

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:4/ PLR-118548-99
Date:
July 26, 2000

Re:

Legend:

- Decedent =
- Decedent's will =
- Daughter =
- Daughter's will =
- Date 1 =
- Date 2 =
- State X =
- Trust =
- Son 1 =
- Son 2 =
- Business Managers =
- b =
- c =
- d =
- e =
- f =

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g =h =i =

Sole Proprietorship =

Corporation =

Dear :

This responds to your authorized representative's letter dated November 16, 1999, and subsequent correspondence, requesting rulings under §§ 2013 and 6166 of the Internal Revenue Code. Specifically, you request rulings concerning whether proposed transactions will constitute dispositions under § 6166(g) and whether the filing of a protective claim, within the time prescribed in § 6511, will preserve Daughter's estate's right to a refund of any overpayment of Federal estate tax and interest attributable to the § 2013 credit.

Facts

Decedent died testate on Date 1, a resident of State X. Decedent's gross estate consisted primarily of a Sole Proprietorship, b acres of farmland, a closely-held C corporation, and excess capital held in Decedent's name.

Decedent purchased the Sole Proprietorship from his father shortly before his father's death. The Sole Proprietorship was engaged in numerous business activities, but was primarily involved in direct farming operations, focused mainly on growing seasonal crops. At his date of death, Decedent owned c different parcels of farmland totaling approximately b acres. Decedent and d full-time employees actively farmed this property, as well as an additional e acres of property leased by Decedent from third-party landowners.

Prior to his death, Decedent formed Corporation, a closely-held C corporation, which manufactures fertilizer, hauls farm products, and acts as a middleman for farm produce. Decedent owned f of the outstanding stock at his death, with the remaining shares held by current employees. At the time of his death, Corporation employed g full-time employees.

During his lifetime, Decedent used profits earned by the Sole Proprietorship and Corporation as working capital to finance additional land acquisitions and to purchase municipal bonds and United States Treasury obligations. Additional amounts were held

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as excess capital (defined as passive assets in excess of working capital needs). Portions of the excess capital were titled in the name of the Decedent, the Sole Proprietorship, and the Corporation.

Pursuant to Article IV of his will, upon Decedent's death, the residue of Decedent's estate passes outright to Daughter.

On Date 2, within one year of Decedent's date of death, Daughter died testate, a resident of State X. Pursuant to Article IV of Daughter's will, the residue of Daughter's estate passes to Trust, a revocable living trust which became irrevocable at Daughter's death.

Article II of the Trust agreement provides that, upon Daughter's death, Trust is to be divided into two equal trusts, one trust for each of Daughter's children (Son 1 and Son 2). Pursuant to Article II, Section A, the trustees of the trust designated for Son 1 are authorized in their sole discretion to distribute income and principal from such trust to provide for Son 1's support, health, care, and maintenance. Upon the death of Son 1, any accumulated income or undistributed principal of such trust is to be distributed to the trust created for Son 2.

Article II, Section B of the Trust agreement provides that during Son 2's lifetime, the net income from the trust designated for Son 2 is to be paid to or for the benefit of Son 2 in quarterly or other convenient installments. The trustees may, in their discretion, distribute principal from such trust for any unusual or major medical expenses of Son 2. Son 2 has the right, but not the obligation, to withdraw up to one-third of the principal of his trust at any time after five years from the date of Daughter's death, up to one-half of the balance thereof at any time after ten years from the date of Daughter's death, and the entire balance thereof at any time after fifteen years from the date of Daughter's death.

Article II, Section B further provides that upon Son 2's death, any remaining principal of his trust shall be paid to such one or more persons or organizations (except his estate, his creditors, and the creditors of his estate) on such terms as Son 2 appoints by his will, specifically referring to this power of appointment. In default of this appointment or insofar as it is not effectual, the remaining principal shall pass to Son 2's then living descendants, per stirpes.

Son 2, as an employee of Decedent's estate, conducts a farming operation on a portion of Decedent's farmland.

It is represented that both Decedent's estate and Daughter's estate elected to pay a portion of the respective estate's federal estate tax liability in installments under § 6166. The Decedent's estate identified approximately \$h of active business assets qualifying for installment treatment. The Daughter's estate identified \$i of active

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business assets for installment treatment.

Decedent's estate, in an attempt to limit its potential liability arising from the continuance of the farming operations during estate administration, proposes the following transactions:

(1) The active business assets of the Sole Proprietorship will be transferred by Decedent's estate into a newly formed LLC. Currently, Decedent's estate is the sole member and owner of the LLC. Son 2 and Business Managers will become managing members of the LLC. In addition, excess capital titled in the name of the Sole Proprietorship will not be transferred to the LLC, but will be retitled in the name of Decedent's estate;

(2) Decedent's estate will dissolve Corporation while continuing the active business operations of the Corporation. Decedent's estate will contribute the active business assets of the Corporation (other than the real estate) as working capital to the LLC so that the LLC can continue the active business interests previously conducted by Decedent. Decedent's estate plans to withdraw any profits generated by the LLC;

(3) A quarry included in Decedent's gross estate will be transferred into a separate LLC (Quarry LLC). Son 2 and Business Managers will become managing members of the Quarry LLC;

(4) Approximately b acres of land will be distributed to the Daughter's estate pursuant to Article IV of Decedent's will. Daughter's estate will receive the land subject to the unpaid federal estate tax liability in both estates and will assume Decedent's estate's state death tax obligations, outstanding debts, and administration expenses. Daughter's estate will initially lease the land to the LLC through crop share agreements, and will eventually lease the land through arms-length cash leases.

(5) Daughter's estate will file a protective claim, within the period prescribed in § 6511, for an amount equal to the entire credit for the tax paid on prior transfers under § 2013, in order to preserve the estate's right to a refund of any overpayment of Federal estate tax and interest attributable to the § 2013 credit. This initial protective claim will be subsequently perfected by the filing of annual claims for refund on Form 843, upon the payment of each installment of the Federal estate tax by Decedent's estate.

Ruling Requests

(1) The distribution of excess capital held in the name of the Sole Proprietorship to Decedent's estate will not constitute a disposition as defined under § 6166(g).

(2) The conversion of the Sole Proprietorship into an LLC and the dissolution of the Corporation will not be treated as dispositions under § 6166(g).

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(3) The distribution of farmland from Decedent's estate to Daughter's estate is not a disposition under § 6166(g).

(4) The farmland leased by Daughter's estate to the LLC remains active, and entering into the lease is not a disposition under § 6166(g).

(5) The distribution of profits of the LLC and the Quarry LLC to Decedent's estate is not a disposition under § 6166(g).

(6) The filing of a protective claim, within the time prescribed in § 6511, for the entire amount of the credit that would be allowable for tax paid on prior transfers under § 2013 will preserve the right of Daughter's estate to a refund of any overpayment of Federal estate tax and interest attributable to the § 2013 credit.

Law and Analysis

The Tax Reform Act of 1976 enacted new § 6166 and redesignated the former § 6166 as § 6166A. The Economic Recovery Tax Act of 1981 repealed § 6166A and amended § 6166 so that the section applies in most cases that were previously governed by § 6166A. There is no indication in the statute or the underlying legislative history that Congress intended that a transaction that would have constituted a disposition of an interest under § 6166A prior to repeal would not be a disposition under § 6166. Therefore, the regulations under § 6166A are considered applicable to this ruling request to the extent that those regulations are not inconsistent with the language of § 6166.

Section 6166(a)(1) 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 under § 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 § 6151(a) for payment of the tax.

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

Section 6166(g)(1)(A) provides that if (i) any portion of an interest in a closely held business that qualifies for the § 6166(a)(1) election is distributed, sold, exchanged, or otherwise disposed of, or money and other property attributable to such an interest is withdrawn from such trade or business, and (ii) the aggregate of such distributions, sales, exchanges, or other dispositions and withdrawals equals or exceeds 50 percent

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of the value of the closely held business, then the extension of time for payment of tax provided in § 6166(a) shall cease to apply, and the unpaid portion of the tax payable in installments shall be paid upon notice and demand from the Secretary.

Ruling Request #1

Section 6166(b)(1) states that the term “interest in a closely held business” means:

- (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 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)(9)(A) provides, in part, that for purposes of § 6166(a)(1) and determining the closely held business amount (but not for the purpose of § 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. Section 6166(b)(9)(B) provides that passive assets are any assets other than assets used in carrying on a trade or business.

Section 20.6166A-2(c)(2) of the Estate Tax Regulations provides that, in the case of a trade or business carried on as a proprietorship, the interest in the closely held business includes only those assets of the decedent which were actually utilized by him in the trade or business. Whether an asset is used in the trade or business will depend on the facts and circumstances of the particular case.

In this case, Decedent conducted his business as a sole proprietorship. Under § 20.6166A-2(c)(2), where a trade or business is carried on as a proprietorship, the interest in the closely held business includes only those assets of the decedent which were actually utilized by him in the trade or business. As a result, 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. Therefore, for purposes of § 6166, the value of Decedent’s interest in the Sole Proprietorship’s closely-held business is determined solely by the value of the active business assets. The excess capital titled in Decedent’s name and the Sole Proprietorship’s name do not

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constitute part of Decedent's interest in the Sole Proprietorship's closely held business amount for purposes of § 6166(a)(1). As such, distributions of excess capital titled in either the name of Decedent or the Sole Proprietorship will not be considered dispositions under § 6166(g).

Ruling Request #2

Section 20.6166A-3(e)(1) provides that in any case where in the aggregate 50 percent or more of the decedent's interest in a closely held business has been distributed, sold, exchanged, or otherwise disposed of, the privilege of paying the tax in installments terminates and the whole of the unpaid portion of the tax which is payable in installments becomes due and shall be paid upon notice and demand from the District Director. A transfer by the executor of an interest in the closely held business to a beneficiary or trustee named in the decedent's will or to an heir who is entitled to receive it under the intestacy law does not constitute a distribution thereof for purposes of determining whether 50 percent or more of an interest in a closely held business has been distributed, sold, exchanged, or otherwise disposed of.

Section 20.6166A-3(e)(2) states that the phrase "distributed, sold, exchanged, or otherwise disposed of" comprehends all possible ways by which an interest in a closely held business ceases to form part of the gross estate. In general, the term does not, however, extend to transactions which are mere changes in form.

Rev. Rul. 66-62, 1966-1 C.B. 272, holds that a change in the operation of a business from an incorporated form to an unincorporated form does not materially alter the business or the interest of the estate in the business, and therefore, will not result in the termination of the installment election under § 6166, if it is otherwise available to the estate.

In this case, Decedent's estate proposes to transfer active business assets from the Sole Proprietorship to an LLC in exchange for all of the ownership and membership interests in the LLC. The ownership of the LLC will be identical to the ownership of the assets in the Sole Proprietorship. In addition, Decedent's estate proposes to dissolve the Corporation while continuing the active business operations currently carried on by the Corporation. Decedent's estate will subsequently contribute all of the Corporation's active business assets, other than real estate, to the LLC. It is represented that the businesses previously conducted by the Sole Proprietorship and the Corporation will be conducted in substantially the same manner by the LLC following the change in the forms of the business entities. Therefore, operating the active business assets as an LLC will not materially alter the business and is merely a change in form. As a result, neither the transfer of active assets held by the Sole Proprietorship into the LLC nor the dissolution of the Corporation and the transfer of Corporation's active assets, other than real estate, into the LLC are dispositions under § 6166(g).

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Furthermore, Decedent's estate represents that it will not withdraw other property or money from the Sole Proprietorship and will not distribute the real estate titled in the Corporate name to the LLC. If Decedent's estate "distributes, sells, exchanges, or otherwise disposes of" the real estate (or any other excess capital) titled in the Corporate name, such an act will constitute a disposition for purposes of § 6166(g)(1)(A).

Ruling Request #3

Section 6166(g)(1)(A)(i) provides that if any portion of an interest in a closely held business which qualifies under § 6166(a)(1) is distributed, sold, exchanged, or otherwise disposed of, or money and other property attributable to such an interest is withdrawn from such trade or business, and (ii) the aggregate of such distributions, sales, exchanges, or other dispositions and withdrawal equals or exceeds 50 percent of the value of such interest, then the extension of time for payment of tax provided in subsection (a) shall cease to apply, and the unpaid portion of the tax payable in installments shall be paid upon notice and demand from the Secretary.

Section 6166(g)(1)(D) provides that § 6166(g)(1)(A)(i) does not apply to a transfer of property of the decedent to a person entitled by reason of the decedent's death to receive the property under the decedent's will, the applicable law of descent and distribution, or a trust created by the decedent. A similar rule applies in the case of a series of subsequent transfers of the property by reason of death so long as each transfer is to a member of the family (within the meaning of § 267(c)(4)) of the transferor in such transfer.

Section 20.6166A-3(e)(1) provides, in pertinent part, that a transfer by the executor of an interest in a closely held business to a beneficiary or trustee named in the decedent's will, or an heir who is entitled to receive the interest under the applicable intestacy law, does not constitute a distribution thereof for purposes of determining whether 50 percent or more of an interest in a closely held business has been distributed, sold, exchanged, or otherwise disposed of.

In this case, pursuant to Article IV of Decedent's will, the residue of Decedent's estate (including the farmland) passes outright to Daughter. Accordingly, the transfer of the farmland by Decedent's estate to Daughter's estate (the estate of the person entitled by reason of Decedent's death to receive the property under Decedent's will) in order to limit Decedent's estate's potential liability from third-parties who could be injured by the continued farming operations will not constitute a distribution thereof for purposes of determining whether 50 percent or more of an interest in a closely held business has been distributed, sold, exchanged, or otherwise disposed of.

According to the terms of Daughter's will, the residue of Daughter's estate passes to Trust. Therefore, the executor of Daughter's estate will distribute the residue of Daughter's estate, including the farmland received as part of Decedent's residuary

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bequest to Daughter, to Trust.

It is represented that the farming business will be operated through the LLC. Although the core of the farming operation is conducted through the LLC, the farmland constitutes a fundamental part of the overall farming operation and will continue to be utilized in the farming operation. Thus, the transfer of the farmland by Daughter's estate to Trust pursuant to the terms of Daughter's will will not constitute a distribution thereof for purposes of determining whether 50 percent or more of an interest in a closely held business has been distributed, sold, exchanged, or otherwise disposed of.

Ruling Request #4

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

In this case, the farmland will not be characterized as a passive asset if it is leased by Daughter's estate to the LLC. The farmland is a fundamental asset used in carrying on the overall farming operation and is directly related to the reasonable needs of the business. Further, as beneficiaries of the trusts receiving the residue of Daughter's estate, Son 1 and Son 2 are the beneficial owners of both the farmland and the LLC. As a result, leasing the farmland to the LLC will have no effect on continued qualification under § 6166 because entering into the lease will not be considered a distribution, sale, or exchange of property.

Ruling Request #5

Section 20.6166A-3(d)(1) provides that in any case where money or other property is withdrawn from the trade or business and the aggregate withdrawals of money or other property equal or exceed 50 percent of the value of the trade or business, the privilege of paying the tax in installments terminates and the whole of the unpaid portion of the tax which is payable in installments becomes due and shall be paid upon notice and demand from the District Director. A withdrawal will trigger this acceleration provision only if the withdrawn money or other property constitutes "included property" within the meaning of that term as used in § 20.2032-1(d). Section 20.2032-1(d) defines included property as all property interests existing at the decedent's death which form a part of the gross estate. The provisions of § 20.6166A-3(d)(1) do not apply to the withdrawal of money or other property which constitutes "excluded property." Section 20.2032-1(d) defines excluded property as property earned or accrued after the date of decedent's death.

The profits earned by the LLC and the Quarry LLC after the date of Decedent's

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death are excluded property under § 20.2032-1(d), and as such, would not constitute a withdrawal of money or other property from a closely held business within the meaning of § 6166(g). Accordingly, the withdrawal of current and future profits from the LLC and the Quarry LLC will not be considered a disposition or a withdrawal of funds from the closely held business for purposes of § 6166(g)(1)(A)(i). However, withdrawal of any included property (as defined under § 20.2032-1(d)) from the closely held business will be considered a disposition for purposes of § 6166(g).

Ruling Request #6

Section 2001(a) provides that a tax is imposed on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

Section 2013(a) provides that the tax imposed by § 2001 shall be credited with all or a part of the amount of the Federal estate tax paid with respect to the transfer of property (including property passing as a result of the exercise or non-exercise of a power of appointment) to the decedent (the “transferee”) by or from a person (the “transferor”) who died within 10 years before, or within 2 years after, the decedent’s death. In general, the amount of the credit is the lesser of the amount determined under § 2013(b) (the “first limitation”) and the amount determined under § 2013(c) (the “second limitation”). See also § 20.2013-1(b) of the Estate Tax Regulations. If the transferee dies more than 2 years after the transferor, the credit is reduced based on a schedule in § 2013(a).

In general, under § 2013(b), the first limitation is an amount which bears the same ratio to the estate tax paid with respect to the transferor’s estate as the value of the property transferred bears to the taxable estate of the transferor (determined for purposes of the estate tax) decreased by any death taxes paid with respect to such estate.

Under § 2013(c), the second limitation is the amount of estate tax paid by the transferee’s estate with respect to the transferred property.

Rev. Rul. 83-15, 1983-1 C.B. 224, holds that when the Federal estate tax of a transferor-decedent is being paid in installments under § 6166, the amount of the installments actually paid by the transferor-decedent’s estate is a limitation on the amount of the § 2013 credit allowable with respect to the estate of the transferee-decedent. In Rev. Rul. 83-15, A (the transferor-decedent) bequeathed shares in a closely held corporation to D (the transferee-decedent). A’s executor elected under § 6166 to pay the Federal estate tax in installments. D subsequently died within two years of A’s death. D’s executor claimed a credit based on the “first limitation” of § 2013(b). When D’s Federal estate tax was due, A’s estate had only paid \$140,000 of its \$300,000 Federal estate tax liability. Under the first limitation described in § 2013(b), the amount of credit allowable for tax on prior transfers is limited by the amount of Federal estate tax attributable to the transferred property in the transferor- decedent’s

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estate which is actually paid before the filing of transferee-decedent's estate tax return. Therefore, in Rev. Rul. 83-15, only \$140,000 (the amount of Federal estate tax actually paid by A's estate, rather than A's total Federal estate tax liability of \$300,000) is used to compute the first limitation of the § 2013 credit for D's estate.

Rev. Rul. 83-15 further holds that subsequent installment payments by A's estate will increase the amount of the § 2013 credit. To safeguard the right or potential right to receive a refund after each installment is paid, the executor of D's estate must file, within the time prescribed by § 6511, a protective claim for refund for the entire amount of the § 2013 credit potentially allowable. A protective claim asserting a future claim for refund will be sufficient even though no present right to the refund has arisen at the time the protective claim is filed. The initial protective claim must be perfected by filing a subsequent claim for refund, using Form 843, for the additional credit allowable upon the payment of each installment of Federal estate tax by the transferor-decedent's estate.

Section 6511(a) provides that a claim for credit or refund of an overpayment of any tax imposed by this title in respect of which tax the taxpayer is required to file a return shall be filed by the taxpayer within 3 years from the time the return was filed or 2 years from the time the tax was paid, whichever of such periods expires the later, or if no return was filed by the taxpayer, within 2 years from the time the tax was paid.

Section 6511(b)(1) provides that no credit or refund shall be allowed or made after the expiration of the period of limitation prescribed in § 6511(a) for the filing of a claim for credit or refund, unless a claim for credit or refund is filed by the taxpayer within such period.

Section 6611 provides that interest shall be allowed and paid upon any overpayment in respect of an internal revenue tax at the overpayment rate established under § 6621. Section 301.6611-1(b) of the Procedure and Administration Regulations provides that the date of overpayment is the date of payment of the first amount which is in excess of the tax liability and the dates of payment of all amounts subsequently paid with respect to such tax liability.

In this case, Decedent died testate on Date 1, and pursuant to Article IV of Decedent's will, the residue of his estate passed outright to Daughter. Decedent's estate elected to pay its Federal estate tax liability in installments under § 6166. Daughter subsequently died within 2 years of Decedent's date of death, thereby entitling Daughter's estate to the credit provided for under § 2013. However, as of the due date of Daughter's federal estate tax return, Decedent's estate had only paid a portion of its Federal estate tax liability.

When computing the first limitation described in § 2013(b) in determining the amount of the credit for tax on prior transfers for Daughter's estate, the amount is limited by the amount of Federal estate tax actually paid by Decedent's estate as of the

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date Daughter's estate tax return was filed. However, subsequent installment payments by Decedent's estate will increase the amount of the first limitation. Daughter's estate anticipates that it will eventually be entitled to a refund for overpayments of Federal estate tax and interest resulting from the § 2013 credit. Depending on the number of installments elected by Decedent's estate, however, the period of limitations under § 6511 during which claims for refund (occasioned by the annual increases in the amount of credit allowable) may be filed on behalf of Daughter's estate will expire before the last installment is paid.

In order to safeguard its right or potential right to receive a refund, Daughter's estate proposes to file a protective claim on Form 843, within the time prescribed in § 6511(a). The amount of the potential refund and the reasons for such claim are included in the protective claim.

We hold that filing a protective claim, within the time prescribed in § 6511, for the entire amount of credit potentially allowable for tax paid on prior transfers under § 2013 will preserve Daughter's estate's right to claim a refund for any overpayment of Federal estate tax and interest attributable to the § 2013 credit ultimately allowable. The subsequent filing of claims for refund, using Form 843, for the additional credit allowable upon the payment of each installment of Federal estate tax by Decedent's estate will perfect the initial protective claim and will entitle Daughter's estate to claim any refund to which it is entitled at the time the subsequent claim is filed.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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

Sincerely,
Associate Chief Counsel
Passthroughs and Special Industries
By: George Masnik
Chief, Branch 4

Enclosure

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