

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

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subject: Issues involving bonds and liens as security for an election to defer payment of estate tax under section 6166.

This memo responds to your questions regarding bonds or liens required to secure the estate tax attributable to a closely held business and payable in installments under section 6166 of the Internal Revenue Code (IRC). Before addressing these questions specifically, we have included a background section to explain the relevant code sections and regulations, recent case law, and the IRS's change in policy. This memo may not be used or cited as precedent.

Issues:

1. Can the required bond or lien amount include accrued interest on the tax?
2. Can the bond or lien amount be compromised?
3. Can the Office of Appeals (Appeals) make valuation determinations with respect to the property upon which the lien will attach? Can Appeals determine whether certain types of property are adequate security for the section 6324A lien?
4. With respect to Issue 3, when Appeals determines the value of property, how should this determination be made? Must Appeals rely upon the value of the asset listed on the Form 706, or can Appeals determine value based upon other factors? For example, if property was valued under section 2032A as farm property, can it be valued as business or residential property for the lien? Or, for example, can the undiscounted

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value of a FLP interest be used for the lien, even though the FLP interest was discounted for Form 706 purposes?

5. Can previously pledged or mortgaged property be used for the section 6324A lien? Is the value to be used the full value or the net equity?

6. When Appeals settles a nondocketed case and determines the taxpayer is entitled to the election, for example by determining the value or type of asset to which the lien will attach, in what format should Appeals issue its determination to the taxpayer and how should it notify the IRS of its determination?

### Conclusions

1. Yes, it can. The bond amount required refers to the amount of the estate tax payable in installments under section 6166. However, because the IRS is authorized to require a bond up to double the amount of tax due, the IRS may request a bond in an amount equal to tax plus interest, so long as the amount of interest does not exceed the amount of tax deferred. The value of the collateral securing the lien may equal the deferred tax and the aggregate amount of interest payable over the first 4 years of the deferral period under section 6166.

2. Yes. The amount of the bond provided by a taxpayer is not required to equal twice the amount of the deferred tax. Similarly, the amount of the collateral securing the lien is not required to equal the deferred tax plus the first 4 years interest. The amount of the bond or the value of the collateral securing the lien should reflect the amount of estate tax payable in installments that is at risk of default. Whether to require a bond or to accept a lien for an amount less than the total amount of the deferred tax plus the first 4 years of interest must be made on a case-by-case basis and based upon all of the facts and circumstances of that particular situation.

3. Yes. Delegation order 66, Treasury Regulation §601.106, and Rev. Proc. 2005-33, 2005-24 I.R.B. 1231, allow Appeals to determine value with respect to the section 6166 lien property proffered as collateral for the special estate tax lien under section 6324A. Appeals may also determine whether certain types of property are adequate security to which the special estate tax lien under section 6324A may attach.

4. The valuation determination made by Appeals should be based on the current fair market value of the section 6166 lien property on the date the section 6324A lien agreement, as defined in section 6324A(c), is signed by all interested parties. The value of the collateral should be based on the property's current and anticipated use and on the interest which the government would have in the property if the lien were foreclosed upon.

5. Yes. The value of the collateral, however, is reduced by all encumbrances on the property.

6. If Appeals settles a nondocketed case and the settlement includes a determination as to the value or adequacy of property, whether Appeals signs an agreement with the taxpayer or simply sends a letter to the taxpayer is a matter of policy to be decided by Appeals. If Appeals decides to issue a form signed by both Appeals and the taxpayer, Appeals will need to create a new form. Form 890 and closing agreements are not adequate for this purpose. The format in which this decision is conveyed to Advisory is also a matter of policy to be decided by Appeals.

### Background

Pursuant to I.R.C. §6166(a)(1), an executor may elect to pay all or a portion of the estate tax attributable to a closely held business in 2 or more (but not exceeding 10) equal annual installments if the value of the decedent's interest in a closely held business exceeds 35 percent of the value of the adjusted gross estate. The amount of estate tax deferred and paid in installments is limited to the portion of the estate tax attributable to the value of the interest in the closely held business. I.R.C. §6166(a)(2). If an election under section 6166(a) is made, the provisions of subtitle F apply as though the Secretary were extending the time for payment of the tax. I.R.C. §6166(d). The Secretary has authority to require a bond, if necessary, in the case of an extension under section 6166. I.R.C. §6166(k)(1). In lieu of the bond, the executor may elect to provide a lien under section 6324A. I.R.C. §§6166(k)(2) and 6324A(a), 6324A(d)(6). The IRS instituted a policy in 2002 that required all estates to provide a bond or a lien when electing to pay the estate tax in installments under section 6166. In Estate of Roski v. Commissioner, 128 T.C. 113 (2007), a taxpayer challenged this policy, and the Tax Court determined that the IRS abused its discretion by requiring a bond as a prerequisite for granting the section 6166 election. On November 13, 2007, the IRS published Notice 2007-90 announcing that it had changed its policy and would begin making case-by-case determinations as to whether an estate will be required to provide a bond if it elects to pay the estate tax in installments under section 6166. Notice 2007-90, 2007-46 I.R.B. 1003. The notice also included a non-exclusive list of factors IRS will consider in determining whether the government's interest in collecting the estate tax is sufficiently at risk to require a bond. Id.

Under section 6324(a), a general federal estate tax lien arises upon the decedent's date of death and attaches for ten years to all assets of the gross estate (except those used to pay certain expenses). This general federal estate tax lien may not be extended beyond the ten-year period following the date of death. As a result, when an estate qualifies and elects under section 6166 to pay estate tax over a period of up to 14 years, the government's interest in the deferred estate tax is secured by the general federal estate tax lien for only the first nine years and three months of the installment payment period. During the final four years and nine months of the 14-year installment payment period, the government's interest is no longer secured by the general estate tax lien. In most cases, approximately one-half of the total deferred estate tax still remains to be paid during that final, unsecured portion of the deferral period.

If the IRS requires a bond under section 6165, the bond must be an acceptable surety bond as defined in section 7101 and Treasury Regulation §301.7101-1. In lieu of providing a bond, the executor may elect to provide a special estate tax lien under section 6324A. If the executor makes this election, the executor is no longer personally liable for payment of the estate tax and will not be required to provide a bond, unless the value of property initially pledged for the special estate tax lien under section 6324A is less than the aggregate value of the deferred tax plus the first 4 years of interest during the deferral period. I.R.C. §§2204, 6324A(d)(6), and 6324A(b)(3). The executor elects what property will be provided as the section 6166 lien property to secure the special estate tax lien under section 6324A. The IRS must accept the section 6166 lien property proffered unless it does not meet the statutory definition of section 6166 lien property. Section 6166 lien property is defined as interests in real or other property to the extent such interests can be expected to survive the deferral period and are designated in the type of agreement described in section 6324A(c). I.R.C. §6324A(b)(1). The section 6166 lien property does not have to be property of the estate, but rather, can be any property as long as all parties having an interest in the property sign the section 6324A(c) agreement. Treas. Reg. §20.6324A-1(b). If the property subject to the lien, however, is property of the estate, the section 6324 estate tax lien with respect to that property is extinguished by the special estate tax lien under section 6324A. I.R.C. §6324A(d)(4). During the deferral period if the value of the section 6166 lien property decreases below the unpaid portion of the deferred amount and the required interest amount, the IRS may require additional property to secure the lien. I.R.C. §6324A(d)(5). If the additional property is not proffered within 90 days of notice and demand, the IRS may terminate the section 6166 election. Id.

When the IRS preliminarily terminates a section 6166 election because the estate refuses to provide adequate security, the taxpayer is able to appeal the determination. Rev. Proc. 2005-33, 2005-24 I.R.B. 1231. Appeals must make a final determination as to whether the election should in fact be terminated. This determination is separate from any deficiency proceeding. If Appeals determines the election should be terminated, Appeals issues Letter 3570, Notice of Final Determination as Provided in IRC §7479 That Extension of Time for Payment under IRC §6166 Has Ceased to Apply, to the taxpayer, attaching a detailed explanation of why the election was terminated. Letter 3570 grants the taxpayer the right to petition Tax Court under section 7479 for a declaratory judgment as to whether the election should continue to apply. To support the IRS's litigation position, Appeals must carefully detail, in writing, the basis for the termination and include in the administrative file a copy of all information used in making its determination.

### Discussion and Analysis

## 1. Can the required bond or lien amount include accrued interest on the tax?

### Section 6165 Surety Bond

Section 6165 states that in the event the Secretary grants an extension of time to pay tax, “the Secretary may require the taxpayer to furnish a bond in such amount (not exceeding double the amount with respect to which the extension is granted) conditioned upon the payment of the amount extended in accordance with the terms of such extension.” Treas. Reg. §1.6165-1 further provides that the IRS, as a condition of the granting of an extension of time within which to pay any tax, may require the taxpayer to furnish a bond in an amount not exceeding double the amount of the tax with respect to which the extension is granted.

Section 6165 is silent as to whether the term “tax” includes the interest on the deferred amount under section 6166. Section 250(f) of the Revenue Act of 1921 is a predecessor to current section 6165. Regulation 62, article 1014 of section 250(f) of the Revenue Act of 1921, discusses the procedures for requesting an extension of time to pay tax when payment would cause undue hardship to the taxpayer. The regulation states that when an application is tentatively approved and a bond is required, the bond, “shall be conditioned for the payment of the deficiency and applicable penalties, if any, and interest in accordance with the terms of the extension to be granted...” Thus, the regulations previously allowed the bond amount to include the liability, penalties, and interest. When the statute was later amended, the language was changed to allow for the bond amount to be up to double the amount extended.

To make a valid election to pay the estate tax in installments under section 6166, the taxpayer must attach a notice of election to a timely filed tax return. I.R.C. §6166(d) and Treas. Reg. §20.6166-1(b). If the statutory requirements under section 6166 are met, the estate automatically qualifies for the deferral. Under Treas. Reg. §20.6166-1(b)(2), the estate must list on its notice of election the amount of tax that is to be paid in installments. When the taxpayer makes the section 6166 election, the provisions of subtitle F apply as though the Secretary were extending the time for payment of the tax. I.R.C. §6166(d). Under section 6166, the amount with respect to which an extension is being granted is the amount of estate tax listed in the notice of election. Thus, the IRS may request a bond in an amount not exceeding twice the amount of estate tax listed in the notice of election. So long as the interest that would accrue during the first four years of the deferral period does not exceed the total tax liability payable in installments, the IRS may require that the amount of the bond also include interest.

### Section 6324A Special Estate Tax Lien

Section 6324A(a) states that if the executor elects and files the requisite lien agreement, the deferred amount plus any interest, additional amount, addition to tax, assessable penalty, and costs attributable to the deferred amount shall be a lien in favor of the United States on the section 6166 lien property. Section 6324A(b)(1) defines section 6166 lien property as any interests in real and other property to the extent the interests

will survive the deferral period and are designated in the lien agreement defined in section 6324A(c). Section 6324A(b)(2) states that the IRS may not require section 6166 lien property in excess of the deferred amount and the required interest amount, but the parties to the agreement may voluntarily designate property having a fair market value in excess of such amount. Treas. Reg. §301.6324A-1(a)(2). The required interest amount is defined as the aggregate amount of interest which will be payable over the first 4 years of the deferral period with respect to the deferred amount. IRC §6324A(e)(2). Thus, the IRS may require that the value of the collateral securing the lien equal the deferred tax plus the interest payable over the first 4 years of the deferral period.

## 2. Can the Bond or Lien Amount be Compromised?

### Impact of case law and legislative history

Section 6166(k)(1) makes a cross-reference to section 6165, which states that the IRS “may” require the taxpayer to furnish a bond if the IRS grants an extension of time to pay. Section 6166(k)(2) makes a cross-reference to section 6324A to allow a lien in lieu of the bond. The use of the term “may” in section 6165 in conjunction with the fact that security is not a requirement for making the election under section 6166 means that the IRS must use its discretion in determining whether an estate must provide a bond to continue to pay the tax in installments under section 6166. Estate of Roski at 128. Because the IRS must use its discretion in requiring security when an estate elects to pay the estate tax in installments under section 6166, it follows that the IRS must use its discretion in determining whether twice the amount of the liability, the entire liability plus 4 years interest, or a lesser amount should be secured.

### Section 6165 Surety Bond

Section 6165 uses the term “not exceeding” when it discusses the amount that may be required as a bond to secure payment of the extended tax liability. The plain meaning of this term indicates that the Service may request a bond in an amount up to twice the amount of tax extended, but it may accept less. Because the statute contains a maximum amount, the Service may compromise the amount to the extent it believes the government’s interest in collecting the estate tax to be paid in installments is not at risk to require a bond for the full amount of the deferred estate tax liability.

### Section 6324A Special Estate Tax Lien

Under section 6324A(a), if the executor makes the election and files a lien agreement, a lien arises in the amount of the deferred amount plus any interest, additional amount, addition to tax, assessable penalty, and costs attributable to the deferred amount. Although a lien arises for the full amount deferred plus interest, to the extent Appeals believes the government’s interest in collecting the deferred tax is secure, the IRS may accept collateral valued at less than the deferred amount plus any interest. There may be instances where factors listed in Notice 2007-90 indicate that the government’s

collection of a portion of the deferred estate tax is sufficiently at risk to require a bond. For example, a portion of the estate's assets could consist of cash reserves or U.S. bonds, but the amount of those assets is less than the amount of the deferred estate tax. Appeals could determine that to the extent the estate has cash reserves or U.S. bonds, and there is no reason to believe such assets will be dissipated, security will not be required. Thus, Appeals could require section 6166 lien property with a fair market value of less than the aggregate of the deferred tax and the first 4 years of interest. This being said, if after evaluating the factors in Notice 2007-90 Appeals determines the government's interest in collecting the tax is sufficiently at risk to require security, Appeals must obtain either a bond or a lien as provided under sections 6165 and 6324A and the regulations thereunder. Accepting an alternative form of security that is not provided for under the code, such as a personal guarantee, would frustrate Congress's intent.

3. Can Appeals make valuation determinations with respect to the property upon which the lien will attach? Can Appeals determine whether certain types of property are adequate security for the section 6324A lien?

Under section 6324A, the executor elects to grant the government a section 6324A lien on property by submitting a section 6324A(c) agreement that pledges acceptable section 6166 property to secure the deferred estate tax payable in installments under section 6166. Delegation order 66 and Treas. Reg. §601.106(a)(ii)(a) grant Appeals the authority to make determinations with respect to section 6166 cases, which includes determining the value of property and whether collateral is adequate. In addition, Rev. Proc. 2005-33, 2005-24 I.R.B. 1231, provides that a taxpayer may Appeal the IRS's preliminary determination that an estate ceases to qualify to pay the estate tax in installments under section 6166.

Appeals may also make a determination as to whether certain types of property are adequate security for the special estate tax lien under section 6324A. In making this determination, Appeals must consider the statutory definition of section 6166 lien property. Under section 6324A(b)(1), "section 6166 lien property" means interests in real and other property to the extent such interests can be expected to survive the deferral period and are designated in the agreement referred to in the lien agreement defined in section 6324A(c). The deferral period is the period for which the payment of tax is deferred pursuant to the election under section 6166, or in the case of a deficiency, the deferral period is determined as of the due date of the first installment after the deficiency is prorated to installments under section 6166. Treas. Reg. §20.6324A-1(e)(3) and (4). We note that the IRS has the statutory right to monitor the value of the section 6166 lien property and the creditworthiness of the estate throughout the deferral period. Whether property may be expected to survive the deferral period is based on all facts and circumstances and made on a case-by-case basis. For example, a decrease in the value of corporate stock may be an indication that the company may not survive the deferral period, but that factor alone, does not automatically mean that the company will not survive. In addition, property encumbered by liens may not be expected to survive the deferral period if there is little equity in the property.

Should Appeals determine that the property proffered by the executor is inadequate section 6166 lien property, Appeals may negotiate with the estate to secure acceptable section 6166 lien property. The property designated as section 6166 lien property is not required to be property included in the estate of the decedent and may, in fact, be property of another person, so long as each person having an interest in the property is a party to the section 6324A(c) lien agreement. Treas. Reg. §20.6324A-1(b)(1).

4. With respect to Issue 3, when Appeals determines the value of property, how should this determination be made? Must Appeals rely upon the value of the asset listed on the Form 706, or can Appeals determine value based upon other factors? For example, if property was valued under section 2032A as farm property, can it be valued as business or residential property for the lien? Or, for example, can the undiscounted value of a FLP interest be used for the lien, even though the FLP interest was discounted for Form 706 purposes?

#### Date to use in valuation

The value of the section 6166 lien property shall be determined as of the date payment of the estate tax was due, excluding extensions, and shall take into account any encumbrances. IRC §§6324A(b)(2) and 6151(c). Section 6324A(d)(5) states that additional lien property may be required at any time the value of the section 6166 lien property is less than the unpaid portion of the deferred amount and the required interest amount. The IRS must send notice and demand for additional property, and if it is not received within 90 days, the IRS can terminate the section 6166 election. IRC §6324A(d)(5). Although the code requires the IRS use the fair market value of the property on the date the estate tax was due for purposes of determining whether the collateral is adequate to secure the deferred tax, if the value has declined to the point where the IRS is under-secured, Appeals can require additional property to adequately secure the lien under section 6324A(d)(5). If the taxpayer then refuses to voluntarily provide additional section 6166 lien property, Appeals or the IRS must send notice and demand for additional section 6166 lien property, and then terminate the election if additional property is not received within 90 days.

#### Factors to consider in valuation

Appeals should consider all facts and circumstances affecting the fair market value, including the current and anticipated future use of the property and the value of the interest the government would obtain if the government were to foreclose upon the property. IRM §4.48 provides guidelines for valuing businesses, artwork, real property, tangible personal property, and intangible personal property. In addition, Revenue Ruling 59-60, 159-1C.B. 237, provides guidance on valuing the stock of closely held corporations. These same methods should be applied in determining the value of the section 6166 lien property. Any preexisting liens on the property would also impact its value. The value is not necessarily based on the amount reported on the Form 706 for a number of reasons: a significant amount of time may have passed between the date

of death, which is the value reported on Form 706, and the date the section 6324A lien will attach; the value of the property may differ because the lien could attach only to a portion of the property; the use of the property may have changed between the date of decedent's death and the date the special estate tax lien under section 6324A will attach; and heirs may pledge property as collateral for the special estate tax lien under section 6324A that was not included in the decedent's estate. If property is being used as farmland under a section 2032A election, then the value should reflect that use. Similarly, if a FLP interest was discounted on the Form 706, the same discounts may apply to the interest given as collateral. For instance, if the estate pledges a 10% interest in a FLP with transferability restrictions, then the value for purposes of the lien should include minority and lack of marketability discounts as well.

5. Can previously pledged or mortgaged property be used for the section 6324A lien? Is the value to be used the full value or the net equity?

Previously pledged or mortgaged property may be used as section 6166 lien property. When determining the value of the property, however, any encumbrances, such as a mortgage or a lien, are taken into account. Treas. Reg. 20.6324A-1(b)(2). Thus, the equity in the section 6166 lien property must equal the unpaid portion of the deferred tax and the required interest amount or, if less, the amount of security required by Appeals.

6. When Appeals settles a nondocketed case and determines the taxpayer is entitled to the election, for example by determining the value or type of asset to which the lien will attach, in what format should Appeals issue its determination to the taxpayer and how should it notify the IRS of its determination?

This is not a legal issue. When Appeals settles a case, whether it decides to sign an agreement with the taxpayer or to contact Advisory with instructions regarding the bond or lien is a business decision. If Appeals and the taxpayer reach an agreement as to the value or type of asset to which the lien will attach, Appeals could simply require the taxpayer submit a revised Form 13925, or a Lien Agreement, with the information required under section 6324A(c) and Treas. Reg. §301.6324A-1(b). Appeals could then submit the Lien Agreement to Advisory to file the section 6324A lien. Appeals could also create a form letter to send to taxpayer, with a copy to Advisory, advising them of the decision agreed upon by both parties.

If the taxpayer insists upon an agreement signed by both the taxpayer and the IRS, Appeals will need to create a new form. Forms 890, 890-AD, 870 or 870-AD should not be used to close an agreed section 6166 determination case because these forms may only be used when a deficiency is determined. Determining whether a taxpayer is entitled to pay the estate tax in installments under section 6166 is not a deficiency case, and these determinations should be handled separately from a deficiency case for the same estate. Form 12257 is used by Appeals when a taxpayer agrees with Appeal's determination in a collection due process case, which is similar to a section 6166 case because there is no deficiency. Appeals could create a form similar to Form 12257 to use in settled section 6166 cases. Thus, if a case is agreed, Appeals could either have

the taxpayer submit a revised Form 13925 or Lien Agreement or create a form to execute with the taxpayer that is forwarded to Advisory to secure the bond or lien.

If Appeals determines an estate's election under section 6166 should be terminated, Appeals must issue Letter 3570. This letter is issued regardless of whether a statutory notice of deficiency is issued in the deficiency case. Section 8.7.4 generally, and in particular section 8.7.4.2.9, of the IRM will need to be revised to provide procedures for section 6166 determination cases.

If you have any further questions, please contact Laura Daly at (202) 622-3600.

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