



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

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MEMORANDUM FOR SBSE ASSOCIATE AREA COUNSEL (BALTIMORE)

FROM: Alan C. Levine
Chief, Branch 1 Collection, Bankruptcy & Summonses

SUBJECT: Actual Use Valuation under I.R.C. § 2057 and the Corresponding
Special Lien

This memorandum responds to your request for advice, pertaining to the special estate tax election under I.R.C. § 2057. This document may not be used or cited as precedent. I.R.C. § 6110(k)(3).

ISSUES:

1. What is the specific property that may be reached by the section 2057(i)(3)(P) lien? Does this lien reach personal property as well as real property?
2. How should the Form 668H Notice of Federal Estate Tax Lien be completed in order to reach this property?
3. Are there any methods to effectively encumber the transfer of stock in a closely-held corporation other than filing the Form 668H?
4. Are the qualified heirs personally liable for any additional estate tax which may arise under section 2057(f)? Do others with an interest in the property subject to the section 2057(i)(3)(P) lien consent to collection of any additional estate tax from the property?

CONCLUSIONS:

1. The property reached by the section 2057(i)(3)(P) lien is the property specifically described in the form used to make the section 2057 election and may be personal property (such as a stock interest in the qualified family-owned business) or real property (such as farm property used in the qualified family-owned business).
2. The Form 668H should be revised by pen-and-ink changes as further discussed below in order to be applicable to the section 2057(i)(3)(P) lien. When the property used to secure this lien is personal property, care should be taken to ensure compliance with the filing requirements for personal property found in I.R.C. § 6323(f)(1)(A)(ii) and Treas. Reg. § 301.6323(f)-1(a)(1)(ii).

3. Contingent upon local law, a collateral agreement (i.e., in which stock certificates are held by an escrow agent) is a possible means of providing further security and preventing the transfer of stock.

4. The qualified heirs are personally liable for the additional estate tax to the extent of the portion of that tax attributable to his or her interest in the qualified family-owned business. Other parties with an interest in the subject property also must consent to collection of additional estate tax liability from that property.

DISCUSSION:

The Taxpayer Relief Act of 1997, P.L. 105-34, added a new estate tax election, current section 2057, which permits estates meeting certain requirements to deduct from the gross estate the value of qualified family-owned business interests (up to \$675,000). For section 2057 elections, section 2057(i)(3)(P) provides the mechanism for establishing, by reference to I.R.C. § 6324B, a lien for the collection of the additional estate tax imposed if a recapture event, described in section 2057(f), occurs: "Rules similar to the following rules shall apply: ... (P) Section 6324B (relating to special lien for additional estate tax)." Section 2057(i)(3)(P). Thus, a lien arises by operation of law under section 2057(i)(3)(P) at the time the section 2057 election is made. See I.R.C. § 6324B(b).

For purposes of the section 2057 election, all family members who have acquired from the decedent an interest in a qualified family-owned business (qualified heirs), and all other persons with an interest in business property to which the section 2057(i)(3)(P) lien is to attach, must sign an agreement consenting to the creation and filing of the lien. Section 2057(b)(1)(B); section 2057(h); section 2057(i)(3)(H); I.R.M. 5.5.8.3.1(2); Form 706 United States Estate (and Generation-Skipping Transfer) Tax Return, Schedule T. The property that will be subject to the section 2057(i)(3)(P) lien is listed in an attachment to the agreement.

You are responding to an advice request from your local Technical Support, Advisory Unit, raising several issues pertaining to the section 2057 election and associated lien. You were provided with examples of cases in which the property description in the attachment to the section 2057 agreement merely lists the name of a closely-held corporation rather than more specifically describing the property that will be subject to the section 2057(i)(3)(P) lien. The advice request also raises concerns in cases in which personal property, such as closely-held stock, is used to secure the section 2057(i)(3)(P) lien, as the lien may not be effective to prevent transfer of such property. The specific issues raised, which are listed above, will be addressed in turn below.

1. Property reached by the section 2057(i)(3)(P) lien

We have been advised by the Office of Associate Chief Counsel (Passthroughs and Special Industries) that section 2057 encompasses both real and personal property. As you recognize, however, there are specific problems associated with the use of

personal property, such as shares of stock, to secure the section 2057(i)(3)(P) lien. The lien may be ineffective to prevent transfer of the property without notification to the Internal Revenue Service (the "Service"). In the event that the Service is ultimately required to take enforcement action against the section 2057(i)(3)(P) lien property, such property may also be difficult to value and administratively sell.

Accordingly, it is preferable, whenever possible, to obtain an agreement to use real property to secure the section 2057(i)(3)(P) lien. The "interest" in the qualified family-owned business may include the underlying real property itself and is not limited to the type of ownership interest in the property such as shares of stock. Use of personal property to secure the section 2057(i)(3)(P) lien should be avoided where such property is not susceptible of valuation and could not be easily sold by the Service. In cases in which the only property available to secure the lien is personal property or the available real property is insufficient to secure the lien, Area Counsel should be consulted for guidance prior to accepting the personal property as security.

2. Completion of Form 668H

Form 668H, Notice of Federal Estate Tax Lien, was originally developed for recording the notice of a section 6324B consensual lien arising upon an election under I.R.C. § 2032A. Branch 1 (Collection, Bankruptcy & Summonses) recently approved a modification to the Form 668H, to permit that form to be used for the section 2057(i)(3)(P) lien. In particular, the phrase "and/or section 2057" should be added by pen and ink to the Notice paragraph of the form. Also, the phrase "regarding the specially valued property" should be stricken from the two-line sentence beginning with "Name and address of agent." These pen-and-ink revisions should be made to the form until a revised Form 668H can be printed. Specific guidance on these revisions was also issued to all Compliance Area Directors on May 4, 2001.

The description of property contained in the Form 668H, as well as in the form used to request the section 2057 election, should be specific. For example, the description should not merely provide the name of the qualified family-owned business corporation but should sufficiently reference the property used to secure the section 2057(i)(3)(P) lien, i.e. the number of shares of stock held in XYZ corporation.

As previously discussed, the revised Form 668H used in conjunction with a section 2057 election, unlike the Form 668H filed in connection with a section 6324B lien, may reach both real and personal property. Accordingly, the Service should ensure compliance, when appropriate, with the filing requirements for personal property found in I.R.C. § 6323(f)(1)(A)(ii) and Treas. Reg. § 301.6323(f)-1(a)(1)(ii).

3. Methods to encumber transfer of section 2057(i)(3)(P) personal property

As previously discussed, there are special concerns regarding the ability of the Service to effectively secure its interest in potential additional estate tax liability where the property used to secure the section 2057(i)(3)(P) lien is personal property such as stock

in a closely-held corporation. In particular, the lien may be ineffective to prevent transfer of the encumbered stock without the Service's knowledge. These concerns are inherent in any lien secured by personal property. Accordingly, as we previously advised, a section 2057(i)(3)(P) lien secured by real property is always preferable.

We have been informally advised of certain offices entering into additional agreements, however, which may be effective to secure the Service's interest and prevent transfer of the section 2057(i)(3)(P) property in some cases. For example, we have learned that one office has drafted an escrow agreement which may be executed by the Service, the estate representative, the qualified heirs, and an escrow agent. Pursuant to such agreement, shares of stock used as section 2057(i)(3)(P) property are deposited with and held by an escrow agent bank, to be held and distributed by such agent only in accordance with certain terms and conditions. The agreement provides that in the event of tax recapture under section 2057(f), the Service may pursue enforcement including requiring the administrative sale or delivery to the Service of the escrow property. The agreement further provides for termination of the escrow agreement upon the lapse of the time period for recapture under section 2057(f) or upon full payment of all estate taxes owed. Upon termination and agreement by the Service, the shares may be released to the qualified heirs if all taxes have been satisfied. You may wish to consider the use of a similar agreement, contingent upon local state law.

4. Personal liability of qualified heirs

Finally, qualified heirs are personally liable for any recapture tax that may arise under section 2057(f), to the extent of the portion of that recapture tax attributable to his or her interest in the qualified family-owned business. In addition, any other parties who hold an interest in the section 2057(i)(3)(P) lien property also consent to allow the Service to take collection action against this property.

I.R.C. § 2057(i)(3)(F) provides that a rule "similar" to section 2032A(c)(5), with respect to liability for the tax and furnishing of a bond, will apply to section 2057. Section 2032A(c)(5) provides, generally, that a qualified heir shall be personally liable for additional tax imposed with respect to his or her interest unless he or she has posted a bond. Treas. Reg. § 20.2032A-8(c)(1) additionally provides that qualified heirs consent to personal liability under section 2032A(c) if certain early dispositions of property or cessation of material participation/qualified use occurs. The regulation further provides that parties other than qualified heirs with interests in the qualified property must consent to collection of any additional estate tax imposed under section 2032A(c) from that property.

As a final note, the Office of Associate Chief Counsel (Passthroughs and Special Industries) is currently engaged in a Year 2001 Priority Guidance Plan project to issue proposed regulations under section 2057. The regulations, when published, will provide further guidance on these issues.

If you have any further questions, please call 202-622-3610.