal representative of Decedent's estate.

Decedent's federal estate tax return reported a gross estate of a. Of the total gross estate, b represented the value of real estate, including a closely-held business interest in the form of a commercial shopping center. The shopping center was valued for federal estate tax purposes at c, and thus comprised approximately w percent of the value of Decedent's gross estate. This percentage of business assets met the percentage requirements for purposes of the election under § 6166. Decedent's estate elected under § 6166(a), therefore, to defer payment of the federal estate tax attributable to the value of the shopping center and to pay the estate tax in installments together with annual payments of interest on the unpaid portion of the federal estate tax liability during the deferral period. To date, the estate has made the required payments.

It has been represented that Niece, the personal representative and principal beneficiary of Decedent's estate, received approximately x percent of Decedent's estate. It has been further represented that Niece holds a y percent direct interest in the commercial shopping center and, as well, currently operates the shopping center. The remaining z percent is held in a trust for the benefit of Niece's daughter.

Decedent's estate represents that it has had difficulty obtaining operational lines of credit because of the federal tax lien resulting from the election under § 6166 and that the future payments required under § 6166 would cause a strain on the cash flow of the commercial shopping center. Decedent's estate further represents that the majority of other gross estate assets have been liquidated to pay estate taxes. Accordingly, Decedent's estate has determined that it is in the best interests of the closely-held business to obtain a commercial loan for the purpose of paying off the deferred estate taxes in full. To date, such a loan has been secured and the deferred estate taxes have been paid in full.

It has been represented that a loan has been secured and the deferred estate taxes have been paid in full. Inasmuch as the applicable loan documents contain a prepayment option, however, it has been further represented that the loan documents will be amended to provide that the loan may not be prepaid, and upon default all interest that would have been owed throughout the loan term must be paid in full at the time of default. Decedent's estate represents that it will not deduct the interest attributable to the loan as an administration expense until the loan documents have been amended to remove any possibility of prepayment.

The Decedent's estate requests the following ruling:

The interest attributable to a loan obtained through a commercial lender to pay off federal estate taxes deferred under § 6166 is deductible as an administration expense under § 2053(a)(2) of the Internal Revenue Code.

Section 2053(a)(2) of the Code provides that, for purposes of the tax imposed by § 2001, the value of the taxable estate shall be determined by deducting from the value of the gross estate such amounts for administration expenses as are allowable by the laws of the jurisdiction under which the estate is being administered.

Section 20.2053-1(b)(3) of the Estate Tax Regulations provides that an item may be entered on the return for deduction though its exact amount is not then known, provided it is ascertainable with reasonable certainty, and will be paid. No deduction may be taken upon the basis of a vague or uncertain estimate.

Section 20.2053-3(a) provides that amounts deductible from a decedent's gross estate as "administration expenses" are limited to such expenses as are actually and necessarily incurred in the administration of the decedent's estate; that is, in the collection of assets, payment of debts, and distribution of property to the persons entitled to it. The expenses contemplated in the law are such only as attend the settlement of an estate and the transfer of the property of the estate to individual beneficiaries or to a trustee, whether the trustee is the executor or some other person. Expenditures not essential to the proper settlement of the estate, but incurred for the individual benefit of the heirs, legatees, or devisees, may not be taken as deductions. See Estate of Reilly v. Commissioner, 76 T.C. 369, 373 (1981) (quoting Porter, Transferee v. Commissioner, 49 T.C. 207, 225 (1967)).

Revenue Ruling 81-154, 1981-1 C.B. 470, holds that the interest on a federal estate tax liability is a deductible administration expense to the extent allowable under local law regardless of the reason incurred.

Revenue Ruling 84-75, 1984-1 C.B. 193, holds that interest on a loan obtained by an executor of an estate is a deductible administration expense, provided the loan was reasonably and necessarily incurred in the administration of the estate. The revenue ruling concludes that because the loan was obtained in order to avoid a forced sale of assets, the loan was reasonably and necessarily incurred in administering the estate. However, because the estate's obligation to make payments on the loan could be accelerated (because, for example, the estate might prepay the loan or the estate might default), the amount of interest the estate might pay in the future is uncertain within the meaning of § 20.2053-1(b)(3). Accordingly, the ruling concludes that the interest is deductible by the estate only after it accrues and any estimated amount of interest to accrue in the future is not deductible.

In Estate of Bahr v. Commissioner, 68 T.C. 74, 82 (1977), acq. 1978-2 C.B. 1, the Tax Court found that it was well settled that an estate may borrow money from a private lender to satisfy its federal estate tax liability and deduct the interest incurred on the debt as an administration expense under § 2053(a)(2). Relying upon Estate of Huntington v. Commissioner, 36 B.T.A. 698 (1937), the Tax Court noted that since that decision, it has consistently held that expenses incurred to prevent financial loss to an estate resulting from forced sales of its assets in order to pay its estate taxes are deductible for estate tax purposes as administration expenses.

Estate of Bahr, 68 T.C. at 78. Furthermore, a given expense associated with the administration of an estate may be incurred for various reasons, that is, to benefit the heirs, but at the same time to acquire cash to pay expenses, preserve the estate, or to effect a distribution. See Park's Estate v. Commissioner, 57 T.C. 705, 709 (1972), rev'd, 475 F.2d 673, 676 (6th Cir. 1973) (in reversing the Tax Court, noting that a given expense associated with the administration of an estate that benefits the estate will also in effect benefit the beneficiaries).

Section 114.305 of the State Code provides, in relevant part, that,

a personal representative, acting reasonably for the benefit of interested persons, is authorized to:

....

(13) Insure the assets of the estate against damage and loss, and insure the personal representative against liability to third persons.

(14) Advance or borrow money with or without security.

....

(17) Pay taxes, assessments and expenses incident to the administration of the estate.

....

(19) Prosecute or defend actions, claims or proceedings in any jurisdiction for the protection of the estate of the personal representative in the performance of duties as personal representative.

....

(21) Continue any business or venture in which the decedent was engaged at the time of death to preserve the value of the business or venture.

Decedent's estate has represented that the federal tax lien resulting from the election under § 6166 has made it difficult for Niece to obtain operational lines of credit for the commercial shopping center. Thus, Niece believes that it is in the best interests of the business of operating the shopping center to obtain a commercial loan for the purpose of paying off in full the deferred estate taxes.

Based upon the representations made and the information submitted, we conclude that interest attributable to a loan obtained through a commercial lender to pay off federal estate taxes

deferred under § 6166 is deductible as an administration expense under § 2053(a)(2) of the Code, assuming that the amount of interest is ascertainable with reasonable certainty, and will be paid, and is not based upon a vague or uncertain estimate. While the loan may have incidentally benefitted Niece, we do not believe that Decedent's estate obtained the loan solely for the individual benefit of Niece. Rather, we believe that the loan was necessary for the preservation of a significant asset of Decedent's estate. Because the loan was obtained to avoid a forced sale of assets, therefore, the loan was reasonably and necessarily incurred in the administration of the estate.

Except as ruled above, we express or imply no opinion concerning the federal tax consequences of this transaction under the cited provisions or any other provision of the Code.

This letter ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

A copy of this letter should be sent to the Service Center where the Decedent's federal estate tax return was filed. A copy is enclosed for that purpose.

Sincerely,

James C. Gibbons

James C. Gibbons
Badge Number 50-02622
Assistant to the Branch Chief, Branch 7
Assistant Chief Counsel (Passthroughs and
Special Industries)

Enclosures:

Copy of letter

Copy for § 6110 purposes