

Internal Revenue Service

Number: **200449031**

Release Date: 12/3/04

Index Number: 2053.05-00

Department of the Treasury
Washington, DC 20224

Person To Contact:

Telephone Number:

Refer Reply To:

CC:PSI:B04 – PLR-154219-03

Date:

July 29, 2004

LEGEND:

Decedent =
Spouse =
Trust =

Corporation =
Date 1 =
Date 2 =
Date 3 =
Date 4 =
Date 5 =

a =
b =
c =
d =
e =
f =
g =
h =
i =
J =
k =
State =
State Statute =
Bank =

Dear :

This is in response to your letter of September 10, 2003, and other correspondence, requesting a ruling concerning the deductibility of interest expense under section 2053 of the Internal Revenue Code.

The facts submitted are as follows:

On Date 1, Decedent executed a will. After the fulfillment of a number of specific and pecuniary bequests, Article V of the will provides that the remainder of Decedent's property (other than certain capital stock) will pass to Trust, an inter vivos revocable trust established by Decedent on Date 2. Other than a nominal amount, Decedent transferred no assets to Trust during his lifetime.

Article III, Section 3.1 of Trust provides that the Decedent shall have the right and power, at all times, and from time to time during his lifetime, by written instrument delivered to the Trustees to revoke the Trust Agreement, in whole or in part, or to alter, amend, or modify any of the terms or provisions of the Trust to any extent. However, Decedent shall have no power to alter, amend or revoke as to any assets contributed to the Trust by someone else. Any other person contributing assets to the Trust, including Spouse, shall have the right at any time during her lifetime to withdraw any assets contributed by her or the proceeds from any reinvestment thereof, but shall have no right to withdraw any assets contributed to the Trust by the Decedent or any other person.

Article III, Section 3.2 provides that the Decedent and any other person may add property to Trust by gift, will or otherwise. The Decedent may withdraw any property contributed by him, but not by others.

Article III, Section 3.4 provides that during the Decedent's lifetime, the Trustees are to pay the entire net income from assets contributed by the Decedent, if any, of the Trust to the Decedent not less frequently than quarterly. Any net income from any assets contributed by Spouse shall be paid to Spouse, during her lifetime, in installments not less frequently than quarterly. After the death of either Decedent or Spouse, the Trustee shall pay the entire net income to the survivor in monthly or quarterly installments but at least annually.

Article IV, Section 4.3 provides that the Trustee shall have the right to pay to the personal representative of Decedents' estate the amount by which the estate, succession, death or similar taxes assessed by reason of Decedent's death are increased as a result of the inclusion of the assets of Trust in Decedent's taxable estate.

Article IV, Section 4.4(a) provides that after Decedent's death, the Trust shall continue and the income shall be divided into as many shares as there are Decedent's children surviving or if any of Decedent's children are deceased leaving issue surviving, such deceased child's share shall go equally to or among his or her issue as set forth in Article 4.6.

Article V, Section 5.1 provides that the Trust shall continue for 15 years after the date of Decedent's death and end at the end of the calendar month ending 15 years after Decedents' death.

Article V, Section 5.2 provides that within a period not to exceed 6 months after the termination of the Trust, the Trustees shall divide the corpus of the Trust and any undistributed income into 6 parts, one of which shall be distributed for the benefit of each of Settlor's children.

Spouse predeceased Decedent on Date 3. Under the terms of her will, k shares of common stock in Corporation owned by Spouse and other assets passed to Trust to be held under the terms of Trust. The executor of Spouse's estate made a qualified terminable interest property (QTIP) election under section 2056(b)(7) with respect to the assets that passed from Spouse to Trust.

Decedent died on Date 4. Decedent's gross estate included stock in Corporation and other closely held business interests owned by Decedent. Decedent's gross estate also included under section 2044, the portion of Trust that constituted QTIP. Decedent's estate is entitled to be reimbursed for any estate tax attributable to the inclusion of the QTIP property in Decedent's gross estate.

On Date 5, the executors of Decedent's estate filed the Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return. The return reported a gross estate of \$a. Of the total gross estate, the value of Decedent's interest in closely-held businesses was \$b and thus comprised approximately c% of the value of the adjusted gross estate.

The executors and Trustees determined that it would not be a prudent exercise of their fiduciary duties to sell the stock in the Corporation or its underlying assets. The executors have liquidated or will liquidate a substantial portion of the estate's non-closely held business assets which amounts will be used to pay a portion of the estate tax liability. Consequently, the executors have determined that it is in the best interest of the Corporation to secure a commercial loan with Bank to pay the balance of the estate tax liability.

The Corporation has issued separate notes (Redemption Notes) to the Estate and the Trust in exchange for some of the Corporation stock in a redemption pursuant to section 303 of the Internal Revenue Code. The Estate will redeem e shares for a note in the amount of \$f and the Trust will redeem g shares for a note in the amount of \$h. The Redemption Notes will be secured by mortgages on the d properties. The repayment of the Redemption Notes will be used to pay off the commercial loan.

The notes have been pledged to Bank in exchange for a loan in the amount of \$i with the Estate and Trust as Co-Borrowers. The loan proceeds were applied to pay the

State Estate Tax of \$J. The balance of the loan will be used to pay the federal estate tax.

Section 3.4 of the Loan Agreement between Bank and the Estate and Trust provides that all or any part of the outstanding principal of the Loan may be prepaid at any time without prepayment penalty or premium, unless Borrower has irrevocably waived its right to such prepayment by written notice delivered to Lender in accordance with the terms of this Agreement. It has been represented that the Estate and Trust intend to irrevocably waive their right of prepayment, if it is determined that the loan was necessary for the administration of the estate. In addition, the parties have represented that during the period the loan is outstanding the Corporation stock will not be sold.

State Statute provides, in part, that except as restricted or otherwise provided by the will, a personal representative, acting reasonably for the benefit of the interested persons, may properly borrow money with or without security to be repaid from the probatable assets or otherwise; and advance money for the protection of the estate; and pay taxes, assessments, compensation of the personal representative, and other expenses incident to the administration of the estate.

You have requested a ruling that the interest attributable to the loan obtained from Bank is deductible as an administration expense under section 2053(a)(2).

Section 2053(a)(2) provides that, for purposes of the tax imposed by section 2001, the value of the taxable estate shall be determined by deducting from the value of the gross estate such amounts for administration expenses as are allowable by the laws of the jurisdiction under which the estate is being administered.

Section 20.2053-1(b)(3) of the Estate Tax Regulations provides that an item may be entered on the return for deduction though its exact amount is not then known, provided it is ascertainable with reasonable certainty, and will be paid. No deduction may be taken upon the basis of a vague or uncertain estimate.

Section 20.2053-3(a) provides that amounts deductible from a decedent's gross estate as "administration expenses" are limited to such expenses as are actually and necessarily incurred in the administration of the decedent's estate; that is, in the collection of assets, payment of debts, and distribution of property to the persons entitled to it. The expenses contemplated in the law are such only as attend the settlement of an estate and the transfer of the property of the estate to individual beneficiaries or to a trustee, whether the trustee is the executor or some other person. Expenditures not essential to the proper settlement of the estate, but incurred for the individual benefit of the heirs, legatees, or devisees, may not be taken as deductions. See Estate of Reilly v. Commissioner, 76 T.C. 369, 373 (1981) (quoting Porter v. Commissioner, 49 T.C. 207, 225 (1967)).

Revenue Ruling 84-75, 1984-1 C.B. 193, holds that interest on a loan obtained

by an executor of an estate is a deductible administration expense, provided the loan was reasonably and necessarily incurred in the administration of the estate. The revenue ruling concludes that under the facts presented in the revenue ruling, because the loan was obtained in order to avoid a forced sale of assets, the loan was reasonably and necessarily incurred in administering the estate. However, because the estate's obligation to make payments on the loan could be accelerated (because, for example, the estate might prepay the loan or the estate might default), the amount of interest the estate might pay in the future is uncertain within the meaning of section 20.2053-1(b)(3). Accordingly, the ruling concludes that the interest is deductible by the estate only after it accrues and any estimated amount of interest to accrue in the future is not deductible.

In Estate of Lasarzig v. Commissioner, T.C. Memo 1999-307, the Tax Court denied a deduction for interest on a loan used to pay a QTIP trust's share of the estate tax liability because the expense was not an administrative expense within the meaning of section 2053. In that case, the QTIP Trust assets were distributed to the individual beneficiaries. These beneficiaries then contributed the property to their own family trusts, which in turn applied for loans to pay the portion of the estate tax attributable to the QTIP Trust. The Court noted that, while the QTIP trust had a nexus to the estate because the value of the trust assets were a part of the gross estate, the family trust had no such nexus. As a result, there remained no assets in the estate to administer and the borrowers had no relationship to the estate. For these reasons, the Tax Court found that the interest expense failed to meet the requirements of section 2053.

In the present case, the Estate and the Trust (including the QTIP share) are the co-borrowers for the full amount of the loan from Bank. The estate will seek contribution from the QTIP trust for its portion of the deferred estate taxes as directed in the trust instrument and required by law.

Based upon the representations made and the information submitted we conclude that the interest attributable to the loan obtained from Bank to pay the estate's federal and state estate tax liability is deductible as an administration expense under section 2053(a)(2), if it is determined that the loan was necessary for the administration of the estate. We express no opinion on whether or to what extent the loan is necessary for the administration of the estate. We note, however, that the amount of the loan determined to be necessary to pay the estate taxes should reflect any reduction in the estate tax liability resulting from any deduction ultimately allowed for interest on the loan.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer and to the taxpayer's other authorized representative.

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.

A copy of this letter should be sent to the Service Center where the Decedent's federal estate tax return was filed. A copy is enclosed for that purpose.

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.

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

Sincerely yours,

George Masnik
Chief, Branch 4
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure:

Copy of letter for section 6110 purposes

Copy of letter