



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

July 2, 2001

Number: **200141015**
Release Date: 10/12/2001
CC:PA:APJP:Br2
TL-N-1982-01
UILC: 303.00-00, 303.01-00, 303.02-00, 6166.00-00, 6166.02-00, 6166.50-00,
6166.52-00

INTERNAL REVENUE SERVICE NATIONAL OFFICE CHIEF COUNSEL ADVICE

MEMORANDUM FOR: ASSOCIATE AREA COUNSEL
(Small Business/Self-Employed)
Area 2 - Pittsburgh
CC:SB:2:PIT

FROM: Assistant Chief Counsel
(Administrative Provisions & Judicial Practice)
CC:PA:APJP

SUBJECT: Deferral of Estate Taxes Under Section 6166

This Chief Counsel Advice responds to your memorandum dated April 2, 2001. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

LEGEND

Decedent =

ISSUES

1. Whether Decedent's estate fails to qualify for an extension of time to pay estate taxes under section 6166 because the Stock Transfer Restriction Agreement requires a series of redemptions of stock held by the estate representing an interest in a closely held business.
2. Whether a redemption required by the Stock Transfer Restriction Agreement constitutes a distribution, sale, exchange, or other disposition of an interest in a closely held business under section 6166(g)(1)(A).
3. Whether the failure of Decedent's estate to timely make an interest payment provides sufficient cause for the Service Center to issue notice and demand

TL-N-1982-01

under section 6166(g)(3)(A), thereby terminating the estate's installment privileges.

CONCLUSIONS

1. Decedent's estate qualifies for an extension of time to pay estate taxes under section 6166. The eligibility for the section 6166 election is not affected by the subsequent redemptions required under the Stock Transfer Restriction Agreement.

2. Under section 6166(g)(1)(A), when 50% or more of the value of an interest in a closely held business is distributed, sold, exchanged, or otherwise disposed of, the section 6166 extension ceases to apply and any unpaid installments become payable upon notice and demand by the Service. As an exception to the general rule, section 6166(g)(1)(B) provides that certain redemptions of stock to which section 303 applies will not be treated as distributions or withdrawals for purposes of the acceleration rule of section 6166(g)(1)(A). In order to determine whether (or to what extent) the section 6166(g)(1)(B) exception applies, your office should consider the two alternative approaches to section 6166(g)(1)(B) explained in Rev. Rul. 86-54, 1986-1 C.B. 356, and should perform the necessary calculations.

3. As a general rule, when an estate fails to make payments of principal or interest, the Service may terminate the deferred payment election and force an acceleration of payment of the estate tax by issuing notice and demand. Note, however, that the Service cannot accelerate the estate tax installments so long as payment is made within 6 months of the due date. Although Decedent's estate failed to pay the interest due on _____, Decedent's estate paid the interest within 6 months of that date. Consequently, the Service is not entitled to issue notice and demand and thus Decedent's estate does not lose its installment privileges simply because the interest payment was untimely.

FACTS

Decedent died on _____ owning 470 shares of stock in a closely held corporation. The remaining 760 shares in the corporation were owned by one other shareholder. Prior to Decedent's death, Decedent and the other shareholder entered into an agreement ("Stock Transfer Restriction Agreement"). As amended, the agreement provided that upon the death of either shareholder, the executor of that shareholder's estate must offer the decedent's shares of stock to the corporation at the price fixed pursuant to the agreement, and the corporation shall then be obligated to accept the offer and purchase the decedent's stock. The Stock Transfer Restriction Agreement further provided that the corporation was required to pay to the estate the total proceeds received from a life insurance policy owned by the corporation insuring the life of the deceased shareholder. This payment was to be made within 10 days after receipt of the insurance proceeds. In addition, the balance of the purchase price was to be paid not less than annually

TL-N-1982-01

over a term not in excess of 10 years. Further, the Stock Transfer Restriction Agreement provided that the estate selling the stock shall deliver the shares of stock only as payment is received. The agreement also provided that any shares of stock for which payment has not been made shall not be considered sold and shall remain the property of the estate until paid for.

On _____, the corporation paid Decedent's estate the proceeds from the life insurance policy (approximately \$ _____) and redeemed 86 shares of stock in accordance with the terms of the amended agreement. Beginning on _____, the corporation redeemed 38.4 shares, and is scheduled to redeem 38.4 shares on that day in each succeeding year until the final redemption on _____. For each 38.4 shares redeemed, the stated redemption price is \$ _____.

Although Decedent's estate tax return was originally due on _____, Decedent's estate requested and was granted an extension of time to file the return and pay the estate tax until _____. On _____, Decedent's estate timely filed an estate tax return and elected to pay the estate tax in installments pursuant to section 6166; _____ was a Sunday. See I.R.C. § 7503.

The Service tentatively granted Decedent's estate's section 6166 election in a notice dated _____, and indicated that the first installment was due on _____. The Service issued a billing notice to Decedent's estate on _____, indicating that an interest payment (in the amount of \$ _____) was due on _____. The estate paid the interest on _____, approximately 3 weeks after the stated due date.

The transcript of the account shows the following payments have been made.

| <u>Date</u> | <u>Amount</u> |
|-------------|---------------|
| | \$ _____ |
| | \$ _____ |
| | \$ _____ |

LAW AND ANALYSIS FOR ISSUE 1

As a general rule, the estate tax return (Form 706) and payment of the estate tax liability of a decedent is due within nine months of the decedent's death. I.R.C. §§ 6075(a); 6151(a). As an exception to the general rule, section 6166(a) of the Internal Revenue Code provides that if the value of an interest in a closely held

TL-N-1982-01

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. The first installment of tax must be paid on or before the date selected by the executor which is not more than 5 years after the date prescribed by section 6151(a) for payment of the tax. An executor electing to defer estate taxes under section 6166 must make annual payments of interest during the deferral period. In particular, interest must be paid annually during the period before the first installment of tax is due. I.R.C. § 6166(f)(1).

Section 6166(b)(1) defines the term “interest in a closely held business” to include stock in a corporation carrying on a trade or business if “(i) 20 percent or more in value of the voting stock of such corporation is included in determining the gross estate of the decedent, or (ii) such corporation had 15 or fewer shareholders.”¹ I.R.C. § 6166(b)(1)(C)(i), (ii). The determination of whether the stock of a corporation qualifies as an interest in a closely held business is “made as of the time immediately before the decedent’s death.” I.R.C. § 6166(b)(2)(A).

Certain activities trigger the acceleration of the estate tax payments. In this regard, 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, exchanged, 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. I.R.C. § 6166(g)(1)(A) (emphasis added). See also Treas. Reg. § 20.6166A-3(e)(1).² Thus, although certain events will terminate the section 6166 deferral, those events are only

¹ Note that for decedents dying after December 31, 2001, the Economic Growth and Tax Relief Reconciliation Act of 2001 increased the number of shareholders from 15 to 45. See Pub. L. No. 107-16.

²The 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 Chief Counsel Advice to the extent that those regulations are not inconsistent with the language of section 6166.

TL-N-1982-01

relevant after the election has been granted; the fact that acceleration may occur at a future date is not taken into account when determining whether an estate qualifies for the section 6166 installment privilege.

In the present situation, immediately before death, Decedent held 470 shares of stock in a closely held corporation. Although the terms of the Stock Transfer Restriction Agreement required that Decedent's estate sell the shares after Decedent's death, sales after death are not relevant in determining whether the estate initially qualified for the section 6166 election. Such sales are relevant only for purposes of determining whether a distribution, sale, exchange, or other disposition occurs under section 6166(g)(1)(A), as discussed below (Issue 2), such that the section 6166 extension ceases to apply.

In this case, Decedent's estate qualified for an extension of time to pay estate taxes under section 6166. The estate qualified for the extension because the value of the 470 shares held by Decedent represented 38.2% (470/1230) of the voting stock of the corporation. In addition, Decedent was only 1 of 2 shareholders in the corporation. Thus, Decedent's shares of stock constituted an interest in a closely held business within the meaning of section 6166(b)(1)(C). Moreover, the value of those shares of stock exceeded 35 percent of Decedent's adjusted gross estate. The terms of the Stock Transfer Restriction Agreement do not disqualify Decedent's estate from initial qualification for section 6166 deferral.

LAW AND ANALYSIS FOR ISSUE 2

In general, 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, exchanged, 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. I.R.C. § 6166(g)(1)(A). See also Treas. Reg. § 20.6166A-3(e)(1). 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 an exception to the general rule of acceleration, section 6166(g)(1)(B) provides that a distribution in redemption of stock under section 303 is not treated as a distribution for purposes of section 6166(g)(1)(A) and, for purposes of section 6166(g)(1)(A), the value of the interest in the closely held business will be considered to be such value reduced by the value of the stock redeemed. See also Treas. Reg. § 20.6166A-3(e)(5). Note, however, that section 6166(g)(1)(B) applies only if on or before the date prescribed for payment of the first installment due after the date of the distribution (or, if earlier, on or before the day that is 1 year after the

TL-N-1982-01

date of the distribution), there is paid an amount of the tax imposed by section 2001 (estate tax) not less than the amount of money and other property distributed.

Section 303(a) provides that a distribution of property to a shareholder by a corporation in redemption of stock of the corporation, the value of which is included in the decedent's gross estate, shall be treated as a distribution in full payment in exchange for the stock redeemed, to the extent that the amount of the distribution does not exceed the sum of the estate, inheritance, legacy, and succession taxes (plus interest) and the amount of funeral and administration expenses allowable as deductions for Federal estate tax purposes.

This case involves a series of separate redemptions and payments under the Stock Transfer Restriction Agreement. The agreement provides that any shares of stock for which payment has not been made shall not be considered sold and shall remain the property of the estate until paid for. Thus, until payment is made for the stock, the stock is not considered "distributed, sold, exchanged, or otherwise disposed of" and no money or other property attributable to the stock is considered withdrawn from the trade or business for purposes of section 6166(g)(1)(A). However, when payment is made for the stock, a distribution, sale, exchange, or other disposition will occur under section 6166(g)(1)(A) unless the exception provided in section 6166(g)(1)(B) applies. When determining whether the 50 percent threshold is met, dispositions and withdrawals are aggregated. I.R.C. § 6166(g)(1)(A)(ii). Thus, if the exception in section 6166(g)(1)(B) does not apply, acceleration of the installment payments will be triggered once Decedent's estate has redeemed 50 percent or more of the shares of stock and the Service has issued notice and demand.

Your request for Chief Counsel Advice makes no mention of Rev. Rul. 86-54, 1986-1 C.B. 356, which provides two alternative approaches to the requirement of 6166(g)(1)(B) that estate tax must be paid in an amount not less than the amount of money and other property distributed in the redemption on or before the date prescribed for payment of the first installment due after the date of the distribution (or, if earlier, on or before the day that is 1 year after the date of the distribution). We therefore recommend that your office make the calculations required under Rev. Rul. 86-54 to determine whether the redemptions that have occurred to date fail, in whole or in part, to qualify under section 6166(g)(1)(B). You should keep in mind that to the extent one or more redemptions qualify under section 6166(g)(1)(B), the value of the interest in the closely held business is considered reduced by the value of the stock redeemed in such qualifying redemptions. This affects the calculation required under section 6166(g)(1)(A). See I.R.C. § 6166(g)(1)(B)(ii); Treas. Reg. § 20.6166A-3(e)(6), Examples 2 and 3. We would be pleased to discuss this matter with you further after you have made the necessary calculations to determine whether the aggregate of distributions, sales, exchanges, or other dispositions and withdrawals equals or exceeds 50 percent of the value of

TL-N-1982-01

the interest in the closely held business, as reduced in accordance with section 6166(g)(1)(B)(ii).

LAW AND ANALYSIS FOR ISSUE 3

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)(3)(A) provides that a failure to make any payment of principal or interest on or before the date fixed for payment (including any extension of time) will result in the unpaid portion of the tax payable in installments becoming due upon notice and demand from the Secretary. See also Treas. Reg. § 20.6166A-3(c). Note, however, that for any payment of principal or interest made within six months after the due date, the Secretary cannot give notice and demand for acceleration of the remaining installments. I.R.C. § 6166(g)(3)(B)(i).

As a general rule, when an estate fails to pay a section 6166 installment, a Service Center letter is issued to inform the estate to pay the installment or lose the installment privilege. IRM 5.5.6.4(1). Although an estate defaults on a payment, acceleration of the remaining installment payments does not actually occur until the Service serves notice and demand for payment on the estate. Lake Shore National Bank v. Coyle, Jr., 419 F.2d 958 (7th Cir. 1969). Note, however, that if an estate fails to make a timely payment, but pays within six months of the due date, the estate loses the benefit of the 2% interest rate for that payment and must include in its late payment a penalty equal to 5% of the payment originally due, multiplied by the number of months (including fractions thereof) from the original due date to the date of actual payment. I.R.C. § 6166(g)(3)(B)(ii), (iii).

All requests for section 6166 installment privileges are tentatively allowed by the Service. I.R.M. 104.8, Exhibit 21-2. After the Service Center receives the section 6166 extension request, the Service issues a preliminary determination letter to the estate, confirming that the Service has received a notice of election to make installment payments of estate tax. A tentative payment schedule is generally included. See Letter 249C.

In the present situation, Decedent's estate did not timely pay the interest due on _____; however, Decedent's estate paid the interest amount within six months of the due date. Thus, the Service is not entitled to issue notice and demand to terminate Decedent's estate's installment privileges. I.R.C. § 6166(g)(3)(B)(i).

In the event Decedent's estate fails to make a required payment of interest or tax within six months of the due date, the Service may issue notice and demand and thus terminate the estate's installment privileges. I.R.C. § 6166(g)(3)(A). You ask whether issuance of such notice and demand would be proper if the Service Center

TL-N-1982-01

fails to timely notify the estate of the amount of interest due. This issue is not raised by the facts presented because in this case the Service Center did notify Decedent's estate of the amount of interest due. However, we believe that even if the Service Center fails to send the estate a bill for a required payment, the estate would in most cases be presumed to know the amount and due date of the required payment. Thus, in the usual case in which the estate is presumed to know the amount and due date of a required payment, issuance of notice and demand is proper if the estate fails to make a required payment within six months of the due date. In such a case, it is irrelevant that no bill was sent to the estate.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney client privilege. If disclosure becomes necessary, please contact this office for our views.

Please contact this office if the calculations required by Rev. Rul. 86-54, 1986-1 C.B. 356, raise legal issues that cannot be easily resolved. If you have questions, please contact Susan L. Hartford at (202) 622-4940.

CURTIS G. WILSON

By: _____
Michael L. Gompertz,
Assistant to the Branch Chief
Branch 2