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Department of the Treasury

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**Person to Contact:**

**Telephone Number:**

**Refer Reply To:**

PLR-111796-03

**Date:** June 25, 2003

In re: Letter Ruling Request on I.R.C. § 6166.

LEGEND

Decedent =

Date 1 =

Corporation 1 =

Corporation 2 =

Dear

This letter responds to your request for a ruling dated February 10, 2003, regarding the application of section 6166 of the Internal Revenue Code to the situation described below. Specifically, you asked us to rule that for purposes of section 6166, certain interests in commercial rental real estate activities constitute interests in a closely held business and would not be considered passive assets. You also asked that we rule that if the interests are not considered passive assets, then they may be treated as an interest in a single closely held business pursuant to section 6166(c).

FACTS

Decedent died on Date 1. At the time of death, Decedent was the grantor of a revocable grantor trust, which was the sole shareholder of two S corporations: Corporation 1 and Corporation 2 (sometimes collectively referred to as “the companies”). Decedent’s gross estate consisted of his interest in the revocable grantor trust (and other assets not relevant to this ruling request). The companies own six commercial properties, properties A through F. Corporation 1 owns properties B through F, while Corporation 2 owns property A. The companies employ 10 full-time employees to conduct various aspects of their respective real estate businesses. Corporation 1 acts as the common paymaster for Corporation 2. Three officers and two staff members manage all corporate activities on a day-to-day basis. The remaining five employees perform all maintenance.

Prior to his death, Decedent met or spoke with the chief financial officer every business day, and discussed all decisions regarding the operations of the business, including, but not limited to: negotiating and renegotiating leases, advising as to other corporate matters, supervising and planning maintenance activities, overseeing and contracting tenant improvements, coordinating and planning the marketing of the properties, billing and collecting rents, handling tenant complaints, maintaining tenant relations, coordinating legal and accounting services, and negotiating with and paying all vendors. In addition, Decedent maintained absolute discretion regarding personnel hiring and firing. Further, Decedent approved all major leasing, acquisition and construction decisions.

The employees of the companies make frequent property inspections and provide 24-hour on-call emergency services. In addition, Corporation 1 owns and maintains both light and heavy equipment and inventories tools and supplies, which are also used by Corporation 2, thereby enabling the companies to provide extensive repair and maintenance services. The companies hire independent contractors to provide assistance with extraordinary projects, such as major roof repairs, large tenant improvements and parking lot paving.

From the information provided, properties A through E have similar leases. Unless otherwise indicated, the detailed description of the property A lease applies to the leases for properties B through E as well.

### **Property A**

Property A is a commercial shopping center and office building complex. Corporation 2, pursuant to the lease, is required to provide elevator service, lighting replacements for standard building lights, restroom supplies, window washing and janitorial services. In addition, Corporation 2 is responsible for electrical and HVAC systems and mechanical and structural systems. The tenant, however, is required to reimburse Corporation 2 for operating costs incurred by Corporation 2 in maintaining and operating the shopping center and office building. These costs include, but are not limited to utilities, supplies,

insurance, and compensation of all persons who perform duties connected with the operation, maintenance, repair or overhaul of the building (including services of independent contractors). In addition, the tenant must reimburse Corporation 2 for equipment, improvement and facilities, management of the shopping center, rental expenses for personal property (or a reasonable depreciation allowance) used in the maintenance or repair of the shopping center or office building, and costs, expenditures or charges required by any government or quasi-government authority. Additionally, some of the tenants are required to reimburse Corporation 2 for real estate and personal property taxes.

### **Property B**

Property B consists of a two-story office building and an industrial complex. Corporation 1, pursuant to the lease, is required to provide elevator service, lighting replacements for building standard lights, restroom supplies, window washing and janitorial services. Like property A, the tenant is required to reimburse Corporation 1 for operating costs incurred by Corporation 1 in maintaining and operating the office building and industrial complex.

### **Property C**

Property C consists of three buildings used for research and development projects. Pursuant to the lease, Corporation 1 must maintain the common areas and repair and operate the property. The tenant is required to pay its proportionate share of all real property taxes, as well as general and special assessments. Further, the tenant is required to reimburse Corporation 1 for the cost of a comprehensive public liability insurance policy, and hazard and rental income insurance policies maintained by Corporation 1. The tenant is further charged with maintaining the leased space, including nonstructural interior and exterior areas, systems and equipment. Like property A, the tenant is required to reimburse Corporation 1 for operating costs incurred by Corporation 1 in maintaining and operating the buildings. For minor tenant improvements, Corporation 1 sometimes hires independent contractors.

### **Property D**

Property D is a two-story office building. Corporation 1, pursuant to the lease, must furnish all custodial and trash removal services required by the tenant. Unlike property A, Corporation 1 must keep the premises in good order, repair, and condition and none of these operating costs are reimbursed. Corporation 1 manages and oversees all building maintenance, including replacing ceiling tiles, fixing lights, repairing plumbing, and painting. For minor tenant improvements, Corporation 1 hires independent contractors. Corporation 1 must furnish all utilities necessary for the use and enjoyment of the tenant at the expense of the tenant.

## **Property E**

Property E is a two-story office building. Pursuant to the lease, Corporation 1 must provide elevator service, lighting replacement for building standard lights, restroom supplies, window washing and janitorial services. In addition, Corporation 1 supplies the tenants with electricity for normal desktop use and HVAC. Like property A, the tenant is required to reimburse Corporation 1 for operating costs incurred by Corporation 1 in maintaining and operating the building.

## **Property F**

Property F is a mountain-top radio site consisting of three buildings with attached radio towers. Pursuant to the lease, Corporation 1 provides access to its tower site for the lessee to operate and maintain communications equipment. Corporation 1 is responsible for compliance with all tower and building markings and lighting requirements required under Federal law. In addition, Corporation 1 maintains the access road to the towers.

## **RULINGS REQUESTED**

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

1. Whether Decedent's interest in Corporation 1 constitutes an interest in a closely held business within the meaning of section 6166(b)(1) or whether the interest in Corporation 1 constitutes a passive asset within the meaning of section 6166(b)(9).
2. Whether Decedent's interest in Corporation 2 constitutes an interest in a closely held business within the meaning of section 6166(b)(1) or whether the interest in Corporation 2 constitutes a passive asset within the meaning of section 6166(b)(9).
3. Whether the interests in Corporation 1 and Corporation 2 can be treated as an interest in a single closely held business pursuant to section 6166(c).

## **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 an interest that constitutes an interest in a closely held business under section 6166A would not qualify under section 6166. As a result, the regulations under section 6166A are applicable to the extent that

those regulations are not inconsistent with the language of section 6166.

Section 6166(a)(1) provides, in part, that if the value of an interest in a closely held business, which is included in determining the gross estate of a decedent who was (at the date of his death) a citizen or resident of the United States, exceeds 35 percent of the adjusted gross estate, the executor may elect to pay part or all of the tax imposed by section 2001 in two or more (but not exceeding ten) equal installments.

Section 6166(b)(1) defines the term "interest in a closely held business" to mean:

(A) an interest as a proprietor in a trade or business carried on as a proprietorship;

(B) an interest as a partner in a partnership carrying on a trade or business, if-- (i) 20 percent or more of the total capital interest in such partnership is included in determining the gross estate of the decedent, or (ii) such partnership had 45 or fewer partners; or

(C) 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 45 or fewer shareholders.

I.R.C. § 6166(b)(1)(A) - (C).

Section 6166(b)(2)(C) provides, in part, that property owned directly or indirectly, by or for a trust, shall be considered as being owned proportionately by or for its beneficiaries. For purposes of section 6166, a person shall be treated as a beneficiary of a trust only if such person has a present interest in the trust.

For stock in a corporation to qualify as an interest in a closely held business, the corporation must be carrying on a trade or business. It is not necessary, however, that all assets of a corporation be used in carrying on the trade or business. Treas. Reg. § 20.6166A-2(c)(1).

Section 6166(b)(9)(A) provides that for purposes of section 6166(a)(1), the value of any interest in a closely held business shall not include the value of that portion of such interest which is attributable to passive assets held by the business. In general, the term "passive asset" means any asset other than an asset used in carrying on a trade or business. I.R.C. § 6166(b)(9)(B)(i).

Section 6166(c) provides that interests in two or more closely held businesses, with respect to each of which there is included in determining the value of the decedent's gross estate 20 percent or more of the total value of each such business, shall be treated as an interest in a single closely held business.

Rev. Rul. 75-365, 1975-2 C.B. 471, considered a situation where a decedent individually maintained a fully equipped business office to collect rental payments on commercial and farm rental properties, receive payments on notes receivable, negotiate leases, make occasional loans, and direct the maintenance of the properties by contract. The ruling holds that the decedent was merely an owner managing investment assets to obtain the income ordinarily expected from them, rather than conducting a business. Therefore, the commercial and farm rental properties and notes receivable included in the decedent's gross estate did not constitute an interest in a closely held business for purposes of section 6166.

Rev. Rul. 75-366, 1975-2 C.B. 472, involved a decedent who paid 40 percent of the expenses, received 40 percent of the crops and actively participated in important management decisions of a tenant farm included in the decedent's gross estate. The decedent made almost daily visits to inspect and discuss operations, and occasionally delivered supplies to the tenants. The ruling holds that farming under these circumstances is a productive enterprise like a manufacturing enterprise distinguishable from management of investment assets. Therefore, the decedent's farm asset constitutes an interest in a closely held business.

Rev. Rul. 75-367, 1975-2 C.B. 472, holds that a decedent's ownership of 100 percent of the stock of an electing small business corporation that built homes on land owned and developed by the decedent and a business office and warehouse used by the corporation and the decedent constituted an interest in a closely held business. The ruling holds, however, that eight homes built by the corporation that decedent owned and rented, collected rents, made the mortgage payments, and made necessary repairs and maintenance, was not an interest in a closely held business because the decedent's interest in such homes merely represented an investment.

## ANALYSIS

### Issues 1 and 2

According to Rev. Ruls. 75-365, 75-366, and 75-367, the determination of what constitutes a "trade or business" within the meaning of section 6166 should not be made by mere reference to a broad definition of the term for purposes of some other Code section, but should reflect the intent of Congress in enacting section 6166. Section 6166 was enacted to permit the deferral of the payment of federal estate tax when it would be necessary to sell assets used in a going business (and thereby disrupting or destroying the business enterprise) to pay the estate tax at one time. The section was intended to permit deferral of tax on income-producing assets only where the assets formed a part of an active enterprise producing business income rather than income solely from the ownership of property. It is the level of activity that distinguishes a trade or business from merely managing rental property. In determining the level of business activity carried on by a corporation, the activities of its agents and/or employees are taken into account. The activities of independent contractors or lessees, however, are not taken into account.

Decedent's revocable trust, as the sole shareholder, owned the companies. Decedent's level of activity (as assisted by the employees of the companies) determines whether the companies are carrying on a trade or business for purposes of section 6166. With respect to properties A through E, the level of Decedent's activities associated with Corporation 1 and Corporation 2 indicates more than a mere owner managing investments. Much like the decedent in Rev. Rul. 75-366, Decedent participated in the management of the properties and consistently participated in the day-to-day operations. While the employees were on the payroll of Corporation 1, Corporation 1 was acting as a common paymaster for Corporation 2. As a result, the employees are also treated as employees of Corporation 2. Thus, activities conducted by the employees with respect to property A are attributed to Corporation 2. Corporation 2 provided significant services to property A, including elevator service, lighting replacements, restroom supplies, window washing, and janitorial services. In addition, Corporation 2 incurred numerous operating costs for property A. Although Corporation 2 hired some independent contractors for certain aspects of maintaining property A, a sufficient proportion of Decedent's activities and those of the employees of Corporation 2 were devoted to the performance of substantial services. Thus, Corporation 2 was conducting an active trade or business. Consequently, Decedent's stock (owned directly by his trust) in Corporation 2 constitutes an interest in a closely held business.

Similarly, the activities conducted with respect to properties B through E by the employees are attributed to Corporation 1. Corporation 1 provided significant services to properties B through E, much like those services provided by Corporation 2 to property A. Thus, Corporation 1 was also conducting an active trade or business and consequently, Decedent's stock (owned directly by his trust) in Corporation 1 constitutes an interest in a closely held business. With regard to property F, although the activities of the employees are attributed to Corporation 1, those activities were merely activities necessary for investment management; Corporation 1 did little more than maintain the condition of the road leading to the towers and ensured compliance with federal requirements for the buildings and the towers. Thus, Property F is a passive asset within the meaning of section 6166(b)(9)(B)(i). Because Decedent's interest in Corporation 1 (based on the activities associated with properties B through E) constitutes an interest in a closely held business, it is not necessary for property F to be used in carrying on a trade or business. For purposes of determining the amount of tax eligible for deferral, however, the value of Corporation 1 that is attributable to property F is not included.

### Issue 3

Section 6166(c) provides that interests in two or more closely held businesses, with respect to each of which there is included in determining the value of decedent's gross estate 20 percent or more of the total value of each such business, shall be treated as an interest in a closely held business. In this case, the Decedent's trust owned 100% of the companies and the value of them was included in Decedent's gross estate. For purposes of section 6166, Decedent's interests in the companies are treated as an interest in a single closely held business.

## CONCLUSIONS

Based on the information provided and the representations made, we conclude as follows:

1. Decedent's interest in Corporation 1 qualifies as an interest in a closely held business for purposes of section 6166. Accordingly, provided the other requirements of section 6166 are met, the federal estate tax attributable to Decedent's interest in Corporation 1 may be paid in installments under section 6166. The federal estate tax attributable to the value of property F, however, may not be paid in installments because it is a passive asset.
2. Decedent's interest in Corporation 2 qualifies as an interest in a closely held business for purposes of section 6166. Accordingly, provided the other requirements of section 6166 are met, the federal estate tax attributable to Decedent's interest in Corporation 2 may be paid in installments under section 6166.
3. Decedent's interests in Corporation 1 and Corporation 2 qualify as an interest in a single closely held business.

No opinion is expressed in this ruling as to the federal tax consequences of the sharing of employees between Corporation 1 and Corporation 2.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) 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 any questions, please contact 202-622-4940.

Sincerely,

Assistant Chief Counsel  
(Administrative Provisions & Judicial Practice)

By: \_\_\_\_\_  
Susan L. Hartford  
Acting Senior Technician Reviewer  
Branch 2

Enclosures:

Copy of letter  
Copy for section 6110 purposes

cc: