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Outside the Box on Estate Tax Reform: Reviewing Ideas to Simplify Planning

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Outside the Box on Estate Tax Reform: Reviewing Ideas to Simplify Planning*

I thank you for inviting me to testify about simplifying planning to address the payment of federal estate taxes. I am testifying on my own behalf and do not speak for any other person, organization, or entity. My testimony is based on my 30 years' experience in private practice representing individual clients, particularly closely held business owners, and assisting my clients in planning to deal with the burden of federal gift, estate and generation-skipping taxes. (I will refer to these taxes collectively as "transfer taxes.")

I applaud this Committee's efforts to resolve this year the uncertainty concerning the transfer tax laws. Taxpayers can deal more effectively with the federal transfer tax burden on their property when taxpayers know what the law will be in the foreseeable future. I have heard mamy complaints from clients about being unable to plan for the federal transfer tax burden given the uncertainty under the existing transfer tax laws.

I will testify about two matters (1) the *Report on Reform of Federal Wealth Transfer Taxes*, which addresses numerous aspects of federal transfer taxes, and (2) an issue of importance to closely held business owners, the installment payment of estate taxes attributable to a closely held business under Internal Revenue Code section[1] 6166.[2]

I. Report on Reform of Federal Wealth Transfer Taxes

I was the Chair of the Task Force on Federal Wealth Transfer Taxes which produced the *Report on Reform of Federal Wealth Transfer Taxes*. The Task Force was formed by seven organizations representing professionals who advise clients on federal wealth transfer taxes.[3] The Task Force members were some of the most knowledgeable professionals in

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* Editor's note: The following is the written testimony of Dennis I. Belcher submitted to the United States Senate Committee on Finance, April 3, 2008. Thanks to Michael Barker and William Sanderson of McGuireWoods for locating this testimony, which helps preserve Dennis's unique insights.

[1] Each reference to "section" is a reference to a section of the Internal Revenue Code of 1986, as amended.

[2] The term "installment payment provision" refers to section 6166.

[3] The American College of Trust and Estate Counsel Foundation, the American Tax Policy Institute and the American Bar Association Section of Real Property, Trust and Estate Law provided grants to enable the Task Force to publish their Report on Reform of Federal Wealth Transfer Taxes.

the United States who advise clients in transfer tax planning. The organizations participating in the Task Force were the following:

- The American College of Trust and Estate Counsel,
- The American Bar Association Section of Real Property, Trust and Estate Law,
- The American Bar Association Section of Taxation,
- The American Institute of Certified Public Accountants,
- The American Bankers Association, and
- The American College of Tax Counsel.

The purpose of the Task Force was to produce a report that would provide expert analysis of the changes enacted by the Economic Growth and Tax Relief Reconciliation Act of 2001 (the 2001 Tax Act) regarding federal wealth transfer taxes. The Task Force did not consider policy questions having to do with the economic effects of a wealth transfer tax system as compared to other systems of taxation or whether redistribution of wealth was an appropriate goal of the transfer tax system. The Task Force's central concern was to assess, on the basis of simplicity, compliance, and consistency of enforcement, the temporary repeal of the estate and generation-skipping transfer taxes, the phaseout period, the continuation of the gift tax after repeal, the modified carryover basis rule, and alternatives to federal wealth transfer tax repeal.

The Task Force prepared the Report to provide diverse views and perspectives on a wide range of issues concerning the current federal wealth transfer tax system and the changes the 2001 Tax Act made to that system. The Report suggested options that Congress may consider but did not make any specific recommendations for regulatory or legislative action. The Task Force members and sponsoring organizations support the analysis of the alternative solutions to the issues identified but did not endorse any specific solution.

I believe the two most significant changes suggested in the Report are

- Reunification of the gift and estate tax systems, and
- Portability of the unified credit and the GST exemption.

The Task Force distributed a copy of the Report to each member of the Congressional tax writing committees and their staff.[4]

I hope that the Committee and its staff will call upon the Task Force as you consider changes to the federal wealth transfer tax system.

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[4] TASK FORCE ON FED. WEALTH TRANSFER TAXES, REPORT ON REFORM OF FEDERAL WEALTH TRANSFER TAXES (2004), https://www.americanbar.org/content/dam/aba/administrative/taxation/migrated/pubpolicy/2004/04fwtt.authcheckdam.pdf.

II. Paying the Federal Estate Tax on Closely Held Business Interests in Installments

A. Significance of Closely Held Businesses

Family owned businesses are a major part of the United States economy, making up eighty to ninety percent of all businesses in North America and contributing significantly (in excess of five trillion dollars) to the United States Gross Domestic Product.[5] In a study of the companies making up the S & P 500, one study[6] found that one-third of these companies have deep family connections.[7] These families are heavily invested in the family business, and, on average, sixty-nine percent of the family's total wealth is invested in the family enterprise. Because of the large, concentrated investment, family businesses operate in unique and efficient ways, including looking to the long-term future of the business and the reputation of the family. The study also found that family businesses generally out-perform non-family businesses, posting a 6.65 percent greater return on assets than non-family businesses.[8]

The death of a closely held business owner often foretells the death of the business. Only thirty percent of all privately owned businesses survive past the first generation.[9] Although it is the goal of many business owners to transfer ownership of the business to future generations, only twelve percent of private businesses survive into the third generation, and a mere three percent are still in existence at the fourth generation and beyond.[10] There are many reasons for the lack of survival of closely held businesses for future generations, including lack of succession planning, business failure, and inability to meet liquidity needs (some of which is caused by the federal transfer tax laws).

The Statistics of Income Division of the Internal Revenue Service produces data files from samples of tax and information returns filed with the Internal Revenue Service. The Statistics of Income Division publishes information on the number of returns filed, the amount of tax collected, and other tax return information. The Statistics of Income Di-

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5 J.H. Astrachan & M.C. Shanker, *Family Businesses' Contribution to the U.S. Economy: A Closer Look*, 16 Fam. Bus. Rev. 211 (2003).

6 Ronald C. Anderson, Sattar A. Mansi & David M. Reeb, *Founding Family Ownership and the Agency Cost of Debt*, 68 J. Fin. Econ. 263 (2003) [hereinafter Anderson, Mansi, Reeb Study].

7 The study defined a "deep family connection" as the family responsible for starting the company still being heavily invested in the company, and having, on average, eighteen percent of company equity.

8 Anderson, Mansi, Reeb Study, *supra* note 6.

9 Mass Mutual Fin. Grp. & Raymond Inst., *American Family Business Survey* (2003) http://www.fambiz.org.au/wp-content/uploads/2003-Mass-Mutual-FB-Survey.pdf.

10 *Id.*

vision released recently a report entitled "Estate Tax Returns Filed in 2006: Gross Estate by Type of Property, Deductions, Taxable Estate, Estate Tax and Tax Credits, by Size of Gross Estate."[11]

The Statistics of Income Report showed that approximately 49,000 estate tax returns were filed in 2006 and approximately fifteen percent (7,567) of the tax returns listed as an asset stock in one or more closely held businesses.[12] The Statistics of Income Report also showed that those estates classified as the largest gross estates (greater than twenty million dollars) held a higher percentage of stock in a closely held business than smaller estates. Approximately fifty percent of those estates greater than twenty million dollars listed stock in a closely held business as an asset. In addition, the Statistics of Income Report showed that closely held stock was approximately five percent of the gross estate for all estates, but closely held stock constituted approximately fourteen percent of the gross estate of estates greater than twenty million dollars. It appears that for estate tax returns filed in 2006, the larger the estate, the more likely the estate will own a higher percentage of closely held stock.

From a review of statistics for years before 2006, there is a similar pattern of ownership of closely held stock in prior years. Accordingly, notwithstanding that the assets that can pass free of federal estate tax is scheduled to increase to $3,500,000 in 2009, there will still be a significant number of closely held business owners who will be subject to federal estate tax and whose estates will need relief in the form of the installment payment provision.

Because of the illiquid nature of a closely held business, federal transfer taxes present a serious obstacle to a closely held business surviving the death of the business owner. The shortfall of sufficient liquid assets to pay the federal transfer taxes incurred as a result of the business owner's death may necessitate a forced sale or liquidation of the business, thereby preventing the continuation of the business.

For many closely held business owners, the business represents the most valuable, and usually the most illiquid, asset in the business owner's estate. During the business owner's lifetime, the business is generally the primary vehicle of economic and emotional support for the business owner's family. As the primary asset of the business owner's estate, the business will be the source of funds to pay federal and state transfer taxes, debts, and administration expenses, as well as to pay for

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11 The Report can be found at https://www.irs.gov/pub/irs-soi/06es01fy.xls.

12 It does not appear that farm assets, including farm land, limited partnerships or limited liability companies are classified as closely held business interests for purposes of these statistics. If these assets were included, there would be a significantly larger percentage of estates holding closely held businesses.

the support of the business owner's surviving spouse and other dependents. With careful planning to ensure the availability of the installment payment provision, the family may be able to retain the business and not sell the business to meet liquidity needs. If the family is forced to sell the business, the sale may occur at an inopportune time, either because of external forces, such as a down turn in the economy, or internal forces, such as a lack of business succession planning, internal strife, and emotional distress.

There are several provisions of the Internal Revenue Code offering benefits to the estate of a closely held business owner, including sections 303, 2032A, 2057, and 6166. Section 303 provides an income tax benefit by allowing the transfer of assets from a closely held business for an amount equal to the federal and state estate taxes and costs of administration. Section 2032A provides an estate tax benefit by valuing real property (generally farm real property) for federal estate tax purposes at the use value of the real property instead of the fair market value of the property. Until section 2057 terminated in 2003, section 2057 provided an estate tax benefit by excluding $675,000 in value from certain family businesses. Section 6166, the installment payment provision, provides an estate tax benefit by allowing the installment payment of the federal estate taxes attributable to a closely held business interest over a fourteen-year period at a bargain interest rate.[13]

If certain stringent requirements are met, each of the above provisions can offer relief to the estate of a closely held business owner. Unfortunately, there are issues that make planning to meet the qualification for this relief uncertain. The purpose of my testimony is to discuss the issues that I believe Congress should address associated with the installment payment of estate taxes attributable to a closely held business.

B. History of Installment Payment of Estate Taxes Attributable to Closely Held Business Interests

In 1958, Congress provided the first installment payment provision for the estate tax attributable to closely held businesses by enacting section 6166. In the 1958 version, section 6166 provided payment in installments over nine years for the estate tax attributable to closely held

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[13] For estates of individuals dying in 2008, the interest rate on the unpaid tax is two percent on the tax attributable to the first $1,280,000 of value of closely held business interests (or two percent interest rate on $576,000 of estate taxes) and forty-five percent of the interest rate applicable to underpayment of tax (3.15 percent with an underpayment rate of seven percent). Section 6166 does not reduce the estate taxes payable and the savings under section 6166 relate solely to the deferral of the payment of estate taxes and the bargain interest rate.

business interests if the business interests constituted more than thirty-five percent of the decedent's adjusted gross estate or fifty percent of the decedent's taxable estate. The 1958 version of section 6166 did not provide any bargain interest rate.

In 1976, Congress expanded the installment payment relief by designating the 1958 version of section 6166 as new section 6166A and enacting a replacement section 6166. The new section 6166 expanded the installment payments by providing for a four-year period of interest-only payments followed by ten equal payments of the federal estate tax (a fourteen-year deferral period) if the business interests constituted more than sixty-five percent of the decedent's adjusted gross estate. In addition, the 1976 version of section 6166 provided for a bargain interest rate of four percent for a portion of the federal estate tax.

In 1981, Congress, as a part of the Economic Recovery Tax Act of 1981, repealed section 6166A and reduced the percentage test of qualifying for installment payments under section 6166. Under the 1981 version of section 6166, Congress changed the closely held business interest percentage test from sixty-five percent to thirty-five percent and retained the fourteen-year payout period. The Tax Reform Act of 1984 added a provision dealing with the treatment of stock of any holding company that represents direct or indirect ownership and a provision dealing with passive assets held by business entities.

The last significant change to the installment payment provision occurred in 1997 when Congress reduced the interest rates charged on the unpaid tax and increased the amount of unpaid tax eligible for the reduced interest rate. In exchange for the lower interest rates, Congress eliminated the federal estate and income tax deduction of the interest paid on the tax deferred under the installment payment provision. In 2001 Congress amended the installment payment provision to provide special rules for closely held business interests in qualifying lending and finance businesses and also amended the holding company rules.

Although installment payments of federal estate tax attributable to a closely held business can be a helpful alternative to a closely held business owner's estate, closely held business owners have encountered difficulties concerning the application, operation and interpretation of the installment payment provision. I have observed the following significant issues with the installment payment provision:

- *Closely Held Business Owners Need the Ability to Pay Estate Taxes in Installments.* Closely held business owners need the ability to pay the estate taxes attributable to their business interests in installments. Closely held businesses are illiquid and cannot be converted to cash. Without the

ability to pay federal estate taxes in installments, some closely held businesses will fail.

- *Congress Should Modernize the Installment Payment Provision.* The installment payment provision has not kept pace with modem business practices. The installment payment provision addresses the corporate and partnership forms of doing business but does not address new forms of doing business such as limited liability companies, limited liability partnerships, or business trusts. A closely held business owner must select carefully the type of business entity for the business enterprise to preserve the ability for the business owner's estate to pay the estate tax in installments under the installment payment provision. Congress should modernize the installment payment provision to reflect the new forms of business entities and treat limited liability companies, partnerships, and business trusts the same as corporations.
- *Congress Should Cure the Inadequate Treatment of Holding Companies under the Installment Payment Provision.* Under modem business practices, closely held business owners will frequently use a holding company and subsidiary structure (referred to as "tiered entities") to conduct various business activities. The installment payment provision does not deal adequately with holding companies and tiered entities. Because of the complex and confusing[14] holding company rules under the installment payment provision, a closely held business owner needs to consult a knowledgeable (i.e. expensive) tax advisor when using a holding company structure so as to preserve the benefits of the installment payment provision.
- *Congress Should Improve the Definition of Passive Assets under the Installment Payment Provision.* Because the benefits of the installment payment provision are intended to be limited to active businesses, the installment payment provision precludes the installment payment of the federal estate taxes attributable to assets not used in the business (called "passive assets").[15] The present definition of passive assets under the installment payment provision,[16] however, needs modification to accommodate the way closely held business owners are conducting businesses. Otherwise, a

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14 I.R.C. § 6166(b)(8).
15 I.R.C. § 6166(b)(9).
16 I.R.C. § 6166(b)(9)(B).

business owner is forced to artificially structure the owner's business entities to comply with the rigid requirements of the installment payment provision.

- *Congress Should Allow Business Owners to Obtain Advance Rulings from the Internal Revenue Service on Whether the Business Owner's Estate Will Meet the Requirements of the Installment Payment Provision.* Unlike many tax planning situations where a taxpayer can request an advance ruling from the Internal Revenue Service on the tax effect of a proposed business structure, a closely held business owner cannot request the Internal Revenue Service to rule on whether the business owner's assets will qualify for installment payment of the estate tax. Congress should authorize and direct the Internal Revenue Service to issue advance rulings so a business owner can determine whether the deferral under the installment payment provision is available under the business owner's current business structure.
- *Congress Should Improve the Burdensome Lien Procedures under the Installment Payment Provision.* The Internal Revenue Service has implemented lien procedures to maximize the collectability of the federal estate tax deferred under the installment payment provision. These lien procedures have been implemented unevenly by Internal Revenue Service agents in the field and can create an undue and unnecessary impediment to the closely held business owner's successors. Congress should change the lien procedures so as to minimize the administrative impediments for a closely held business owner's estate.

I will discuss briefly each of these issues.[17]

C. Closely Held Business Owners Need the Ability to Pay Estate Taxes in Installments

Estate taxes are due nine months after a business owner's death. The executor of a closely held business owner's estate generally needs liquidity to pay estate taxes, debts, beneficiary needs, and costs of administration. In some instances, the closely held business owner has sufficient liquidity because of planning through the use of life insurance

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[17] For a detailed discussion of these issues and other deficiencies with the installment payment provision, see Steven B. Gorin et al., *Internal Revenue Code Section 6166: Comments to Tax Counsel for the Senate Finance Committee*, 41 REAL PROP. PROB. & TR. J. 73 (2006).

and other techniques. In those instances where the business owner's estate does not have sufficient liquidity (the business owner may have been uninsurable or the business may have grown faster than the business owner could plan), the business owner's executor generally faces a difficult time in raising funds to meet liquidity needs, particularly funds to pay estate taxes (estate tax payments provide no new benefit to the business and only maintain the status quo). Accordingly, the executors of some closely held business owners' estates are faced with the need to raise significant funds at the most inopportune time, when the closely held business is in transition because of the death of an owner.

1. *Modernization of the Installment Payment Provision*

Before a closely held business owner's estate can receive the benefits of the installment payment provision, the estate must meet several requirements. One requirement is that the estate must have an interest in a "closely held business."[18] The Internal Revenue Code defines a closely held business under the installment payment provision[19] as a proprietorship, a partnership, and a corporation and does not mention a limited liability company, a limited liability partnership, or a business trust.

Business owners have changed the way they do business since the installment payment provision was enacted in 1976. When the installment payment provision was first enacted, most business owners conducted their businesses either in the form of a corporation or partnership. Since the enactment of the installment payment provision, new business forms, such as limited liability companies, limited liability partnerships, and business trusts, have been used by business owners to conduct their business operations. Unfortunately, the definition of a closely held business for purposes of the installment payment provision has not kept up with the times.

Although I have not encountered personally an instance where the Internal Revenue Service has denied the benefits of the installment payment provision where the closely held business was a limited liability company, the definition of the installment payment provision should be brought up to date to make sure that the benefits of the installment payment provision are available to a business owner's estate regardless of the business form.

In addition to the inadequate definition of a closely held business interest, the installment payment provision does not treat all business forms uniformly. For example, stock in a corporation will qualify as a

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18 I.R.C. § 6166(a)(1).

19 I.R.C. § 6166(b)(1)(B)-(C).

closely held business interest if twenty percent of more of the *voting stock* is owned by the estate[20] while a partnership interest will qualify if twenty percent or more of the *total capital interest* is owned by the estate.[21] A better rule would be to allow qualification if a business owner's estate included either a twenty percent voting interest or a twenty percent capital interest. There are other examples under the installment payment provision of inconsistent treatment of business forms.[22]

Recommendation: *Amend the definition of "closely held business" under the installment payment provision to make it clear that all forms of businesses qualify for the benefits of the installment payment provision. Provide for the consistent application of the requirements under the installment payment provision regardless of business form.*

2. *Holding Companies and the Installment Payment Provision*

Many closely held business owners now conduct their business operations in multiple entities owned by a holding company. The installment payment provision has not adapted to these changes which creates significant uncertainty for the business owner in determining whether the installment payment provision will be available upon the business owner's death.

Many business owners place assets used in an active business in separate entities with the entities being owned by a holding company. For example, an individual may create a limited liability holding company called "Brookdale Farms Holding Company." The individual may transfer (1) the farm real property to a separate limited liability company called "Brookdale Farm Real Estate Company," (2) cattle and other livestock to a third limited liability company called "Brookdale Farm Livestock Company," and (3) the operating equipment to a fourth limited liability company called "Brookdale Farm Operating Company." Brookdale Farms Holding Company would own all of the interests in the three separate limited liability companies. If the individual wants to take advantage of the installment payment provision, the individual must be careful in making gifts and how the individual conducts the business activities. Otherwise, the installment payment provision may not be available.

Business owners use a holding company structure for many reasons, including estate planning (giving interests in the farm real property limited liability company to one child and giving interests in the operating business to another child) and the limitation of tort liability. Because the

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20 I.R.C. § 6166(b)(1)(B)(i).
21 I.R.C. § 6166(b)(1)(C)(i).
22 I.R.C. § 6166(b)(8)-(9). *See* Gorin et al., *supra* note 17, at 84.

Internal Revenue Service took the position that a corporation with its sole asset stock of another corporation is not a closely held business,[23] Congress amended the installment payment provision to allow the portion of stock of a holding company that directly or indirectly owns stock in a closely held active trade or business to be considered stock in the business company for purposes of the installment payment provision.[24] Before the holding company stock may qualify for installment payment, however, the holding company stock must meet several requirements and the executor must make an election.

The holding company structure presents numerous issues. What is the level of activity required by a subsidiary in order to qualify as a closely held business under the installment payment provision? Are intra-company loans (a loan from Brookdale Farm Operating Company to Brookdale Farm Real Estate Company) considered passive assets and not entitled to installment payment? Because the installment provision uses the term "company" in describing personal holding entities, is the application of the installment provision limited to corporate entities?

Recommendation: *Amend the definition of "holding company" under the installment payment provision to combine all interests owned by the closely held business owner for all purposes of the installment payment provision.*

3. *Definition of Passive Assets*

The installment payment provision limits the installment payment of estate taxes attributable to business interests that conduct an active trade and business. Passive assets held by an interest in an entity conducting a trade or business are excluded in determining whether the estate qualifies for the benefits of the installment payment provision and the amount of estate tax that can be paid in installments. A passive asset is defined as "any asset other than an asset used in carrying on a trade or business."[25] Although the limitation is a proper goal, the passive asset rules are unclear.[26]

The provisions of the installment payment provision do not provide when the amount of passive assets is to be deducted in determining the value of the closely held business interests. The Senate Committee Re-

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23 Estate of Moore v. United States, No. M–85–56–CA, 1987 WL 47917 (E.D. Tex. May 12, 1987); PLR 8448006 (Aug. 20, 1984); TAM 8219007 (Jan. 28. 1982); PLR 8130175 (May 1, 1981); TAM 8134012 (Apr. 30, 1981).

24 I.R.C. § 6166(b)(8)-(9).

25 I.R.C. § 6166(b)(9)(B).

26 *See* RICHARD B. COVEY & DAN T. HASTINGS, PRACTICAL DRAFTING 1757-76 (1989).

port relating to the provisions of the installment payment provision dealing with passive assets stated,

> The committee intends that the Treasury Department issue regulations defining the circumstances under which partnership and corporate assets are to be treated as passive investments, and therefore, disregarded for purposes of the installment payment provision.[27]

Because Treasury has not issued these regulations, closely held business owners have no or little guidance as to the definition of passive assets.

Recommendation: *Amend the definition of "passive assets" under the installment payment provision to make it clear what is a passive asset and how the amount of passive assets is to be deducted in determining the value of a closely held business interest.*

4. *Ability to Obtain Advance Ruling*

In many tax planning situations, a taxpayer can request an advance ruling from the Internal Revenue Service on the tax effect of a proposed business structure. Under current law, however, a closely held business owner cannot request the Internal Revenue Service to rule on whether the business owner's assets will qualify for installment payment of the estate tax while the business owner is alive and able to make appropriate changes. This creates significant uncertainty for some business owners. Congress should authorize and direct the Internal Revenue Service to establish procedures for the issuance of advance rulings so a business owner can determine whether the deferral under the installment payment provision is available under the business owner's current business structure.

Recommendation: *Allow taxpayers to request advance rulings from the Internal Revenue Service on issues relating to the installment payment provision.*

5. *Lien Procedures*

In March 2000, the Treasury Inspector General for Tax Administration issued a Final Audit Report - *The Internal Revenue Service Can Improve the Estate Tax Collection Process*.[28] In the Report, the Inspector General found that the United States Treasury was owed $1.4 billion of estate taxes unpaid attributable to closely business interests under the installment payment provision and of this amount $1.3 billion was not secured by liens. The Report recommended that the Internal Revenue

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27 S. REP. NO. 98-169, at 715 (1984).

28 U.S. Treas. Dep't., Ref. No. 2000-30-059 (Mar. 2000).

Service secure liens for the amount of the unpaid tax at the time of the approval of the installment payment election. The Internal Revenue Service has been implementing this recommendation.

Section 5.5.6.6(1) of the Internal Revenue Manual[29] covers the installment payment provision dealing with bonds and liens to secure the unpaid federal estate tax. According to the Manual, the Internal Revenue Service has these options to secure payment of the estate tax deferred under the installment payment provision:

> Require the estate to furnish a performance bond with a face value up to double the amount of tax being deferred, or
> Allow the estate to substitute the filing of a special lien (Form 668J) pledging the estate's right, title, and interest to specific property to the government.

Although the Federal Register lists approximately one hundred acceptable bonding companies, one individual with the Internal Revenue Service stated that she was not aware of any bond ever having been written for an estate that elected the installment payment provision. Because a bond is unpractical (no bonding company will issue a bond for a fourteen-year period without marketable collateral equal to the amount of the bond), the Internal Revenue Service requires a lien to secure the amount of the unpaid estate tax. Although this is a reasonable position in theory, the issue arises as to what is the proper collateral for the unpaid estate tax.

A general estate tax lien[30] arises upon the decedent's death and attaches to all assets in the decedent's estate and lasts ten years which cannot be extended. When an estate elects to pay the estate tax in installments, the Internal Revenue Service is secured by the general estate tax lien for only the first nine years and three months of the installment payment period unless the Internal Revenue Service obtains a special lien for the estate tax paid in installments.[31]

The Internal Revenue Service agents in the field determine what collateral is necessary to secure the unpaid tax. Many agents are acting responsibly and are accepting as collateral the property owned by the decedent that qualifies for the installment treatment. This is usually stock in a closely held corporation or a partnership interest in a limited partnership, and is generally not disruptive to most business operations. Without definitive statutory guidance, however, some Internal Revenue

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29 Internal Revenue Serv., *Internal Revenue Manual* § 5.5.6.6(1), https://www.irs.gov/irm/part5/irm_05-005-006#idm140049585469488.

30 I.R.C. § 6324(a).

31 The Internal Revenue Service may obtain a special lien under section 6324A for the estate tax deferred under section 6166.

Service agents are not accepting the closely held business interests as collateral for the deferred federal estate tax and are requiring an executor to put up other assets, such as real estate or marketable securities owned by the estate or owned by members of the decedent's family, to secure the lien. Because a lien on these assets may prevent the decedent's family from borrowing funds necessary to operate the business, this is very disruptive to the business of the closely held business owner.

Recommendation: *Amend section 6324(a) to extend the general estate tax lien for estates electing to pay the federal estate tax in installments under section 6166 for the duration of the installment payment period plus a reasonable period of time (such as one year) to provide the Internal Revenue Service sufficient time to collect if there is a default in payment by the estate. Provide that the Internal Revenue Service can only require as collateral assets that were owned by the decedent unless the executor elects to provide other collateral.*

III. Conclusion

I hope that the Committee and its staff will call upon the Task Force who prepared the *Report on Reform of Federal Wealth Transfer Taxes* as you consider changes to the federal wealth transfer tax system. In addition, the estates of private business owners need the ability to pay in installments the federal estate taxes attributable to a closely held business interest. I encourage the Committee and its staff to address the following significant issues with the installment payment provision:

- Modernize the installment payment provision,
- Cure the inadequate treatment of holding companies,
- Improve the definition of passive assets,
- Improve the burdensome lien procedures, and
- Allow advance rulings.

I thank you for allowing me to express my views on this important subject.