

**Office of Chief Counsel
Internal Revenue Service
Memorandum**

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to: SB/SE Associate Area Counsel (Long Island)
(CC:SB:1:LI)
Attn: Donald Glasel

from: Acting Chief, Branch 1 Collection, Bankruptcy & Summons
(CC:PA:CBS:BR1)

subject: Effect of Section 6324A Special Estate Tax Lien on Section 6324 Estate Tax Lien

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ISSUE

Whether the recording of the special estate tax lien for deferred taxes pursuant to I.R.C. § 6324A automatically divests all assets comprising the gross estate from the I.R.C. § 6324(a) estate tax lien.

CONCLUSION

The recording of the section 6324A lien divests the section 6324(a) lien only with respect to the property designated on the section 6324A lien agreement. It does not divest the remainder of the gross estate property from the section 6324(a) lien.

FACTS

You have provided the following hypothetical factual scenario:

The decedent died owning the following property: 1. Principal residence with fair market value of \$500,000; 2. marketable securities with fair market value of \$500,000; 3. closely-held real estate management corporation with fair market value of \$1,000,000 (the only clients are other closely-held corporations); and 4. three closely-held corporations, each holding \$4,000,000 in real estate equity, with shares valued on the Form 706 estate tax return at \$3,000,000 each.

The decedent's sole heir is his son/executor. The estate tax liability shown on the return is \$5,000,000. Payment of \$ 4,500,000 of this amount is deferred pursuant to election under I.R.C. § 6166. For purposes of the section 6166 election, the amount of deferred estate tax plus four years of interest payments totals \$5,000,000.

Each of the underlying parcels of real estate is encumbered by a mortgage which states that the mortgagor will be in default if a lien is filed on the aforementioned real estate. The estate cites that provision for its refusal to designate real property as security for the section 6324A lien required as a condition of granting the section 6166 election and instead offers \$5,000,000 of shares from two of the closely-held companies as security.

If these shares meet the requirements of section 6324A(b) and are designated on the section 6324A lien agreement as section 6166 lien property, you ask whether this extinguishes the section 6324(a) lien on all of the property of the gross estate described above or just divests the section 6324(a) lien from the shares. In other words, in the event of a default on the section 6324A lien agreement, if the section 6166 lien property value is insufficient to satisfy the amount of remaining deferred liability, is the remaining gross estate property still secured by the section 6324(a) general estate tax lien?

LAW AND ANALYSIS

Section 6324(a)(1) provides that, unless the estate tax imposed by Chapter 11 is paid in full or becomes unenforceable by reason of lapse of time, it shall be a lien upon the gross estate of the decedent for ten years from the date of death (except for the part of such gross estate used for the payment of charges against the estate and expenses of administration allowed by the court shall be divested of such lien).

Section 6324(a)(2) provides, generally, for divestment of the section 6324(a)(1) lien from property included in the gross estate pursuant to I.R.C. §§ 2034 through 2042 (commonly known as nonprobate property) upon certain transfers of such property. Section 6324(a)(3) generally provides for the continuation of the section 6324(a)(1) lien even after discharge of the fiduciary under I.R.C. § 2204, except with respect to certain parts of the gross estate transferred to a purchaser or security interest holder. In other words, the discharge of a fiduciary from personal liability does not, in and of itself, effect the existence of the section 6324(a)(1) lien. These are the only provisions in section 6324 which address divestment of the section 6324(a)(1) lien.

Section 6166 allows an estate to elect to defer payment of tax attributable to interests in a closely held business. Essentially, estates entitled to elect deferral under section 6166 can defer payment of tax for five years and pay the balance of interest and tax due in installments over the next ten years.

The Service requires security as a prerequisite to granting a section 6166 election. See I.R.C. §§ 6166(k)(1); 6165. Such security can take the form of a bond, pursuant to section 6165. In the alternative, the estate can elect to subject property to a lien under section 6324A.

Section 6324A(a) provides, generally, that where an estate has made an election under section 6166 and filed the agreement referred to in section 6324A(c), the deferred amount (plus any interest, additional amount, addition to tax, assessable penalty, and costs attributable to that amount) shall be a lien on the property designated in the lien agreement ("6166 lien property").

Section 6324A(b)(1) defines section 6166 lien property to include any interests in real or other property that are designated in the lien agreement and are expected to survive the deferral period. Section 6324A(b)(2) provides that the maximum value the Service can require for section 6166 lien property is a value not greater than the sum of the deferred amount and required interest amount. There is no requirement that section 6166 lien property be property included in the gross estate and subject to the section 6324(a)(1) lien. Treas. Reg. §§ 20.6324A-1(b); 301.6324A-1(b)(1).

Section 6324A(c) requires a written agreement signed by every person in being who has an interest in the section 6166 lien property consenting to the lien's creation.

Section 6324A(d)(2) provides that the section 6324A lien arises at the earlier of the date the lien agreement is filed, or when the executor is discharged from liability under section 2204. Section 2204(a) provides that an executor, upon payment of any nondeferred amount due and upon furnishing a bond for amounts deferred under section 6166, is discharged from personal liability. Section 2204(c) provides that a "bond" for this purpose includes a section 6324A lien agreement "with respect to the amount for which the time for payment has been extended under section 6166."

Section 6324A(d)(4) provides: "If there is a lien under this section on any property with respect to any estate, there shall not be a lien under section 6324 on such property with respect to the same estate." (Emphasis added). See also Treas. Reg. §§ 20.6324A-1; 301.6324A-1(e).

The quoted language is the focus of your inquiry as to what specific property is divested from the section 6324(a)(1) lien upon creation of a section 6324A lien. Our position, based upon the plain language of this provision, is that the "such property" language refers to the property subject to the section 6324A lien. In other words, the section 6324A lien displaces the section 6324(a)(1) lien only with respect to the section 6166

lien property. Further support for this position is found in the legislative history for the Tax Reform Act of 1976, P.L. 94-455. The Joint Committee explanation states that the section 6324A lien is "... in lieu of the regular estate tax lien (under sec. 6324) as to the property subject to the special lien." (Emphasis added). P.L. 94-455, Section 2004.¹

This issue has never been directly addressed by any court. In In re Roth, 301 B.R. 451 (Bankr. W.D. Pa. 2003), aff'd, 2004-1 U.S.T.C. ¶ 60,485 (W.D. Pa.), we argued on appeal to the district court that a section 6324A lien on shares of stock displaced the section 6324(a) lien only with respect to those shares of stock. The court held that it need not reach this issue, however, as the other assets the Service was seeking to collect were not assets of the gross estate ever subject to the section 6324(a) lien. See also Noble v. Soler, 98-1 U.S.T.C. ¶ 60,297 (S.D. Ohio 1997) (court does not reach issue of extent of displacement of section 6324(a) lien because section 6324A lien agreement was never filed). In a bankruptcy case involving section 6324B (which makes the language of section 6324A(d)(4) applicable pursuant to section 6324B(c)(1)), the court again does not directly address this issue, but notes that "[m]oreover, any property against which a Section 6324B lien is filed is divested of the Section 6324 lien regardless of whether the property was Section 2034 to 2042 property." In re Druse, Sr., Ltd., 82 B.R. 1013, 1016 (Bankr. D. Neb. 1988).

As demonstrated by the facts of your hypothetical, payment of the entire estate tax imposed by section 2001 is not necessarily deferred. See I.R.C. § 6166(a)(1). Thus, a portion of the estate tax may be immediately due and owing. If the filing of the section 6324A lien did entirely extinguish the section 6324(a)(1) lien, cases would arise in which the deferred amount would be fully secured (by the section 6324A lien) but the nondeferred amount already due would be unsecured. It is unlikely that Congress intended this result.

We also do not believe Congress intended a construction of section 6324A(d)(4) in which the extent the Service's interest is secured would differ significantly depending upon whether the property designated as section 6166 lien property was property of the gross estate, subject to the section 6324(a)(1) lien, or was other property. As previously discussed, nothing in section 6324A requires property designated as section 6166 lien

¹ The language of section 2204(c) previously discussed, pertaining to an executor's discharge from personal liability, is similarly circumscribed to provide a discharge only with respect to amounts deferred under section 6166, not a general discharge with respect to the entire estate tax liability. Even if the filing of a section 6324A lien did have an effect of a general discharge under section 2204(a), however, the language of section 6324(a)(3) makes it clear that this would not in itself effect the section 6324(a)(1) lien.

property to be property of the gross estate, and the regulations specifically provide that section 6166 lien property need not be property of the gross estate. If the filing of the section 6324A lien did entirely extinguish the section 6324(a)(1) lien, under the facts of your hypothetical, the Service's security interest would only extend to the shares designated as 6166 lien property. If the estate had designated non-estate property of the same type and value as 6166 lien property, however, under the language of section 6324A(d)(4), the Service's security interest would also include a section 6324(a)(1) lien on all gross estate property.

Accordingly, our position is that, under the facts of your hypothetical, in the event of a default on the section 6324A lien agreement, if the value of the shares designated as section 6166 lien property becomes insufficient to fully satisfy the unpaid estate tax liability, collection action may be taken against the remaining gross estate property, which is still subject to the section 6324(a)(1) lien.

Please call (202) 622-3610 if you have any further questions.