

#### 4.25.2.1.6 (09-11-2009)

### Estate Installment Privileges under IRC Section 6166

1. The maximum amount of tax that can be deferred under IRC section 6166 is determined by the following formula:

$$\frac{\text{Value of closely held business}}{\text{Amount of Adjusted Gross Estate}} \times \text{Tax Due} = \text{Amount Deferrable}$$

2. The criteria for qualifying for installment payments are:
  - A. Decedent was a citizen or resident of the United States on the date of death.
  - B. The Value of interest in closely held business must exceed 35% of the adjusted gross estate.
  - C. A timely filed return including a timely IRC section 6166 election request was filed.
3. An interest in closely held business is defined as:
  - A. A proprietorship that carries on a trade or business.
  - B. An interest in a partnership that carries on a trade or business. Deceased partner's interest must be 20% or more of the total capital interest in the partnership or the partnership has 45 or fewer partners.
  - C. Stock in a corporation carrying on a trade or business if 20% or more of the value of voting stock of the corporation is included in the gross estate, or the corporation has 45 or fewer shareholders.

#### **Note:**

Indirect Ownership: Ownership of stock by the spouse or family members may be considered to meet the required percentage. IRC section 6166(b)(2)(B)(i) and (ii) provide the attribution rules for the spouse and IRC section 6166(b)(2)(D) provides the attribution rules for family members.

4. If the decedent owns two businesses that independently qualify for the IRC section 6166 election, the estate may elect to bifurcate the installment payments. Bifurcation allows the taxpayer to pay taxes attributable to each closely held business over the longest installment period available for that particular business. To receive this treatment, the executor must make a separate election for each business.
5. IRC section 6166(c) applies if the decedent owns two or more businesses that do not independently qualify to make a section 6166 election. Section 6166(c) provides that interest in two or more closely held businesses shall be treated as an interest in a single closely held business.
6. Deferral is not available for passive assets. See IRC section 6166(b)(9). IRC 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. See Rev. Rul. 2006-34; 2006 IRB LEXIS 379; 2006-26 I.R.B. 1171 (2006) concerning the

ownership of rental property and the level of owner's activity. See PLR 200518047, PLR 200521014, PLR 200842012 and PLR 200845023 regarding the Service's more recent view of the level of activity needed to make rental property an active trade or business.

7. In order for stock in a holding company to qualify for installments the security cannot be traded on a stock exchange or over-the counter market. The corporation owned by the holding company must carry on a trade or business. Generally only five (5) installments of tax, rather than the usual ten (10), will be allowed. See IRC section 6166(b)(8)(B)
8. IRC section 6166(b)(8)(A) provides that holding company stock will qualify to the extent it owns a subsidiary that carries on trade or business.
  - A. Under IRC section 6166(b)(8)(A)(ii), there is no 5 year deferral of principal and the first payment is due when the return is filed.
  - B. Under IRC section 6166(b)(8)(A)(iii) interest should be computed at 45% of the Federal Underpayment Rate (and not at the special 2% rate) or at the Federal Underpayment Rate if date of death is prior to 1-1-98. See also IRM 4.25.2.1.24(2) - (6).
9. IRC section 6166(b)(6) provides that the adjusted gross estate is equal to the value of the gross estate less debts allowable. The value of the adjusted gross estate is based on the facts and circumstances in existence on the date for filing return including extensions.
  - A. Administrative expenses claimed on Form 1041 can be used to compute debts.
  - B. Installment interest deductions not in existence at date of filing are not entered into the computation of adjusted gross estate. Note that for decedents dying after 12-31-1997 no deduction is allowed for interest accruing during the IRC section 6166 extension. Federal and state interest accrued after an estate tax return is filed are not to be considered debts when figuring the adjusted gross estate.
10. IRC section 6166(b)(10), provides that an estate may elect to treat all the assets used in a "qualifying lending and finance business" as assets used in carrying on a trade or business. Thus, none of the assets in a "qualifying lending and finance business" will be considered passive assets under IRC section 6166(b)(9). An estate that makes the section IRC section 6166(b)(10) election is required to make its first installment of tax and interest thereon on the date prescribed by IRC section 6151(a) for payment of the tax; the first installment cannot be deferred. In addition, estates that elect IRC section 6166(b)(10) are allowed a maximum of 5 installments of tax, rather than the usual 10.
11. IRC section 6166(a) election must be made with a timely filed return and include the following information:
  - A. The executor must attach a statement to the Form 706 with computations showing the deferred, non-deferred tax and closely held business amount. The statement should include the following information:
  - B. The decedent's name and taxpayer identification number.
  - C. The amount of tax that is to be paid in installments.
  - D. The date selected for payment of the first installment.
  - E. The number of annual installments including the first installment, in which the tax is to be paid.
  - F. The properties shown on the estate tax return which constitute the closely held business interest (identified by schedule and item number).

- G. The facts that formed the basis for the executor's conclusion that the estate qualifies for payment of the estate tax installment.

**Note:**

**See Treas. Reg. section 20.6166-1(b) which provides information necessary for the Notice of Election.**

12. Non-deferred tax must be paid by the return due date, unless the estate has an extension of time to pay under IRC section 6161 .
13. If property qualifies for installments, generally only interest on the unpaid balance is due on the first four anniversary dates after the due date of the return. The first tax payment along with interest payment is due on the 5th anniversary of the due date of the return. Generally the maximum amount of time for payment of deferred tax is 10 years. The executor may select a shorter period, in which case the deferment will be the period selected.
14. IRC section 6403 provides that no refund on an overpayment of an installment is allowed until total payments exceed the total estate tax liability.
15. IRC section 6166(g)(1) provides for acceleration of installments. The balance of installments are accelerated upon notice and demand if any portion of an interest in the qualifying business is distributed, sold, exchanged or otherwise disposed of, or money or property attributable to the interest is withdrawn from the business and the aggregate of such distributions, etc. equals or exceeds 50% of the value of the entire interest, measured at the value reported on the Form 706. Dispositions are cumulative, so a record should be kept of dispositions.
16. The following will not accelerate payments if:
  - A. Transfers to heirs pursuant to a will, trust instrument or statute of descent and distribution. See IRC section 6166(g)(1)(D).
  - B. Redemptions of stock, to which IRC section 303 applies (or so much of IRC section 304 as it relates to IRC section 303), where proceeds are used to pay IRC section 6166 installments of tax .
17. IRC section 6166(g)(3) provides if installment of tax and/or interest is not paid timely, the entire balance of installments due accelerates upon notice and demand.

**Note:**

**IRC section 6166(g)(3)(B) states if the balance due is paid within 6 months of the due date, the installment privilege can be reinstated if the estate pays a 5% per month penalty on the unpaid installment plus statutory interest from the installment due date to the payment date. Failure to pay penalties will apply on the unpaid installment that relates to principal.**

18. IRC section 6166(h) provides for the election to defer the deficiency tax, if the estate is not already making payments under IRC section 6166:
  1. IRC section 6166(h)(2) election must be made within 60 days of the issuance of the notice and demand.

2. The deficiency is prorated per formula in IRC section 6166(a)(1). The estate cannot defer more than the deficiency. See Rev. Rul. 81-294, 1981-2 CB 237
  3. The deficiency may not be due to negligence, intentional disregard or fraud.
19. IRC section 6166(e) provides for the proration of deficiency installments if the estate is paying in installments under IRC section 6166 when the assessment is made. The part of the deficiency attributable to the closely-held business shall be prorated to the installments. A part of the deficiency's prorated installments that are due and payable shall be paid upon notice and demand.