

## Internal Revenue Service

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Person to Contact:

Telephone Number:

Refer Reply To:

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Date:

April 18, 2001

### Legend

Decedent =

Decedent's Spouse =

ABC Land =

Trust X =

Trust Y =

Trustee 1 =

Trustee 2 =

Foundation =

Endowment Fund =

Date 1 =

Date 2 =

Date 3 =

ABC LLC =

Personal Representative of Decedent's Estate =

Dear \_\_\_\_\_ :

This letter responds to your request for a ruling, dated May 31, 2000, regarding the application of section 6166 of the Internal Revenue Code to certain proposed transactions. Specifically, you have asked us to rule that the proposed transactions will not result in the acceleration of the payments of estate tax under section 6166(g).

### Facts

Prior to Date 1, Decedent and Decedent's Spouse held properties comprising ABC Land as their community property. ABC Land is an unincorporated closely held business. On Date 1, Decedent's Spouse died and under the terms of his will, his one-half community property interest in ABC Land was distributed to two trusts, Trust X and Trust Y. Trust X was created as a qualified terminable interest property ("QTIP") trust under section 2056(b)(7). Decedent was the income beneficiary of Trust X and was a discretionary beneficiary of Trust Y. The assets funding Trust Y were included in the taxable estate of the Decedent's Spouse. Trust X was included in Decedent's gross estate under section 2044. Trust Y was not included in Decedent's gross estate.

The terms of both Trust X and Trust Y provided that upon the death of Decedent, the assets remaining in each trust were to be distributed to Trustee 1 and Trustee 2, who are the children of Decedent and Decedent's Spouse and the co-trustees of Trust X and Trust Y. For federal income tax purposes, Trust X and Trust Y are treated as one trust in accordance with section 643(f).

From Date 1 to Date 2, Decedent and the trustees of Trust X and Y actively managed ABC Land. Decedent died on Date 2. Under the terms of Decedent's will, Decedent's interest in ABC Land passed to two charitable organizations, the Foundation and the Endowment Fund. Decedent's gross estate included her one-half interest in ABC Land, which was to pass to the Foundation and Endowment Fund, and the interest in ABC Land held in Trust X, which was to be distributed to Trustee 1 and Trustee 2.

The interests in ABC Land included in Decedent's gross estate qualified as an interest in a closely held business. As a result, the Personal Representative of Decedent's Estate elected under section 6166 to pay the portion of estate tax attributable to the value of Decedent's interests in ABC Land in installments. After Decedent's death, ABC Land was owned one-half by Trust X and Trust Y (collectively) and one-half by Decedent's probate estate. For various business reasons, the Trustees of Trust X and Trust Y (collectively) and the Personal Representative of

Decedent's Estate exchanged their one-half interests in certain ABC Land properties. To accomplish this, Trust X and Decedent's probate estate exchanged certain interests, and then Trust Y and Decedent's probate estate exchanged certain interests. This re-shuffling of interests was approved by court order on Date 3.

The trustees of Trust X and Trust Y as well as the Personal Representative of Decedent's Estate propose to undertake the following transactions with respect to their interests in ABC Land:

#### Transaction 1

The Trustees of Trust X and Trust Y plan to transfer all of the trusts' interests in ABC Land to a limited liability company in exchange for membership interests in the limited liability company. The limited liability company will be known as ABC LLC and will be taxed as a partnership for federal income tax purposes. Trust X will not withdraw any property or cash from the business in conjunction with the transfer to ABC LLC.

ABC LLC will continue to operate the business of ABC Land in the same manner that it was operated before the transaction occurred. In their roles as beneficiaries and trustees of Trust X, neither Trustee 1 nor Trustee 2 intend to sell or dispose of any of the property or cash held in ABC LLC, except in the ordinary course of business.

#### Transaction 2

Under the terms of Trust X as established in Decedent's Spouse's will, upon the death of Decedent, Trustees 1 and 2 are to distribute the remaining assets in Trust X in equal shares to themselves. However, after the transfer of Trust X's interests in ABC Land to ABC LLC in Transaction 1, Trustees 1 and 2 propose to distribute all of Trust X's interest in ABC LLC to themselves. Upon distribution, Trustees 1 and 2 will continue to operate and manage ABC LLC in the same manner as prior to the distribution.

#### Rulings Requested

On the basis of the above facts and representations, the following rulings have been requested:

1. That Transaction 1 will not constitute a distribution, sale, exchange, or other disposition of an interest in a closely held business under section 6166(g)(1)(A) and therefore will not result in acceleration of the installment payments.
2. That Transaction 2 will not constitute a distribution, sale, exchange, or other disposition of an interest in a closely held business under section 6166(g)(1)(A) by reason of section 6166(g)(1)(D) and therefore will not result in acceleration of

the installment payments.

### Relevant Authorities

The Tax Reform Act of 1976 created a new section 6166 of the Code and redesignated the former section as section 6166A. Pub. L. No. 94-455, § 2004(a). The Economic Recovery Tax Act of 1981 repealed section 6166A and amended section 6166 so that it would apply in most cases that were previously governed by section 6166A. Pub. L. No. 97-34, § 422(d). Neither the Economic Recovery Tax Act of 1981 nor its legislative history indicate any intent on the part of Congress that a disposition of an interest under section 6166A would not be a disposition under section 6166. As a result, the regulations under section 6166A are considered applicable to this ruling request to the extent that those regulations are not inconsistent with the language of section 6166.

Under section 6166(a) of the Code, if the value of an interest in a closely held business included in determining the gross estate of a decedent exceeds 35 percent of the adjusted gross estate, the executor of the estate may elect to pay part or all of the tax imposed by section 2001 (estate tax) in two or more (but not exceeding ten) equal installments. However, certain activities trigger the acceleration of the payments. Section 6166(g) identifies the activities which terminate the deferred payment election and force an acceleration of payment of the estate tax. In particular, section 6166(g)(1)(A) provides that if 50 percent or more of the value of an interest in a closely held business which qualified for installment payments under section 6166(a)(1) is distributed, sold, or otherwise disposed of, then the extension of time to pay the tax shall cease to apply and the unpaid portion of the tax will be accelerated and due upon notice and demand. See also Treas. Reg. § 20.6166A-3(e)(1).

Section 6166(g)(1)(D), however, provides that the acceleration rule of section 6166(g)(1)(A) “does not apply to a transfer of property of the decedent to a person entitled by reason of the decedent’s death to receive the property under the decedent’s will, the applicable law of descent and distribution, or a trust created by the decedent.” When determining whether the 50 percent threshold is met, dispositions and withdrawals are aggregated.

For purposes of determining whether acceleration of payments is triggered, the phrase “distributed, sold, exchanged, or otherwise disposed of” is broad in scope and “comprehends all possible ways by which an interest in a closely held business ceases to form a part of the gross estate.” Treas. Reg. § 20.6166A-3(e)(2). As a general rule, however, the phrase does not encompass transactions which are mere changes in form. Id.

For estate and generation-skipping tax purposes, property included in a decedent's gross estate under section 2044 (i.e., property in which the decedent had a

qualifying income interest for life for which a marital deduction was allowed under section 2056(b)(7) or for which a deduction was allowed under section 2523(f)) is considered to have passed from the decedent to the person receiving the property upon the decedent's death. See section 2044(c) of the Code and Treas. Reg. § 20.2044-1(b). The regulations further provide that "the tax imposed on property includible under section 2044 is eligible for the installment payment of estate tax under section 6166." Treas. Reg. § 20.2044-1(b).

## Analysis

### Transaction 1

The regulations promulgated under section 6166A indicate that the phrase "distributed, sold, exchanged, or otherwise disposed of" generally does not extend to transactions that are mere changes in form. Treas. Reg. § 20.6166A-3(e)(2). Moreover, Rev. Rul. 66-62, 1966-1 C.B. 272, holds that where a change in the operation of a business from a corporate form to an unincorporated form does not materially alter the business or the interest of the estate in the business, the change does not cause the termination of the installment election under section 6166 that was otherwise available to the estate.

The change in this case, from operating the business assets in trust form to operating them in a limited liability company, does not materially alter the business and is a mere change in form. After Trustees 1 and 2 transfer the Trusts' interests in ABC Land, the business that was conducted by Trust X and Trust Y will be conducted by a limited liability company. Furthermore, there will be no withdrawal of money or other property from the business formerly conducted by Trust X and Trust Y. In addition, as owners of the limited liability company, Trust X and Trust Y (and ultimately Trustees 1 and 2) remain the owners of the property that will constitute ABC LLC and will thus remain the owners of the closely held business assets belonging to Trust X and Trust Y. Moreover, after the proposed transaction has been completed, the business that is now operated by Trust X and Trust Y will be operated in the form of a limited liability company and Decedent's estate will hold the same proportionate ownership interest as it holds now. Accordingly, the proposed transfer of the Trusts' interests in ABC Land properties to ABC LLC is a mere change in form and will not constitute a disposition of closely held business property within the meaning of section 6166(g)(1)(A). Thus, the proposed transaction will not result in the acceleration of the estate tax installments.

### Transaction 2

As explained below, we conclude that this transaction is not within the scope of section 6166(g)(1)(A). Therefore, it is not necessary to address whether the transaction falls within the exception in section 6166(g)(1)(D).

Section 20.6166A-3(e)(1) of the Estate Tax Regulations provides that the disposition of an interest in a closely held business must be a disposition of an interest which constitutes "included property" within the meaning of section 20.2032-1 of the Estate Tax Regulations. The provisions of section 20.6166A-3(e)(1) do not apply to the withdrawal of money or other property which constitutes "excluded property" within the meaning of section 20.2032-1(d). Id. The term "included property" is defined to include all property interests existing at the date of decedent's death which form a part of the gross estate as determined under sections 2033 through 2044. Treas. Reg. § 20.2032-1(d).

In the present situation, the interest in ABC Land held in Trust X was included in Decedent's gross estate by reason of section 2044 and thus constitutes "included property" under Treas. Reg. § 20.2032-1(d). As a result, any distribution, sale, exchange or other disposition of that interest could trigger acceleration of estate tax under section 6166(g)(1)(A). We conclude, however, that transaction 2 does not involve a distribution, sale, exchange or other disposition of ABC Land or any interest therein within the meaning of section 6166(g)(1)(A). We first note that Decedent's interest in Trust X terminated at her death. Thus, Decedent could not transfer her interest in Trust X under the terms of her will. As a result, she could not distribute, sell, exchange, or otherwise dispose of this interest after her death. Further, Decedent never possessed any power to transfer or dispose of any interest in the Trust X corpus. Also, although Trust X corpus is treated under section 2044(c) as property passing from Decedent for purposes of chapter 11 (estate tax) and chapter 13 (generation-skipping tax), section 6166 is not within chapter 11 or chapter 13. Trust X corpus is therefore not treated as passing from Decedent to Trustee 1 and Trustee 2 for purposes of section 6166(g)(1)(A) even though Trust X corpus is property includible in her gross estate and is taken into account in determining whether the 35 percent test of section 6166(a)(1) is satisfied. See Treas. Reg. § 20.2044-1(b), which provides that the tax imposed on property includible under section 2044 is eligible for the installment payment of estate tax under section 6166. Accordingly, we conclude that Transaction 2 is not described in section 6166(g)(1)(A) and cannot trigger acceleration of the installment payments. It is thus unnecessary to address whether the section 6166(g)(1)(D) exception would apply to transaction 2.

Based on the facts and information submitted and the representations set forth above, we rule as requested with respect to the following:

1. Transaction 1 will not constitute a distribution, sale, exchange, or other disposition of an interest in a closely held business under section 6166(g)(1)(A) and therefore will not result in acceleration of the installment payments.
2. Transaction 2 will not constitute a distribution, sale, exchange, or other disposition of an interest in a closely held business under section 6166(g)(1)(A) and therefore will not result in acceleration of the installment payments.

Pursuant to the powers of attorney on file in this office, this letter is being sent to you as authorized representatives for Personal Representative of Decedent's Estate, and Trustees 1 and 2 in their capacities as co-trustees of Trust X. This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent. A copy of this letter ruling should be attached to Decedent's federal estate tax return.

If you have questions, please contact

(202) 622-4940.

Very truly yours,

Assistant Chief Counsel  
(Administrative Provisions & Judicial Practice)

By:

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Michael L. Gompertz  
Assistant to the Branch Chief,  
Branch 2