Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
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Person To Contact:
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Telephone Number:

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Date:
January 14, 2005

Legend:

Decedent =

Date 1 =
Trust =

Corporation 1 =
Corporation 2 =
Property A =
Property B =

X =

Dear :

This is in response to your authorized representative's letter, dated April 23, 2004, submitted on behalf of Decedent's estate, requesting a ruling under §§ 2057 and 6166 of the Internal Revenue Code.

The facts submitted and representations made are summarized as follows: Decedent died on Date 1. At the time of his death, Decedent indirectly owned, through Trust, 100 percent of the stock of Corporation 1 and 100 percent of the stock of Corporation 2. Decedent was the sole beneficiary of Trust during his lifetime. Corporation 1 and Corporation 2 are both retail automobile dealerships. It is represented that Decedent was the director, president, and treasurer of both Corporation 1 and Corporation 2 until the time of his death and was actively involved in the day-to-day operations of both corporations. Decedent made all decisions and supervised all employees of Corporation 1 and Corporation 2.

In addition, Decedent directly owned certain real estate assets, including Property A and Property B. The buildings on Property A and Property B were

constructed specifically for use by Corporation 1 and Corporation 2 in the automobile dealership business and contain unique features such as showrooms with special doors that allow cars to enter the showroom, parts and service areas with automobile exhaust systems, car lifts, and service bays. Property A and Property B were also used to house inventory, office space, and parking. Decedent leased Property A to Corporation 1 and Property B to Corporation 2. It is represented that Property A and Property B represent approximately X percent of the value of Corporation 1 and Corporation 2, combined.

The executor of Decedent's estate requests the following rulings: (1) that Decedent's interests in Corporation 1 and Corporation 2, corporations wholly owned by Decedent through Trust, and Property A and Property B, owned directly by Decedent and leased to Corporation 1 and Corporation 2, qualify as an interest in a single closely held business within the meaning of § 6166; and (2) that Property A and Property B, the real property owned directly by Decedent and leased to Corporation 1 and Corporation 2, qualify as qualified family-owned business interests for purposes of § 2057.

Ruling Request 1:

The Tax Reform Act of 1976 created a new § 6166 and redesignated the former section as § 6166A. Pub. L. No. 94-455, § 2004(a). The Economic Recovery Tax Act of 1981 repealed § 6166A and amended § 6166 so that it would apply in most cases that were previously governed by § 6166A. Pub. L. No. 97-34, § 422(d). Neither the Economic Recovery Tax Act of 1981 nor its legislative history indicate any intent on the part of Congress that an interest that constitutes an interest in a closely held business under § 6166A would not qualify under § 6166. As a result, the regulations under § 6166A are applicable to this ruling request to the extent that those regulations are not inconsistent with the language of § 6166.

Under § 6166(a), if the value of an interest in a closely held business included in determining the gross estate of a decedent who was (at the date of death) a citizen or resident of the United States exceeds 35 percent of the adjusted gross estate, the executor of the estate may elect to pay part or all of the tax imposed by § 2001 (the estate tax) in two or more (but not exceeding ten) equal installments.

Section 6166(b)(1) provides 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 capital interest in such partnership is included in determining the gross estate of the decedent, or
    (ii) such partnership had 45 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 45 or fewer shareholders.

Section 6166(b)(9)(A) provides that for purposes of § 6166(a)(1) and in determining the closely held business amount, the value of any interest in a closely held business shall not include the value of the portion of such interest which is attributable to passive assets held by the business. Section 6166(b)(9)(B)(i) provides that "passive asset" means, in general, any asset other than an asset used in carrying on a trade or business.

Section 20.6166A-2(c)(2) of the Procedure and Administration 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 that were actually utilized by him in a trade or business. For stock in a corporation carrying on a trade or business, however, it is not necessary that all assets of the corporation be used in carrying on the trade or business.

Section 6166(c) provides that interests in two or more closely held businesses, with respect to each of which there is included in determining the value of the decedent's gross estate of 20 percent or more of the total value of each such business, shall be treated as an interest in a single closely held business.

Revenue Ruling 75-366, 1975-2 C.B. 472, involved a decedent who paid 40 percent of the expenses, received 40 percent of the crops and actively participated in important management decisions of a tenant farm included in the decedent's gross estate. The decedent made almost daily visits to inspect and discuss operations, and occasionally delivered supplies to the tenants. The ruling holds that farming under these circumstances is a productive enterprise like a manufacturing enterprise, and is distinguishable from management of investment assets. Therefore, the decedent's farm asset constitutes an interest in a closely held business.

Section 6166 was enacted to permit the deferral of the payment of the federal estate tax where, in order to pay the tax at one time, it would be necessary to sell assets used in a going business, and thereby, disrupt or destroy the business enterprise. This section was intended to permit deferral of tax on income-producing assets only if the assets formed part of an active trade or business producing business income rather than income solely from the ownership of property. 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.

Corporation 1 and Corporation 2

The employees of Corporation 1 and Corporation 2 are engaged in the selling of automobiles, automotive parts and related supplies. Much like the decedent in Rev. Rul. 75-366, Decedent was actively involved in the day-to-day operations of Corporation 1 and Corporation 2. Further, Decedent supervised all employees of Corporation 1 and Corporation 2. Thus, Corporation 1 and Corporation 2 were conducting an active trade or business. Consequently, Decedent's stock in Corporation 1 (owned by Trust for which Decedent was the grantor) constitutes an interest in a closely held business. Similarly, Decedent's stock in Corporation 2 (also owned by Trust) constitutes an interest in a closely held business. Because 100 percent of the value of the stock in each corporation will be included in Decedent's gross estate, Decedent's interests in Corporation 1 and Corporation 2 are treated as an interest in a single closely held business.

Property A and Property B

Property A and Property B were held by Decedent for the benefit of the overall operation and management of Corporation 1 and Corporation 2. Both Property A and Property B consist of unique structures and surrounding land specifically necessary and essential to carry out the day-to-day operations of Corporation 1 and Corporation 2. The fact that Property A and Property B were personally owned by Decedent and not by Corporation 1 or Corporation 2 does not diminish the essential nature of Property A and Property B to the overall operations of the automobile dealerships. Corporation 1 and Corporation 2 could not function without the use of Property A and Property B. Therefore, Property A and Property B are not passive assets within the meaning of § 6166(b)(9)(B)(i). Consequently, Decedent is a proprietor in a trade or business carried on as a proprietorship. Because 100 percent of the value of Decedent's proprietorship will be included in the value of the gross estate, Decedent's interests in Property A and Property B can be combined with his interests in Corporation 1 and Corporation 2 and be treated as an interest in a single closely held business.

Based on the facts and information submitted and the representations set forth above, we rule that Decedent's interests in Corporation 1 and Corporation 2, as well as Property A and Property B, qualify as an interest in a single closely held business within the meaning of § 6166.

Accordingly, provided the other requirements of § 6166 are met, the federal estate tax attributable to Decedent's interest in the closely held business may be paid in installments under § 6166.

Ruling Request 2:

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

Section 2057(a)(1) provides that for purposes of the tax imposed by § 2001, in the case of an estate of a decedent to which this section applies, the value of the taxable estate shall be determined by deducting from the value of the gross estate the adjusted value of the qualified family-owned business interests of the decedent that are described in § 2057(b)(2). Section 2057(a)(2) provides that the deduction allowed by § 2057 shall not exceed $675,000.

Section 2057(b)(1) provides, generally, that § 2057 shall apply to an estate if: (A) the decedent was (at the date of the decedent's death) a citizen or resident of the United States; (B) the executor elects the application of this section and files the agreement referred to in § 2057(h); (C) the sum of the adjusted value of the qualified family-owned business interests described in § 2057(b)(2), plus the amount of the gifts of such interests determined under § 2057(b)(3), exceeds 50 percent of the adjusted gross estate; and (D) during the 8-year period ending on the date of the decedent's death there have been periods aggregating 5 years or more during which such interests were owned by the decedent or a member of the decedent's family and there was material participation (within the meaning of § 2032A(e)(6)) by the decedent or a member of the decedent's family in the operation of the business to which such interests relate.

Section 2057(b)(2) provides that the qualified family-owned business interests described in § 2057(b) are the interests which are included in determining the value of the gross estate, and are acquired by any qualified heir from, or passed to any qualified heir from, the decedent (within the meaning of § 2032A(e)(9)).

Section 2057(e)(1) provides, generally, that for purposes of § 2057, the term "qualified family-owned business interest" means an interest as a proprietor in a trade or business carried on as a proprietorship, or an interest in an entity carrying on a trade or business, if: (1) at least 50 percent of such entity is owned (directly or indirectly) by the decedent and members of the decedent's family; (2) at least 70 percent of such entity is so owned by members of 2 families and at least 30 percent of such entity is so owned by the decedent and members of the decedent's family; or (3) at least 90 percent of such entity is so owned by members of 3 families and at least 30 percent of such entity is so owned by the decedent and members of the decedent's family.

Section 2057(e)(2)(C) and (D) provide, in part, that the term "qualified family-owned business interest" shall not include: (C) any interest in a trade or business not described in § 542(c)(2), if more than 35 percent of the adjusted ordinary gross income of such trade or business for the taxable year which includes the date of the decedent's death would qualify as personal holding company income (as defined in § 543(a) without regard to § 543(a)(2)(B)) if such trade or business were a corporation; (D) and that portion of an interest in a trade or business that is attributable to: (i) cash or marketable securities, or both, in excess of the reasonably expected day-to-day working capital needs of such trade or business; and (ii) any other assets of the trade or business (other than assets used in the active conduct of a trade or business described

in § 542(c)(2)), which produce, or are held for the production of, personal holding company income. In the case of a lease of property on a net cash basis by the decedent to a member of the decedent's family, income from such lease shall not be treated as personal holding company income for purposes of § 2057(e)(2)(C), and such property shall not be treated as an asset described in § 2057(e)(2)(D)(ii), if such income and property would not be so treated if the lessor had engaged directly in the activities engaged in by the lessee with respect to such property.

In this case, Decedent directly owned Property A and Property B and leased these properties to Corporation 1 and Corporation 2, respectively, for use in Corporation 1's and Corporation 2's automobile dealership businesses. Corporation 1 and Corporation 2 were entities wholly owned by Decedent through Trust. As discussed above, Property A and Property B consist of unique structures that are integral to the business operations of Corporation 1 and Corporation 2. Thus, Decedent's interests in Property A and Property B constitute an interest as a proprietor in a trade or business carried on as a proprietorship. Moreover, under § 2057(e)(2), the income from the lease of Property A and Property B to Corporation 1 and Corporation 2, respectively, is not treated as personal holding company income because such income would not be treated as personal holding company income if the lessor (Decedent) had engaged directly in the activities engaged in by the lessee (Corporation 1 and Corporation 2) with respect to such property. Accordingly, we conclude that Decedent's interests in Property A and Property B qualify as "qualified family-owned business interests" under § 2057(e).

In addition, § 2057 contains many similarities to and incorporates many of the provisions of § 2032A by cross reference. Although § 2057 does not contain a specific cross reference to § 2032A(b)(2) (relating to qualified use), the provisions of § 20.2032A-3(b)(1) of the Estate Tax Regulations address a similar issue. Section 20.2032A-3(b)(1) provides, generally, that all specially valued property must be used in a trade or business. Directly owned real property that is leased by a decedent to a separate closely held business is considered to be qualified real property, but only if the separate business qualifies as a closely held business under § 6166(b)(1) with respect to the decedent on the date of his or her death and for sufficient other time (combined with periods during which the property was operated as a proprietorship) to equal at least 5 years of the 8 year period preceding the death. For example, real property owned by the decedent and leased to a farming corporation or partnership owned and operated entirely by the decedent and fewer than 15 members of the decedent's family is eligible for special use valuation.

As ruled above, Decedent's interests in Corporation 1 and Corporation 2 qualify as an interest in a closely held business under § 6166. Thus, under § 2032A(b), Property A and Property B would be considered "qualified real property" and eligible for special use valuation. Likewise, we conclude that Decedent's interests in Property A and Property B qualify as "qualified family-owned business interests" under § 2057(e).

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 specifically ruled herein, we express or imply no opinion on the federal tax consequences of the transaction under the cited provisions or under any other provisions of the Code. Specifically, we express or imply no opinion on whether the estate qualifies for the deduction under § 2057. The burden of establishing to the satisfaction of the Service that all of the requirements of § 2057 have been met remains with Decedent's estate.

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

In accordance with a power of attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

James F. Hogan
Senior Technician Reviewer, Branch 9
(Passthroughs & Special Industries)

Enclosures
Copy for section 6110 purposes
Copy of letter