employee of the Service Center issued the taxpayer a written response that concluded that based on the specific facts submitted by the taxpayer, the amount was not includible in income on the taxpayer's 1989 return. Since the response provided a conclusion regarding the tax treatment accorded the taxpayer on the basis of the facts submitted, the response constitutes "advice" for purposes of section 6404(f). The taxpayer filed his 1989 return and, relying on the Service's advice, did not include the item in income. Upon examination, it was determined that the item should have been included in income on the taxpayer's 1989 return. Because the taxpayer reasonably relied upon erroneous written advice from the Service, any penalty or addition to tax attributable to the erroneous advice will be abated by the Service. However, the erroneous advice will not affect the amount of any taxes and interest owed by the taxpayer (except to the extent interest relates to a penalty or addition to tax attributable to the erroneous advice) due to the fact that the item was not included in income.

Example 2. In March 1989, an individual submitted a written request to the National Office of the Internal Revenue Service regarding whether a certain activity constitutes a passive activity within the meaning of section 469 of the Code. The request did not meet the procedural requirements set forth by the National Office for consideration of the submission as a private letter ruling request and, thus, was not treated as such by the Service. The Service furnished the taxpayer with a written response that transmitted various published provisions of section 469 and the regulations thereunder relevant to the determination of whether an activity is passive within the meaning of those provisions. The Service also included a Publication regarding the tax treatment of passive activities. However, the Service's response contained no opinion or determination regarding whether the taxpayer's described activity was or was not passive under section 469. The Service's response is not advice within the meaning of section 6404(f), and cannot be relied upon for purposes of an abatement of a portion of a penalty or addition to tax under that section.

Example 3. On April 1, 1989, an individual submitted a written request for advice to an Internal Revenue Service Center. The advice related to an item included on a federal tax return. The individual filed a federal income tax return with the appropriate Service Center on April 15, 1989. Subsequently, on May 1, 1989, the individual received advice from the Service Center concerning the written request made on April 1. Because the individual filed his tax return prior to the date on which written advice from the Service was received, the individual did not rely on the Service's written advice for purposes of section 6404(f). If, however, the individual amends his tax return to conform with the written advice received from the Service, the individual will be considered to have reasonably relied upon the Service's advice.

Example 4. Individual A, on May 1, 1989, received advice from the Service that concluded that interest paid by the taxpayer with respect to a specific loan was interest paid or accrued in connection with a trade or business, within the meaning of section 163(h)(2)(A) of the Code. The advice relates to a continuing action. Therefore, provided the facts submitted by the taxpayer to obtain the advice remain adequate and accurate (that is, the circumstances relating to the indebtedness do not change), Individual A may rely on the Service's advice for subsequent taxable years until the individual is put on notice that the advice no longer represents Service position and, thus, is no longer valid.

Example 5. An individual, on June 1, 1989, received advice from the Service that concluded that no gain or loss would be recognized with respect to a transfer of property to his spouse under section 1041. The advice does not relate to a continuing action. Therefore, the taxpayer may not rely on the advice of the Service for transfers other than the transfer discussed in the taxpayer's written request for advice.

(g) *Effective date.* Section 6404(f) shall apply with respect to advice requested on or after January 1, 1989.

Par. 4. The authority for Part 602 continues to read as follows:

Authority: 26 U.S.C. 7805

Par. 5. Section 602.101(c) is amended by inserting in the appropriate place in the table:

"§301.6404-3T(d) .....1545-0024."

The provisions contained in this Treasury decision are needed to provide immediate guidance. For this reason, it is found impracticable and contrary to public interest to issue this Treasury decision with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

Michael J. Murphy,
Acting Commissioner of Internal Revenue.

Approved May 8, 1989.

John G. Wilkins,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on May 15, 1989, 8:45 a.m., and published in the issue of the Federal Register for May 16, 1989, 54 F.R. 21055)

Chapter 67.—Interest
Subchapter A.—Interest on Underpayments

Section 6601.—Interest on Underpayment, Nonpayment, or Extensions of Time for Payment of Tax

26 CFR 301.6601-1: Interest on underpayments. (Also Sections 6166, 6621; 20.6166-1, 301.6621-1.)

Interest rate; estate tax; closely held business. If the time for payment of estate tax is extended under section 6166 of the Code and a deficiency is assessed after the estate has timely made one or more interest payments, the 4-percent rate prescribed by section 6601(j) is applied to determine the amount of interest that should have been paid in each annual payment. Interest on any underpayment of interest thus determined accrues at the prevailing rate under section 6601(a) from the date the interest should have been paid under section 6166(f)(1) had the return shown the correct tax liability. Rev. Rul. 67-161 clarified and amplified.

Rev. Rul. 89-32

ISSUE

If the time for payment of estate tax is extended under section 6166 of the Internal Revenue Code and a deficiency is assessed after the estate has timely made one or more annual interest payments, at what rate does interest accrue on unpaid interest that should have been paid on each past annual interest payment date?

LAW AND ANALYSIS

Section 6166(a)(1) of the Code provides generally that if the value of an interest in a closely held business is included in determining the gross estate of a decedent and exceeds 35 percent of the adjusted gross estate, the executor may elect to pay all or part of the estate tax in up to 10 equal installments.

Section 6166(a)(3) of the Code provides generally that if the time for payment of estate tax is extended under section 6166, the first annual installment of tax must be paid on or before the date selected by the executor, which cannot be more than 5 years after the date prescribed by section 6151(a) for payment of estate tax.

Under section 6166(e) of the Code, if an election under section 6166(a) has been made and if a deficiency has been assessed, the deficiency shall (subject to the limitation provided by section 6166(a)(2)) be prorated to the installments payable under section 6166(a). Section 6166(e) does not apply if the deficiency is due to negligence, to intentional disregard of rules and regulations, or to fraud with intent to evade tax.

Section 6166(f) of the Code prescribes the time for payment of interest when the time for payment of tax has been extended pursuant to a section 6166(a) election. Under section 6166(f)(1), interest payable under section 6601 must be paid annually on any unpaid portion of the tax attributable to the first 5 years after the date prescribed by section 6151(a) for payment of the tax.

Section 6166(g)(3) of the Code provides generally that if any payment of principal or interest is not paid within 6 months of the date fixed for its payment under section 6166, the unpaid portion of the tax payable in installments must be paid upon notice and demand from the Secretary.

Section 6601(a) of the Code provides generally that if any amount of tax is not paid on or before the last date prescribed for payment, interest on the unpaid amount must be paid at an annual rate established under section 6621 for the period from such last date to the date paid.

Under section 6601(e)(1) of the Code, any reference in the Code (except subchapter B of chapter 63, relating to deficiency procedures) to any tax imposed by the Code shall be deemed also to refer to interest imposed by section 6601 on such tax.

Section 6601(j)(1) of the Code provides generally that if the time for payment of an amount of estate tax, including any deficiency, is extended as provided in section 6166, interest on the 4-percent portion of the amount shall (in lieu of the annual rate provided by section 6601(a)) be paid at the rate of 4 percent.

Section 6601(j)(2) of the Code provides that the "4-percent portion" means the lesser of —

(A) $345,800 reduced by the amount of the credit allowable under section 2010(a); or

(B) the amount of the tax imposed by chapter 11 that is extended as provided in section 6166.

Through the statutory provisions described above, Congress has provided liquidity relief to an estate in which the decedent's interest in a closely held business is a significant part of the gross estate. If an election is made under section 6166 of the Code, the estate makes only annual interest payments during the initial five-year period on the tax attributable to the closely held business during which time payment of the tax is deferred. Moreover, within the limits of section 6601(j)(2), interest accrues during the period of deferral under section 6601(j)(1) at the rate of 4 percent rather than under section 6601(a) at the prevailing rate.

If a deficiency is assessed during the five-year deferral period, and the deficiency is attributable to the decedent's interest in a closely held business and is within the limits of section 6601(j)(2) of the Code, the deficiency is prorated to the scheduled installments of tax, and interest is imposed at the rate of 4 percent. Sections 6166(e) and 6601(j).

The question presented is how interest is calculated if the deficiency is assessed after one or more annual interest payments have been made. In such case, the interest payments that were made before assessment of the deficiency will have been less than the payments that would have been made had the correct liability been shown on the return. If the 4-percent rate of interest were applied to the interest that should have been paid in past annual interest payments from the date such interest was due until the date of notice and demand for such interest, the estate would be in a better position than if the tax liability had been reported correctly on the return.

Under section 6166(f)(1) of the Code, interest on any unpaid deferred tax attributable to the first 5 years after the date prescribed by section 6151(a) for payment of tax must be paid annually. Because a deficiency represents a portion of the unpaid tax, interest attributable to a deficiency that qualifies for deferral must also be paid annually under section 6166(f)(1). When a deficiency is assessed after an annual interest payment date, the fact that the correct amount of interest was not paid within 6 months of the past annual interest payment date does not cause acceleration of the unpaid tax under section 6166(g)(3) if the additional interest is paid within 6 months of notice and demand. This does not mean, however, that the 4-percent rate of interest applies to the underpayment of interest until there is notice and demand.

The operation of what is now designated as section 6601(j) of the Code was explained by Congress in H.R. Rep. No. 2198, 85th Cong., 1st Sess. 20-21 (1958), 1959-2 C.B. 709, 723:

> *Rate of Interest.* — . . . [T]he bill amends subsection (b) of section 6601 [presently subsection (j)] of the 1954 Code, relating to interest on extension of time to pay estate tax, to provide that interest shall be payable on any amount of estate tax, including a deficiency, which comes within the scope of section 6166, at the rate of 4 percent per annum instead of the normal rate . . . which is provided by subsection (a) of section 6601. However, if any amount of such tax is not paid on or before the expiration of the period of extension applicable thereto, the [normal] rate will apply from the date of such expiration to the date the tax is paid.

Under section 6166(f)(1) of the Code, an estate is obligated to pay the interest on the full amount of its unpaid tax annually, and the 4-percent rate of interest prescribed by section 6601(j) extends only to the date on which the interest should have been paid. Congress did not intend that an estate with a deficiency be entitled to the 4-percent rate of interest for any period beyond the date on which the annual interest payment on the full amount of unpaid tax was due. Because interest is considered part of the tax under section 6601(a), interest on any underpayment of interest accrues at the prevailing rate under section 6601(e) from the date the interest should have been paid under section 6166(f)(1) had the return shown the correct tax liability.

The above principles are illustrated with the following example:

D died on March 31, 1982. *E*, the executor, timely filed *D*'s estate tax return on December 31, 1982. The estate elected to pay $200,000 of the estate tax attributable to an interest in a closely held business in 10 equal installments under section 6166(a) of the Code. The first installment of tax is due December 31, 1987. The first interest payment of $8,161.66 as determined under Rev. Proc. 83-7, 1983-1 C.B. 583, which provides tables and procedures for computing interest using the daily compounding rules, was due December 31, 1983, and *E* made the payment timely.

$200,000 × .040808298 (Table 10) for the period: (1-1-83 to 12-31-83) 365 days at 4 percent	=	$8,161.66

Subsequently, the Internal Revenue Service asserted a deficiency of $40,000 against the estate, all of which qualified under section 6166(a). Notice and demand was sent to *E* on August 31, 1984.

The entire deferred deficiency accrues interest at 4 percent because the limits imposed under section 6601(j)(2) of the Code have not been reached, and the date has not passed for payment of any portion of the deficiency. However, the date for payment of the first annual interest payment was December 31, 1983, and interest attributable to the deficiency was not paid. This unpaid interest accrues interest under section 6601(a) at the prevailing rate from the date it was due (December 31, 1983) until paid. The total additional interest payable as of August 31, 1984, as reflected in the notice and demand, is:

Interest on $40,000 for the period: (1-1-83 to 12-31-83) 365 days at 4 percent $40,000 × 040808298 (Table 10)		$1,632.33
(1-1-84 to 6-30-84) 182 days at 11 percent/leap years $1,632.33 × .056214263 (Table 41)	=	$ 91.76
(7-1-84 to 8-31-84) 62 days at 11 percent/leap years $1,724.09 × .018805661 (Table 41)		$ 32.42
Total		$1,756.51

This amount must be paid within 6 months of notice and demand in order to avoid the acceleration provisions of section 6166(g)(3)(A).

Interest for 1984 on the principal amount of the deficiency will be paid on December 31, 1984, as part of the annual interest payment due under section 6166(f).

HOLDING

If the time for payment of estate tax is extended under section 6166 of the Code and a deficiency is assessed after the estate has timely made one or more interest payments, the 4-percent rate prescribed by section 6601(j) is applied to determine the amount of interest that should have been paid in each annual payment. Interest on any underpayment of interest thus determined accrues at the

prevailing rate under section 6601(a) from the date the interest should have been paid under section 6166(f)(1) had the return shown the correct tax liability.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 67-161, 1967-1 C.B. 342, concludes that the 4-percent rate provided in former section 6601(b) of the Code, now section 6601(j)(1), applies to a deficiency prorated under section 6166 to tax installments, both past and future. However, Rev. Rul. 67-161 does not address the period of time during which the 4-percent rate applies. The portion of a deficiency prorated to an installment accrues interest at 4 percent (if within the 4-percent limitations) from the date prescribed by section 6151(a) for payment of the tax until the date prescribed by section 6166(a)(3) for payment of the installment to which the portion of the deficiency is prorated. Thereafter, the portion of the deficiency accrues interest under section 6601(a). Rev. Rul. 67-161 is clarified and amplified.

Subchapter C.—Determination of Interest Rate; Compounding of Interest

Section 6621.—Determination of Rate of Interest

26 CFR. 301.6621-1: Interest rate.

Interest rates; underpayments and overpayments. The rate of interest determined under section 6621 of the Code for the calendar quarter beginning April 1, 1989, will increase to 11 percent for overpayments and 12 percent for underpayments.

Rev. Rul. 89-36

Section 6621 of the Internal Revenue Code establishes differential rates for allowance of interest on tax overpayments and assessment of interest on tax underpayments. Under section 6621(a)(1), the overpayment rate is the sum of the federal short-term rate plus 2 percentage points. Under section 6621(a)(2), the underpayment rate is the sum of the federal short-term rate plus 3 percentage points.

Section 6621(b)(1) of the Code provides that the Secretary shall determine the federal short-term rate for the first month in each calendar quarter.

Section 6621(b)(2)(A) of the Code provides that the federal short-term rate determined under section 6621(b)(1) for any month shall apply during the first calendar quarter beginning after such month.

Section 6621(b)(2)(B) of the Code provides that in determining the addition to tax under section 6654 for failure to pay estimated tax for any taxable year, the federal short-term rate which applies during the third month following such taxable year shall also apply during the first 15 days of the fourth month following such taxable year.

Section 6621(b)(3) of the Code provides that the federal short-term rate for any month shall be the federal short-term rate determined during such month by the Secretary in accordance with section 1274(d), rounded to the nearest full percent (or, if a multiple of ½ of 1 percent, the rate shall be increased to the next highest full percent).

Notice 88-59, 1988-1 C.B. 546, announced that in determining the quarterly interest rates to be used for overpayments and underpayments of tax under section 6621 of the Code, the Internal Revenue Service will use the federal short-term rate based on daily compounding because that rate is most consistent with section 6621 which, pursuant to section 6622, is subject to daily compounding.

Rounded to the nearest full percent, the federal short-term rate based on daily compounding determined during the month of January 1989 is 9 percent. Accordingly, an overpayment rate of 11 percent and an underpayment rate of 12 percent are established for the calendar quarter beginning April 1, 1989. These rates apply to amounts bearing interest during that calendar quarter except that, pursuant to section 6621(b)(2)(B) of the Code, the 11 percent rate applicable to underpayments for the calendar quarter beginning January 1, 1989, continues to be applicable to individual estimated tax underpayments from April 1, 1989, through April 15, 1989. For April 16, 1989, through June 30, 1989, the 12 percent underpayment rate applies to such individual estimated tax underpayments.

Interest factors for daily compound interest for annual rates of 11 percent and 12 percent were published in Tables 17 and 18 of Rev. Proc. 83-7, 1983-1 C.B. 583, 600, 601.

Annual interest rates to be compounded daily pursuant to section 6622 of the Code that apply for prior periods are set forth in the accompanying tables.

TABLE OF INTEREST RATES
PERIODS BEFORE JUL. 1, 1975 - DEC. 31, 1986
OVERPAYMENTS AND UNDERPAYMENTS

PERIOD	RATE	DAILY RATE TABLE IN 1983-1 C.B.
Before Jul. 1, 1975	6%	Table 2, pg. 586
Jul. 1, 1975—Jan. 31, 1976	9%	Table 4, pg. 588
Feb. 1, 1976—Jan. 31, 1978	7%	Table 3, pg. 587
Feb. 1, 1978—Jan. 31, 1980	6%	Table 2, pg. 586
Feb. 1, 1980—Jan. 31, 1982	12%	Table 5, pg. 588
Feb. 1, 1982—Dec. 31, 1982	20%	Table 6, pg. 588
Jan. 1, 1983—Jun. 30, 1983	16%	Table 22, pg. 605
Jul. 1, 1983—Dec. 31, 1983	11%	Table 17, pg. 600
Jan. 1, 1984—Jun. 30, 1984	11%	Table 41, pg. 625
Jul. 1, 1984—Dec. 31, 1984	11%	Table 41, pg. 625
Jan. 1, 1985—Jun. 30, 1985	13%	Table 19, pg. 602
Jul. 1, 1985—Dec. 31, 1985	11%	Table 17, pg. 600
Jan. 1, 1986—Jun. 30, 1986	10%	Table 16, pg. 599
Jul. 1, 1986—Dec. 31, 1986	9%	Table 15, pg. 598