



Congress created section 6166 of the Internal Revenue Code to allow estates to pay the federal estate tax in installments. This benefit is available only to estates that own an interest in a closely held business. Congressional intent was to preserve the family business. Absent Code § 6166, an estate might be forced to sell the closely held family business to pay estate taxes. A key element of Code § 6166 is security. How does the IRS protect its interest in the unpaid deferred estate tax? Security under Code § 6166 has not been handled consistently by the IRS. In November

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Background and History of Code § 6166

Under Code § 6166(a), an estate may elect to pay estate tax attributable to a

by requiring a bond or special lien as a condition precedent to qualification under Code § 6166, and that Congress intended that the IRS review the facts and circumstances of each case before making its determination.

IRS Notice 2007-90

On November 13, 2007, the IRS issued Notice 2007-90 ("Notice") in response to the *Roski* decision. The Notice states that the IRS will determine on a case-by-case basis whether it will require security when an estate elects to pay estate tax in installments under Code § 6166 and provides interim guidance

The IRS's Section 6166 Security Dance

IRS Notice 2007-90 and Security for Deferred Payment of Estate Taxes Under Code § 6166

By Jessica A. Cohan and William S. Forsberg

2007 the IRS published Notice 2007-90 as interim guidance for estates electing to pay estate taxes over time under Code § 6166 and requested comments. The Business Planning Group of the Real Property, Trust and Estate Law Section (RPTE) of the American Bar Association formed a task force ("Task Force") to submit comments to the IRS. The Task Force was chaired by the co-author of this article, William S. Forsberg (vice-chair of the Business Planning Group). The principal author of the comments and the co-author of this article was Jessica

decedent's interest in a closely held business in up to 10 equal, annual installments. The first payment must be made no later than five years after the due date of the federal estate tax return. An estate qualifies to make the election if the value of the decedent's interest in the closely held business exceeds 35% of the decedent's adjusted gross estate and the decedent was a citizen or resident of the United States. The IRS has the right to require an estate to furnish a bond as security. If it does, an estate may elect to instead provide a special lien on estate property with a value equal to the deferred estate tax plus interest for four years ("the required interest amount").

The *Roski* Decision

On April 12, 2007, the Tax Court decided *Estate of Roski v. Commissioner*, 128 T.C. 113 (2007). The Tax Court held that the IRS abused its discretion

on the factors the IRS will consider in determining whether to require a bond or special lien from an estate. The Notice also requested comments from interested persons.

IRS CCA 200747019

On November 23, 2007, the IRS released CCA 200747019. The CCA states that, if the requirements under Code § 6324A are met, the collateral (including an interest in a closely held business) proffered by the estate must be accepted by the IRS.

IRS Internal Legal Memorandum 200803016

Finally, on January 18, 2008, the IRS issued Internal Legal Memorandum 200803016, which said that if the statutory requirements under Code § 6324A are met, then the IRS must accept the estate's interest in a limited liability company as collateral.

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Task Force Comments and Recommendations

General Comments Regarding Notice 2007-90 and the *Roski* Opinion

The administrative issue presented by the *Roski* decision involves the proper exercise of the IRS's discretion in determining whether a bond will be required to secure payment of the deferred estate tax under Code § 6166 that is not "arbitrary, capricious, or unreasonable" as held by the *Roski* court. The Tax Court took notice of the legislative history and congressional intent behind Code § 6166.

Congress was concerned that "[i]n many cases, the executor is forced to sell a decedent's interest in a farm or

Under Code § 6324(a), a general estate tax lien arises on the decedent's death and attaches to all assets of the gross estate for a period of 10 years.

other closely held business in order to pay the estate tax." H. Rep. No. 94-1380, *supra*, at 30, 1976-3 C.B. (Vol. 3) at 764.

The Task Force acknowledged the challenge to the IRS to improve collection while balancing congressional intent. The Task Force, however, believed that the Notice failed to consider some key policies underlying Code § 6166.

General Comments Regarding CCA 200747019 and Collateral for the Code § 6324A Lien

To qualify as collateral for a lien under Code § 6324A, the collateral must be expected to survive the deferral period, the collateral must be identified in an agreement, and the value of the

collateral must be sufficient to pay the estate tax liability plus the required interest amount. The Task Force agreed with the CCA statement that the IRS has no authority to reject collateral proffered by an estate on the grounds that it would be burdensome for the IRS to make the economic or business calculations to determine the collateral's value or because the IRS would prefer other collateral, as long as the above three requirements are met. Anecdotal evidence, however, indicates that this is not the practice always followed by the IRS.

Legislative Solution by Amending Code §§ 6324, 6324A, and 6325

Amend Code § 6324 to extend the term of the general estate tax lien for estate tax deferrals under Code § 6166. Under Code § 6324(a), a general estate tax lien arises on the decedent's death and attaches to all assets of the gross estate for a period of 10 years. This 10-year period may not be extended. As such, when an estate files its federal estate tax return (generally nine months after the death of the decedent) and elects to pay the estate tax in installments under Code § 6166, the IRS's interest in the deferred estate tax is secured by the general estate tax lien for only the first nine years and three months of the installment payment period. Rather than promulgating regulations pertaining to bonds or special liens, the Task Force recommended that a better solution was for the U.S. Treasury Department ("Treasury") to seek legislative relief from Congress in the form of an amendment to Code § 6324(a) that would extend the general estate tax lien for estates electing to pay the estate tax in installments under Code § 6166 for the duration of the installment payment period. The Notice appears to indicate that the IRS believes its interest is adequately secured by the general estate tax lien for the first nine years and three months of the installment payment period but is concerned with securing its interest until the deferred estate tax is paid in full. Further, the general estate tax lien under Code § 6324(a) is

easier for the IRS to enforce than the special lien under Code § 6324A, both administratively and in terms of its strength as a lien. Extending the general estate tax lien for estates electing to pay the estate tax in installments for the duration of the installment payment period would provide the IRS with the security it desires and help to alleviate the burden of devoting resources to balance the risk of collection, without imposing an undue burden on the estate or the closely held business.

Amend Code § 6325 to provide more flexibility regarding release, subordination, and substitution of collateral for the estate tax liens.

Under Code § 6325, the IRS has little flexibility to accommodate business financing through the release and subordination of liens or through the substitution of collateral security. The Task Force recommended that Code § 6325 be amended to provide greater flexibility for the IRS to facilitate business financing.

General Policy to Delay the Bond Requirement Decision to Secure Deferred Tax Payment After Expiration of the Existing Code § 6324 General Lien

Because the IRS's interest in the deferred estate tax is adequately secured by the general estate tax lien, as an alternative to seeking legislative relief the Task Force recommended that the Treasury issue regulations for the IRS to implement a procedure whereby the IRS agrees that a bond or special lien from an estate would ordinarily not be required until, at the earliest, a reasonable period before the expiration of the general estate tax lien. The Task Force recommended that in conjunction with the annual notice in the eighth or ninth year of the installment period (before the expiration of the general estate tax lien), the IRS evaluate whether a bond or special lien should be required for each estate on a case-by-case basis. The Task Force did not think the new procedure should apply in all cases. The IRS should retain the authority to require a bond, during the initial

deferral period when the Code § 6324(a) general lien is in place, to allow for special cases, but these cases should be exceptional.

Comments to the Questions Posed by the Notice

The Task Force thought that the solutions offered above best balance the IRS's interest in collecting the estate tax with Congress's intent of alleviating the liquidity problems experienced by estates in which a substantial portion of the assets consist of a closely held business. Should the Treasury decide to go forward, however, with issuing regulations as indicated in the Notice, the Task Force offered comments in response to the questions posed in the Notice. Below are the specific questions posed by the Notice and the Task Force's comments.

What factors, in addition to or in place of those stated in the Notice, should the IRS use in determining whether to require a bond or special lien from an estate electing to pay the estate tax in installments? The three factors provided in the Notice (duration and stability of the business, ability to timely pay the installments of tax and interest, and compliance history) all focus on the credit risk to the IRS. Consistent with the purpose behind Code § 6166, the Task Force recommended that the factors provided in the Notice should be balanced against factors that focus on the burden of the bond or special lien on the estate and business. These factors include the commercial availability of a bond, the effect of the lien on the existing terms of the business's financing, the effect of the lien on the availability of future financing opportunities for the business, the effect on distributions from the business, and the nature and number of potential beneficiaries required to be signatories to the Code § 6324A agreement. This list is not intended to be exhaustive but merely illustrative.

- *Whether the estate controls the business.* In addition, whether the estate controls the business or not is a relevant factor for consideration. To the extent that the

estate holds a controlling interest, it has the ability, and the incentive, to manage the business and distributions in a manner that will facilitate the payment of the tax deferred under Code § 6166. Furthermore, if the estate has control, it has the ability to participate in negotiations with other lenders on the estate's estate tax liability and the business's financing requirements. If the estate does not control the business, the liquidity concerns that Code § 6166 was intended to alleviate may be even greater for the estate and make the balancing analysis more difficult. If the estate is a significant enough owner of the business that other lenders required the guaranty of the decedent for business borrowing, the estate likely will be required to provide a similar guaranty to maintain the business financing. The imposition of a bond or lien in those circumstances may force the sale of the business interest, contrary to Congress's intent in enacting Code § 6166.

- *Executor's potential personal liability for deferred estate tax.* The executor's potential personal liability for payment of deferred estate tax under Code § 6166 also should be a factor for consideration. As a general matter, the executor may be *personally* liable for payment of deferred estate taxes. Such personal liability is discharged only on the posting of a bond or when a Code § 6324A lien is provided. See Treas. Reg. §§ 20.2204-1(b), 20.2204-3; I.R.M. 5.5.8.5.4.E. As long as the executor has potential personal liability, the Task Force believes that the executor is in the best position to determine whether it is in the best

interest of the executor, the estate, and its beneficiaries to provide a Code § 6324A lien or to continue with the Code § 6324 general lien. The executor is likely to refuse to make distributions from the estate unless the executor has confidence that sufficient assets and liquidity will be available to make deferred estate tax principal and interest payments.



If the executor does not have that confidence, then it is likely that the estate will voluntarily elect to provide a Code § 6324A lien, even without the IRS's demand for a bond under Code § 6165, to enable the estate to make distributions to its beneficiaries. Even if such distributions are made, the beneficiaries would continue to be jointly and severally liable for any deficiency as transferees. See Code § 6901.

- *Elections reducing the Code § 6166 payment deferral period to less than 15 years.* If the estate makes an election under Code § 6166(b)(7) (regarding certain nonreadily tradable stock or partnership interests), Code § 6166(b)(8) (a "Holding Company" election),

or Code § 6166(b)(10)(A) (“Lending or Financing Company” election), the five-year interest only deferral of Code § 6166(a)(3) is not available and the first principal payment is due on the normal estate tax payment date nine months following the decedent’s death. The deferred estate tax must be paid within nine years of the initial payment date of the Code § 6166(b)(7) and (8) elections, and within four years of the initial payment date of the Code § 6166(b)(10) election. Consequently, the Task Force recommended that there should be an *absolute policy* of not requiring a bond or Code § 6324A lien when such elections are made because the due date for all payments is within the period of the Code § 6324 general lien.

How often during the installment payment period (or on what occurrences) should the IRS reevaluate whether the estate poses a sufficient credit risk to justify the requirement of a bond or special lien? Consistent with the Task Force’s recommendations regarding the general estate tax lien above, the Task Force suggested that the IRS should not reevaluate whether the estate poses a sufficient credit risk to justify the requirement of a bond or special lien until the earlier of default, one year before the expiration of the general estate tax lien, or the reporting of an adverse event on the annual Code § 6166 notification.

What facts evident from a review of the estate tax return are likely to be reasonably accurate predictors of either a future default or full payment of the deferred tax payments and interest? To the extent that an estate tax return contains an appraisal in accordance with Rev. Rul. 59-60, the Task Force thought that the opinion of the expert on the continued viability of the business is the most reasonably accurate predictor of either a future default or full payment of the deferred tax payments and interest. If

an estate is audited, the IRS’s estate tax attorney immediately becomes privy to company information and financial data that should allow the IRS to make a preliminary evaluation of the business’s financial stability, cash flow, and tax compliance history, as well as its ability to make the required tax installment payments. An analysis of an estate’s undistributed income also may be a reasonably accurate predictor of either a future default or payment in full.

What additional financial information should the IRS require from an estate to assist in making the determination of whether the estate poses a sufficient credit risk to justify

An analysis of an estate’s undistributed income may be a reasonably accurate predictor of either a future default or payment in full.

the requirement of a bond or special lien? The IRS already has a procedure in place for each installment payment date before each anniversary of the regular estate tax due date requiring the executor to certify that the estate tax has not been accelerated because of dispositions or distributions under Code § 6166(g).

- *Annual certification of nondefault of other financing.* In conjunction with this certification, the IRS could require the executor to certify that the estate has not been notified that any business lender (whether senior or subordinated to the Code § 6324 or § 6324A liens) has notified the business of a default on any existing financing arrangements, nor has any lender declared a

default on any loan to the estate. Any such default would justify a reevaluation of the appropriateness of a bond, lien, or other security arrangement for the deferred estate tax.

- *Providing income tax/information returns for the estate and business.* The IRS could also require the executor to include a copy of the estate’s most recently filed fiduciary income tax return and the business’s most recently filed income tax return. Any requirements for business records need to be flexible to account for situations in which the executor does not have access to all of the business’s records. This might be the case if the estate is a minority owner of the business.
- *Additional Code § 6166(g)(2) payments.* Code § 6166(g)(2) obligates the estate to make additional principal payments on the deferred estate tax equal to the estate’s undistributed income by the extended due date for the estate’s income tax return for any taxable year ending on or after the date for the first principal installment payment. Undistributed net income is essentially the estate’s distributable net income (defined by Code § 643(a)) less (1) the deductions for distributions under Code § 661(a), (2) the federal income tax imposed on the estate, and (3) Code § 6166 federal principal and interest payments (but not equivalent deferred state estate tax payments and interest). The Task Force was not aware of any procedure in place within the Code § 6166 administrative structure to determine whether such additional payments are being made. Requiring a copy of the estate’s fiduciary income tax return in conjunction with the annual certification would provide such a mechanism. Having undistributed income that results in additional payments should be strong evidence that no bond or

lien should be required for an estate. A similar analysis would also be appropriate at the time of the estate tax examination (even if Code § 6166(g)(2) does not apply at that time) as one factor to consider is whether a bond or lien should be required.

Should the IRS define a surety bond to also include other forms of security, and, if so, what other forms should be included? The Task Force believed that the IRS should define a surety bond to include other forms of security. The other forms should include letters of credit from reputable financial institutions and personal guarantees from credit-worthy ultimate beneficiaries of an estate. These alternative forms of security should not be substitutes for the surety bond that may be mandated by the IRS, but instead should be alternatives that are available to the taxpayer at its election.

Comments Regarding the Application of Code § 6325 Regarding Releases and Subordination of Code §§ 6324 and 6324A Liens

Applicability of Code § 6325 Security Subordination and Substitution to Initial Determination Regarding Bond or Code § 6324A Lien. The application of Code § 6325 and the exercise of the IRS's discretion regarding the subordination or substitution of security when a Code § 6324A lien is required was, in the Task Force's judgment, a relevant factor in the reasonable exercise of the IRS's initial discretion. The IRS's practical decision to require a Code § 6324A lien will potentially affect the estate and business for up to 15 years. Code § 6325(d) and Treas. Reg. § 301.6325-1(d)(2) provide the IRS with discretion to accept or reject a request by an estate to subordinate the Code § 6324 or § 6324A liens that will often be required to facilitate reasonable business financing. Even that discretion is limited by those provisions to circumstances in which the district

director "believes that the subordination of the lien will ultimately result in an increase in the amount realized . . . from the property subject to the lien and will ultimately facilitate the ultimate collection of the tax liability." See Treas. Reg. § 301.6325-1(d)(2)(i); see also Treas. Reg. § 301.6325-1(d)(2)(ii), ex. (1)–(3). In addition, Code §§ 6325 and 6324A and the existing regulations do not appear to provide any opportunity to the estate to substitute security initially given in a Code § 6324A lien agreement. Consequently,



the factors that the IRS must weigh to reasonably exercise its discretion must anticipate the potential burden of requiring a bond/Code § 6324A lien over an extended period of time. Furthermore, unless other provisions permit a substitution of collateral for lien property, the IRS must assume that such a decision is irrevocable. Finally, the IRS also must assume that subordination of a previously granted Code § 6324A lien is not in any way assured. Therefore, the inflexibility imposed by Code § 6325 would strongly suggest not requiring a Code § 6324A lien other than in select cases.

Consistency of lien procedures for Code §§ 6324A and 6324B (for Code § 2032A Special Use Valuation).

Under Code § 6325(d)(1)–(2), the IRS may issue a certificate of subordination for a special lien arising under Code § 6324A, if the estate pays over to the government an amount equal to the amount of the lien or interest subordinated or if the IRS believes that the amount the government will collect will ultimately be increased by reason of the issuance of a certificate and that the ultimate collection of the tax liability will be facilitated by the subordination. The Task Force recommended that Code § 6325(d)(3) be amended to permit the IRS to issue a certificate of subordination for a special lien arising under Code § 6324A, if the IRS determines that the government's interest will continue to be adequately secured after the subordination. This change will result in consistent standards for subordination of the special liens under Code §§ 6324A and 6324B.

Conclusion

The *Roski* decision forced the IRS to address the issue of security under Code § 6166 for the payment of deferred estate taxes. The congressional intent of Code § 6166 was to preserve the closely held family business. To that end the IRS must carry a two-edged sword. On one hand, it must assure that estate tax is collected. On the other hand, it must adhere to congressional intent by assuming some level of collection risk so that its policies do not force the liquidation of a closely held business. We will have to await the IRS's response to the recommendations of the Task Force to see what requirements and level of scrutiny will be imposed on the taxpayer. The ABA RPTE Task Force also submitted its comments to Congress for possible action because it believed that extending the general estate tax lien under Code § 6166(a) over the entire period of estate tax deferral is the simplest and most equitable solution to the problems and concerns raised by the IRS in Notice 2007-90. ■