

Office of Chief Counsel
Internal Revenue Service
Memorandum

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to: Vicki Martinson
Technical Services Advisor
(Oakland Advisory Group, Technical Services, Area Cal-West)

from: Blaise G. Dusenberry
Special Counsel
(Procedure & Administration)

subject: Impact of the expiration of the statute of limitations for assessment on the Service's determination with respect to a taxpayer's section 6166 election.

This Chief Counsel Advice responds to your request for assistance dated March 9, 2006. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice may not be used or cited as precedent.

ISSUES

1. Whether there is a statutory period of limitations for obtaining either a surety bond or section 6324A special lien from the taxpayer when a taxpayer makes a section 6166 election.
2. Whether the expiration of the period of limitations for assessment under section 6501 precludes the Service from obtaining either a surety bond or section 6324A special lien from the taxpayer, or denying/terminating a section 6166 election when the Service is unable to secure either of the above forms of security.

3. Whether issuing a closing letter to the executor of the estate prohibits the Service from obtaining either a surety bond or section 6324A special lien from a taxpayer who makes a section 6166 election.

CONCLUSIONS

1. There is no limitations period under any Internal Revenue Code (the "Code") section for obtaining security from a taxpayer electing to pay the estate tax in installments under section 6166 as long as the assessment remains unpaid.

2. Section 6501 sets forth a three-year period of limitations on assessment of estate tax. The Service's ability, however, to demand that the taxpayer provide security under section 6166(k)(1), with respect to the deferred payments, is separate and distinct from the Service's ability to assess a tax. Thus, the Service may demand security at any time, notwithstanding, or even after, the period of limitations on assessment has expired so long as the assessment remains unpaid.

3. Issuing a closing letter to the executor of the estate will not prevent the Service from obtaining a surety bond under section 6165 or section 6324A special lien from the taxpayer.

FACTS

An Estate has properly elected on its timely filed United States Estate (and Generation-Skipping Transfer) Tax Return, Form 706, to pay a portion of the estate tax in installments under section 6166. The period of limitations on assessment has expired, and the Service has issued a closing letter to the executor of the Estate. The Estate has not yet provided a section 6165 bond or granted the Service a section 6324A lien in lieu of the bond. In addition, the Service has not yet granted the Estate the section 6166 election.

LAW AND ANALYSIS

As a general rule, the estate tax return, Form 706, and payment of the estate tax liability of a decedent are due within nine months of the decedent's death. I.R.C. §§ 6075(a); 6151(a). Section 6166(a) of the Internal Revenue Code, as an exception to the above rule, provides that if the value of an interest in a closely held business included in determining the value of the gross estate of a decedent 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 section 2001 (estate tax) in two or more (but not exceeding ten) equal installments. The first installment of tax must be paid on or before the date selected by the executor which is not more than 5 years after the date prescribed by section 6151(a) for payment of the tax. An executor electing to defer estate taxes under section 6166 must make annual payments of interest during the deferral period. In particular, interest must be paid annually during the five-year period before the first installment of tax is

due. I.R.C. § 6166(f). When an estate fails to make payments of principal or interest the Service may terminate the deferred payment election and force an acceleration of payment of the estate tax by issuing notice and demand. I.R.C. § 6166(g)(3).

Under the provisions of section 6166(a), an election to pay the estate tax in installments must be made on a timely filed return. I.R.C. § 6166(d). Section 20.6166-1(b) of the Estate Tax Regulations set forth the required contents of an election under section 6166(a) which includes, in part, the amount of tax to be paid in installments, the date selected for payment of the first installment and the number of installments in which the tax is to be paid. In addition, section 6166(h)(1) provides that if the executor has not made an election under section 6166(a), a deficiency is imposed, and the estate qualifies under section 6166(a)(1), the executor may elect within 60 days of the issuance of notice and demand to pay the deficiency in installments provided the deficiency is not due to negligence, intentional disregard of rules and regulations, or fraud with intent to evade tax.

With regards to the Service's ability to require security for a section 6166 election, section 6166(k)(1) and (2) specifically cross reference sections 6165 and 6324A. These sections allow the Secretary to require security in the case of an extension under section 6166. Section 6165 states that in the event the Secretary grants any extension of time within which to pay any tax or any deficiency therein, the Secretary may require the taxpayer to furnish a bond in such amount (not exceeding double the amount with respect to which the extension is granted) conditioned upon the payment of the amount extended in accordance with the terms of such extension. Pursuant to this statutory provision, the Service may require an executor to provide a bond with respect to estate taxes deferred under section 6166. In the alternative, the Service has indicated that an executor desiring to be discharged from personal liability can elect a section 6324A lien. I.R.C. § 2204. Such a lien will be in lieu of the bond required pursuant to section 6165. I.R.C. § 6324A. The section 6324A lien will also be in lieu of the estate tax lien which arises under section 6324(a)(1). I.R.C. § 6324A(4).

Issues 1 and 2:

Under the federal self-assessment system of taxation, every taxpayer liable for any tax imposed by the internal revenue laws is required to file a return on forms prescribed by the Service, and to show thereon information upon which the tax liability can be determined. I.R.C. § 6011(a); Treas. Reg. § 601.103(a). In most cases, the taxpayer's self-assessment of tax liability is accepted, and becomes the final tax liability determination. Pursuant to section 6201, the Service is authorized to make inquiries, determinations, and assessments of all taxes (including interest and penalties). In addition, the Service can assess the tax as reported by the taxpayer on the return, or as determined by the Service through audit. If, upon audit, an initial determination is made that a taxpayer has not determined the correct tax liability and that additional tax is due, such determination becomes a final determination of tax liability if the taxpayer agrees with, or does not contest, the Service's determination.

Section 6211 defines a deficiency as the amount by which the tax imposed exceeds the amount shown as tax on the taxpayer's return, plus any amounts previously assessed, less the amounts of any rebates. In such cases, the Service issues a notice of proposed deficiency which details the nature and amount of the proposed adjustments. The letter also sets forth the taxpayer's right to appeal the proposed adjustments to Appeals. If the taxpayer does not timely avail itself of the right to seek Appeals consideration, a statutory notice of deficiency is issued to the taxpayer. This letter informs the taxpayer that they have 90 days in which to file a petition with the Tax Court to contest the deficiency.

As a general rule, a tax reported on a return, or any deficiency determined by the Service, must be assessed by the Service within three years after the taxpayer files the return. I.R.C. § 6501(a). Section 6503(d) suspends the limitation period for collection during any extension of time for estate tax payment under sections 6161, 6163, or 6166. Yet, the taxpayer's obligation to provide security under section 6166 is separate and distinct from the Service's ability to assess and/or collect, and the procedures under sections 6501 and 6213 have no effect on section 6166 determinations.

Section 7479 sets forth a declaratory judgment remedy for taxpayers regarding an estate's qualification for the section 6166 election. Until the enactment of the Taxpayer Relief Act of 1997, however, the Tax Court had no jurisdiction to resolve disputes between an estate and the IRS regarding an estate's qualification for section 6166 deferral. Pub. L. 105-34, 111 Stat. 788, 854. To limit the potential hardship caused by an erroneous denial of a section 6166 election, a declaratory judgment remedy was added to the Code under section 7479. Under section 7479(b)(2), however, the Tax Court may not issue a declaratory judgment unless the taxpayer has exhausted all administrative remedies within the Service.

Several steps must be taken in order to exhaust all available administrative remedies. Rev. Proc. 2005-33, 2005-24 I.R.B. 1231. First, the taxpayer must timely file, including extensions, a Form 706 on behalf of the estate and attach the election to extend the time to pay pursuant to section 6166(a). Next, the taxpayer must request, in writing, an Appeals conference within 30 calendar days after the mailing date of the preliminary determination letter, or by such later date as is agreed to between the taxpayer and the Service. Upon reaching a final determination, Appeals will issue a final determination letter to the taxpayer. The determination by Appeals, regarding the estate's initial or continuing eligibility under section 6166, is final and may not be appealed further within the Service. In the final determination letter, the taxpayer receives notice of the right to petition the Tax Court under section 7479.

A review of the applicable authority indicates that there is no statutory period of limitations for obtaining security for a section 6166 election as long as the assessment has not been satisfied. To the extent possible, security should be obtained from the taxpayer as early in the section 6166 election process as is feasible. We believe the

Service may seek security, or additional security, for the section 6166 election at any time, including instances where the security may no longer sufficiently secure the Service's interest. This is so because once the Service has granted the section 6166 election, the estate tax liability is not currently due and payable. Without security, the Service's interest in the estate tax liability would be unsecured for the duration of the deferral under section 6166. Just like a lender, the Service has the ability to seek security to shelter its unprotected interest during the period of time the estate tax liability is deferred.

Similarly, the expiration of the limitations period on assessment under section 6501 does not impact the ability of the Service to seek security for a section 6166 election. This is true regardless of whether the section 6166 election was made on a timely filed estate tax return, or made with respect to a deficiency pursuant to section 6166(h). If an election was made pursuant to section 6166(h), it would be done after completion of the audit and after the taxpayer receives notice and demand to pay the deficiency. Permitting the taxpayer to make the section 6166 election on a deficiency further supports the conclusion that the expiration of the limitations period on assessment has no effect on the Service's ability to seek security for a section 6166 election.

In addition, it is also our view that a section 6166 election can be denied or terminated at any time if the Service is unable to obtain a section 6165 bond or 6324A special lien in lieu of the bond. Such denial or termination does not impede upon any taxpayer rights given that the taxpayer has the opportunity to appeal the decision through administrative remedies, and if the matter can not be resolved through Appeals, to petition the Tax Court under section 7479 for declaratory judgment.

Issue 3:

If an audit is settled at the examination or the appeals level, the Service will send an estate tax closing letter to the executor. I.R.C. § 2204(a). This letter is evidence that the tax return for the estate has either been accepted as filed, or has been accepted after an adjustment. In addition, the closing letter provides that if the time for payment has been extended under sections 6161, 6163, or 6166, personal liability shall not be released until full payment has been received. The issuance of the closing letter is designed to provide a measure of assurance that the estate's federal tax liabilities have been satisfied, or fixed and determined in the case where the tax is deferred under sections 6161, 6163 or 6166, thus permitting the closing of the probate estate at the local level. Notifying the taxpayer that the estate tax liability has been fixed and determined is unrelated to the determination of when the tax is due. Thus, terminating or denying a section 6166 election will have no impact on the estate tax liability, rather, it will only accelerate the payment date. It is also important to note that an estate tax closing letter is not a formal closing agreement under section 7121. Accordingly, the issuance of a closing letter has no effect on the Service's ability to require a section 6165 bond, or should the executor chose, a section 6324A lien in lieu of the bond. Rather, the closing letter merely provides that the Service will not reopen/audit the

return unless notified by the executor or there is (1) evidence of fraud, malfeasance, collusion, concealment or misrepresentation of material fact, (2) a clearly defined substantial error based upon an established Service position, or (3) a serious administrative error.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

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Please call (202) 622-4940 if you have any further questions.