

Department of the Treasury

Internal Revenue Service

Washington, DC 20224

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Person to Contact:

Telephone Number:

Refer Reply To:

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Date:

July 1, 2003

In Re: Letter Ruling Request on Section 6166

Legend

Decedent =

Date 1 =

State X =

Property 1 =

Property 2 =

Property 3 =

Property 4 =

Property 5 =

Property 6 =

Property 7 =

Property 8 =

Dear _____ :

This letter is in response to your request for a private letter ruling, dated February 18, 2003, and supplemental correspondence, dated May 21, 2003, and June 23, 2003, concerning whether Decedent's interests in certain real estate qualify as an interest in a closely held business for purposes of section 6166 of the Internal Revenue Code ("Code").

Facts

Decedent died on Date 1, a resident of State X. Decedent owned and operated as a sole proprietor 109 rental units on six parcels of real property (multiple family residences, Properties 1 through 6). In addition, Decedent owned a 50% interest in 36 rental units on two additional parcels of real property (multiple family residences, Properties 7 and 8). Decedent and his son owned Property 7 as tenants in common. For purposes of this ruling request, Decedent's ownership of Property 7 is treated as a partnership interest. Property 8 was owned by a limited liability company in which Decedent had a 50% interest and his son and his daughter each had a 25% interest. For federal tax purposes, the limited liability company was treated as a partnership. Up until his death, Decedent's primary source of income was from the ownership of these properties. Decedent's gross estate consisted of his sole proprietorship, Properties 1 through 6, his interest in the tenancy, and his interest in the limited liability company.

Decedent and his son, assisted by five part-time employees, performed all services in the management and maintenance of Properties 1 through 8. These activities included, but were not limited to, advertising vacant apartments, interviewing, screening and selecting prospective tenants, negotiating and executing leases, collecting rents, maintaining common areas, making ordinary plumbing and electrical repairs, purchasing appliances, supplies, and equipment, and inspecting rental units. Decedent and his son routinely devoted up to 14 hours a day on weekdays and several hours on weekends for maintenance and management of Properties 1 through 8. In addition, Decedent and his son were on call twenty-four hours a day, seven days a week, for emergency repairs. On the rare occasions where repairs and maintenance were beyond the capabilities of Decedent, his son, or the part-time employees, specialized workers were hired. These major repairs and renovations by independent contractors included the installations of a new roof and intercom system, factory replacement of windows, boiler maintenance, and jobs requiring licenses and/or permits. Decedent exercised total day-to-day management responsibility of Properties 1 through 8 up until three years before his death, when health reasons required his son to assume the role of day-to-day manager. During Decedent's illness, Decedent's son consulted with Decedent regarding management decisions on an almost daily basis and assumed all responsibilities previously handled by Decedent.

Rulings Requested

On the basis of the above facts and representations, the following rulings have been requested:

1. Whether Decedent's interest as a proprietor in Properties 1, 2, 3, 4, 5, and 6 qualifies as an interest in a closely held business within the meaning of section 6166(b)(1).
2. Whether Decedent's interests as a partner in the partnerships that owned

Properties 7 and 8 qualify as interests in a closely held business within the meaning of section 6166(b)(1).

3. Whether Decedent's interests as a proprietor and as a partner can be treated as an interest in a single closely held business pursuant to section 6166(c).

Relevant Authorities

Under section 6166(a) of the Code, 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 section 2001 (estate tax) in two or more (but not exceeding ten) equal installments.

Section 6166(b)(1) of the Code 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;
- (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.

I.R.C. § 6166(b)(1)(A)-(C).

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.

Rev. Rul. 75-365, 1975-2 C.B. 471, considered a situation where a decedent individually maintained a fully equipped business office to collect rental payments on commercial and farm rental properties, receive payments on notes receivable, negotiate leases, make occasional loans, and direct the maintenance of the properties by contract. The ruling holds that the decedent was merely an owner managing investment assets to obtain the income ordinarily expected from them, rather than conducting a business. Therefore, the commercial and farm rental properties and notes receivable included in the decedent's gross estate did not constitute an interest in a

closely held business for purposes of section 6166.

Rev. Rul. 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 distinguishable from management of investment assets. Therefore, the decedent's farm asset constitutes an interest in a closely held business.

Rev. Rul. 75-367, 1975-2 C.B. 472, holds that a decedent's ownership of 100 percent of the stock of an electing small business corporation that built homes on land owned and developed by the decedent and a business office and warehouse used by the corporation and the decedent constituted an interest in a closely held business. The ruling holds, however, that eight homes built by the corporation that decedent owned and rented, collected rents, made the mortgage payments, and made necessary repairs and maintenance, was not an interest in a closely held business because the decedent's interest in such homes merely represented an investment.

Analysis

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 manufacturing, mercantile, or service enterprise, as distinguished from management of investment assets.

As Rev. Ruls. 75-365, 75-366, and 75-367 suggest, the level of the activity is the factor that distinguishes a trade or business under section 6166 from the act of merely managing rental property to obtain the rents ordinarily expected in the course of business. In determining the level of activity carried on by a decedent, the activities of agents and employees are taken into account; however, the activities of third parties such as independent contractors or lessees, who are neither agents nor employees of the decedent or of a partnership, are not taken into account.

Decedent's level of activity in connection with Properties 1 through 6, as assisted by his son and the five part-time employees, was greater than the level of activity of the decedent described in Rev. Rul. 75-365. While Decedent's activities in part included those associated with merely managing investment assets, including collecting rents, paying taxes, and making mortgage payments, Decedent actively participated in the management and operation of these properties. Decedent, his son, or the part-time employees personally provided routine repair and maintenance to these properties. In

the event that Decedent, his son, or the part-time employees could not perform a necessary major repair to the properties, independent contractors were hired. While the use of independent contractors is a factor that can weigh against a determination that an active trade or business exists, a sufficient proportion of the activities of Decedent, his son, and the part-time employees were devoted to the performance of substantial other services. Thus, Decedent's activities went beyond those of an owner managing investment assets to obtain the rents ordinarily expected from them.

Similarly, the activities conducted with respect to Properties 7 and 8 by Decedent, his son, and the five part-time employees are attributed to each partnership. The partnership (tenants in common) provided significant services to Property 7 just like the services provided by Decedent as a sole proprietor to Properties 1 through 6. Likewise, the partnership (limited liability company) provided significant services to Property 8. Thus, each partnership was conducting an active trade or business. In addition, each partnership had 45 or fewer partners. Consequently, Decedent's interests as a partner in each partnership constitute interests in a closely held business.

As described above, the entire value of Decedent's interest as a proprietor in Properties 1, 2, 3, 4, 5, and 6, and his interest as a partner in the tenancy and the limited liability company represent interests in a closely held business. Decedent's gross estate consists of the value of his sole proprietorship and Properties 1 through 6. In addition, Decedent's interest in Property 7 as a tenant in common with his son is included in determining the value of Decedent's gross estate. Further, the entire value of Decedent's 50% ownership interest in the limited liability company is included in determining the value of Decedent's gross estate. Therefore, these interests, together, should be treated as an interest in a single closely held business. See I.R.C. § 6166(c).

Conclusions

Based on the facts and information submitted and the representations set forth above, we rule as requested with respect to the following:

1. Decedent's interest as a proprietor in Properties 1, 2, 3, 4, 5, and 6 qualifies as an interest in a closely held business within the meaning of section 6166(b)(1).
2. Decedent's interests as a partner in the partnerships that owned Properties 7 and 8 qualify as interests in a closely held business within the meaning of section 6166(b)(1).
3. Decedent's interests as a proprietor and as a partner can be treated as an interest in a single closely held business pursuant to section 6166(c).

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

Except as specifically ruled above, no opinion is expressed as to the federal tax treatment of any issue addressed in this ruling under any other provisions of the Internal Revenue Code.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent. A copy of this letter ruling should be attached to Decedent's federal estate tax return.

If you have questions, please contact

Sincerely yours,

Assistant Chief Counsel
(Administrative Provisions & Judicial Practice)

By:

Susan L. Hartford
Acting Senior Technician Reviewer,
Branch 2

Enclosures:

Copy of letter
Copy for section 6110 purposes