

## VIII. DRAFTING INFORMATION

The principal author of this notice is Don M. Parkinson of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities), although other Treasury and IRS officials participated in its development. For further information on the provisions of this notice addressing the calculation of the amount includible in income under § 409A, contact Stephen Tackney at (202) 927-9639; for further information on other provisions of this notice, including the reporting and withholding provisions contained in this notice, contact Mr. Parkinson at (202) 622-6040 (not toll-free numbers).

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### Security Under Section 6166 Elections

#### Notice 2007-90

##### PURPOSE

The purpose of this notice is to alert taxpayers, tax practitioners, executors and other persons who represent estates, that, in light of a recent Tax Court decision, the Internal Revenue Service is changing its policy and now will determine on a case-by-case basis whether security will be required when a qualifying estate elects under Internal Revenue Code section 6166 to pay all or a part of the estate tax in installments. This notice invites comments from the public regarding the relevant factors and appropriate standards for determining whether security is deemed to be necessary (and thus will be required) to protect the government's interest in obtaining full payment of the estate tax and interest thereon when that liability is deferred under section 6166.

##### BACKGROUND

Under section 6166, an estate that meets all of the requirements of the statute may elect to pay the estate tax attributable to the decedent's interest in a closely held business in up to 10 equal, annual installments. The first of those annual payments must be made by the 5<sup>th</sup> anniversary of the due date (determined without regard to any extension) of the estate tax liability that is

not deferred under section 6166. An estate qualifies for a section 6166 election if the value of the decedent's interest in the closely held business exceeds 35 percent of the adjusted gross estate, the decedent was a United States citizen or resident at the time of his or her death, and the estate made the election by attaching a full and complete notice of election with a timely filed federal estate tax return. I.R.C. § 6166(a) and (d). If the estate qualifies for the election, the estate pays a reduced rate of interest on the portion of estate tax deferred under section 6166; that interest is payable annually during the entire deferral period, and in most instances, interest only is paid during the first four years of the deferral period. I.R.C. §§ 6166(f) and 6601(j). The deferred tax is payable in no more than ten equal annual installments, beginning on a date that is not more than five years after the due date of the Federal estate tax return, which is generally nine months from the date of death. I.R.C. §§ 6166(a)(1) and (3).

Under section 6324(a), a general federal estate tax lien arises upon the decedent's date of death and attaches for ten years to all assets of the gross estate (except those used to pay certain expenses). This general federal estate tax lien may not be extended beyond the ten-year period following the date of death. As a result, when an estate qualifies and elects under section 6166 to pay estate tax over a period of up to 14 years, the government's interest in the deferred estate tax is secured by the general federal estate tax lien for only the first nine years and three months of the installment payment period. (Although the lien runs from the date of death, the installment payment period generally runs from the normal payment due date, nine months after the date of death, thus reducing the time the general lien protects the government to nine years and three months). During the final four years and nine months of the 14-year installment payment period, the government's interest is no longer secured by the general estate tax lien. In most cases, approximately one-half of the total deferred estate tax still remains to be paid during that final, unsecured portion of the deferral period.

Sections 6166(k)(1) and 6165, however, permit the IRS to require a surety bond (not exceeding double the amount with respect to which the extension is

granted) from an estate to ensure payment of the deferred estate tax to be paid in installments under section 6166. In lieu of the requirement to post a surety bond, the executor may elect to grant the IRS a special extended estate tax lien (in the amount of the deferred amount plus any interest, additional amount, addition to tax, assessable penalty, and costs attributable to the deferred amount) to secure the government's interest. I.R.C. §§ 6166(k)(2) and 6324A. This special lien does not expire until the earlier of the date the estate tax is paid in full or the tax becomes uncollectible. I.R.C. §§ 6324A(d)(2), 6502, and 6503(d).

In March 2000, the Treasury Inspector General for Tax Administration recommended, in report 2000-30-059 "The Internal Revenue Service Can Improve the Estate Tax Collection Process," that the IRS protect the government's interest in estate tax deferred under section 6166. In 2002 in response to that report, the IRS implemented a policy requiring a surety bond, or in the alternative, a section 6324A special lien, as a prerequisite to making the section 6166 election. On April 12, 2007, in *Estate of Roski v. Commissioner*, 128 T.C. 113 (2007), the Tax Court held that the IRS had abused its discretion by requiring that all estates electing to pay the estate tax in installments under section 6166 must provide a bond (or alternatively a special lien). The court found that it was Congress's intent that the IRS determine, on a case-by-case basis, that the government's interest is at risk prior to requiring security from an estate electing to pay the estate tax in installments under section 6166.

##### INTERIM PROVISIONS

The Treasury Department and the IRS are in the process of establishing standards to be applied on a case-by-case basis in the future to identify those estates making an election under section 6166 in which the government's interest in the deferred estate tax and the interest thereon is deemed to be sufficiently at risk to justify the requirement of a bond or special lien. The Treasury Department and the IRS intend to issue regulations implementing those standards and related procedures. Until those regulations are issued, however, the IRS will evaluate the factors described below and all other relevant facts to determine on

a case-by-case basis whether, at any time and from time to time during the deferral period, the government's interest in the estate tax deferred under section 6166 and interest thereon is sufficiently at risk to justify the requirement of a bond or special lien.

In order to determine whether the government's interest in the deferred tax is adequately secured up to the amount allowed under sections 6165 and 6324A, the IRS will consider information contained in the estate tax return, attachments to the return, information obtained during examination in audited cases, and any other relevant information described in paragraphs 1 through 3 of the discussion of the factors to be considered. Estates that have filed returns that do not contain adequate information to make this determination may be contacted and required to provide additional financial information to the IRS for purposes of making this determination. The IRS may terminate an estate's election for failure to respond to such requests within a reasonable timeframe. If, after this individual evaluation and analysis, the IRS determines there is a sufficient credit risk regarding the government's collection of the estate tax payments deferred under section 6166 and the interest thereon, the IRS will notify the estate that it must provide a bond or elect to provide a section 6324A special lien in lieu of a bond. If the estate then refuses to provide a bond or a section 6324A special lien, the IRS will terminate the estate's section 6166 election. The estate may then seek reconsideration of the termination by the Office of Appeals and, if the Office of Appeals upholds the IRS's determination, the estate then will have the opportunity to petition the Tax Court under section 7479 for a declaratory judgment with regard to whether its section 6166 election may be continued. I.R.C. § 7479; Rev. Proc. 2005-33, 2005-1 C.B. 1231.

The factors the IRS will consider in determining whether deferred installment payments of estate tax under section 6166 pose a sufficient credit risk to the government to justify the requirement of a bond or special lien are described below. In making this determination, the IRS will consider all relevant facts and circumstances, in addition to the factors identified in the following, non-exclusive list. No single

factor will be determinative, and not all factors may be relevant to every estate.

1. *Duration and stability of the business.* This factor considers the nature of the closely held business on which the estate tax is deferred under section 6166 and of the assets of that business, the relevant market factors that will impact the business's future success, its recent financial history, and the experience of its management, in an effort to predict the likelihood of its success and survival through the deferred payment period. Facts relevant to this factor are likely to appear primarily in the appraisal and the financial statements that accompany the estate tax return. Information regarding any outstanding liens, judgments, or pending or anticipated lawsuits or other claims against the business, if any, that are not disclosed in that documentation should be provided by the estate with the election. The estate may be required to furnish such information in response to an inquiry by the IRS.

2. *Ability to pay the installments of tax and interest timely.* This factor considers how the estate expects to be able to make the annual payments of tax and interest as due, and the objective likelihood of realizing that expectation. Facts relevant to this factor may include the nature of the business's significant assets and liabilities, and the business's cash flow (both historical and anticipated). If not sufficiently disclosed in the documents attached to the estate tax return, the estate should submit relevant information with the election under section 6166. The estate may be required to furnish such information in response to an inquiry by the IRS.

3. *Compliance history.* This factor addresses the business's history regarding compliance with all federal tax payment and tax filing requirements, in an effort to determine whether the business and its management respect and comply with all tax requirements on a regular basis. This factor also addresses the estate's compliance history with respect to federal tax payment and filing requirements. The estate may use a sworn affidavit or other probative documents to provide this information.

This notice is applicable to each estate: (1) that timely elects to pay the estate tax in installments under section 6166 and that timely files a return on or after November 13, 2007; (2) whose return was being clas-

sified, surveyed or audited by the IRS as of April 12, 2007; or (3) that is currently in the deferred payment period but that has not yet provided a bond or special lien if (a) the general federal estate tax lien will expire within two years from November 13, 2007 or (b) the IRS reasonably believes that the government's interest in collecting the deferred estate tax and interest thereon in full is sufficiently at risk to require a bond or special lien.

## REQUEST FOR COMMENTS

The Treasury Department and the IRS intend to issue regulations regarding the appropriate standards to be applied by the IRS in exercising its discretion with regard to whether a bond or special lien will be required in order to avoid an IRS termination of an estate's election under section 6166, and invite interested persons to submit comments regarding such standards and possible alternatives to a bond or special lien for providing security under section 6166.

In particular, comments are requested with regard to the following issues:

1. What factors, in addition to or in place of those stated above, should the IRS use in determining whether to require security from an estate electing to pay the estate tax in installments under section 6166?

2. How often during the section 6166 installment payment period (or on what occurrences) should the IRS reevaluate whether the estate poses a sufficient credit risk to the government's collection of the deferred estate tax and related interest to justify the requirement of a bond or special lien?

3. What facts evident from a review of the estate tax return are likely to be reasonably accurate predictors of either a future default in or full payment of the deferred tax payments and related interest?

4. What additional financial information should the IRS require from an estate to assist in making the determination as to whether the estate poses a sufficient credit risk to the government with regard to the deferred estate tax and interest thereon to justify requiring a bond or special lien?

5. For purposes of sections 6165 and 6166(k), should the IRS define a surety bond under section 7101 to also include other forms of security, and, if so, what other forms of security, such as certain ir-

revocable letters of credit from reputable financial institutions or United States Treasury Bonds, should be so included?

Comments are encouraged to be submitted by January 14, 2008, to: Internal Revenue Service, CC:PA:LPD:PR (Notice 2007-90), room 5203, P.O. Box 7604, Ben Franklin Station, Washington, DC 20224. Submissions may be hand delivered Monday through Friday between the hours of

8 a.m. and 4 p.m. to: CC:PA:LPD:PR (Notice 2007-90), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit electronic comments directly to the IRS e-mail address: [notice.comments@irs.counsel.treas.gov](mailto:notice.comments@irs.counsel.treas.gov). Please include "Notice 2007-90" in the subject line of any electronic communication.

#### DRAFTING INFORMATION

The principal author of this notice is Laura Urich Daly of the Office of Associate Chief Counsel (Procedure and Administration). For further information regarding this notice, contact Laura Urich Daly at (202) 622-3600 (not a toll-free call).