Internal Revenue Service

Department of the Treasury

P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

199903038

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Person to Contact:

Telephone Number:

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Date:

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This is in reply to your letter dated May 20, 1998, in which you requested a ruling concerning the qualification of certain interest payments as an expense of administration that is deductible under § 2053(a)(2) of the Internal Revenue Code.

Decedent, a resident of Mississippi, died testate in 1998, survived by four children and several grandchildren. At the time of his death, Decedent owned over 20 percent of the outstanding stock in M Corporation, a closely-held corporation. The value of the M Corporation stock owned by Decedent at his death comprised no less than 80 percent of the value of his gross estate. In addition to the stock owned outright, Decedent was also vested with additional shares of M Corporation stock in that company's Employee Stock Option Ownership Plan, M Corporation stock is publicly traded on the Nasdaq exchange.

Under the terms of Decedent's will, after establishing a trust for the benefit of his grandchildren, funded to the extent of Decedent's available generation-skipping transfer tax exemption, his residuary estate passed in equal shares to his children. Article SEVENTH of Decedent's will confers upon Decedent's executors ". . . all powers enumerated in the Mississippi Uniform Trustees' Powers Law, §§ 91-9-101 through 91-9-119. . ."

Section 91-17-11 of the Mississippi Trusts and Estates laws provides that, "Unless the will otherwise provides and subject to subsection (2) [not applicable here], all expenses incurred in connection with the settlement of a decedent's estate, including . . . interest and penalties concerning taxes . . . shall be charged against the principal of the estate." Miss. Code Ann. § 91-17-11 (1972).

Section 91-9-105 of the Mississippi Uniform Trustees' Powers Law provides that the trustee has all powers conferred upon him by the provisions of this article unless limited in the trust instrument. Any instrument which is not a trust may incorporate any part of this article by reference.

Section 91-9-107 provides that:

> (1) From time of creation of the trust until final distribution of the assets of the trust, a trustee has the power to perform, without court authorization, every act which a prudent man would perform for the purposes of the trust, including but not limited to the powers specified in subsection (3) of this section, and those powers, rights and remedies set forth in section 91-9-9, Mississippi Code of 1972.
>
> (2) In the exercise of his powers, including the powers granted by this article, a trustee has a duty to act with due regard to his obligations as a fiduciary.
>
> (3)
> . . .
> (r) to borrow money to be paid from trust assets or otherwise; . . .

Miss. Code Ann. §§ 91-9-105 and 91-9-107 (1972).

The executors propose to borrow sufficient funds to pay the federal and state estate taxes. The executors will petition the appropriate local court for approval to borrow the necessary funds from a commercial bank. The loan will provide for annual payment of both interest and principal over a specified term of years that does not exceed seven years at a fixed rate of interest. The note will also provide that principal and interest may not be prepaid. In the event of a default, the note will provide that the entire interest that would have been paid under the full term of the note will be accelerated and the total interest will be due and payable at the time of default.

The estate requests a ruling that a deduction may be claimed on a Federal estate tax return for the total amount of interest

that will be paid over the term of the installment loan as an administration expense under § 2053(a)(2).

Section 2001(a) imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

Section 2051 provides that, for purposes of the tax imposed by § 2001, the value of the taxable estate is determined, in part, by deducting from the value of the gross estate the deductions provided for under §§ 2053.

Section 2053(a)(2) allows a deduction from the value of the gross estate for such amounts of administration expenses as are allowable by the laws of the jurisdiction under which the estate is being administered.

Section 2053(c)(1)(D) provides that, for decedents dying after December 31, 1997, no deduction shall be allowed for any interest payable under § 6601 on any unpaid portion of the federal estate tax for the period during which an extension of time for payment of the tax is in effect under § 6166.

Section 20.2053-1(a)(1) of the Estate Tax Regulations provides, in part, that for purposes of § 2053, the term "allowable by the laws of the jurisdiction" means allowable by the law governing the administration of decedents' estates.

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 persons entitled to it. The expenses contemplated are only expenses that attend the settlement of the estate and the transfer of the property of the estate to the individual beneficiaries or to a trustee. 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.

This regulation imposes a separate federal requirement that expenses must be "actually and necessarily" incurred in order to be deductible and, in addition, must satisfy the statutory requirement that the expense be allowable under local law. See Estate of Millikin v. Commissioner, 125 F.3d 339 (6th Cir. 1997).

Section 20.2053-1(b)(3) provides that an item may be entered on a 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. If the amount of the liability was not ascertainable at the time of final audit of the return by the district director and, as a consequence, it was not allowed as a deduction in the audit, and subsequently the amount of the liability is ascertained, relief may be sought by a petition to the Tax Court or a claim for refund as provided by §§ 6213(a) and 6511, respectively.

In Rev. Rul. 84-75, 1984-1 C.B. 193, in order to avoid a forced sale of estate assets, the executor borrowed funds to pay the estate tax. The revenue ruling concludes that because the loan was obtained to avoid a forced sale of estate assets, the loan was reasonably and necessarily incurred in administering the estate. Therefore, interest incurred on the loan is deductible as an expense of administration under § 2053(a)(2). 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. See also, Rev. Rul. 80-250, 1980-2 C.B. 278, holding that interest incurred when payment of tax is deferred under § 6166 (prior to the enactment of § 2053(c)(1)(D)) is deductible only as the interest accrues, since the tax liability could be prepaid at any time.

In Estate of Graegin v. Commissioner, T.C. Memo. 1988-477, the executors of the decedent's estate borrowed funds from the decedent's closely-held corporation to pay the estate's federal estate tax liability. The loan, which had been approved by the appropriate local court, was evidenced by a note bearing interest at 15 percent per year, payable in one single payment of both interest and principal at the end of 15 years. The note prohibited the prepayment of principal or interest. The term of the note was calculated to coincide with the surviving spouse's life expectancy because, at that spouse's death, the funds from her trust, along with the dividends paid over the term of the note, would be available to satisfy the obligation. The decedent's estate deducted the full amount of the single interest payment due on maturity of the note in 15 years as an expense of administration under § 2053(a)(2). The court concluded that the loan was reasonably and necessarily incurred in the administration of the estate. Further, the court concluded that, in view of the terms of the loan (interest and principal due at the 15 year term with prepayment of principal and interest prohibited) the entire amount of the interest on the note was deductible as an administration expense. The court also

concluded that the note was a genuine indebtedness and that, in view of the terms of the note, the amount of the interest to be paid was ascertainable with reasonable certainty and would be paid.

Under § 91-17-11 of the Mississippi Code Annotated, interest expense concerning taxes incurred in the administration of the estate can be a proper estate administration expense.

Accordingly, in view of the terms of the loan, we conclude that a deduction may be claimed on the Form 706 for the entire amount of the post-death interest expense to be incurred by the estate, provided the expense is necessarily incurred in the administration of the estate within the meaning of § 20.2053-3(a) and is allowable under local law. Whether the interest expense will be necessarily incurred in the administration of the estate is a factual determination and we are specifically not ruling on this issue.

This ruling is conditioned on the estate obtaining approval for the proposed transaction from the appropriate local court, as represented.

Except as we have specifically ruled herein, we express no opinion on the federal tax consequences of the transaction under the cited provisions of the Code or under any other provisions of the Code.

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

Sincerely,

Assistant Chief Counsel
(Passthroughs and Special Industries)

By George Masnik
George Masnik
Assistant to the Branch Chief
Branch 4

Enclosure
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