

Internal Revenue Service

Department of the Treasury

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Person to Contact:

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Refer Reply To:

CC:DOM:IT&A:1/PLR-119988-98

Date:

April 26, 1999

Legend

Taxpayer =

Decedent =

State =

Corporation =

Trust =

Date 1 =

Date 2 =

Date 3 =

Property 1 =

Property 2 =

Property 3 =

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Property 4 =

Property 5 =

Property 6 =

Property 7 =

Property 8 =

Property 9 =

Property 10 =

Property 11 =

Property 12 =

Property 13 =

Property 14 =

Property 15 =

Property 16 =

Property 17 =

Property 18 =

Property 19 =

Property 20 =

Property 21 =

Property 22 =

Property 23 =

Property 24 =

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Property 25 =

Property 26 =

Property 27 =

Property 28 =

Property 29 =

Property 30 =

Property 31 =

Property 32 =

Property 33 =

Property 34 =

Dear :

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This letter responds to your submission of October 22, 1998, and supplemental correspondence, dated December 30, 1998, March 9, 1999, March 22, 1999, and April 22, 1999, in which you requested a ruling on behalf of Taxpayer. Specifically, you have requested a ruling that Decedent's interests in certain real estate and in Corporation qualify as interests in a closely held business for purposes of section 6166 of the Internal Revenue Code (Code).

FACTS

The Taxpayer makes the following representations.

In the early 1960s, Decedent began purchasing vacant lots upon which he developed commercial and residential rental properties. On Date 1, Decedent formed Corporation in State in order to assist in the management of the rental properties. On Date 2, Decedent transferred the rental properties, as well as all the stock in Corporation to Trust. Decedent was the sole beneficiary of Trust, a grantor trust for federal tax purposes.

Corporation leases and manages all of the properties owned by Trust. Decedent, an employee of Corporation until the time of his death, was actively involved in the day-to-day operations of Corporation and in the management of the properties. He maintained an office at Corporation and reported there regularly. Corporation employs six individuals on a full-time basis. These employees consist of three leasing agents, one accountant, and two maintenance workers. In addition to the employees of Corporation, Trust employs three individuals on a full-time basis. These employees consist of a general contractor, a painter, and a maintenance worker. The Trust employees provide services to the same properties that are managed by Corporation. Decedent supervised all employees of Corporation and Trust.

At the time of his death, Decedent (a United States citizen and a resident of State) indirectly owned Properties 1 through 34 through Trust. Properties 1 through 30 consist of commercial and residential rental properties. Properties 31 through 34 are undeveloped properties. Most of the properties are located in close proximity to each other. There are 523 commercial and residential units on the properties.

Properties 1 through 34 and the stock of Corporation are includable in Decedent's adjusted gross estate. Decedent's interest in the properties, together with the value of his interest in Corporation, exceeds 35% of his adjusted gross estate.

The employees of Corporation are responsible for managing the properties. Their duties include interviewing and screening prospective tenants; negotiating commercial and residential lease terms; collecting rent; reviewing invoices; preparing required state reports; preparing periodic financial reports detailing results of operations on a property-by-property basis; signing payroll checks; paying taxes and mortgage

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payments; reviewing tenant's insurance coverage for accuracy; obtaining competitive bids on property, and developing advertising campaigns for all forms of media.

In addition to managing the properties, the employees of both Corporation and Trust maintain and service all of the commercial and residential income properties. Maintenance of the properties includes maintaining and repairing the plumbing fixtures and air conditioning units; patching or replacing roofs; seal coating and striping of parking lots; repairing and maintaining interior and exterior walls; fixing flooring; and performing electrical work. Further, the employees maintain the common areas of the properties; provide a 24-hour on-call general contractor and/or emergency maintenance worker for the tenants; landscape the properties; provide trash removal and pest control; patrol for abandoned cars and illegally parked cars; pressure clean the exterior of buildings, awnings, sidewalks and windows; and provide notary services and self-addressed stamped envelopes for rent payments. Services provided to tenants include assisting tenants in opening up their businesses by obtaining for them the necessary licenses, permits, and inspections from governmental authorities; assisting tenants by meeting with appropriate governmental officials, such as building inspectors or the fire marshal; and remodeling the interior of commercial units in order to meet new tenant's specifications.

LAW

Section 6166(a)(1) of the Code 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. If such an election is made, the first installment shall be paid on or before the date selected by the executor which is not more than five years after the date prescribed by section 6151(a) for payment of the tax.

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

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- (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 a partnership had 15 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 15 or fewer shareholders.

Section 6166(b)(2)(A) of the Code provides that the determination under section 6166(b)(1) shall be made as of the time immediately before the decedent's death.

Section 6166(b)(2)(C) of the Code 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 this section, a person shall be treated as a beneficiary of a trust only if such person has a present interest in the trust.

Section 6166(b)(9) of the Code provides in part that for the purposes of section 6166(a)(1) and in determining the closely held business amount (but not for the purpose of section 6166(g)), 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.

Section 6166(c) of the Code provides in part that for purposes of section 6166, 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, holds that rental commercial property, rental farm property, and notes receivable included in decedent's gross estate do not constitute an interest in a closely held business under section 6166 where decedent maintained a fully equipped business office, collected rental payments on the properties, received payments on notes receivable, negotiated leases, made occasional loans, and by contract directed the maintenance of the properties. Under these facts, decedent's relationship to the assets was merely that of an owner managing investment assets to obtain the income ordinarily expected from them.

Rev. Rul. 75-366, 1975-2 C.B. 472, holds that where a decedent paid 40 percent

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of the expenses, received 40 percent of the crops, and actively participated in the important management decisions of a tenant farm included in the decedent's estate, the farm constitutes an interest in a closely held business under section 6166. Under these facts, the decedent made almost daily visits to inspect and discuss operations and occasionally delivered supplies to the tenants.

Rev. Rul. 75-367, 1975-2 C.B. 472, holds that land owned by a decedent that was held for the purpose of building homes, decedent's ownership of stock in a corporation that built homes on such land, and a business office and warehouse owned by the decedent and used by both the corporation and decedent, qualify as an interest in a closely held business under section 6166. However, eight homes built by the decedent's corporation that were sold and later repurchased by the decedent, who collected the rents, made the mortgage payments and made the necessary repairs and maintenance to the homes in order to maintain the condition and appearance of the rental homes, were not an interest in a closely held business because the decedent's relationship to the properties was merely that of an owner managing investment assets to obtain the rents ordinarily expected from them.

ANALYSIS

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 merely by reference to a broad definition of the term for purposes of some other section of the Code, but should reflect the intent of Congress in enacting section 6166. Section 6166 was enacted to permit the deferral of the payment of the federal estate tax where, in order to pay the tax at one time, it would be necessary to sell assets used in a going business and, thereby, disrupt or destroy the business enterprise. This 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. Section 6166 was intended to apply only with respect to a business such as a manufacturing, mercantile, or service enterprise, as distinguished from management of investment assets.

As the above revenue rulings suggest, the level of the activity is the factor that distinguishes a trade or business under section 6166 from merely managing rental property to obtain the rents ordinarily expected from them. In determining the level of activity carried on by a proprietorship, partnership, or corporation, the activities of its agents and employees are taken into account. The activities of persons such as independent contractors or lessees who are neither agents nor employees, on the other hand, are not taken into account.

Corporation

Corporation is engaged in the business of leasing and managing commercial and

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residential rental real estate. In addition to Decedent, Corporation employed six full-time employees who were actively involved in providing management and leasing services. Because 100 percent of Corporation's stock is included in determining Decedent's gross estate, Decedent's interest in Corporation is an interest in a closely held business under section 6166.

Properties 1-30

Decedent's level of activity in connection with Properties 1 through 30 (as assisted by the employees of Corporation and Trust) determines whether the properties are part of a trade or business for purposes of section 6166. As substantiated by extensive documentation, the activities with respect to the properties went substantially beyond the typical activities associated with merely managing investment assets, such as collecting rents, paying taxes, making mortgage payments, and making necessary repairs. Decedent (as assisted by the employees of Corporation and Trust) provided significant services to the tenants of the properties, including assisting tenants in opening up their businesses by obtaining for them the necessary licenses, permits and inspections from governmental authorities; assisting tenants by meeting with appropriate governmental officials, such as building inspectors or the fire marshal; remodeling the interior of commercial units in order to meet new tenant's specifications; providing a 24-hour on-call general contractor and/or emergency maintenance worker; maintaining common areas; and providing trash removal, pest control, and landscaping. These activities constitute a service enterprise producing business income. Accordingly, Decedent's interests in Properties 1 through 30 are interests in a closely held business for purposes of section 6166.

Properties 31-34

Decedent (as assisted by the employees of Corporation and Trust) also engaged in the business of purchasing land and developing commercial and residential rental real estate. All of the income producing properties owned by Decedent at the time of his death were ones he purchased as undeveloped land and later developed into commercial and residential rental properties. Decedent's land development business constitutes a closely held business for purposes of section 6166.

At the time of Decedent's death, Properties 32 and 34 were being used by the tenants of Property 7, and Corporation was actively pursuing rezoning of Property 33 in order to develop the land. Accordingly, Decedent's interest in Properties 32, 33, and 34 are included in determining the closely held business amount for purposes of section 6166.

Property 31 has been leased for advertising purposes since Date 3. At the time of Decedent's death, there were no plans to develop Property 31. Accordingly,

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Decedent's interest in Property 31 is not included in determining the closely held business amount for purposes of section 6166.

Single Closely Held Business

Under section 6166(c), Decedent's interests in Corporation, the service enterprise (including Properties 1 through 30) and the land development business (including Properties 32 through 34) are treated as interests in a single closely held business. This also is consistent with the fact that these interests were treated as a single integrated business enterprise during Decedent's lifetime.

CONCLUSIONS

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

1. Decedent's interest in Properties 1 through 30, 32, 33, 34 and in Corporation are interests in a single closely held business for purposes of section 6166 of the Code. Accordingly, provided the other requirements of section 6166 of the Code are met, the federal estate tax attributable to Decedent's interest in the closely held business may be paid in installments under section 6166.
2. Decedent's interest in Property 31 is not included in determining the closely held business amount for purposes of section 6166(a)(1).

Except as specifically ruled above, no opinion is expressed as to the federal tax treatment of any issue addressed in this ruling under other provisions of the Internal Revenue Code and Regulations that may be applicable.

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

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Pursuant to the power of attorney on file in this office, the original of this letter is being sent to the Taxpayer's authorized representative.

Sincerely,

DAVID B. AUCLAIR
Assistant to the Chief, Branch 1
Office of Assistant Chief Counsel
(Income Tax and Accounting)

Enclosures (2):

Copy of this letter

Copy for section 6110 purposes

cc: