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Re: Report of the American College of Trust and Estate Counsel on Proposed Sections 6166 and 6166A

Dear Ladies and Gentlemen:

The American College of Trust and Estate Counsel (“ACTEC”) is pleased to submit this recommendation to substantially revise IRC Section 6166 and to propose the enactment of a new IRC Section 6166A to address the important issues related to providing deferral treatment for federal estate tax and generation-skipping transfer tax attributable to closely held business interests. As Congress considers legislative proposals related to the transfer tax system, the enclosed Report provides analysis regarding changes that, in the opinion of ACTEC, would improve the administration of the estate tax deferral regime and provide a new deferral opportunity with respect to generation-skipping transfer taxes.

Executive Director
DEBORAH O. MCKINNON

ACTEC is a professional organization of approximately 2,400 lawyers from throughout the United States. Fellows of ACTEC are elected to membership by their peers on the basis of professional reputation and ability in the fields of trusts and estates and on the basis of having made substantial contributions to those fields through lecturing, writing, teaching, and bar activities. Fellows of ACTEC have extensive experience in providing advice to taxpayers on matters of estate and generation-skipping transfer taxes and business succession planning. ACTEC offers technical comments about the law and its effective administration but does not take positions on matters of policy or political objectives.

ACTEC's comments and recommendations are set forth in the attached Report, which is the product of nearly a decade of research and analysis on this topic.

If you or your staff would like to discuss the contents of this report with the ACTEC Fellows who created it, please contact Beth Kaufman, who is Chair of the Tax Policy Study Committee, at 202.862.5062 or bkaufman@capdale.com; David Sloan, who chaired the Subcommittee that prepared the Report, at 801.237.0423 (direct) or 801.979.1241 (cell) or dsloan@sloanlawslc.com; or Deborah O. McKinnon, ACTEC Executive Director, at 202.684.8460 or domckinnon@actec.org.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Ann Burns".

Ann B. Burns, President

Attachment: Report of The American College of Trust and Estate Counsel on Proposed Sections 6166 and 6166A

**REPORT OF THE AMERICAN COLLEGE
OF TRUST AND ESTATE COUNSEL
ON PROPOSED SECTIONS 6166
AND 6166A**

**Recommendations to Substantially Revise IRC Section 6166, Which
Allows for the Extension of Time for the Payment of Estate Tax, and to
Enact IRC Section 6166A, Which Allows for the Extension of Time for
the Payment of Generation-Skipping Transfer Tax for Taxable
Terminations Occurring at Death of a Non-Skip Person**

Summary

This Report describes the proposed changes that ACTEC would make to Internal Revenue Code section 6166, which provides deferral treatment for the federal estate tax attributable to closely held business interests owned by a decedent. As modified for the generation-skipping transfer tax context, all of these changes would also apply to proposed section 6166A, which provides deferral treatment for GST taxes arising from taxable terminations resulting from the death of an individual. So that the GST changes can be reviewed in isolation, we have not incorporated our section 6166 changes into our section 6166A draft. We recommend, however, that any section 6166 changes adopted be integrated into section 6166A. The work on these two code sections has taken place over the past nine years under the direction of the Tax Policy Study Committee (formerly, the Transfer Tax Study Committee), with valuable input from the Business Planning Committee. Accompanying the Report are the two proposed code sections and two redline documents showing the changes between (1) current and proposed section 6166, and (2) current section 6166 and proposed section 6166A.

Although the Report proposes hundreds of changes, the following list of seven key changes to section 6166 provides a sample:

1. A number of new definitions are added, such as "Entity," "Ownership Interest," and "Proprietorship." The new definition of "closely held business" focuses on "business companies" rather than partnerships and corporations as under existing law. The new definition of "business company" means any entity carrying on a trade or business that is treated for purposes of Subtitle A as a corporation or a partnership, making state law classifications irrelevant.
2. The passive asset test of current subsection (b)(9) becomes subsection (a)(3) and converts into a "reasonable needs of the business" test under section 537.
3. For purposes of the "at least 20%" test, the new definition of "Ownership Interest" is based on the decedent's portion of a hypothetical liquidation value for the entire business.

4. In counting owners, section 6166 treats as one owner all persons who would be treated as one shareholder under section 1361(c)(1).
5. The special elections for modified deferral treatment in current subsections (b)(7), (8), and (10) are eliminated. All deferrals will be interest-only for five years followed by combined tax and interest payments for ten years.
6. Unlike current subsection (c), which allows interests in two or more different closely held businesses to be combined only if each business satisfies a 20% test, subsection (c) allows for the combination of interests if each business satisfies either the 20% test or the 45-owner test.
7. The special interest rate for the 2% portion under section 6601(j) is eliminated. The special 45% of the underpayment rate, which currently applies to amounts in excess of the 2% portion, is modified to reflect the highest marginal estate tax rate applicable to that decedent.

TABLE OF CONTENTS

SUMMARY i

I. INTRODUCTION 1

II. HISTORICAL SECTIONS 6166 AND 6166A 3

III. LEGISLATIVE HISTORY AND CONGRESSIONAL INTENT RELATING TO SECTION 6166..... 4

IV. LEGISLATIVE HISTORY AND CONGRESSIONAL INTENT RELATING TO THE GENERATION-SKIPPING TRANSFER TAX..... 5

V. REASONS FOR CHANGE 6

VI. POSSIBLE METHODS FOR CHANGE..... 9

VII. RECOMMENDATION AND PROPOSAL TO SUBSTANTIALLY REVISE SECTION 6166..... 9

VIII. RECOMMENDATION AND PROPOSAL FOR NEW CODE SECTION 6166A 17

IX. CONCLUSION 21

APPENDIX:

PROPOSED SECTION 6166

REDLINE COMPARISON OF PROPOSED SECTION 6166 AND CURRENT SECTION 6166

PROPOSED SECTION 6166A

REDLINE COMPARISON OF PROPOSED SECTION 6166A AND CURRENT SECTION 6166

I. INTRODUCTION

This report ("Report"), which has been prepared by The American College of Trust and Estate Counsel ("ACTEC"), describes and analyzes two related proposals concerning the extension of time or "deferral" regimes in the Internal Revenue Code (the "Code")¹ for the estate tax and the generation-skipping transfer tax.² The Report has been prepared by members of the 6166 Revision and 6166A Subcommittees of ACTEC'S Tax Policy Study Committee (formerly the Transfer Tax Study Committee) and has been discussed and approved by the Committee as a whole.

- A. Revised Section 6166. The first proposal is to substantially revise current section 6166 of the Internal Revenue Code, a section which provides deferral treatment for estate taxes attributable to certain closely held business interests.
1. Different versions of section 6166 have been part of the law since 1958, including two sections--6166 and 6166A³--that simultaneously provided for similar but distinct levels of deferral during the five-year period beginning in 1976. In 1981, Congress combined these two code sections into a single section 6166. Although important changes were made to section 6166 in 1984 and in 1997, no major revisions have been made to the code section since 1981 (see discussion of historical code sections in Part II, below).
 2. The rationale for allowing deferral of estate taxes under section 6166 always has been to prevent a forced sale of a closely held business that might result from imposing and collecting estate taxes when a qualifying business owner dies (see discussion of legislative history in Part III).
 3. During the past forty years, modern business practices, ownership structures, and available legal entities have changed dramatically. For example, limited liability companies were not generally available when current section 6166 was enacted. Many of the changes recommended

¹ All section references are to the Internal Revenue Code of 1986, as amended, unless otherwise stated.

² ACTEC understands that there have been proposals for the enactment of other tax legislation which could have an impact on certain taxpayers similar to that of the estate tax. These proposals include a deemed realization of capital gains at death tax and a wealth tax. If such legislation were enacted, provisions similar to those found in the proposed section 6166 attached to this Report may be useful in those contexts as well.

³ Former section 6166A should not be confused with proposed section 6166A, which would provide deferral treatment for generation-skipping transfer taxes similar to what current section 6166 provides for estate taxes. Proposed section 6166A is attached to this Report and is discussed below.

by ACTEC are intended to make the code section consistent with the current business landscape and to ensure that similar rules apply regardless of the type of entity involved.

4. At the same time, ACTEC believes there are significant benefits and continuity that come from using familiar concepts and provisions that have been interpreted over the years by practitioners, the IRS, and the courts. For that reason, an effort was made to follow the structure and language of the existing statute unless there was a good reason to change it (see Proposed Section 6166 attached).
 5. In addition to updating section 6166 and making its application more uniform regardless of the choice of underlying business entity, another key goal of ACTEC is to simplify a very complex statute and to make it more understandable and internally consistent. ACTEC's recommended revisions to section 6166 are attached (see Proposed Section 6166).
- B. Proposed Section 6166A. The second proposal is to enact a new section of the Code (section 6166A) which would provide deferral treatment for generation-skipping transfer ("GST") taxes arising from taxable terminations upon death similar to that provided for estate taxes under section 6166.
1. The rationale for imposing a GST tax upon a taxable termination occurring by reason of the death of a non-skip person is to impose a tax that is "similar" to the estate tax that would have been due had the transfer been includable in the non-skip person's taxable estate (see discussion of legislative history in Part IV).
 2. Consistent with this rationale, certain income tax sections of the Code were amended to align the income tax results arising from the imposition of the GST tax on taxable terminations with the income tax results arising from the imposition of the estate tax on a transfer at death (see discussion of legislative history in Part IV).
 3. Notwithstanding this underlying rationale, section 6166 has never been amended to allow deferral of payment of the GST tax imposed on a taxable termination upon death similar to what is provided for under the estate tax regime, which is contrary to the intention stated in the legislative history of the GST tax. Although this disparity has never been specifically addressed, it would appear to be an oversight and not an intentional omission (see Reasons for Change, Part V).
 4. There is insufficient legislative authority to correct this disparity through the adoption of new regulations or interpretive guidance, and thus a legislative remedy is needed (see Possible Methods for Making Changes, Part VI).

5. The best way to remedy this disparate treatment is to enact a new Code section that follows the principles of section 6166 and takes into account the rules governing the GST tax. Because of the significant differences between the estate tax rules and the GST taxable termination rules, this disparity cannot be fixed by simply amending section 6166 so that it applies to the GST tax (see Recommendation and Proposal for New Section 6166A, Part VIII).
6. Consistent with these conclusions, ACTEC's proposed new section 6166A is attached to the Report and explained in detail in Part VIII (see attached draft of proposed section 6166A).
7. Any updates made to section 6166 (as described in more detail below) should also be made to proposed section 6166A, subject to modification as necessary for the GST tax regime.

II. HISTORICAL SECTIONS 6166 AND 6166A

Section 6166 was originally enacted as part of the Small Business Tax Revision Act of 1958 and was part of an amendment to the Internal Revenue Code of 1954.⁴ The first section 6166 (the "First 6166") provided for ten years of installment payments, but did not provide for a preceding initial five years of interest only deferral. The First 6166 also required that the value of the closely held business interest (for all versions of the statute, hereinafter the "Interest") must exceed either 35% of the adjusted gross estate or 50% of the taxable estate.

In 1976, the First 6166 was re-designated as section 6166A and a new section 6166 was enacted (the "Second 6166"). The Second 6166 introduced an initial five-year interest-only deferral period, allowing total deferral of principal for up to fourteen years instead of the nine years possible under the First 6166. Although deferral was longer, eligibility requirements were more stringent. For example, the Second 6166 required that the Interest exceed 65% of the adjusted gross estate, whereas the First 6166 only required that the Interest exceed 35% of the adjusted gross estate. In 1981, section 6166 and former section 6166A were combined into a new section 6166 (the "Third 6166") and former section 6166A was repealed. Eligibility for the Third 6166 required that the Interest exceed 35% of the adjusted gross estate. Although important changes were made to the Third 6166 in 1984 and in 1997, the last major revision to this section occurred in 1981.⁵

Certain elements of section 6166 have remained constant throughout its history. For example, the definition of a closely held business has consistently meant a sole proprietorship, a partnership, or a corporation which carries on a trade or business. Also,

⁴ The provision was effective with respect to the estates of decedents dying in 1958 and after that time, with section 6166(i) applying to the estates of decedents dying after the date of the 1954 Act but whose returns were due before the date of the 1958 Act. Surprisingly, there seems to be confusion in some of the sources as to whether the original statute was designated as section 6166 or section 6166A.

⁵ Two significant changes made in 1984 were the addition of special rules excluding passive assets from eligibility for deferral and treating the stock of a holding company as stock of a business company.

there always has been a requirement that the decedent either own at least 20% of the Interest or the entity have no more than a certain number of owners, a number which has increased from ten under the First 6166, to 15 under the Second, and to 45 under the Third.

The business aggregation requirement for purposes of determining eligibility also has been modified over time. Under the First 6166, aggregation was permitted if more than 50% of the value of two businesses was owned by the decedent. Under the Second and Third, aggregation was permitted if at least 20% of each business is included in the gross estate (which is currently the law).

III. LEGISLATIVE HISTORY AND CONGRESSIONAL INTENT RELATING TO SECTION 6166

The legislative history of section 6166 clearly states that the purpose of the statute is to remedy the liquidity problem caused by the imposition of an estate tax arising upon the death of an owner of certain closely held business interests. These liquidity problems can force the sale of a closely held business. In House Report No. 2198 (the "1958 House Report"), which was prepared in connection with the passage of the original legislation in 1958, the purpose of providing deferral is explained:⁶

This provision is primarily designed to make it possible to keep together a business enterprise where the death of one of the larger owners of the business results in the imposition of a relatively heavy estate tax. Where the decedent had a substantial proportion of his estate invested in the business enterprise, under existing law this may confront the heirs with the necessity of either breaking up the business or of selling it to some larger business enterprise, in order to obtain funds to pay the federal estate tax. Your committee believes that this result has an especially unfortunate result in the case of small businesses. Therefore, although not removing any Federal estate tax in these cases, your committee hopes that by spreading out the period over which the estate tax may be paid, it will be possible for the estate tax in most cases to be paid for out of earnings of the business, or at least that it will provide the heirs with time to obtain funds to pay the Federal estate tax without upsetting the operation of the business. Your committee believes that this provision is particularly important in preventing corporate mergers and in maintaining the free enterprise system. (Emphasis added.)

Later reports from the House and Senate Finance Committee echo the 1958 House Report's explanation that allowing estate tax to be paid in installments could prevent forced sales of closely held businesses. For example, a House Report explained that "[t]he present provisions have proved inadequate to deal with the liquidity problems experienced by estates in which a substantial portion of the assets consist of a closely held business or other illiquid assets."⁷ A Senate Report stated that "the installment payment provisions need to be expanded in order to better address the liquidity problems of estates holding farms and closely held businesses, to prevent the liquidation of such businesses in order to

⁶ There was no Senate Report prepared at this time.

⁷ See H.R. Rep. No. 1380, 94th Cong., 2d Sess. (1976).

pay estate taxes.”⁸ Another Report states that the Senate Finance Committee “wishes to expand and modify availability of the [installment payment of estate tax] provision to enable more estates of decedents with an interest in a closely held business to claim the benefits of installment payment of estate tax”).⁹

A Senate Report from 1981 explaining the reasons for combining sections 6166 and 6166A helps illustrate some of the original purposes of the law that is currently in effect:

Under present law, though both §6166 and 6166A permit deferred tax payments for illiquid estates, there are unnecessary differences between the two sections. The definition of an interest in a closely held business, the percentage of estate assets required to be represented by such interest, the length and conditions of the deferral, the appropriate interest rate and the conditions for acceleration, vary between the sections. In addition, §303, which permits an estate consisting largely of interests in a closely held business to redeem stock to pay estate taxes, funeral expenses, and administration expenses contains a third threshold minimum value test and different aggregation rules. The committee believes that these provisions should be simplified and coordinated to provide a single set of rules to govern the estate tax treatment and qualified stock redemption of interests in a closely held business.¹⁰

The legislative history cited above makes clear that, for almost sixty years, Congress has been consistently concerned with the ability of active trades or businesses to maintain their viability in the face of substantial estate taxes for which the trade or business may be the only source of funds. Improving and expanding deferral as proposed in this Report will further alleviate those concerns.

IV. LEGISLATIVE HISTORY AND CONGRESSIONAL INTENT RELATING TO THE GENERATION-SKIPPING TRANSFER TAX

The current GST tax law was enacted as part of the Tax Reform Act of 1986, which also retroactively repealed the original generation-skipping tax law from 1976. In enacting the new law, a general explanation prepared by the staff of the Joint Committee of Taxation (the “Joint Committee Report”) states the following:

Reasons for Change

The Congress believed, as it stated when the generation-skipping transfer tax originally was enacted in 1976, that the purpose of the three transfer taxes (gift, estate, and generation-skipping) was not only to raise revenue, but also to do so in a manner that has as nearly as possible a uniform effect. This policy is best served when transfer tax consequences do not vary widely depending on whether property is transferred outright to immediately

⁸ S. Rep. No. 33, 105th Cong., 1st Sess. 48 (1997). Interestingly, the 1997 Senate Report indicates the Senate bill would have extended “the period for which Federal estate tax installments may be made under section 6166 to a maximum period of 24 years. If the election is made, the estate pays only interest for the first four years, followed by up to 20 annual installments of principal and interest.” However, this provision never became part of the law.

⁹ S. Pt. 107-30, at 83–84 (2001).

¹⁰ S. Rep. No. 144, 97th Cong., 2d Sess. (1981) (emphasis added).

ucceeding generations or is transferred in ways that skip generations. The Congress determined that the present generation-skipping transfer tax was unduly complicated. Therefore, the Congress determined that this tax should be replaced with a simplified tax, determined at a flat rate. The Act accomplishes Congress' goal of simplified administration while ensuring that transfers having a similar substantial effect will be subject to tax in a similar manner. (Emphasis added)

The Joint Committee Report also states:

Coordination with other provisions

The Act also includes several provisions coordinating the generation-skipping transfer tax with the gift and estate taxes. The Code provisions governing administration of the gift and estate taxes also apply to the amended generation-skipping transfer tax. Estate tax rules apply to generation-skipping transfers occurring as a result of death, and gift tax rules apply in other cases.

In addition to any adjustment to basis received under the gift or estate tax basis provisions, the basis of property subject to the amended generation-skipping transfer tax generally is increased by the amount of that tax attributable to the excess of the property's value over the transferor's basis. In the case of taxable terminations occurring as a result of death, a step-up in basis like that provided under the estate tax (sec. 1014) is provided.

...

The special rules under which estate tax attributable to interests in certain closely held businesses may be paid in installments also apply to direct skips occurring as a result of death. The provision permitting tax-free redemptions of stock to pay estate tax is amended to permit those redemptions to pay generation-skipping transfer tax in the case of such transfers occurring as a result of death. (Emphasis added)

V. REASONS FOR CHANGE

The principal rationale for allowing deferral of estate taxes under section 6166 always has been to prevent forced sales of closely held businesses that might otherwise result from estate taxes arising upon the death of a qualifying business owner. As noted in the legislative reports quoted above, other reasons for allowing deferral are to help maintain the free enterprise system, prevent corporate mergers, preserve jobs, and strengthen communities.

Although important changes were made to section 6166 in 1984 and in 1997, as noted in this Report, no major revisions have been made to this section since 1981. During the past forty years, modern business practices, ownership structures, and available legal entities have changed dramatically. For example, limited liability companies were not generally available when the current law was enacted. Many of the changes recommended by ACTEC are intended to make section 6166 consistent with the current business landscape and more effective in providing the relief intended by Congress.

In addition to updating section 6166, another key goal of ACTEC is to simplify a very complex statute in order to make it more understandable. The 1981 Senate Report illustrates the importance that Congress places on eliminating “unnecessary differences” and upon simplification and coordination of the tax laws. Furthermore, the Supreme Court has recently restated “the fundamental canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme.” *King v. Burwell*, quoting *Utility Air Regulatory Group*, 573 U. S., at ___ (slip op., at 15) (emphasis added).

Clearly, the Congressional intent to preserve and protect small businesses is not carried out when the statute intended to achieve that purpose is so burdensome and complex that estates owning interests in those businesses may be unable or unwilling to take advantage of the protection afforded.¹¹ ACTEC believes that the proposed section 6166 attached to this Report is a significant improvement over the existing statute in terms of creating greater internal consistency while furthering “the overall statutory scheme.” At the same time, ACTEC believes there are significant benefits and continuity that come from using familiar concepts and provisions that have been interpreted over the years by practitioners, the IRS, and the courts. For that reason, ACTEC made an effort to follow the structure and language of the existing statute unless there was a good reason to change it.

In addition, as indicated in the Joint Committee Report relating to the GST tax, it is the stated goal of Congress that “transfers having a similar substantial effect will be subject to tax in a similar manner.” This corresponds to the stated purpose that transfer taxes should have “as nearly as possible a uniform effect.” Furthermore, this “policy is best served when transfer tax consequences do not vary widely depending on whether property is transferred outright to immediately succeeding generations or is transferred in ways that skip generations.” Significantly, with respect to taxable terminations occurring as a result of death, “a step-up in basis like that provided under the estate tax (sec. 1014) is provided.”

It is noteworthy that the Joint Committee Report specifically refers to installment treatment for GST taxes solely in the context of direct skips, which is the only form of generation-skipping transfer covered in section 6166 (see section 6166(i)). There are at least three possible explanations for singling out direct skips in the context of section 6166. First, Congress may not have intended for taxable terminations of any type to receive installment treatment. Second, Congress may have forgotten to include taxable terminations resulting from death or simply did not recognize the problem. Third, Congress

¹¹ With respect to sections 6166, 2057, and 2032A, a Congressional Joint Committee Report notes that “[a] chief criticism has been that those rules are complex, uncertain in their application, and a poor fit with actual business structures.” (Joint Committee of Taxation Report, JCX-23-08, p. 21 (April 2, 2008)). The Joint Committee Report also summarizes the conclusions of a Task Force from the American Bar Association’s Real Property, Probate and Trust Law Section, which found that “the installment payment rules make planning difficult because they require a subjective determination whether a closely held business is an active business; include special rules for distinguishing between passive assets and non-passive assets and for looking through certain holding companies to their underlying assets; and demand post-death monitoring of dispositions or similar transactions that would end deferral of estate tax payments.” See *id.* at p. 21 (citing Steven B. Gorin, E. Burke Hinds, Benjamin H. Pruetz, Don Kozusko, and Michael Patiky Miller, Internal Revenue Code Section 6166: Comments to Tax Counsel for the Senate Finance Committee, 41 Real Property, Probate and Trust Journal 73 (Spring 2006)).

may have concluded that section 6166 is so closely related to the estate tax that there was no simple way to extend that treatment to taxable terminations resulting from death.

In considering these possibilities, the sentence in the Joint Committee Report that immediately follows the reference to installment treatment for direct skips is very important: "The provision permitting tax-free redemptions of stock to pay estate tax is amended to permit those redemptions to pay generation-skipping transfer tax in the case of such transfers occurring as a result of death" (emphasis added). Section 303(d) provides for this treatment in cases "where stock in a corporation is the subject of a generation-skipping transfer (within the meaning of section 2611(a)) occurring at the same time as and as a result of the death of an individual." Section 2611(a) states that "the term 'generation-skipping transfer' means—(1) a taxable distribution, (2) a taxable termination, and (3) a direct skip." Thus, taxable terminations resulting from death were specifically included in this redemption treatment which was part of an effort to coordinate the transfer tax laws and to provide for a uniform result to the extent reasonably possible. Based on this analysis, it seems most likely that Congress did not address the availability of installment treatment for taxable terminations upon death because this would have required that a completely new code section be drafted, something that was beyond the scope of its legislative efforts at that time. At a minimum, there is nothing in the legislative history that would suggest that Congress did not want taxable terminations upon death to receive similar treatment to other transfers occurring upon death.

Private Letter Ruling ("PLR") 200939003, which concluded that section 6166 does not extend to taxable terminations, is consistent with the foregoing conclusion:

Under these provisions, the estate's eligibility for the deferral, as well as the amount of tax that may be deferred, is dependent on the inclusion of the property in the gross estate, and the size of the adjusted gross estate, which in turn is dependent on the amount of estate administration expenses, claims, etc. In contrast, the amount of the GST tax is dependent on the "taxable amount", i.e., the value of the property subject to the taxable termination less the deductions allowed as provided in section 2622. The elements involved in this calculation are different from those used under section 6166 to determine the eligibility for section 6166, i.e., the gross estate and the adjusted gross estate. In view of the statutory requirements contained in section 6166, that section would not otherwise be applicable to, or consistent with, the provisions of the GST tax imposed upon a taxable termination. Section 2661(2), therefore, does not provide a basis for making a section 6166 election in connection with a taxable termination.

Section 2661 states: "Insofar as applicable and not inconsistent with the provisions of this chapter— . . . (2) in the case of a generation-skipping transfer occurring at the same time as and as a result of the death of an individual, all provisions of subtitle F (including penalties) applicable to the estate tax, to chapter 11, or to section 2001 are hereby made applicable in respect of the generation-skipping transfer tax, this chapter, or section 2601 (as the case may be)." Section 6166 is part of subtitle F. Nevertheless, although other interpretations were possible, the Private Letter Ruling concluded the structure of section 6166 is inconsistent with the application of the GST tax, and therefore section 6166 is not applicable.

Based on the foregoing, Congress has clearly demonstrated its intent to prevent forced sales of closely held businesses that might otherwise result from imposing estate or other transfer taxes upon the death of a qualifying business owner. However, the code

section which Congress designed for this purpose has not been updated for forty years, and is often inadequate when it comes to protecting modern businesses and addressing current ownership structures and certain types of legal entities. In addition, a stated congressional priority is to eliminate “unnecessary differences” in the application of the tax laws and to make sure those laws are as simple as possible and consistent with “the overall statutory scheme.”

Furthermore, Congress has demonstrated its intent to provide similar tax consequences to the various forms of transferring assets, whether those transfers are made at death or during life, and whether or not generation-skipping transfers are involved. GST taxes arising from taxable terminations upon death can cause the same types of liquidity issues that are caused by the payment of estate taxes. However, at the time the First 6166 was enacted, there was no GST tax, and therefore the statute was not drafted with that tax in mind. ACTEC has concluded that it would be advisable to extend section 6166 deferral to taxable terminations occurring at death.

VI. POSSIBLE METHODS FOR CHANGE

The best way to make section 6166 more consistent with modern business practice is to substantially revise the current code section. By doing so, the application of section 6166 will be more uniform regardless of the choice of underlying business entity. Furthermore, the section can be greatly simplified.

There are a number of ways to provide deferral treatment for GST taxes caused by taxable terminations upon death. First, the IRS could revoke PLR 200939003 and issue a Revenue Ruling or Notice stating that tax deferral under section 6166 is available for GST taxes arising from taxable terminations upon death. However, it seems unlikely that a Revenue Ruling or Notice could adequately address the many issues raised in this Report. A Revenue Ruling or Notice would also create some degree of uncertainty because it could be revoked, modified, or superseded by the IRS at any time.

A second possibility is that the Treasury Department could promulgate new Regulations. It can be argued that section 2661 provides an implied grant of legislative regulatory authority to apply “all provisions of subtitle F” to taxable terminations arising at death. As noted above, subtitle F includes section 6166. In order to issue regulations making section 6166 applicable to certain taxable terminations, the IRS would need to conclude those provisions are “applicable” (a circular test) and “not inconsistent” with chapter 13. Regulations would offer the opportunity to address the complexities of applying section 6166 in this new context. However, given the IRS’s position in PLR 2009393003, it seems unlikely that it would take advantage of this authority to expand section 6166 by regulatory means.

Third, the issue could be resolved statutorily, either through revisions to existing section 6166 or through the enactment of a new code section. Although it would be possible to amend section 6166 so that it covers taxable terminations resulting from death, PLR 200939003 suggests that the existing framework of section 6166 is not compatible with the methodology for imposing this type of GST tax. In fact, a careful review of the statute indicates it would have to be substantially reworked to make it applicable to GST taxes arising from taxable terminations. In contrast, enacting a new code section that provides deferral for GST taxes arising from taxable terminations is the most effective method for extending deferral in a consistent and coherent manner. ACTEC has concluded that this

change would best be addressed legislatively in conjunction with the proposed changes to section 6166.

VII. RECOMMENDATION AND PROPOSAL TO SUBSTANTIALLY REVISE SECTION 6166

ACTEC recommends that section 6166 be substantially revised and that the proposed section 6166 attached to this Report be considered for that purpose. To assist in reviewing the attached proposed section 6166, a redline document showing the differences between current section 6166 and proposed section 6166 is attached to this Report. In addition, the following discussion describes in detail the proposed changes to be made to current section 6166.¹²

- (a)(1)** This provision remains the same except for making the subsection gender neutral.
- (a)(2)** This limitation remains essentially the same but has been simplified. The existing statute defines "closely held business amount" in subsection (b)(5) solely for purposes of the limitation in subsection (a)(2) and the passive asset test in subsection (b)(9). The draft statute eliminates the subsection (b)(5) definition and in subsection (a)(2)(A) simply references "the value of the interest in the closely held business which qualifies under subsection (a)(1)."
- (a)(3)** Subsection (a)(3) is essentially a simplified passive asset rule that has been moved from subsection (b)(9). Instead of creating its own passive asset definition as does existing subsection (b)(9), proposed subsection (a)(3) is based on "the reasonable needs of the business with the meaning of section 537" (this code section is actually referenced in the legislative history for section 6166). One advantage of this approach is that it makes applicable a well-defined and more substantial body of law that is already in use. Paragraph (3) also states that it is for purposes of subsection (a) but not for purposes of the acceleration provisions of subsection (g). By including passive assets for purposes of subsection (g), the valuation of the closely held business interest is higher, making it easier for estates to avoid acceleration of the deferred tax. ACTEC also considered whether it was reasonable to accumulate funds in the closely held business prior to death in order to pay for redemptions that provide liquidity to pay the estate tax. ACTEC feels that this is a reasonable business need but has decided to leave the issue open under sections 537 and 6166.
- (a)(4)** Formerly subsection (a)(3), this subsection remains the same except for the elimination of unnecessary words.
- (b)** Subsection (b) has been substantially restructured, simplified, and shortened. Major changes include the following: (1) moving the definitions in subsections (b)(4) and (b)(6) to (b)(1); (2) eliminating the definition in subsection (b)(5) as mentioned above; (3) eliminating the special election under subsection (b)(7) that provides for limited deferral in the case of publicly-traded stock; (4) moving

¹² References on the left are to subsections, paragraphs, subparagraphs, etc. of proposed section 6166. The material on the right explains these changes in the context of the existing statute.

the holding company rules from subsection (b)(8) to subsection (b)(3); (5) moving the passive asset rules from subsection (b)(9) to subsection (a)(3); and (6) eliminating the special election for stock in qualifying lending and finance businesses found in subsection (b)(10).

- (b)(1)** Subsection (b)(1) has also been substantially restructured to become a definitional subsection. As noted, the definition of "adjusted gross estate" has been moved from subsection (b)(6) to subsection (b)(1)(A) but is otherwise unchanged. Subsection (b)(1) provides new definitions of "business company," "entity," and "proprietorship" in subparagraphs (B), (C), and (F), respectively. The definition of "value" has been moved from current subsection (b)(4) to become subparagraph (G) with conforming changes only.
- (b)(1)(B)** Although a new definition of "business company" is created, this term is actually defined in the holding company rules of existing section 6166(b)(8). Current paragraph (8)(D)(ii) states that "the term 'business company' means any corporation carrying on a trade or business," but this has limited application outside of the holding company rules. The new definition is made broadly applicable throughout section 6166 and "means any entity carrying on a trade or business that is treated for purposes of Subtitle A as a corporation or a partnership." ACTEC also believes that business trusts will most likely be taxed as either corporations or partnerships and should therefore be covered by the new definition. It should be noted that the term "trade or business" is not defined in either current or draft section 6166. In Revenue Ruling 2006-34, the IRS created a list of factors it would consider in determining whether an interest in real estate constituted a trade or business. Many of these factors focus on how actively involved the decedent was before death, including through agents and employees. However, unlike the special use valuation provisions of section 2032A, there is no material participation requirement in section 6166. ACTEC has not attempted to resolve these issues in the draft statute.
- (b)(1)(C)** The term "entity" is used in current section 6166 without definition. In contrast, this new provision defines "entity" to mean a "person" other than an "individual." "Person" is already a defined term in section 7701(a).
- (b)(1)(D)** In current section 6166, the definition of "interest in a closely held business" constitutes the whole of subsection (b)(1). In the draft statute, this key definition has been substantially revised and is found in subsection (b)(1)(D). Proposed (D)(i) deals with proprietorships and is basically the same as the current statute but simplified. However, the provisions dealing with partnerships and corporations in current subparagraphs (B) and (C) have been collapsed into proposed subparagraph (D)(ii), which more efficiently references the newly defined "business company." In contrast to the current statute, which requires inclusion in the gross estate of 20% or more of "the total capital interest" of a partnership, or of 20% or more of the "value of the voting stock" in a corporation, proposed clause (ii) simply requires that the "decedent's ownership interest" in the business company must be at least 20%. Similar to the treatment of partnerships, this eliminates the requirement that only voting stock be considered. This change is also consistent with the purposes of section 6166 because the owner of non-voting stock will likely need greater protection than the owner of voting stock. The effect of the proposed language is to provide a more

uniform and streamlined approach across various types of entities. It should be noted that there is nothing in the definition of “interest in a closely held business” that precludes a publicly-traded entity from qualifying for deferral treatment. In that case, qualification will most likely be based on the 20% test rather than the 45-owner limitation.

- (b)(1)(E)** Subparagraph (E) provides two completely new definitions which together require inclusion in the gross estate of 20% or more of an entity’s liquidation value. Clause (i) defines the term “decedent’s ownership interest”—which is used in subparagraph (D)—as “the percentage of the total ownership interest” that would have been received in a hypothetical liquidation. The term “total ownership interest” is defined in clause (ii). One advantage of using this “net proceeds of liquidation” approach is that it avoids the complication of valuation discounts.
- (b)(1)(F)** The term “proprietorship” is used in current section 6166 without definition. This new provision defines “proprietorship” to include an interest in a disregarded entity.
- (b)(2)** Subsection (b)(2), which provides rules for purposes of subsection (b)(1), has also been substantially restructured.
- (b)(2)(A)** Because the definition of “adjusted gross estate” has been moved to subsection (b)(1)(A) and that calculation is made at the time of filing, paragraph (2)(A) now provides an exception to the general rule that determinations under subsection (b)(1) will be made immediately before the decedent’s death.
- (b)(2)(B)** Current subparagraph (C) dealing with indirect ownership has been moved to draft subparagraph (B) and has been significantly modified. The existing rule in subparagraph (B) for counting husbands and wives as single owners has been eliminated for the reasons discussed below. New subparagraph (B) makes clear that it applies for purposes of both counting owners and determining the decedent’s ownership interest, including attributed ownership. This contradicts PLR 8428088, which rules that the indirect ownership rules do not apply for purposes of attributing ownership to the decedent. In addition, rather than describing different types of entities and owners, the new provision simply refers to an entity and its owners and beneficiaries. Status as a trust beneficiary is based upon being a “permissible current recipient of income or corpus” (similar to section 2652(c)(1)(B)) rather than having “a present interest in the trust” as is currently the case. Finally, similar to section 267(c)(5), a new sentence is added at the end to make clear that the process of determining ownership is repeated until only individuals are found. The net effect of the new indirect ownership provision is that both the decedent’s percentage ownership and the number of owners may be increased, the former making it easier to qualify and the latter making it harder.
- (b)(2)(C)** Subparagraph (C) provides a new counting rule which provides that all persons who would be treated as a single owner under section 1361(c)(1) will be treated as a single owner for purposes of section 6166. For this purpose, the “applicable date” of section 1361(c)(1)(B) is modified to be the date of the decedent’s death. This new counting rule applies to all owners, not just members of the decedent’s family. Because husbands and wives are part of the same family under section

1361, the husband and wife counting rule of current subsection (b)(2)(B) has been eliminated.

- (b)(2)(D)** Subparagraph (D) maintains the family attribution rule found in current subparagraph (D). Essentially flipping the treatment in PLR 8428088, the new provision makes clear that it is an attribution rule for purposes of the 20% test and not a counting rule. For this purpose, “family” is defined pursuant to section 1361(c)(1) rather than section 267(c)(4).
- (b)(2)(E)** Subparagraph (E) provides a new rule that disregarded entities are treated as owned by the sole owner. Qualified subchapter S subsidiaries are included in this rule.
- (b)(3)** As noted above, the rules for holding companies have been moved from subsection (b)(8) to subsection (b)(3). The major changes to these rules include the following: (1) the rules have been expanded to cover a broad range of entities by replacing “stock” with “ownership interest”; (2) the special election providing for limited deferral in exchange for deemed business company treatment has been eliminated; and (3) the special election providing for even more limited deferral in exchange for deemed business company treatment for publicly-traded business companies is also eliminated. Meanwhile, proposed subsection (b)(3) preserves the requirement that ownership interests in holding companies must be non-readily tradable and incorporates the definition of “non-readily tradable” found in subsection (b)(7)(B) of the current statute. The net result of these changes is that instead of having special limitations on deferral, standard deferral applies in all cases, including for business companies that are publicly traded. The definition of holding company has been expanded from “any corporation holding stock in another corporation” to “any entity that holds an interest in another entity treated as a partnership or a corporation for purposes of Subtitle A.” As noted above, the definition of “business company” has been moved to subsection (b)(1)(B). Other changes have been made to these rules that are consistent with the revisions to section 6166 generally.
- (b)(4)** The special rule for farmhouses has been moved from subsection (b)(3) to subsection (b)(4) with very minor changes. It should be noted that current subsection (b)(3) is very similar to section 2032A(e)(3), which is part of the special use valuation rules. However, as noted above, the decedent’s material participation is not expressly required by section 6166 as it is in section 2032A.
- (c)** Current subsection (c) allows interests in two or more closely held businesses to be combined into one for purposes of subsection (a) if at least 20% of each business is included in the gross estate. Subsection (c) creates its own 20% test that is independent of the 20% test in subsection (b)(1). In contrast, proposed subsection (c) simply relies upon qualification under subsection (b)(1)(D), whether based on the 20% test or the 45-owner limitation. In other words, any businesses that qualify as closely held businesses can be consolidated into a single business for purposes of satisfying the 35% test. Because subsection (b)(2)(D) already contains a family attribution rule, the second sentence of current (c) dealing with ownership by the decedent and the surviving spouse is no longer necessary.

- (d)** Current subsection (d) provides that a section 6166 election “shall be made not later than the time prescribed by section 6075(a) for filing the return of tax imposed by section 2001,” and states that the election “shall be made in such manner as the Secretary shall by regulations prescribe.” In contrast, new subsection (d) simply states that the election “shall be made on the return of the tax imposed by section 2001” and also states that it “shall be made in such manner as the Secretary shall by regulations prescribe.” By eliminating the reference to section 6075(a) with respect to the time for filing, 9100 relief should be available from the IRS with respect to late elections.
- (e)** New subsection (e) consolidates existing subsections (e) and (h) into new paragraphs (1) and (2) of subsection (e), with the result that similar statutory provisions are placed in close proximity. If a deficiency has been assessed, paragraph (1) addresses the proration of that deficiency when a section 6166 election is already in effect. In contrast, paragraph (2) addresses the proration of deficiencies when a section 6166 election has not been made. Because they are so similar, ACTEC considered combining these two provisions into a single paragraph applicable to both situations, but decided that they were clearer if kept separate.
- (e)(1)** The order of proration in paragraph (1) has been switched to be more logical, with proration to payments already due preceding proration to payments not yet due. The new paragraph removes the subsection (a)(2) limitation of current subsection (e) because it is already found in the Regulations, but includes a new provision clarifying that only “the portion of the deficiency attributable to the interest in the closely held business” can be prorated to the installment payments.
- (e)(2)** Paragraph (2) provides that a section 6166 election can be made not later than 60 days after notice and demand for payment of a deficiency. New paragraph (2) is reorganized to make it parallel to paragraph (1) to the extent possible. The same clarification on the “portion of the deficiency” and the removal of the subsection (a)(2) limitation is also made here.
- (e)(3)** New paragraph (3) provides that the benefits of subsection (e) do not apply in certain situations such as fraud and negligence, thereby carrying forward a similar limitation found in current subsections (e) and (h).
- (f)** Subsection (f) has been simplified in a number of ways. First, current paragraphs (1) and (2) have been combined into new paragraph (1) because there is no apparent reason to distinguish between the first five years of interest and the payments made thereafter. A new sentence is added indicating that if an installment is due, interest will be paid as part of the installment. Second, current paragraph (3) is renumbered as paragraph (2) and the multi-pronged assessment language relating to the first five years or later is removed as unnecessary. Instead, a simple statement is made that interest on deficiencies will be paid upon notice and demand. Third, paragraph (4) of current subsection (f) has been removed because the draft statute eliminates special elections providing limited deferral.

- (g)** Subsection (g) in current section 6166 contains almost 1,100 words, which is more than a quarter of the entire statute. In the draft statute, subsection (g) expands to around 1,400 words.
- (g)(1)** Subsection (g)(1) by itself makes up about 15% of the current code section and is even longer in the proposed draft. ACTEC particularly struggled with paragraph (1)(C), ending up with two alternative provisions for consideration.
- (g)(1)(A)** Current subparagraph (A) provides that dispositions of the closely held business interest, or withdrawals attributable to that interest, will terminate the deferral election if they equal or exceed 50% of the interest's value. New subparagraph (A) maintains this same approach. However, current subparagraph (A)(i)(II) provides that the withdrawal of "money and other property" can trigger the acceleration provisions of subparagraph (A). The draft changes this to "money or other property" in several places in subsection (g)(1) on the assumption that this is the true intent of the statute.
- (g)(1)(B)** Subparagraph (B) dealing with redemptions has been made more concise but is essentially the same. In essence, amounts distributed from the business in connection with a section 303 redemption will not be treated as a distribution or withdrawal for acceleration purposes. However, the value of the closely held business interest will be reduced by the value of the stock redeemed, forcing a recalculation of prior transfers with respect to the 50% threshold. Furthermore, deferred tax equal to the value of the property distributed in the redemption must generally be paid by the time of the next installment.
- (g)(1)(C)** Current subparagraph (C), which provides an exception from the acceleration provisions in the case of corporate reorganizations, has been moved to become new subparagraph (D) and has been substantially changed, as discussed below. New subparagraph (C) has been added to provide an exception from the acceleration provisions with respect to installment sales. After considering two different alternatives, ACTEC was unable to decide upon a particular approach, with the result that both alternatives are presented in the draft statute.
- Alternative I:** The shorter first alternative provides that a sale to the business or any of its owners in exchange for an installment obligation will not be considered a disposition under the statute, but payments on the obligation will be considered to be withdrawals from the business for purposes of the acceleration provisions. This means that payments on the obligation would not need to be paid to the Government and no acceleration would occur until the 50% threshold is reached. **Alternative II:** The longer second alternative treats any sale for an installment note as if it were a redemption under subsection (g)(1)(B), with corresponding recalculation for purposes of subsection (g)(1)(A), but only if the seller (as defined in new subsection (g)(1)(H)) makes an election to that effect. If an election is made, then any proceeds (net of other taxes) will be allocated to the remaining installments and paid to the Government at the appropriate times. The seller, who may not be primarily liable for the estate tax, can be reimbursed by those who are primarily liable for any amounts paid by the seller in satisfaction of the tax, and those reimbursements will not be payable to the Government. Finally, the seller's rights to the unpaid proceeds must be protected by a purchase money security interest.

(g)(1)(D) As mentioned above, current subparagraph (C) has been moved to subparagraph (D) and has been rewritten. Instead of the very narrow current provision providing an exception only for corporate reorganizations, new subparagraph (D) applies to all types of entities and provides that there will be no acceleration “to the extent that a change in the legal structure of the business does not result in a change in beneficial ownership.” For example, terminating an S corporation for tax reasons should not result in an acceleration under subsection (g)(1)(A). In drafting subparagraph (D), ACTEC was loosely guided by concepts pertaining to the continuation of partnerships following mergers and divisions, as provided under Regs. 1.708-1. However, ACTEC has not drafted detailed requirements similar to current subparagraph (C), concluding that this was better left to the IRS in Regulations.

(g)(1)(E) Current subparagraph (D) provides that testamentary transfers to beneficiaries under a will or trust created by the decedent do not trigger acceleration. Referring to current subparagraph (D), the IRS has stated: “The reshuffling of a business within the estate (among heirs), while literally a ‘distribution’ is not a triggering event under subsection 6166(g)(1)(A).” See PLR 8806022. This subparagraph becomes a new subparagraph (E) and removes references to the method of testamentary disposition. In addition, a definition of “property” for purposes of this subparagraph has been added. ACTEC considered expanding this provision to include lifetime gifts but decided to leave this issue for future consideration.

(g)(1)(F) Current subparagraphs (E) and (F) have been moved to become new subparagraphs (F) and (G). These related subparagraphs respectively deal with dispositions of a holding company and dispositions by a holding company. Like the holding company rules themselves, new subparagraphs (F) and (G) have been rewritten to cover all types of entities.

(g)(1)(G) See description for subsection (g)(1)(F).

(g)(1)(H) This is a new definitional provision relating to the second alternative subsection (g)(1)(C). Depending upon which alternative subparagraph (C) is chosen, subparagraph (H) may or may not be needed. Alternatively, the definitions of proposed subparagraph (H) could be incorporated into subparagraph (C).

(g)(2) Subsection (g)(2) provides that the undistributed net income of an estate must be paid in satisfaction of the deferred tax. ACTEC generally left paragraph (2) intact, but added two new provisions dealing with specific concerns. First, after considering a number of different approaches, ACTEC added new clause (iv) to subparagraph (B) in order to address the concern of phantom income. In essence, the amount of distributable net income attributable to an entity owned by the estate will not be considered undistributed net income to the extent it exceeds the fair market value of any liquid assets distributed from the entity to the estate. Second, a new subparagraph (C) has been added which expands the definition of “estate” to include a “qualified revocable trust” within the meaning of section 645(b)(1) without regard to whether an election has been made under section 645(a). Finally, current subparagraph (C), in which dividends paid by a business company to a holding company are treated as paid to the estate, has been deleted. Assuming that only a C corporation could be a business company

owned by a holding company under current subsection (b)(8), the C corporation income treated as paid to the estate is essentially a type of phantom income if the holding company is also a C corporation (if the holding company is an S corporation, the dividend to the S corporation should be included in DNI without any help from subparagraph (C)). Because this forced phantom income approach only applies to holding companies deemed to be business companies, it is essentially a penalty for using the holding company rules. The draft statute does not perpetuate the concept of penalizing holding companies, which can be an important part of modern business structure, and current subparagraph (C) has therefore been deleted. To the extent the estate has phantom income under the draft statute, new clause (iv) will eliminate this problem. ACTEC recognizes that there is potential for abuse under both current and new subsection (g)(2) on either side of the estate's DNI equation (e.g., creating an entity to hold liquid assets), but has not attempted to resolve these issues.

- (g)(3)** Subsection (g)(3), dealing with failure to pay the deferred estate tax, remains unchanged. ACTEC considered removing clause (ii) of subparagraph (B), which currently makes the special interest rate provisions of section 6601(j) inapplicable in the event of failure to pay. If section 6601(j) does not apply, then the normal underpayment rate provided by section 6601(a) would apply. Although ACTEC has eliminated the special rate for the "2-percent portion" in the draft section 6601(j) that accompanies this Report (see discussion below), draft subsection (j) continues to provide another special rate, and the denial of that additional special rate by clause (ii) in cases of failure to pay has therefore been left in.
- (h)** Current subsection (h) has been consolidated into subsections (e)(1) and (2), as described above. Current subsection (i), dealing with the treatment of generation-skipping transfer tax on direct skips as a result of the decedent's death, has been moved to draft subsection (h) and remains unchanged.
- (i)** Current subsection (j), authorizing the IRS to promulgate necessary regulations, has been moved to draft subsection (i) and remains unchanged.
- (j)** Current subsection (k), providing cross references, has been moved to draft subsection (j) and remains unchanged.
- 6601(j)** Draft section 6166(j)(4) provides a cross reference to the special interest rate provided by draft section 6601(j). Although draft section 6601(j) eliminates the special interest rate for the "2-percent portion," the regular special rate provided by that subsection would continue to apply. Currently, the regular special rate is 45% of the underpayment rate provided in section 6601(a). In contrast, draft section 6601(j) provides for a floating regular special rate that is equal to the underpayment rate multiplied by one minus the highest marginal rate applicable to the estate. ACTEC believes that this approach is a rough equivalent of the concept underlying the 45% of underpayment rate which was enacted when the estate tax rate was 55%. ACTEC also believes that interest payments on deferred estate tax should continue to be non-deductible.

VIII. RECOMMENDATION AND PROPOSAL FOR NEW CODE SECTION 6166A

In addition to modernizing the process for electing and administering deferral under section 6166, ACTEC recommends that Congress enact a similar deferral election covering taxable terminations upon death. Given the historical relationship between sections 6166 and 6166A, drafting a new section 6166A for this purpose is the most logical choice.¹³ In order to make a more effective comparison between deferral of estate taxes and deferral of GST taxes, and because it was prepared before proposed section 6166, the proposed section 6166A attached to this Report modifies current section 6166. Essentially the only changes made at this time in the proposed section 6166A attached are those necessary to reflect the differences that exist between the estate tax and the GST tax. In addition to the other attachments, a redline document showing the differences between current section 6166 and proposed section 6166A is attached to this Report. However, ACTEC believes that any changes made to current section 6166 should also be made to proposed section 6166A, subject to any additional modifications required in the context of the GST tax.¹⁴

The differences between current section 6166 and proposed section 6166A are outlined below. An obvious change that occurs twice in proposed section 6166A(a) is the reference to the GST tax imposed by section 2601 instead of the estate tax imposed by section 2001. Also, the phrase "the taxable amount of the taxable termination" is derived from section 2622(a) and is the equivalent of the special definition of "adjusted gross estate" found in current section 6166(b)(6). Although that special definition allows for deductions under sections 2053 and 2054, section 2622(b) already allows for deductions similar to what is provided under section 2053, and it appears that chapter 13 does not specifically provide for the deduction of losses during administration similar to what is provided under section 2054. As a result, no special definition is required with respect to taxable terminations and no parallel to section 6166(b)(6) is included in the proposed statute.

Furthermore, the phrase "the value of all property with respect to which the taxable termination has occurred" is taken verbatim from section 2622(a)(1) and is the equivalent of the term "gross estate of the decedent" found in section 2031. This new phrase is incorporated into the definition of a closely held business in section 6166A(b)(1). The 35% test found in the general rule of section 6166A(a)(1) uses a similar phrase but modifies the words "taxable termination" to require that the termination be one which is "directly resulting from the death of a non-skip person." As noted above, the legislative history makes clear that Congress intended to provide similar transfer tax treatment for different forms of transfers occurring at death, so this provision is consistent with that history.

Another important change in the proposed statute reflects the fact that the person who is liable to pay the tax under section 2603(a)(2) is the trustee rather than the

¹³ Although adding a new section 6166A would add to the already complicated legislative history of these two code sections, this may have little relevance except to the drafters of reports such as this. On the other hand, because of this confusing background, it is already important to carefully consider which version of this section is involved when it is cited in case law or IRS rulings. Furthermore, at some point, the original IRS Regulations under section 6166 were re-designated as being under former section 6166A. This continues to be the case even though there is not a section 6166A at the present time. If proposed section 6166A is enacted, that would be even more reason for the Regulations pertaining to section 6166 to be re-designated back to the proper Code section.

¹⁴ ACTEC would be happy to assist with this if it would be helpful.

executor. The trustee is also the person who files Form 706GS(T) in order to report taxable terminations to the IRS. Because the only credit applicable to the federal GST tax was the now repealed credit for certain state GST taxes under section 2604, in the phrase “reduced by the credits against such tax,” the word “the” has been changed to “any” in the proposed statute. Also, because direct skips occurring upon the death of an individual are already covered by section 6166, there is no need to have a provision similar to section 6166(i) in the proposed statute (and a direct skip at death is more closely related to a transfer subject to the estate tax in any event).

As ACTEC considered these changes, there was a significant amount of discussion about the need for aggregation of trusts for which there is a common grantor and a common non-skip person whose death triggers the generation-skipping transfer tax. ACTEC concluded that in order to prevent taxpayers from manipulating the opportunity for tax deferral under proposed section 6166A, there should be aggregation rules for combining generation-skipping trusts for purposes of qualification under such circumstances. Although section 6166A(b) provides a number of definitions and special rules, the aggregation provision has been placed in section 6166A(a) because of its relationship to the 35% test of subsection (a)(1). Furthermore, although subsection (b)(2) provides certain aggregation and attribution rules, the purpose of those rules is to determine whether the 45 or fewer partners and shareholders tests have been met under subsection (b)(1), which defines the term “interest in a closely held business,” and subsection (a) is therefore a more appropriate place for a trust aggregation rule.

Along the same lines, current subsection (b)(2)(D) provides an attribution rule which treats the decedent as owning any stock or partnership interests owned by the decedent’s family. In other words, this attribution rule helps the decedent’s estate qualify for the deferral election because there are fewer shareholders or partners when it is applied, thereby making it easier to qualify under the 45 or fewer partners or shareholders limitation. However, because a trust subject to a taxable termination does not have a family, this beneficial rule does not apply in the context of section 6166A. Therefore, to place the two taxpayers (i.e., under sections 6166 and 6166A) on a somewhat equal footing, for purposes of section 6166A, any trusts that would be aggregated under subsection (a)(4) are also aggregated under subsection (b)(2)(D) for purposes of the 45-person limitation.¹⁵

In contrast, the effect of the attribution rule of current subsection (b)(2)(C) is to make shareholders, partners, and beneficiaries owners for purposes of the 45-person limitation, thereby increasing the number of owners and making it harder to qualify. However, this attribution rule does not apply to the decedent’s estate because subsection (b)(2)(A) provides that the time for testing is “immediately before the decedent’s death,” meaning that the decedent’s estate does not yet exist and therefore no one will be treated as indirectly owning the decedent’s interests. Therefore, to again place the two taxpayers on a more equal footing, the trust subject to the taxable termination is carved out from the attribution rule applying to trusts.

¹⁵ ACTEC also considered whether the phrase “the same transferor” should be expanded to be “the same transferor or the transferor’s spouse” in the aggregation provisions of subsections (a)(4) and (b)(2)(D). After discussion, ACTEC decided not to add the additional language to the proposed statute, but to instead indicate through this Report that Congress may want to consider this alternative with respect to either or both subsections.

Although there would not be attribution *from* the trust subject to the taxable termination, there may be attribution *to* such a trust under subsection (b)(2)(C) (e.g., if the trust is a shareholder, partner, or beneficiary). In the event that a business interest is attributed to the trust under subsection (b)(2), the trustee may make an election under subsection (b)(6) to have the business interest treated as owned by the trust for purposes of the 20% test of subsection (b)(1)(B) or (C) (presumably the business interest would not qualify as closely held without this election). However, it should be noted that this election does not cause the attributed property to be subject to the taxable termination. In the event of such an election, the initial five-year deferral period is eliminated and the special interest rate is not available. This election is the equivalent of the election that currently exists under subsection (b)(7). Like the current election, the election under proposed subsection (b)(6) also applies to the aggregation rule of subsection (c), which allows interests in different businesses that each equal at least 20% of the value of all property with respect to the taxable termination to be joined together for purposes of the 35% requirement of subsection (a)(1).

A number of other relatively minor changes are found in proposed section 6166A. For example, proposed subsection (b)(4), dealing with the value of the property subject to tax, refers to "chapter 13" instead of "chapter 11." Although an alternative would be to refer to section 2624, which deals specifically with valuation for purposes of chapter 13, referring to the chapter instead of to the individual code section more closely tracks the language of section 6166 and has the advantage of being broader than the reference to section 2624, which begins with the words "Except as otherwise provided in this chapter." Also, with respect to the acceleration of the deferred payments under subsection (g), the phrase "transferor in such transfer" used in subparagraph (D) has been changed to "person making such transfer" in order to avoid possible confusion with the term "transferor" as used in the generation-skipping transfer tax context. In that same subparagraph, the exception provided for a transfer of property to a person entitled to receive it "under the decedent's will, the applicable law of descent and distribution, or a trust created by the decedent" has been narrowed to simply receipt "under the terms of the trust." Finally, with respect to the treatment of undistributed income under the acceleration provision, subsection (g)(2)(B)(iii) refers to taxes imposed by both sections 2001 and 2601 because of the possibility that the trust subject to the taxable termination could also have assets subject to an existing section 6166 election.

In addition to the changes mentioned above, a certain non-change is noteworthy. Current section 6166 refers five different times to "the date prescribed by section 6151(a)," which is the date for paying the estate tax. Although section 2662 provides specific requirements for preparing and filing generation-skipping returns, it does not deal with the payment of the generation-skipping tax, which is instead covered by section 6151(a). Therefore, the references to that tax payment code provision are left unchanged in the proposed statute. This treatment is also consistent with the administrative provisions of section 2661, which generally apply the rules of subtitle F (including section 6151) to generation-skipping transfers.

Finally, a significant difference between the proposed code section and the existing code section is the inclusion of new subsection (i), dealing with the application of other code provisions that apply as written to the estate tax context. These code provisions include the special lien for estate taxes under section 6324A, the extensions for limitations periods under section 6503(d), the special interest rate under section 6601(j), and redemption

treatment under section 303. Rather than revise these other code sections or add new ones applicable to the generation-skipping transfer tax context, the proposed statute provides that rules similar to those found in the other code provisions will apply. It should be noted that although section 303(d) already includes a special rule treating generation-skipping transfer taxes as estate taxes for purposes of that section, the extended distribution period provided in section 303(b)(1)(C) is only applicable if a section 6166 election has been made. The extended period would not apply to an election under section 6166A without specific authorization in either section 303 or section 6166A.

IX. CONCLUSION

For the reasons stated above, ACTEC believes that section 6166 should be substantially revised to update the statute for the modern business world. ACTEC believes that the proposed section 6166 attached to this Report would accomplish this objective and would also simplify a very complex statute, making it more usable by taxpayers.

In addition, ACTEC believes that the Internal Revenue Code should be amended to provide deferral treatment for generation-skipping transfer taxes arising from taxable terminations resulting from death similar to what currently exists for estate taxes under section 6166. ACTEC also believes that the proposed section 6166A attached to this Report would more accurately and efficiently implement what we understand to be the objectives and the intent of Congress than do the provisions of current law.

Finally, any modernization made to section 6166, as recommended in this Report, should be imported to proposed section 6166A as well.

These recommendations were prepared by members of the 6166 Revision Subcommittee of ACTEC's Tax Policy Study Committee. Contact persons with respect to this report are David Sloan (dsloan@fabianvancott.com, 801-979-1241), who chaired the Subcommittee, Beth Shapiro Kaufman (bkaufman@capdale.com, 202-862-5062), current chair of the Tax Policy Study Committee, and Don Kozusko (dkozusko@kozlaw.com, 202-457-7211), current chair of ACTEC's Washington Affairs Committee. We appreciate the opportunity to provide these recommendations and would be pleased to discuss these proposals further if desired.

Proposed Section 6166

PROPOSED SECTION 6166

EXTENSION OF TIME FOR PAYMENT OF ESTATE TAX WHERE ESTATE CONSISTS LARGELY OF INTEREST IN CLOSELY HELD BUSINESS

(a) 5-YEAR DEFERRAL; 10-YEAR INSTALLMENT PAYMENT

- (1) **IN GENERAL.** - If the value of an interest in a closely held business which is included in determining the gross estate of a decedent who was (at the date of the decedent's death) a citizen or resident of the United States exceeds [35] percent of the adjusted gross estate, the executor may elect to pay part or all of the tax imposed by section 2001 in 2 or more (but not exceeding 10) equal installments.
- (2) **LIMITATION.** - The maximum amount of tax which may be paid in installments under this subsection shall be an amount which bears the same ratio to the tax imposed by section 2001 (reduced by the credits against such tax) as—
- (A) The value of the interest in the closely held business which qualifies under subsection (a)(1), bears to
- (B) the adjusted gross estate.
- (3) **BENEFITS OF SECTION ONLY AVAILABLE FOR ASSETS HELD FOR REASONABLE NEEDS OF BUSINESS.** - For purposes of this subsection (a) (but not for purposes of subsection (g)), the value of an interest in a closely held business shall exclude the value of that portion of such interest which is attributable to assets not held for the reasonable needs of the business within the meaning of section 537, applying that section as if the business were a corporation subject to subchapter C.
- (4) **DATE FOR PAYMENT OF INSTALLMENTS.** - If an election is made under paragraph (1), the first installment shall be paid on or before the date which is 5 years after the date prescribed by section 6151(a) for payment of the tax, and each succeeding installment shall be paid on or before the date which is 1 year after the date prescribed by this paragraph for payment of the preceding installment.

(b) DEFINITIONS AND SPECIAL RULES.

(1) DEFINITIONS. -- For purposes of this section --

- (A) **ADJUSTED GROSS ESTATE.** - The term "adjusted gross estate" means the value of the gross estate reduced by the sum of the amounts allowable as a deduction under section 2053 or 2054. Such sum shall be determined on the basis of the facts and circumstances in existence on the date (including extensions) for filing the return of tax imposed by section 2001 (or, if earlier, the date on which such return is filed).

- (B) BUSINESS COMPANY.** - The term “business company” means any entity carrying on a trade or business that is treated for purposes of Subtitle A as a corporation or a partnership.
- (C) ENTITY.** The term “entity” means a person that is not an individual.
- (D) INTEREST IN CLOSELY HELD BUSINESS.** The term “interest in a closely held business” means an interest in —
- (i) a proprietorship carrying on a trade or business; or
 - (ii) a business company, if—
 - (I) the decedent’s ownership interest in such entity is at least twenty (20) percent, or
 - (II) such entity had [45] or fewer owners.
- (E) OWNERSHIP INTEREST.**
- (i) The term “decedent’s ownership interest” means the percentage of the total ownership interest that would have been received with respect to an ownership interest in the entity included in the gross estate of the decedent in the event of a liquidation.
 - (ii) The term “total ownership interest” means the total amount of net proceeds that all owners would have received if the entity sold all of its assets and liquidated on the date of death of the decedent.
- (F) PROPRIETORSHIP.** - The term “proprietorship” shall include an interest in an entity that for income tax purposes is not treated as separate from its owner.
- (G) VALUE.** – “Value” shall be value determined for purposes of chapter 11.
- (2) RULES FOR APPLYING PARAGRAPH (1).** - For purposes of paragraph (1) —
- (A) TIME FOR TESTING.** – Except as provided in paragraph (1)(A), determinations shall be made as of the time immediately before the decedent's death.
 - (B) INDIRECT OWNERSHIP.** - In determining the number of owners and the percentage of ownership, property owned, directly or indirectly, by or for an entity shall be considered as being owned proportionately by or for its beneficiaries or owners. For purposes of the preceding sentence, a person shall be treated as a beneficiary of a trust only if such person is a permissible current recipient of income or corpus from the trust. This subparagraph shall be applied repeatedly until it results in ownership only by individuals.
 - (C) NUMBER OF OWNERS.** - In determining the number of owners of an entity, all persons who would be treated as one shareholder under section 1361(c)(1), if such entity were treated as a corporation under subtitle A, shall be treated as one owner.

For this purpose, the “applicable date” in section 1361(c)(1)(B)(iii) shall be the decedent’s date of death.

(D) FAMILY ATTRIBUTION. - For purposes of satisfying the 20-percent requirement in paragraph (1)(D)(ii)(I), any ownership interest held by any member of the family of the decedent (within the meaning of section 1361(c)(1) as modified by paragraph (2)(C)) shall be treated as included in the decedent’s gross estate.

(E) DISREGARDED ENTITY. - The assets of an entity disregarded for purposes of Subtitle A, including a qualified subchapter S subsidiary described in section 1361(b)(3), shall be treated as owned by its sole owner.

(3) RULES FOR HOLDING COMPANIES. For purposes of this section,

(A) The term “holding company” means any entity that holds an interest in another entity treated as a partnership or a corporation for purposes of Subtitle A.

(B) The portion of an ownership interest in any holding company which represents direct ownership (or indirect ownership through 1 or more other holding companies) by such company in a business company shall be deemed to be an ownership interest in the business company.

(C) No ownership interest shall be taken into account for purposes of applying this paragraph unless all of the ownership interests of each holding company taken into account are non-readily-tradable interests. The term “non-readily-tradable interest” means ownership interests for which, at the time of the decedent's death, there was no market on a stock exchange or in an over-the-counter market.

(4) FARMHOUSES AND CERTAIN OTHER STRUCTURES TAKEN INTO ACCOUNT. - For purposes of the [35]-percent requirement of subsection (a)(1), an interest in a closely held business which is in the business of farming includes an interest in residential buildings and related improvements on the farm which are occupied on a regular basis by the owner or lessee of the farm or by persons employed by such owner or lessee for purposes of operating or maintaining the farm.

(c) SPECIAL RULE FOR INTERESTS IN 2 OR MORE CLOSELY HELD BUSINESSES. - For purposes of this section, interests in 2 or more closely held businesses, each of which satisfies the requirements of section 6166(b)(1)(D), shall be treated as an interest in a single closely held business.

(d) ELECTION. - The election under subsection (a) shall be made on the return of the tax imposed by section 2001. Such election shall be made in such manner as the Secretary shall by regulations prescribe. If an election under subsection (a) is made, the provisions of this subtitle shall apply as though the Secretary were extending the time for payment of the tax.

(e) PRORATION AND ELECTION IN CASE OF DEFICIENCY.

(1) If an election has been made under subsection (a) to pay any part of the tax imposed by section 2001 in installments and a deficiency has been assessed, the portion of the deficiency attributable to the interest in the closely-held business shall be prorated to the installments payable under subsection (a). The part of the deficiency so prorated to any installment the date for payment of which has arrived shall be paid upon notice and demand from the Secretary. The part of the deficiency so prorated to any installment the date for payment of which has not arrived shall be paid at the same time as, and as part of, such installment.

(2) If—

- (A) an election has not been made under subsection (a) to pay any part of the tax imposed by section 2001 in installments,
- (B) a deficiency in the tax imposed by section 2001 has been assessed, and
- (C) the estate qualifies under subsection (a)(1),

the executor may elect to pay the portion of the deficiency attributable to the interest in the closely-held business in installments, and such portion shall be prorated to the installments which would have been due if an election had been timely made under subsection (a). An election under this paragraph shall be made not later than 60 days after issuance of notice and demand by the Secretary for the payment of the deficiency, and shall be made in such manner as the Secretary shall by regulations prescribe. The part of the deficiency so prorated to any installment the date for payment of which would have arrived shall be paid at the time of the making of the election under this paragraph. The part of the deficiency so prorated to any installment the date for payment of which has not arrived shall be paid at the time such installment would have been due if such election had been made.

(3) This subsection shall not apply if the deficiency is due to negligence, to intentional disregard of rules and regulations, or to fraud with intent to evade tax.

(f) **TIME FOR PAYMENT OF INTEREST.** If the time for payment of any amount of tax has been extended under this section—

(1) **INTEREST.** - Interest payable under section 6601 on the unpaid portion of such extended amount shall be paid annually on the anniversary of the date prescribed by section 6151(a) for the payment of the tax. If an installment payment is due, the interest shall be paid at the same time as, and as part of, such installment.

(2) **INTEREST IN THE CASE OF A DEFICIENCY.** - In the case of a deficiency to which subsection (e) applies, any accrued and unpaid interest shall be paid upon notice and demand from the Secretary.

(g) **ACCELERATION OF PAYMENT**

(1) **DISPOSITION OF INTEREST; WITHDRAWAL OF FUNDS FROM BUSINESS.**

(A) If -

- (i)
 - (I) any portion of an interest in a closely held business which qualifies under subsection (a)(1) is distributed, sold, exchanged, or otherwise disposed of, or
 - (II) money or other property attributable to such an interest is withdrawn from such business, and
- (ii) the aggregate of such distributions, sales, exchanges, or other dispositions and withdrawals equals or exceeds 50 percent of the value of such interest,

then the extension of time for payment of tax provided in subsection (a) shall cease to apply, and the unpaid portion of the tax payable in installments shall be paid upon notice and demand from the Secretary.

- (B)** In the case of a distribution in redemption of stock to which section 303 (or so much of section 304 as relates to section 303) applies, for purposes of subparagraph (A)—
 - (i) the redemption of such stock, and the withdrawal of money or other property distributed in such redemption, shall not be treated as a distribution or withdrawal, and
 - (ii) the value of the interest in the closely held business shall be considered to be such value reduced by the value of the stock redeemed.

This subparagraph shall apply only if, on or before the date prescribed by subsection (a)(4) for the payment of the first installment which becomes due after the date of the distribution (or, if earlier, on or before the date which is 1 year after the date of the distribution), there is paid an amount of the tax imposed by section 2001 not less than the amount of money and other property distributed.

- (C)** Subparagraph (A)(i)(I) does not apply to the sale of any such portion to the business or any of its owners, directly or indirectly, in exchange for an installment obligation described in section 453A(b)(1) (without regard to the other paragraphs under section 453A(b)); but such installment obligation shall be treated for purposes of subparagraph (A)(i) as an interest qualifying under subsection (a)(1), and payments of interest and principal attributable to such installment obligation shall be treated as money or other property withdrawn from such business for purposes of subparagraph (A)(i)(II). **OR** If there is a disposition as described in subsection (g)(1)(A)(i)(I) for which at least one payment is to be received after the close of the taxable year in which the disposition occurs, the seller may elect to treat such disposition as if it were a section 303 redemption described in subparagraph (B). The election shall be made in such manner as is provided under regulations prescribed by the Secretary. If and to the extent that the seller makes this election:
 - (i) Subject to clause (ii), the proceeds shall be applied against the total unpaid portion of the tax which the executor elected to pay in installments, and shall be divided equally among the installments due after the date of such payment.

- (ii) Clause (i) shall not apply to the extent of the seller's obligations under this title (other than subtitle B) and any taxes imposed by any state or local government with respect to the proceeds. In measuring such tax obligations, the seller is presumed to be in the highest tax bracket.
 - (iii) Any reimbursement the seller receives, from any other person with respect to that person's allocable share of installments required under this section, shall not constitute additional proceeds under this subparagraph (C).
 - (iv) To the extent that any lien under section 6324 or 6324A applied to the property disposed of in the manner described in this subparagraph (C), that lien shall apply instead to the proceeds described in clause (i). Any limitation on the duration of such a lien shall be suspended and shall restart if and to the extent provided in clause (v).
 - (v) The seller's rights to proceeds shall be secured by a purchase money security interest against the property disposed of (except to the extent that the seller proposes and the Secretary accepts substitute security), and the lien described in clause (iv) shall apply to such security if and to the extent that the seller repossesses such security.
- (D)** Subparagraph (A)(i) does not apply if and to the extent that a change in the legal structure of the business does not result in a change in beneficial ownership of the interest that qualifies under subsection (a)(1).
- (E)** Subparagraph (A)(i) does not apply to a transfer of property to a person entitled to receive such property by reason of the decedent's death. A similar rule shall apply in the case of any subsequent transfer of the property by reason of death so long as the transfer is to a member of the family (within the meaning of section 267(c)(4)) of the subsequent transferor. As used in this subparagraph (E), "property" means any item described in subparagraph (A)(i).
- (F) CHANGES IN INTEREST IN HOLDING COMPANY.** If an interest in a holding company is treated as an ownership interest in a business company by reason of subsection (b)(3)(B)—
- (i) the disposition of any portion of the decedent's ownership interest in the holding company, or
 - (ii) the withdrawal of any money or other property from the holding company attributable to the decedent's ownership interest,
- shall be treated for purposes of subparagraph (A) as a disposition of (or a withdrawal with respect to) the interest qualifying under subsection (a)(1).

(G) CHANGES IN INTEREST IN BUSINESS COMPANY. If an interest in a holding company is treated as an ownership interest in a business company by reason of subsection (b)(3)(B)—

- (i) the disposition of any portion of such interest in the business company by the holding company, or
- (ii) the withdrawal by the holding company of any money or other property from the business company attributable to such interest,

shall be treated for purposes of subparagraph (A) as a disposition of (or a withdrawal with respect to) the interest qualifying under subsection (a)(1).

(H) DEFINITIONS. For purposes of this paragraph --

- (i) The term “proceeds” means any amount the seller receives with respect to the disposition, including principal and interest.
- (ii) The term “seller” means the person making the disposition of an interest in a closely held business.

(2) UNDISTRIBUTED INCOME OF ESTATE

(A) If the estate has undistributed net income for any taxable year ending on or after the due date for the first installment, the executor shall, on or before the date prescribed by law for filing the income tax return for such taxable year (including extensions thereof), pay an amount equal to such undistributed net income in liquidation of the unpaid portion of the tax payable in installments.

(B) For purposes of subparagraph (A), the undistributed net income of the estate for any taxable year is the amount by which the distributable net income of the estate for such taxable year (as defined in section 643) exceeds the sum of—

- (i) the amounts for such taxable year specified in paragraphs (1) and (2) of section 661(a) (relating to deductions for distributions, etc.);
- (ii) the amount of tax imposed for the taxable year on the estate under chapter 1;
- (iii) the amount of the tax imposed by section 2001 (including interest) paid by the executor during the taxable year (other than any amount paid pursuant to this paragraph); and
- (iv) the amount of distributable net income attributable to any entity (other than a proprietorship) in excess of the fair market value of any liquid assets distributed from such entity to the estate during such taxable year.

(C) For purposes of this paragraph, the term “estate” includes a “qualified revocable trust” within the meaning of section 645(b)(1) (without regard to whether an election is made under section 645(a)).

(3) FAILURE TO MAKE PAYMENT OF PRINCIPAL OR INTEREST

(A) IN GENERAL. Except as provided in subparagraph (B), if any payment of principal or interest under this section is not paid on or before the date fixed for its payment by this section (including any extension of time), the unpaid portion of the tax payable in installments shall be paid upon notice and demand from the Secretary.

(B) PAYMENT WITHIN 6 MONTHS. If any payment of principal or interest under this section is not paid on or before the date determined under subparagraph (A) but is paid within 6 months of such date—

- (i) the provisions of subparagraph (A) shall not apply with respect to such payment, and
- (ii) there is imposed a penalty in an amount equal to the product of—
 - (I) 5 percent of the amount of such payment, multiplied by
 - (II) the number of months (or fractions thereof) after such date and before payment is made.

The penalty imposed under clause (ii) shall be treated in the same manner as a penalty imposed under subchapter B of chapter 68.

(h) SPECIAL RULE FOR CERTAIN DIRECT SKIPS. - To the extent that an interest in a closely held business is the subject of a direct skip (within the meaning of section 2612(c)) occurring at the same time as and as a result of the decedent's death, then for purposes of this section any tax imposed by section 2601 on the transfer of such interest shall be treated as if it were additional tax imposed by section 2001.

(i) REGULATIONS. The Secretary shall prescribe such regulations as may be necessary to the application of this section.

(j) CROSS REFERENCES. -

(1) SECURITY.- For authority of the Secretary to require security in the case of an extension under this section, see section 6165.

(2) LIEN.- For special lien (in lieu of bond) in the case of an extension under this section, see section 6324A.

(3) PERIOD OF LIMITATION.- For extension of the period of limitation in the case of an extension under this section, see section 6503(d).

(4) INTEREST.- For provisions relating to interest on tax payable in installments under this section, see subsection (j) of section 6601.

(5) TRANSFERS WITHIN 3 YEARS OF DEATH.- For special rule for qualifying an estate under this section where property has been transferred within 3 years of decedent's death, see section 2035(c)(2).

SEC. 6601. INTEREST ON UNDERPAYMENT, NONPAYMENT, OR EXTENSIONS OF TIME FOR PAYMENT, OF TAX

. . .

- (j) INTEREST ON CERTAIN PORTION OF ESTATE TAX EXTENDED UNDER SECTION 6166.** If the time for payment of an amount of tax imposed by chapter 11 is extended as provided in section 6166, then in lieu of the annual rate provided by subsection (a), interest on such amount shall be paid at a rate equal to
- (1)** the annual rate provided by subsection (a) times
 - (2)** one minus the highest marginal tax rate under section 2001(c) applicable to the estate.

Redline Comparison of
Proposed Section
6166 and Current
Section 6166

CURRENT PROPOSED SECTION 6166

**EXTENSION OF TIME FOR PAYMENT OF ESTATE TAX WHERE ESTATE
CONSISTS LARGELY OF INTEREST IN CLOSELY HELD BUSINESS**

(a)

**(a) 5-year—deferral YEAR DEFERRAL; 10-year—installment—payment—YEAR
INSTALLMENT PAYMENT**

(1) In general

(1) IN GENERAL. - If the value of an interest in a closely held business which is included in determining the gross estate of a decedent who was (at the date of ~~his~~the decedent's death) a citizen or resident of the United States exceeds [35] percent of the adjusted gross estate, the executor may elect to pay part or all of the tax imposed by section ~~2001~~2001 in 2 or more (but not exceeding 10) equal installments.

(2) Limitation

(2) LIMITATION. - The maximum amount of tax which may be paid in installments under this subsection shall be an amount which bears the same ratio to the tax imposed by section ~~2001~~2001 (reduced by the credits against such tax) as—

(A) ~~(A)~~ The value of the interest in the closely held business ~~amount, which qualifies~~
under subsection (a)(1), bears to

(B) ~~(B)~~ the amount of the adjusted gross estate.

(3) Date for payment of installments

**(3) BENEFITS OF SECTION ONLY AVAILABLE FOR ASSETS HELD FOR
REASONABLE NEEDS OF BUSINESS.** - For purposes of this subsection (a) (but not for purposes of subsection (g)), the value of an interest in a closely held business shall exclude the value of that portion of such interest which is attributable to assets not held for the reasonable needs of the business within the meaning of section 537, applying that section as if the business were a corporation subject to subchapter C.

(4) DATE FOR PAYMENT OF INSTALLMENTS. - If an election is made under paragraph (1), the first installment shall 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, and each succeeding installment shall be paid on or before the date which is 1 year after the date prescribed by this paragraph for payment of the preceding installment.

~~(b) Definitions and special rules~~

~~(1) Interest in closely held business~~

(b) DEFINITIONS AND SPECIAL RULES.

(1) DEFINITIONS. -- For purposes of this section, ~~the --~~

ADJUSTED GROSS ESTATE. - 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 total 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.~~

~~(2) Rules for applying paragraph (1)~~— For purposes of paragraph (1)—

~~(A) Time for testing~~

~~Determinations shall be made as of the time immediately before the decedent’s death.~~

~~(B) Certain interests held by husband and wife~~

~~Stock or a partnership interest which—~~

~~(i) is community property of a husband and wife (or the income from which is community income) under the applicable community property law of a State, or~~

~~(ii) is held by a husband and wife as joint tenants, tenants by the entirety, or tenants in common,~~

~~shall be treated as owned by one shareholder or one partner, as the case may be.~~

~~(C) Indirect ownership~~

~~Property owned, directly or indirectly, by or for a corporation, partnership, estate, or trust shall be considered as being owned proportionately by or for its shareholders, partners, or beneficiaries. For purposes of the preceding sentence, a person shall be treated as a beneficiary of any trust only if such person has a present interest in the trust.~~

~~**(D) Certain Interests Held By Members of Decedent's Family**~~

~~All stock and all partnership interests held by the decedent or by any member of his family (within the meaning of section 267(c)(4)) shall be treated as owned by the decedent.~~

~~**(3) Farmhouses and certain other structures taken into account**~~

~~For purposes of the 35 percent requirement of subsection (a)(1), an interest in a closely held business which is the business of farming includes an interest in residential buildings and related improvements on the farm which are occupied on a regular basis by the owner or lessee of the farm or by persons employed by such owner or lessee for purposes of operating or maintaining the farm.~~

~~**(4) Value**~~

~~For purposes of this section, value shall be value determined for purposes of chapter 11 (relating to estate tax).~~

~~**(5) Closely held business amount**~~

~~For purposes of this section, the term "closely held business amount" means the value of the interest in a closely held business which qualifies under subsection (a)(1).~~

~~**(6) Adjusted Gross Estate**~~

~~**(A)** For purposes of this section, the term, "adjusted gross estate" means the value of the gross estate reduced by the sum of the amounts allowable as a deduction under section 2053 or 2054. Such sum shall be determined on the basis of the facts and circumstances in existence on the date (including extensions) for filing the return of tax imposed by section 2001 (or, if earlier, the date on which such return is filed).~~

~~**(7) Partnership interests and stock which is not readily tradable**~~

~~**(A) In general**~~

~~If the executor elects the benefits of this paragraph (at such time and in such manner as the Secretary shall by regulations prescribe), then—~~

~~(i) for purposes of paragraph (1)(B)(i) or (1)(C)(i) (whichever is appropriate) and for purposes of subsection (c), any capital interest in a partnership and any non-readily tradable stock which (after the application of paragraph (2)) is treated as owned by the decedent shall be treated as included in determining the value of the decedent's gross estate,~~

~~(ii) the executor shall be treated as having selected under subsection (a)(3) the date prescribed by section 6151(a), and~~

(B) ~~(iii)~~-BUSINESS COMPANY. - The term “business company” means any entity carrying on a trade or business that is treated for purposes of Subtitle A as a corporation or a partnership.

(C) ENTITY. The term “entity” means a person that is not an individual.

(D) INTEREST IN CLOSELY HELD BUSINESS. The term “interest in a closely held business” means an interest in —

(i) a proprietorship carrying on a trade or business; or

(ii) a business company, if—

(I) the decedent’s ownership interest in such entity is at least twenty (20) percent, or

(II) such entity had [45] or fewer owners.

(E) OWNERSHIP INTEREST.

(i) The term “decedent’s ownership interest” means the percentage of the total ownership interest that would have been received with respect to an ownership interest in the entity included in the gross estate of the decedent in the event of a liquidation.

(ii) The term “total ownership interest” means the total amount of net proceeds that all owners would have received if the entity sold all of its assets and liquidated on the date of death of the decedent.

(F) PROPRIETORSHIP. - The term “proprietorship” shall include an interest in an entity that for income tax purposes is not treated as separate from its owner.

(G) VALUE. – “Value” shall be value determined for purposes of ~~applying section 6601(j), the 2 percent portion (as defined in such section)~~chapter 11.

(2) RULES FOR APPLYING PARAGRAPH (1). - For purposes of paragraph (1) —

(A) TIME FOR TESTING. – Except as provided in paragraph (1)(A), determinations shall be made as of the time immediately before the decedent's death.

(B) INDIRECT OWNERSHIP. - In determining the number of owners and the percentage of ownership, property owned, directly or indirectly, by or for an entity

shall be considered as being owned proportionately by or for its beneficiaries or owners. For purposes of the preceding sentence, a person shall be treated as being zero-a beneficiary of a trust only if such person is a permissible current recipient of income or corpus from the trust. This subparagraph shall be applied repeatedly until it results in ownership only by individuals.

~~(B) Non-readily tradable stock defined~~

(C) NUMBER OF OWNERS. - In determining the number of owners of an entity, all persons who would be treated as one shareholder under section 1361(c)(1), if such entity were treated as a corporation under subtitle A, shall be treated as one owner. For this purpose, the “applicable date” in section 1361(c)(1)(B)(iii) shall be the decedent’s date of death.

(D) FAMILY ATTRIBUTION. - For purposes of satisfying the 20-percent requirement in paragraph (1)(D)(ii)(I), any ownership interest held by any member of the family of the decedent (within the meaning of section 1361(c)(1) as modified by paragraph (2)(C)) shall be treated as included in the decedent’s gross estate.

(E) DISREGARDED ENTITY. - The assets of an entity disregarded for purposes of Subtitle A, including a qualified subchapter S subsidiary described in section 1361(b)(3), shall be treated as owned by its sole owner.

(3) RULES FOR HOLDING COMPANIES. For purposes of this paragraph, the term “section,

(A) The term “holding company” means any entity that holds an interest in another entity treated as a partnership or a corporation for purposes of Subtitle A.

(B) The portion of an ownership interest in any holding company which represents direct ownership (or indirect ownership through 1 or more other holding companies) by such company in a business company shall be deemed to be an ownership interest in the business company.

(C) No ownership interest shall be taken into account for purposes of applying this paragraph unless all of the ownership interests of each holding company taken into account are non-readily-tradable interests. The term “non-readily-tradable stock interest” means stock ownership interests for which, at the time of the decedent’s death, there was no market on a stock exchange or in an over-the-counter market.

~~(8) Stock in holding company treated as business company stock in certain cases~~

~~(A) In general~~

~~If the executor elects the benefits of this paragraph, then —~~

~~(4) (i) Holding company stock treated as business company stock.~~ **FARMHOUSES AND CERTAIN OTHER STRUCTURES TAKEN INTO ACCOUNT.** - For purposes of the [35]-percent requirement of subsection (a)(1), an interest in a closely held business which is in the business of farming includes an interest in residential buildings and related improvements on the farm which are occupied on a regular basis by the owner or lessee of the farm or by persons employed by such owner or lessee for purposes of operating or maintaining the farm.

SPECIAL RULE FOR INTERESTS IN 2 OR MORE CLOSELY HELD BUSINESSES. - For purposes of this section, the ~~portion of the stock of any holding company which represents direct ownership (or indirect ownership through 1 or more other holding companies) by such company in a business company shall be deemed to be stock in such business company.~~

~~(ii) 5-year deferral for principal not to apply. The executor shall be treated as having selected under subsection (a)(3) the date prescribed by section 6151(a).~~

~~(iii) 2-percent interest rate not to apply. For purposes of applying section 6601(j), the 2-percent portion (as defined in such section) shall be treated as being zero.~~

(B) All stock must be non-readily tradable stock

~~(i) In general. No stock shall be taken into account for purposes of applying this paragraph unless it is non-readily tradable stock (within the meaning of paragraph (7)(B)).~~

~~(ii) Special application where only holding company stock is non-readily tradable stock. If the requirements of clause (i) are not met, but all of the stock of each holding company taken into account is non-readily tradable, then this paragraph shall apply, but subsection (a)(1) shall be applied by substituting "5" for "10".~~

(C) Application of voting stock requirement of paragraph (1)(C)(i)

~~For purposes of clause (i) of paragraph (1)(C), the deemed stock resulting from the application of subparagraph (A) shall be treated as voting stock to the extent that voting stock in the holding company owns directly (or through the voting stock of 1 or more other holding companies) voting stock in the business company.~~

(D) Definitions

~~For purposes of this paragraph—~~

~~(i) Holding company. The term "holding company" means any corporation holding stock in another corporation.~~

~~(ii) Business company. The term "business company" means any corporation carrying on a trade or business.~~

~~(9) Deferral not available for passive assets~~

~~(A) In general~~

~~For purposes of subsection (a)(1) and determining the closely held business amount (but not for purposes of subsection (g)), the value of any interest in a closely held business shall not include the value of that portion of such interest which is attributable to passive assets held by the business.~~

~~(B) Passive asset defined~~

~~For purposes of this paragraph—~~

~~(i) In general. The term “passive asset” means any asset other than an asset used in carrying on a trade or business.~~

~~(ii) Stock treated as passive asset. The term “passive asset” includes any stock in another corporation unless—~~

~~(I) such stock is treated as held by the decedent by reason of an election under paragraph (8), and~~

~~(II) such stock qualified under subsection (a)(1).~~

~~(iii) Exception for active corporations. If—~~

~~(I) a corporation owns 20 percent or more in value of the voting stock of another corporation, or such other corporation has 45 or fewer shareholders, and~~

~~(II) 80 percent or more of the value of the assets of each such corporation is attributable to assets used in carrying on a trade or business,~~

~~then such corporations shall be treated as 1 corporation for purposes of clause (ii). For purposes of applying subclause (II) to the corporation holding the stock of the other corporation, such stock shall not be taken into account.~~

~~(10) Stock in qualifying lending and finance business treated as stock in an active trade or business company~~

~~(A) In general~~

~~If the executor elects the benefits of this paragraph, then—~~

~~(i) Stock in qualifying lending and finance business treated as stock in an active trade or business company. For purposes of this section, any asset used in a qualifying lending and finance business shall be treated as an asset which is used in carrying on a trade or business.~~

~~(ii) 5-year deferral for principal not to apply. The executor shall be treated as having selected under subsection (a)(3) the date prescribed by section 6151(a).~~

~~(iii) 5 equal installments allowed. For purposes of applying subsection (a)(1), "5" shall be substituted for "10".~~

~~(B) Definitions~~

~~For purposes of this paragraph—~~

~~(i) Qualifying lending and finance business. The term "qualifying lending and finance business" means a lending and finance business, if—~~

~~(I) based on all the facts and circumstances immediately before the date of the decedent's death, there was substantial activity with respect to the lending and finance business, or~~

~~(II) during at least 3 of the 5 taxable years ending before the date of the decedent's death, such business had at least 1 full-time employee substantially all of whose services were the active management of such business, 10 full-time, nonowner employees substantially all of whose services were directly related to such business, and \$5,000,000 in gross receipts from activities described in clause (ii).~~

~~(ii) Lending and finance business. The term "lending and finance business" means a trade or business of—~~

~~(I) making loans,~~

~~(II) purchasing or discounting accounts receivable, notes, or installment obligations,~~

~~(III) engaging in rental and leasing of real and tangible personal property, including entering into leases and purchasing, servicing, and disposing of leases and leased assets,~~

~~(IV) rendering services or making facilities available in the ordinary course of a lending or finance business, and~~

~~(V) rendering services or making facilities available in connection with activities described in subclauses (I) through (IV) carried on by the corporation rendering services or making facilities available, or another corporation which is a member of the same affiliated group (as defined in section 1504 without regard to section 1504(b)(3)).~~

~~(iii) Limitation. The term "qualifying lending and finance business" shall not include any interest in an entity, if the stock or debt of such entity or a controlled group (as defined in section 267(f)(1)) of which such entity was a member was~~

~~readily tradable on an established securities market or secondary market (as defined by the Secretary) at any time within 3 years before the date of the decedent's death.~~

~~(c) Special rule for interest~~interests in 2 or more closely held businesses.

~~(c) For purposes of this section, interest in 2 or more closely held businesses, with respect to each of which there is included in determining the value of the decedent's gross estate 20 percent or more of the total value of each such business, each of which satisfies the requirements of section 6166(b)(1)(D), shall be treated as an interest in a single closely held business. For purposes of the 20 percent requirement of the preceding sentence, an interest in a closely held business which represents the surviving spouse's interest in property held by the decedent and the surviving spouse as community property or as joint tenants, tenants by the entirety, or tenants in common shall be treated as having been included in determining the value of the decedent's gross estate.~~

~~(d) Election~~

~~(d) Any~~ELECTION. - The election under subsection (a) shall be made ~~not later than the time prescribed by section 6075(a) for filing on~~ the return of the tax imposed by section 2001 ~~(including extensions thereof), and. Such election~~ shall be made in such manner as the Secretary shall by regulations prescribe. If an election under subsection (a) is made, the provisions of this subtitle shall apply as though the Secretary were extending the time for payment of the tax.

~~(e) Proration of deficiency to installments~~

~~(e) PRORATION AND ELECTION IN CASE OF DEFICIENCY.~~

~~(1) If an election is~~has been made under subsection (a) to pay any part of the tax imposed by section 2001 in installments and a deficiency has been assessed, the ~~deficiency shall (subject to the limitation provided by subsection (a)(2)) be prorated to the installments described in subsection (a). The part of the deficiency so prorated to any installment the date for payment of which has not arrived shall be collected at the same time as, and as a part of, such installment.~~portion of the deficiency attributable to the interest in the closely-held business shall be prorated to the installments payable under subsection (a). The part of the deficiency so prorated to any installment the date for payment of which has arrived

shall be paid upon notice and demand from the Secretary. The part of the deficiency so prorated to any installment the date for payment of which has not arrived shall be paid at the same time as, and as part of, such installment.

(2) If –

- (A) an election has not been made under subsection (a) to pay any part of the tax imposed by section 2001 in installments,
- (B) a deficiency in the tax imposed by section 2001 has been assessed, and
- (C) the estate qualifies under subsection (a)(1),

the executor may elect to pay the portion of the deficiency attributable to the interest in the closely-held business in installments, and such portion shall be prorated to the installments which would have been due if an election had been timely made under subsection (a). An election under this paragraph shall be made not later than 60 days after issuance of notice and demand by the Secretary for the payment of the deficiency, and shall be made in such manner as the Secretary shall by regulations prescribe. The part of the deficiency so prorated to any installment the date for payment of which would have arrived shall be paid at the time of the making of the election under this paragraph. The part of the deficiency so prorated to any installment the date for payment of which has not arrived shall be paid at the time such installment would have been due if such election had been made.

- (3) This subsection shall not apply if the deficiency is due to negligence, to intentional disregard of rules and regulations, or to fraud with intent to evade tax.

~~(f) Time for payment of interest~~

(f) TIME FOR PAYMENT OF INTEREST. If the time for payment of any amount of tax has been extended under this section—

~~(1) Interest for first 5 years.~~ INTEREST. - Interest payable under section 6601 ~~of any on the~~ unpaid portion of such extended amount ~~attributable to the first 5 years after shall be paid annually on the anniversary of the~~ date prescribed by section 6151(a) for the payment of the tax ~~shall be paid annually.~~

~~(1) (2) Interest for periods after first 5 years. Interest payable under section 6601 on any unpaid portion of such amount attributable to any period after the 5-year period referred to in paragraph (1). If an installment payment is due, the interest shall be paid annually at the same time as, and as a part of, each such installment payment of the tax.~~

~~(2) (3) Interest in the case of certain deficiencies.~~ **INTEREST IN THE CASE OF A DEFICIENCY. -** In the case of a deficiency to which subsection (e) applies ~~which is assessed after the close of the 5-year period referred to in paragraph (1),~~ any accrued and unpaid interest attributable to such 5-year period, and interest assigned under paragraph (2) to any installment the date for payment of which has arrived on or before the date of the assessment of the deficiency, shall be paid upon notice and demand from the Secretary.

~~(4) Selection of shorter period. If the executor has selected a period shorter than 5 years under subsection (a)(3), such shorter period shall be substituted for 5 years in paragraphs (1), (2), and (3) of this subsection.~~

~~(g) Acceleration of payment~~

~~(1) Disposition of interest; withdrawal of funds from business~~

~~(g) (A) ACCELERATION OF PAYMENT~~

(1) DISPOSITION OF INTEREST; WITHDRAWAL OF FUNDS FROM BUSINESS.

~~(A) If — -~~

~~(i)~~

~~(i) (I)~~

~~(I) any portion of an interest in a closely held business which qualifies under subsection (a)(1) is distributed, sold, exchanged, or otherwise disposed of, or~~

~~(II) (H) money and/or other property attributable to such an interest is withdrawn from such trade or business, and~~

~~(ii) (ii) the aggregate of such distributions, sales, exchanges, or other dispositions and withdrawals equals or exceeds 50 percent of the value of such interest,~~

then the extension of time for payment of tax provided in subsection (a) shall cease to apply, and the unpaid portion of the tax payable in installments shall be paid upon notice and demand from the Secretary.

~~(B) (B) In the case of a distribution in redemption of stock to which section 303 (or so much of section 304 as relates to section 303) applies — ,~~ for purposes of subparagraph

~~(A) —~~

- ~~(i)~~ ~~(i)~~ the redemption of such stock, and the withdrawal of money ~~and~~ other property distributed in such redemption, shall not be treated as a distribution or withdrawal ~~for purposes of subparagraph (A), and, and~~
- ~~(ii)~~ ~~(ii)~~ for purposes of subparagraph (A), the value of the interest in the closely held business shall be considered to be such value reduced by the value of the stock redeemed.

This subparagraph shall apply only if, on or before the date prescribed by subsection (a)(~~34~~) for the payment of the first installment which becomes due after the date of the distribution (or, if earlier, on or before the ~~day~~date which is 1 year after the date of the distribution), there is paid an amount of the tax imposed by section 2001 not less than the amount of money and other property distributed.

~~(C)~~ ~~(C)~~ Subparagraph (A)(i)(~~I~~) does not apply to ~~an~~ the sale of any such portion to the business or any of its owners, directly or indirectly, in exchange of stock pursuant to a plan of reorganization for an installment obligation described in subparagraph (D), (E), or (F) of section 368(a)453A(b)(1) ~~nor~~ (without regard to an exchange to which the other paragraphs under section 355 (or so much of section 356 as relates to section 355) applies; 453A(b)); but any stock received in such an exchange installment obligation shall be treated for purposes of subparagraph (A)(i) as an interest qualifying under subsection (a)(1-), and payments of interest and principal attributable to such installment obligation shall be treated as money or other property withdrawn from such business for purposes of subparagraph (A)(i)(~~II~~). **OR** If there is a disposition as described in subsection (g)(1)(A)(i)(~~I~~) for which at least one payment is to be received after the close of the taxable year in which the disposition occurs, the seller may elect to treat such disposition as if it were a section 303 redemption described in subparagraph (B). The election shall be made in such manner as is provided under regulations prescribed by the Secretary. If and to the extent that the seller makes this election:

- ~~(D)~~ ~~(i)~~ Subject to clause (ii), the proceeds shall be applied against the total unpaid portion of the tax which the executor elected to pay in installments, and shall be divided equally among the installments due after the date of such payment.
- ~~(ii)~~ Clause (i) shall not apply to the extent of the seller's obligations under this title (other than subtitle B) and any taxes imposed by any state or local government with respect to the proceeds. In measuring such tax obligations, the seller is presumed to be in the highest tax bracket.
- ~~(iii)~~ Any reimbursement the seller receives, from any other person with respect to that person's allocable share of installments required under this section, shall not constitute additional proceeds under this subparagraph (C).
- ~~(iv)~~ To the extent that any lien under section 6324 or 6324A applied to the property disposed of in the manner described in this subparagraph (C), that lien shall apply

instead to the proceeds described in clause (i). Any limitation on the duration of such a lien shall be suspended and shall restart if and to the extent provided in clause (v).

(v) The seller's rights to proceeds shall be secured by a purchase money security interest against the property disposed of (except to the extent that the seller proposes and the Secretary accepts substitute security), and the lien described in clause (iv) shall apply to such security if and to the extent that the seller repossesses such security.

(D) Subparagraph (A)(i) does not apply if and to the extent that a change in the legal structure of the business does not result in a change in beneficial ownership of the interest that qualifies under subsection (a)(1).

(E) Subparagraph (A)(i) does not apply to a transfer of property of the decedent to a person entitled to receive such property by reason of the decedent's death to receive such property under the decedent's will, the applicable law of descent and distribution, or a trust created by the decedent. A similar rule shall apply in the case of a series of any subsequent transfer of the property by reason of death so long as each the transfer is to a member of the family (within the meaning of section 267(c)(4)) of the subsequent transferor in such transfer. As used in this subparagraph (E), "property" means any item described in subparagraph (A)(i).

(E) Changes in CHANGES IN INTEREST IN HOLDING COMPANY. If an interest in a holding company

(F) If any stock in a holding company is treated as stock an ownership interest in a business company by reason of subsection (b)(8)(A)—3)(B)—

(i) (i) any the disposition of any portion of the decedent's ownership interest in such stock in such the holding company which was included in determining the gross estate of the decedent, or

(ii) (ii) any the withdrawal of any money or other property from such the holding company attributable to any the decedent's ownership interest included in determining the gross estate of the decedent,

shall be treated for purposes of subparagraph (A) as a disposition of (or a withdrawal with respect to) the stock interest qualifying under subsection (a)(1).

(F) Changes in CHANGES IN INTEREST IN BUSINESS COMPANY. If an interest in business company

(G) If any stock in a holding company is treated as stock an ownership interest in a business company by reason of subsection (b)(8)(A)—3)(B)—

(i) (i) any the disposition of any interest in portion of such stock interest in the business company by such the holding company, or

~~(ii) (ii) any~~ the withdrawal by the holding company of any money or other property from ~~such the~~ business company attributable to such ~~stock by such holding company owning such stock~~ interest,

shall be treated for purposes of subparagraph (A) as a disposition of (or a withdrawal with respect to) the ~~stock~~ interest qualifying under subsection (a)(1).

~~(2) Undistributed income~~ DEFINITIONS. For purposes of estate

~~(H) (A) If an election is made under this section and paragraph --~~

~~(i) The term “proceeds” means any amount the seller receives with respect to the disposition, including principal and interest.~~

~~(ii) The term “seller” means the person making the disposition of an interest in a closely held business.~~

(2) UNDISTRIBUTED INCOME OF ESTATE

(A) If the estate has undistributed net income for any taxable year ending on or after the due date for the first installment, the executor shall, on or before the date prescribed by law for filing the income tax return for such taxable year (including extensions thereof), pay an amount equal to such undistributed net income in liquidation of the unpaid portion of the tax payable in installments.

(B) ~~(B)~~ For purposes of subparagraph (A), the undistributed net income of the estate for any taxable year is the amount by which the distributable net income of the estate for such taxable year (as defined in section 643) exceeds the sum of—

~~(i) (i)~~ the amounts for such taxable year specified in paragraphs (1) and (2) of section 661(a) (relating to deductions for distributions, etc.);

~~(ii) (ii)~~ the amount of tax imposed for the taxable year on the estate under chapter 1; ~~and~~

~~(iii) (iii)~~ the amount of the tax imposed by section 2001 (including interest) paid by the executor during the taxable year (other than any amount paid pursuant to this paragraph); ~~and~~

~~(C) For purposes of this paragraph, if any stock in a corporation is treated as stock in another corporation by reason of subsection (b)(8)(A), any dividends paid by such other corporation to the corporation shall be treated as paid to the estate of the decedent to the extent attributable to the stock qualifying under subsection (a)(1).~~

~~(3) Failure to make payment of principal or interest~~

~~(A) In general~~

(iv) the amount of distributable net income attributable to any entity (other than a proprietorship) in excess of the fair market value of any liquid assets distributed from such entity to the estate during such taxable year.

(C) For purposes of this paragraph, the term “estate” includes a “qualified revocable trust” within the meaning of section 645(b)(1) (without regard to whether an election is made under section 645(a)).

(3) FAILURE TO MAKE PAYMENT OF PRINCIPAL OR INTEREST

(A) IN GENERAL. Except as provided in subparagraph (B), if any payment of principal or interest under this section is not paid on or before the date fixed for its payment by this section (including any extension of time), the unpaid portion of the tax payable in installments shall be paid upon notice and demand from the Secretary.

~~**(B) Payment within 6 months**~~

(B) PAYMENT WITHIN 6 MONTHS. If any payment of principal or interest under this section is not paid on or before the date determined under subparagraph (A) but is paid within 6 months of such date—

~~(i) the provisions of subparagraph (A) shall not apply with respect to such payment,~~

~~(i) (ii) the provisions of section 6601(j) shall not apply with respect to the determination of interest on such payment, and~~

~~(ii) (iii) there is imposed a penalty in an amount equal to the product of—~~

~~(I) (i) 5 percent of the amount of such payment, multiplied by~~

~~(II) (ii) the number of months (or fractions thereof) after such date and before payment is made.~~

The penalty imposed under clause ~~(iii)~~ shall be treated in the same manner as a penalty imposed under subchapter B of chapter 68.

~~**(h) Election in case of certain deficiencies**~~

~~**(1) In general**~~

~~If—~~

~~(A) a deficiency in the tax imposed by section 2001 is assessed,~~

~~**(B) SPECIAL RULE FOR CERTAIN DIRECT SKIPS.** - the estate qualifies under subsection (a)(1), and~~

~~(C) the executor has not made an election under subsection (a), the executor may elect to pay the deficiency in installments. This subsection shall not apply if the deficiency is due to negligence, to intentional disregard of rules and regulations, or to fraud with intent to evade tax.~~

~~(2) Time of election~~

~~An election under this subsection shall be made not later than 60 days after issuance of notice and demand by the Secretary for the payment of the deficiency, and shall be made in such manner as the Secretary shall by regulations prescribe.~~

~~(3) Effect of election on payment~~

~~If an election is made under this subsection, the deficiency shall (subject to the limitation provided by subsection (a)(2)) be prorated to the installments which would have been due if an election had been timely made under subsection (a) at the time the estate tax return was filed. The part of the deficiency so prorated to any installment the date for payment of which would have arrived shall be paid at the time of the making of the election under this subsection. The portion of the deficiency so prorated to installments the date for payment of which would not have so arrived shall be paid at the time such installments would have been due if such an election had been made.~~

~~(i) Special Rule for Certain Direct Skips~~

~~(h) To the extent that an interest in a closely held business is the subject of a direct skip (within the meaning of section 2612(c)) occurring at the same time as and as a result of the decedent's death, then for purposes of this section any tax imposed by section 2601 on the transfer of such interest shall be treated as if it were additional tax imposed by section 2001.~~

~~(j) Regulations~~

~~(i) REGULATIONS. The Secretary shall prescribe such regulations as may be necessary to the application of this section.~~

~~(k) Cross references~~

~~(1) Security~~

~~(i) CROSS REFERENCES. -~~

(1) SECURITY.- For authority of the Secretary to require security in the case of an extension under this section, see section 6165.

~~(2) Lien~~

(2) LIEN.- For special lien (in lieu of bond) in the case of an extension under this section, see section 6324A.

~~(3) Period of Limitation~~

(3) PERIOD OF LIMITATION.- For extension of the period of limitation in the case of an extension under this section, see section 6503(d).

~~(4) Interest~~

(4) INTEREST.- For provisions relating to interest on tax payable in installments under this section, see subsection (j) of section 6601.

~~(5) Transfers Within 3 Years of Death~~

(5) TRANSFERS WITHIN 3 YEARS OF DEATH.- For special rule for qualifying an estate under this section where property has been transferred within 3 years of decedent's death, see section 2035(c)(2).

SEC. 6601. INTEREST ON UNDERPAYMENT, NONPAYMENT, OR EXTENSIONS OF TIME FOR PAYMENT, OF TAX

. . .

(j) INTEREST ON CERTAIN PORTION OF ESTATE TAX EXTENDED UNDER SECTION 6166. If the time for payment of an amount of tax imposed by chapter 11 is extended as provided in section 6166, then in lieu of the annual rate provided by subsection (a), interest on such amount shall be paid at a rate equal to

(1) the annual rate provided by subsection (a) times

(2) one minus the highest marginal tax rate under section 2001(c) applicable to the estate.

Proposed Section 6166A

PROPOSED SECTION 6166A

EXTENSION OF TIME FOR PAYMENT OF GENERATION-SKIPPING TRANSFER TAX IN THE EVENT OF A TAXABLE TERMINATION RESULTING FROM DEATH WHERE TRUST CONSISTS LARGELY OF INTEREST IN CLOSELY HELD BUSINESS

(a) 5-year deferral; 10-year installment payment

(1) In general

If the value of an interest in a closely held business which is included in determining the value of all property with respect to which a taxable termination directly resulting from the death of a non-skip person has occurred exceeds 35 percent of the taxable amount of the taxable termination, the trustee who is liable to pay the tax imposed by section 2601 may elect to pay part or all of the tax for which such trustee is liable in 2 or more (but not exceeding 10) equal installments.

(2) Limitation

The maximum amount of tax which may be paid in installments under this subsection by the trustee shall be an amount which bears the same ratio to the tax imposed by section 2601 (reduced by any credits against such tax) as—

- (A) the closely held business amount, bears to
- (B) the taxable amount of the taxable termination.

(3) Date for payment of installments

If an election is made under paragraph (1), the first installment shall be paid on or before the date selected by the trustee which is not more than 5 years after the date prescribed by section 6151(a) for payment of the tax, and each succeeding installment shall be paid on or before the date which is 1 year after the date prescribed by this paragraph for payment of the preceding installment.

(4) Aggregation of trusts established by same transferor

For purposes of this section, all taxable terminations occurring as a result of the death of the same non-skip person and arising from the same transferor shall be aggregated.

(b) Definitions and special rules

(1) Interest in closely held business

For purposes of this section, 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 total capital interest in such partnership is included in determining the value of all property with respect to which the taxable termination has occurred, 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 value of all property with respect to which the taxable termination has occurred, or
- (ii) such corporation had 45 or fewer shareholders.

(2) Rules for applying paragraph (1) - For purposes of paragraph (1)—

(A) Time for testing

Determinations shall be made as of the time immediately before the taxable termination.

(B) Certain interests held by husband and wife

Stock or a partnership interest which—

- (i) is community property of a husband and wife (or the income from which is community income) under the applicable community property law of a State, or
- (ii) is held by a husband and wife as joint tenants, tenants by the entirety, or tenants in common,

shall be treated as owned by one shareholder or one partner, as the case may be.

(C) Indirect ownership

Property owned, directly or indirectly, by or for a corporation, partnership, estate, or trust (other than the trust subject to the taxable termination) shall be considered as being owned proportionately by or for its shareholders, partners, or beneficiaries. For purposes of the preceding sentence, a person shall be treated as a beneficiary of a trust only if such person has a present interest in the trust.

(D) Certain Interests Held By Other Trusts

All stock and all partnership interests held by any trusts subject to a taxable termination occurring as a result of the death of the same non-skip person and arising from the same transferor shall be treated as owned by a single trust.

(3) Farmhouses and certain other structures taken into account

For purposes of the 35-percent requirement of subsection (a)(1), an interest in a closely held business which is the business of farming includes an interest in residential buildings and related improvements on the farm which are occupied on a regular basis by the owner or lessee of the farm or by persons employed by such owner or lessee for purposes of operating or maintaining the farm.

(4) Value

For purposes of this section, value shall be value determined for purposes of chapter 13 (relating to generation-skipping transfer tax).

(5) Closely held business amount

For purposes of this section, the term “closely held business amount” means the value of the interest in a closely held business which qualifies under subsection (a)(1).

(6) Partnership interests and stock which is not readily tradable

(A) In general

If the trustee elects the benefits of this paragraph (at such time and in such manner as the Secretary shall by regulations prescribe), then—

- (i) for purposes of paragraph (1)(B)(i) or (1)(C)(i) (whichever is appropriate) and for purposes of subsection (c), any capital interest in a partnership and any non-readily-tradable stock which (after the application of paragraph (2)) is treated as owned by the trust shall be treated as included in determining the value of all property with respect to which the taxable termination has occurred,
- (ii) the trustee shall be treated as having selected under subsection (a)(3) the date prescribed by section 6151(a), and
- (iii) for purposes of applying rules similar to those found in section 6601(j), the 2-percent portion (as defined in such section) shall be treated as being zero.

(B) Non-readily-tradable stock defined

For purposes of this paragraph, the term “non-readily-tradable stock” means stock for which, at the time of the taxable termination, there was no market on a stock exchange or in an over-the-counter market.

(7) Stock in holding company treated as business company stock in certain cases

(A) In general

If the trustee elects the benefits of this paragraph, then—

- (i) Holding company stock treated as business company stock. For purposes of this section, the portion of the stock of any holding company which represents direct ownership (or indirect ownership through 1 or more other holding companies) by such company in a business company shall be deemed to be stock in such business company.
- (ii) 5-year deferral for principal not to apply. The trustee shall be treated as having selected under subsection (a)(3) the date prescribed by section 6151(a).
- (iii) 2-percent interest rate not to apply. For purposes of applying rules similar to those found in section 6601(j), the 2-percent portion (as defined in such section) shall be treated as being zero.

(B) All stock must be non-readily-tradable stock

- (i) In general. No stock shall be taken into account for purposes of applying this paragraph unless it is non-readily-tradable stock (within the meaning of paragraph (6)(B)).
- (ii) Special application where only holding company stock is non-readily-tradable stock. If the requirements of clause (i) are not met, but all of the stock of each holding company taken into account is non-readily-tradable, then this paragraph shall apply, but subsection (a)(1) shall be applied by substituting “5” for “10”.

(C) Application of voting stock requirement of paragraph (1)(C)(i)

For purposes of clause (i) of paragraph (1)(C), the deemed stock resulting from the application of subparagraph (A) shall be treated as voting stock to the extent that voting stock in the holding company owns directly (or through the voting stock of 1 or more other holding companies) voting stock in the business company.

(D) Definitions

For purposes of this paragraph—

- (i) Holding company. The term “holding company” means any corporation holding stock in another corporation.
- (ii) Business company. The term “business company” means any corporation carrying on a trade or business.

(8) Deferral not available for passive assets

(A) In general

For purposes of subsection (a)(1) and determining the closely held business amount (but not for purposes of subsection (g)), the value of any interest in a closely held business shall not include the value of that portion of such interest which is attributable to passive assets held by the business.

(B) Passive asset defined

For purposes of this paragraph—

- (i) In general. The term “passive asset” means any asset other than an asset used in carrying on a trade or business.
- (ii) Stock treated as passive asset. The term “passive asset” includes any stock in another corporation unless—
 - (I) such stock is treated as held by the trust by reason of an election under paragraph (7), and
 - (II) such stock qualified under subsection (a)(1).
- (iii) Exception for active corporations. If—
 - (I) a corporation owns 20 percent or more in value of the voting stock of another corporation, or such other corporation has 45 or fewer shareholders, and
 - (II) 80 percent or more of the value of the assets of each such corporation is attributable to assets used in carrying on a trade or business, then such corporations shall be treated as 1 corporation for purposes of clause (ii). For purposes of applying subclause (II) to the corporation holding the stock of the other corporation, such stock shall not be taken into account.

(9) Stock in qualifying lending and finance business treated as stock in an active trade or business company

(A) In general

If the trustee elects the benefits of this paragraph, then—

- (i) Stock in qualifying lending and finance business treated as stock in an active trade or business company. For purposes of this section, any asset used in a qualifying lending and finance business shall be treated as an asset which is used in carrying on a trade or business.
- (ii) 5-year deferral for principal not to apply. The trustee shall be treated as having selected under subsection (a)(3) the date prescribed by section 6151(a).
- (iii) 5 equal installments allowed. For purposes of applying subsection (a)(1), “5” shall be substituted for “10”.

(B) Definitions

For purposes of this paragraph—

(i) Qualifying lending and finance business. The term “qualifying lending and finance business” means a lending and finance business, if—

(I) based on all the facts and circumstances immediately before the taxable termination, there was substantial activity with respect to the lending and finance business, or

(II) during at least 3 of the 5 taxable years ending before the taxable termination, such business had at least 1 full-time employee substantially all of whose services were the active management of such business, 10 full-time, nonowner employees substantially all of whose services were directly related to such business, and \$5,000,000 in gross receipts from activities described in clause (ii).

(ii) Lending and finance business. The term “lending and finance business” means a trade or business of—

(I) making loans,

(II) purchasing or discounting accounts receivable, notes, or installment obligations,

(III) engaging in rental and leasing of real and tangible personal property, including entering into leases and purchasing, servicing, and disposing of leases and leased assets,

(IV) rendering services or making facilities available in the ordinary course of a lending or finance business, and

(V) rendering services or making facilities available in connection with activities described in subclauses (I) through (IV) carried on by the corporation rendering services or making facilities available, or another corporation which is a member of the same affiliated group (as defined in section 1504 without regard to section 1504 (b)(3)).

(iii) Limitation. The term “qualifying lending and finance business” shall not include any interest in an entity, if the stock or debt of such entity or a controlled group (as defined in section 267(f)(1)) of which such entity was a member was readily tradable on an established securities market or secondary market (as defined by the Secretary) at any time within 3 years before the date of the taxable termination.

(c) Special rule for interest in 2 or more closely held businesses.

For purposes of this section, interests in 2 or more closely held businesses, with respect to each of which there is included in determining the value of all property with respect to which the taxable termination has occurred 20 percent or more of the total value of each such business, shall be treated as an interest in a single closely held business.

(d) Election

Any election under subsection (a) shall be made not later than the time prescribed by section 2662 for filing the return of tax imposed by section 2601 (including extensions thereof), and shall be made in such manner as the Secretary shall by regulations prescribe. If an election under subsection (a) is made, the provisions of this subtitle shall apply as though the Secretary were extending the time for payment of the tax.

(e) Proration of deficiency to installments

If an election is made under subsection (a) to pay any part of the tax imposed by section 2601 in installments and a deficiency has been assessed, the deficiency shall (subject to the limitation provided by subsection (a)(2)) be prorated to the installments described in subsection (a). The part of the deficiency so prorated to any installment the date for payment of which has not arrived shall be collected at the same time as, and as a part of, such installment. The part of the deficiency so prorated to any installment the date for payment of which has arrived shall be paid upon notice and demand from the Secretary. This subsection shall not apply if the deficiency is due to negligence, to intentional disregard of rules and regulations, or to fraud with intent to evade tax.

(f) Time for payment of interest

If the time for payment of any amount of tax has been extended under this section—

- (1) Interest for first 5 years. Interest payable under section 6601 of any unpaid portion of such amount attributable to the first 5 years after the date prescribed by section 6151 (a) for payment of the tax shall be paid annually.
- (2) Interest for periods after first 5 years. Interest payable under section 6601 on any unpaid portion of such amount attributable to any period after the 5-year period referred to in paragraph (1) shall be paid annually at the same time as, and as a part of, each installment payment of the tax.
- (3) Interest in the case of certain deficiencies. In the case of a deficiency to which subsection (e) applies which is assessed after the close of the 5-year period referred to in paragraph (1), interest attributable to such 5-year period, and interest assigned under paragraph (2) to any installment the date for payment of which has arrived on or before the date of the assessment of the deficiency, shall be paid upon notice and demand from the Secretary.
- (4) Selection of shorter period. If the trustee has selected a period shorter than 5 years under subsection (a)(3), such shorter period shall be substituted for 5 years in paragraphs (1), (2), and (3) of this subsection.

(g) Acceleration of payment

(1) Disposition of interest; withdrawal of funds from business

(A) If—

- (i)
 - (I) any portion of an interest in a closely held business which qualifies under subsection (a)(1) is distributed, sold, exchanged, or otherwise disposed of, or
 - (II) money and other property attributable to such an interest is withdrawn from such trade or business, and
 - (ii) the aggregate of such distributions, sales, exchanges, or other dispositions and withdrawals equals or exceeds 50 percent of the value of such interest, then the extension of time for payment of tax provided in subsection (a) shall cease to apply, and the unpaid portion of the tax payable in installments shall be paid upon notice and demand from the Secretary.
- (B) In the case of a distribution in redemption of stock to which section 303 (or so much of section 304 as relates to section 303) applies—
- (i) the redemption of such stock, and the withdrawal of money and other property distributed in such redemption, shall not be treated as a distribution or withdrawal for purposes of subparagraph (A), and
 - (ii) for purposes of subparagraph (A), the value of the interest in the closely held business shall be considered to be such value reduced by the value of the stock redeemed.

This subparagraph shall apply only if, on or before the date prescribed by subsection (a)(3) for the payment of the first installment which becomes due after the date of the distribution (or, if earlier, on or before the day which is 1 year after the date of the distribution), there is paid an amount of the tax imposed by section 2601 not less than the amount of money and other property distributed.

(C) Subparagraph (A)(i) does not apply to an exchange of stock pursuant to a plan of reorganization described in subparagraph (D), (E), or (F) of section 368 (a)(1) nor to an exchange to which section 355 (or so much of section 356 as relates to section 355) applies; but any stock received in such an exchange shall be treated for purposes of subparagraph (A)(i) as an interest qualifying under subsection (a)(1).

(D) Subparagraph (A)(i) does not apply to a transfer of property of the trust subject to the taxable termination to a person entitled by reason of the death of the non-skip person to receive such property under the terms of the trust. A similar rule shall apply in the case of a series of subsequent transfers of the property by reason of death so long as each transfer is to a member of the family (within the meaning of section 267(c)(4)) of the person making such transfer.

(E) Changes in interest in holding company

If any stock in a holding company is treated as stock in a business company by reason of subsection (b)(7)(A)—

- (i) any disposition of any interest in such stock in such holding company which was included in determining the value of all property with respect to which the taxable termination has occurred, or
- (ii) any withdrawal of any money or other property from such holding company attributable to any interest included in determining the value of all property with respect to which the taxable termination has occurred,

shall be treated for purposes of subparagraph (A) as a disposition of (or a withdrawal with respect to) the stock qualifying under subsection (a)(1).

(F) Changes in interest in business company

If any stock in a holding company is treated as stock in a business company by reason of subsection (b)(7)(A)—

(i) any disposition of any interest in such stock in the business company by such holding company, or

(ii) any withdrawal of any money or other property from such business company attributable to such stock by such holding company owning such stock, shall be treated for purposes of subparagraph (A) as a disposition of (or a withdrawal with respect to) the stock qualifying under subsection (a)(1).

(2) Undistributed income of trust

(A) If an election is made under this section and the trust has undistributed net income for any taxable year ending on or after the due date for the first installment, the trustee shall, on or before the date prescribed by law for filing the income tax return for such taxable year (including extensions thereof), pay an amount equal to such undistributed net income in liquidation of the unpaid portion of the tax payable in installments.

(B) For purposes of subparagraph (A), the undistributed net income of the trust for any taxable year is the amount by which the distributable net income of the trust for such taxable year (as defined in section 643) exceeds the sum of—

(i) the amounts for such taxable year specified in paragraphs (1) and (2) of section 661 (a) (relating to deductions for distributions, etc.);

(ii) the amount of tax imposed for the taxable year on the trust under chapter 1; and

(iii) the amount of the taxes imposed by sections 2001 and 2601 (including interest for each of said sections) paid by the trustee during the taxable year (other than any amount paid pursuant to this paragraph).

(C) For purposes of this paragraph, if any stock in a corporation is treated as stock in another corporation by reason of subsection (b)(7)(A), any dividends paid by such other corporation to the corporation shall be treated as paid to the trust to the extent attributable to the stock qualifying under subsection (a)(1).

(3) Failure to make payment of principal or interest

(A) In general

Except as provided in subparagraph (B), if any payment of principal or interest under this section is not paid on or before the date fixed for its payment by this section (including any extension of time), the unpaid portion of the tax payable in installments shall be paid upon notice and demand from the Secretary.

(B) Payment within 6 months

If any payment of principal or interest under this section is not paid on or before the date determined under subparagraph (A) but is paid within 6 months of such date—

- (i) the provisions of subparagraph (A) shall not apply with respect to such payment,
- (ii) rules similar to those found in section 6601(j) shall not apply with respect to the determination of interest on such payment, and
- (iii) there is imposed a penalty in an amount equal to the product of—
 - (I) 5 percent of the amount of such payment, multiplied by
 - (II) the number of months (or fractions thereof) after such date and before payment is made.

The penalty imposed under clause (iii) shall be treated in the same manner as a penalty imposed under subchapter B of chapter 68.

(h) Election in case of certain deficiencies

(1) In general

If—

- (A) a deficiency in the tax imposed by section 2601 is assessed,
 - (B) the trust qualifies under subsection (a)(1), and
 - (C) the trustee has not made an election under subsection (a),
- the trustee may elect to pay the deficiency in installments. This subsection shall not apply if the deficiency is due to negligence, to intentional disregard of rules and regulations, or to fraud with intent to evade tax.

(2) Time of election

An election under this subsection shall be made not later than 60 days after issuance of notice and demand by the Secretary for the payment of the deficiency, and shall be made in such manner as the Secretary shall by regulations prescribe.

(3) Effect of election on payment

If an election is made under this subsection, the deficiency shall (subject to the limitation provided by subsection (a)(2)) be prorated to the installments which would have been due if an election had been timely made under subsection (a) at the time the return for the taxable termination was filed. The part of the deficiency so prorated to any installment the date for payment of which would have arrived shall be paid at the time of the making of the election under this subsection. The portion of the deficiency so prorated to installments the date for payment of which would not have so arrived shall be paid at the time such installments would have been due if such an election had been made.

(i) Application of other code sections

(1) Application of section 6324A

In the event that an election is made under this section, rules similar to those provided under section 6324A with respect to the special lien for estate taxes deferred under section 6166 shall be applicable to the generation-skipping transfer tax payable as a result of the taxable termination.

(2) Application of section 6503(d)

In the event that an election is made under this section, rules similar to those provided under section 6503(d) with respect to the extension of the period of limitation for the estate tax payable under section 6166 shall apply.

(3) Application of section 6601(j)

In the event that an election is made under this section, rules similar to those provided under section 6601(j) with respect to the payment of interest on the tax payable in installments under section 6166 shall apply.

(4) Application of section 303(b)(1)(c)

In the event that an election is made under this section, rules similar to those provided under section 303(b)(1)(c) with respect to the period for distribution in the case of an election under section 6166 shall apply for purposes of section 303.

(j) Regulations

The Secretary shall prescribe such regulations as may be necessary to the application of this section.

(k) Cross reference

For authority of the Secretary to require security in the case of an extension under this section, see section 6165.

Redline Comparison of
Proposed Section
6166A
and Current Section
6166

CURRENT PROPOSED SECTION 61666166A

EXTENSION OF TIME FOR PAYMENT OF ESTATE TAX WHERE ESTATE CONSISTS LARGELY OF INTEREST IN CLOSELY HELD BUSINESS GENERATION-SKIPPING TRANSFER TAX IN THE EVENT OF A TAXABLE TERMINATION RESULTING FROM DEATH WHERE TRUST CONSISTS LARGELY OF INTEREST IN CLOSELY HELD BUSINESS

(a) 5-year deferral; 10-year installment payment

(1) In general

If the value of an interest in a closely held business which is included in determining the gross estate value of all property with respect to which a decedent who was (a) taxable termination directly resulting from the date of his death, of a citizen or resident of the United States non-skip person has occurred exceeds 35 percent of the adjusted gross estate taxable amount of the taxable termination, the ~~executor~~ trustee who is liable to pay the tax imposed by section 2601 may elect to pay part or all of the tax imposed by section 2004 for which such trustee is liable in 2 or more (but not exceeding 10) equal installments.

(2) Limitation

The maximum amount of tax which may be paid in installments under this subsection by the trustee shall be an amount which bears the same ratio to the tax imposed by section ~~2004~~ 2601 (reduced by ~~the any~~ credits against such tax) as—

- (A) the closely held business amount, bears to
- (B) the taxable amount of the adjusted gross estate taxable termination.

(3) Date for payment of installments

If an election is made under paragraph (1), the first installment shall be paid on or before the date selected by the ~~executor~~ trustee which is not more than 5 years after the date prescribed by section 6151(a) for payment of the tax, and each succeeding installment shall be paid on or before the date which is 1 year after the date prescribed by this paragraph for payment of the preceding installment.

(4) Aggregation of trusts established by same transferor

For purposes of this section, all taxable terminations occurring as a result of the death of the same non-skip person and arising from the same transferor shall be aggregated.

(b) Definitions and special rules

(1) Interest in closely held business

For purposes of this section, 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 total capital interest in such partnership is included in determining the gross-estatevalue of all property with respect to which the decedenttaxable termination has occurred, 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-estatevalue of all property with respect to which the decedenttaxable termination has occurred, or
 - (ii) such corporation had 45 or fewer shareholders.

(2) Rules for applying paragraph (1) - For purposes of paragraph (1)—

(A) Time for testing

Determinations shall be made as of the time immediately before the decedent's deathtaxable termination.

(B) Certain interests held by husband and wife

Stock or a partnership interest which—

- (i) is community property of a husband and wife (or the income from which is community income) under the applicable community property law of a State, or
- (ii) is held by a husband and wife as joint tenants, tenants by the entirety, or tenants in common,

shall be treated as owned by one shareholder or one partner, as the case may be.

(C) Indirect ownership

Property owned, directly or indirectly, by or for a corporation, partnership, estate, or trust (other than the trust subject to the taxable termination) shall be considered as being owned proportionately by or for its shareholders, partners, or beneficiaries. For purposes of the preceding sentence, a person shall be treated as a beneficiary of anya trust only if such person has a present interest in the trust.

(D) Certain Interests Held By Members of Decedent's Family — Other Trusts

All stock and all partnership interests held by any trusts subject to a taxable termination occurring as a result of the decedent or by any memberdeath of his family (within the meaning of section 267(c)(4))same non-skip person and arising from the same transferor shall be treated as owned by the decedent a single trust.

(3) Farmhouses and certain other structures taken into account

For purposes of the 35-percent requirement of subsection (a)(1), an interest in a closely held business which is the business of farming includes an interest in residential buildings and related improvements on the farm which are occupied on a regular basis by the owner or lessee of the farm or by persons employed by such owner or lessee for purposes of operating or maintaining the farm.

(4) Value

For purposes of this section, value shall be value determined for purposes of chapter 413 (relating to estategeneration-skipping transfer tax).

(5) Closely held business amount

For purposes of this section, the term “closely held business amount” means the value of the interest in a closely held business which qualifies under subsection (a)(1).

~~**(6) Adjusted Gross Estate**~~

~~For purposes of this section, the term, “adjusted gross estate” means the value of the gross estate reduced by the sum of the amounts allowable as a deduction under section 2053 or 2054. Such sum shall be determined on the basis of the facts and circumstances in existence on the date (including extensions) for filing the return of tax imposed by section 2001 (or, if earlier, the date on which such return is filed).~~

~~**(7) Partnership interests and stock which is not readily tradable**~~

(A) In general

If the ~~executor~~trustee elects the benefits of this paragraph (at such time and in such manner as the Secretary shall by regulations prescribe), then—

(i) for purposes of paragraph (1)(B)(i) or (1)(C)(i) (whichever is appropriate) and for purposes of subsection (c), any capital interest in a partnership and any non-readily-tradable stock which (after the application of paragraph (2)) is treated as owned by the ~~decedent~~trust shall be treated as included in determining the value of ~~the decedent's gross estate~~all property with respect to which the taxable termination has occurred,

(ii) the ~~executor~~trustee shall be treated as having selected under subsection (a)(3) the date prescribed by section 6151(a), and

(iii) for purposes of applying rules similar to those found in section 6601(j), the 2-percent portion (as defined in such section) shall be treated as being zero.

(B) Non-readily-tradable stock defined

For purposes of this paragraph, the term “non-readily-tradable stock” means stock for which, at the time of the ~~decedent's death~~taxable termination, there was no market on a stock exchange or in an over-the-counter market.

~~**(8) Stock in holding company treated as business company stock in certain cases**~~

(A) In general

If the ~~executor~~trustee elects the benefits of this paragraph, then—

(i) Holding company stock treated as business company stock. For purposes of this section, the portion of the stock of any holding company which represents direct ownership (or indirect ownership through 1 or more other holding companies) by such company in a business company shall be deemed to be stock in such business company.

(ii) 5-year deferral for principal not to apply. The ~~executor~~trustee shall be treated as having selected under subsection (a)(3) the date prescribed by section 6151(a).

(iii) 2-percent interest rate not to apply. For purposes of applying rules similar to those found in section 6601(j), the 2-percent portion (as defined in such section) shall be treated as being zero.

(B) All stock must be non-readily-tradable stock

(i) In general. No stock shall be taken into account for purposes of applying this paragraph unless it is non-readily-tradable stock (within the meaning of paragraph ~~(7)~~(B)).

(ii) Special application where only holding company stock is non-readily-tradable stock. If the requirements of clause (i) are not met, but all of the stock of each holding company taken into account is non-readily-tradable, then this paragraph shall apply, but subsection (a)(1) shall be applied by substituting “5” for “10”.

(C) Application of voting stock requirement of paragraph (1)(C)(i)

For purposes of clause (i) of paragraph (1)(C), the deemed stock resulting from the application of subparagraph (A) shall be treated as voting stock to the extent that voting stock in the holding company owns directly (or through the voting stock of 1 or more other holding companies) voting stock in the business company.

(D) Definitions

For purposes of this paragraph—

- (i) Holding company. The term “holding company” means any corporation holding stock in another corporation.
- (ii) Business company. The term “business company” means any corporation carrying on a trade or business.

(98) Deferral not available for passive assets

(A) In general

For purposes of subsection (a)(1) and determining the closely held business amount (but not for purposes of subsection (g)), the value of any interest in a closely held business shall not include the value of that portion of such interest which is attributable to passive assets held by the business.

(B) Passive asset defined

For purposes of this paragraph—

- (i) In general. The term “passive asset” means any asset other than an asset used in carrying on a trade or business.
- (ii) Stock treated as passive asset. The term “passive asset” includes any stock in another corporation unless—
 - (I) such stock is treated as held by the ~~decedent~~trust by reason of an election under paragraph (87), and
 - (II) such stock qualified under subsection (a)(1).
- (iii) Exception for active corporations. If—
 - (I) a corporation owns 20 percent or more in value of the voting stock of another corporation, or such other corporation has 45 or fewer shareholders, and
 - (II) 80 percent or more of the value of the assets of each such corporation is attributable to assets used in carrying on a trade or business, then such corporations shall be treated as 1 corporation for purposes of clause (ii). For purposes of applying subclause (II) to the corporation holding the stock of the other corporation, such stock shall not be taken into account.

(109) Stock in qualifying lending and finance business treated as stock in an active trade or business company

(A) In general

If the ~~executor~~trustee elects the benefits of this paragraph, then—

- (i) Stock in qualifying lending and finance business treated as stock in an active trade or business company. For purposes of this section, any asset used in a qualifying lending and finance business shall be treated as an asset which is used in carrying on a trade or business.
- (ii) 5-year deferral for principal not to apply. The ~~executor~~trustee shall be treated as having selected under subsection (a)(3) the date prescribed by section 6151(a).
- (iii) 5 equal installments allowed. For purposes of applying subsection (a)(1), “5” shall be substituted for “10”.

(B) Definitions

For purposes of this paragraph—

(i) Qualifying lending and finance business. The term “qualifying lending and finance business” means a lending and finance business, if—

(I) based on all the facts and circumstances immediately before the ~~date of the decedent's death~~ taxable termination, there was substantial activity with respect to the lending and finance business, or

(II) during at least 3 of the 5 taxable years ending before the ~~date of the decedent's death~~ taxable termination, such business had at least 1 full-time employee substantially all of whose services were the active management of such business, 10 full-time, nonowner employees substantially all of whose services were directly related to such business, and \$5,000,000 in gross receipts from activities described in clause (ii).

(ii) Lending and finance business. The term “lending and finance business” means a trade or business of—

(I) making loans,

(II) purchasing or discounting accounts receivable, notes, or installment obligations,

(III) engaging in rental and leasing of real and tangible personal property, including entering into leases and purchasing, servicing, and disposing of leases and leased assets,

(IV) rendering services or making facilities available in the ordinary course of a lending or finance business, and

(V) rendering services or making facilities available in connection with activities described in subclauses (I) through (IV) carried on by the corporation rendering services or making facilities available, or another corporation which is a member of the same affiliated group (as defined in section ~~1504 without regard to section 1504(b)(3)~~ 1504 without regard to section 1504 (b)(3)).

(iii) Limitation. The term “qualifying lending and finance business” shall not include any interest in an entity, if the stock or debt of such entity or a controlled group (as defined in section 267(f)(1)) of which such entity was a member was readily tradable on an established securities market or secondary market (as defined by the Secretary) at any time within 3 years before the date of the ~~decedent's death~~ taxable termination.

(c) Special rule for interest in 2 or more closely held businesses.

For purposes of this section, interest interests in 2 or more closely held businesses, with respect to each of which there is included in determining the value of ~~the decedent's gross estate~~ all property with respect to which the taxable termination has occurred 20 percent or more of the total value of each such business, shall be treated as an interest in a single closely held business. ~~For purposes of the 20-percent requirement of the preceding sentence, an interest in a closely held business which represents the surviving spouse's interest in property held by the decedent and the surviving spouse as community property or as joint tenants, tenants by the entirety, or tenants in common shall be treated as having been included in determining the value of the decedent's gross estate.~~

(d) Election

Any election under subsection (a) shall be made not later than the time prescribed by section ~~6075(a)~~ 2662 for filing the return of tax imposed by section ~~2001~~2601 (including extensions thereof), and shall be made in such manner as the Secretary shall by regulations prescribe. If an election under subsection (a) is made, the provisions of this subtitle shall apply as though the Secretary were extending the time for payment of the tax.

(e) Proration of deficiency to installments

If an election is made under subsection (a) to pay any part of the tax imposed by section ~~2001~~ 2601 in installments and a deficiency has been assessed, the deficiency shall (subject to the limitation provided by subsection (a)(2)) be prorated to the installments described in subsection (a). The part of the deficiency so prorated to any installment the date for payment of which has not arrived shall be collected at the same time as, and as a part of, such installment. The part of the deficiency so prorated to any installment the date for payment of which has arrived shall be paid upon notice and demand from the Secretary. This subsection shall not apply if the deficiency is due to negligence, to intentional disregard of rules and regulations, or to fraud with intent to evade tax.

(f) Time for payment of interest

If the time for payment of any amount of tax has been extended under this section—

(1) Interest for first 5 years. Interest payable under section 6601 of any unpaid portion of such amount attributable to the first 5 years after the date prescribed by section ~~6151(a)~~6151 (a) for payment of the tax shall be paid annually.

(2) Interest for periods after first 5 years. Interest payable under section ~~6601~~6601 on any unpaid portion of such amount attributable to any period after the 5-year period referred to in paragraph (1) shall be paid annually at the same time as, and as a part of, each installment payment of the tax.

(3) Interest in the case of certain deficiencies. In the case of a deficiency to which subsection (e) applies which is assessed after the close of the 5-year period referred to in paragraph (1), interest attributable to such 5-year period, and interest assigned under paragraph (2) to any installment the date for payment of which has arrived on or before the date of the assessment of the deficiency, shall be paid upon notice and demand from the Secretary.

(4) Selection of shorter period. If the ~~executor~~trustee has selected a period shorter than 5 years under subsection (a)(3), such shorter period shall be substituted for 5 years in paragraphs (1), (2), and (3) of this subsection.

(g) Acceleration of payment

(1) Disposition of interest; withdrawal of funds from business

(A) If—

- (i)
 - (I) any portion of an interest in a closely held business which qualifies under subsection (a)(1) is distributed, sold, exchanged, or otherwise disposed of, or
 - (II) money and other property attributable to such an interest is withdrawn from such trade or business, and
- (ii) the aggregate of such distributions, sales, exchanges, or other dispositions and withdrawals equals or exceeds 50 percent of the value of such interest, then the extension of time for payment of tax provided in subsection (a) shall cease to apply, and the unpaid portion of the tax payable in installments shall be paid upon notice and demand from the Secretary.

(B) In the case of a distribution in redemption of stock to which section ~~303 (or so much of section 304 as relates to section 303)~~ applies—303 (or so much of section 304 as relates to section 303) applies—

- (i) the redemption of such stock, and the withdrawal of money and other property distributed in such redemption, shall not be treated as a distribution or withdrawal for purposes of subparagraph (A), and
- (ii) for purposes of subparagraph (A), the value of the interest in the closely held business shall be considered to be such value reduced by the value of the stock redeemed.

This subparagraph shall apply only if, on or before the date prescribed by subsection (a)(3) for the payment of the first installment which becomes due after the date of the distribution (or, if earlier, on or before the day which is 1 year after the date of the distribution), there is paid an amount of the tax imposed by section ~~200+2601~~ not less than the amount of money and other property distributed.

(C) Subparagraph (A)(i) does not apply to an exchange of stock pursuant to a plan of reorganization described in subparagraph (D), (E), or (F) of section ~~368(a)(1) nor to an exchange to which section 355 (or so much of section 356 as relates to section 355)~~ 368 (a)(1) nor to an exchange to which section 355 (or so much of section 356 as relates to section 355) applies; but any stock received in such an exchange shall be treated for purposes of subparagraph (A)(i) as an interest qualifying under subsection (a)(1).

(D) Subparagraph (A)(i) does not apply to a transfer of property of the ~~decedent trust~~ subject to the taxable termination to a person entitled by reason of the ~~decedent's death of the non-skip person~~ to receive such property under the decedent's will, the applicable law of descent and distribution, or a trust created by the decedent terms of the trust. A similar rule shall apply in the case of a series of subsequent transfers of the property by reason of death so long as each transfer is to a member of the family (within the meaning of section 267(c)(4)) of the ~~transferor in person making~~ such transfer.

(E) Changes in interest in holding company

If any stock in a holding company is treated as stock in a business company by reason of subsection (b)(~~87~~)(A)—

- (i) any disposition of any interest in such stock in such holding company which was included in determining the gross estate value of all property with respect to which the ~~decedent taxable termination has occurred~~, or

(ii) any withdrawal of any money or other property from such holding company attributable to any interest included in determining the ~~gross estate of the decedent~~, value of all property with respect to which the taxable termination has occurred,

shall be treated for purposes of subparagraph (A) as a disposition of (or a withdrawal with respect to) the stock qualifying under subsection (a)(1).

(F) Changes in interest in business company

If any stock in a holding company is treated as stock in a business company by reason of subsection (b)(~~87~~)(A)—

(i) any disposition of any interest in such stock in the business company by such holding company, or

(ii) any withdrawal of any money or other property from such business company attributable to such stock by such holding company owning such stock, shall be treated for purposes of subparagraph (A) as a disposition of (or a withdrawal with respect to) the stock qualifying under subsection (a)(1).

(2) Undistributed income of estatetrust

(A) If an election is made under this section and the estatetrust has undistributed net income for any taxable year ending on or after the due date for the first installment, the ~~executor~~trustee shall, on or before the date prescribed by law for filing the income tax return for such taxable year (including extensions thereof), pay an amount equal to such undistributed net income in liquidation of the unpaid portion of the tax payable in installments.

(B) For purposes of subparagraph (A), the undistributed net income of the estatetrust for any taxable year is the amount by which the distributable net income of the estatetrust for such taxable year (as defined in section ~~643~~643) exceeds the sum of—

(i) the amounts for such taxable year specified in paragraphs (1) and (2) of section ~~661(a)~~661 (a) (relating to deductions for distributions, etc.);

(ii) the amount of tax imposed for the taxable year on the estatetrust under chapter 1; and

(iii) the amount of the ~~taxes~~ imposed by ~~sections~~sections 2001 and 2601 (including interest for each of said sections) paid by the ~~executor~~trustee during the taxable year (other than any amount paid pursuant to this paragraph).

(C) For purposes of this paragraph, if any stock in a corporation is treated as stock in another corporation by reason of subsection (b)(~~87~~)(A), any dividends paid by such other corporation to the corporation shall be treated as paid to the ~~estate of the decedent~~trust to the extent attributable to the stock qualifying under subsection (a)(1).

(3) Failure to make payment of principal or interest

(A) In general

Except as provided in subparagraph (B), if any payment of principal or interest under this section is not paid on or before the date fixed for its payment by this section (including any extension of time), the unpaid portion of the tax payable in installments shall be paid upon notice and demand from the Secretary.

(B) Payment within 6 months

If any payment of principal or interest under this section is not paid on or before the date determined under subparagraph (A) but is paid within 6 months of such date—

(i) the provisions of subparagraph (A) shall not apply with respect to such payment,

~~(ii) the provisions of section 6601(j)~~(ii) rules similar to those found in section 6601(j) shall not apply with respect to the determination of interest on such payment, and

(iii) there is imposed a penalty in an amount equal to the product of—

(I) 5 percent of the amount of such payment, multiplied by

(II) the number of months (or fractions thereof) after such date and before payment is made.

The penalty imposed under clause (iii) shall be treated in the same manner as a penalty imposed under subchapter B of chapter 68.

(h) Election in case of certain deficiencies

(1) In general

If—

(A) a deficiency in the tax imposed by section ~~2001~~ 2601 is assessed,

(B) the estate trust qualifies under subsection (a)(1), and

(C) the ~~executor trustee~~ has not made an election under subsection (a), the ~~executor trustee~~ may elect to pay the deficiency in installments. This subsection shall not apply if the deficiency is due to negligence, to intentional disregard of rules and regulations, or to fraud with intent to evade tax.

(2) Time of election

An election under this subsection shall be made not later than 60 days after issuance of notice and demand by the Secretary for the payment of the deficiency, and shall be made in such manner as the Secretary shall by regulations prescribe.

(3) Effect of election on payment

If an election is made under this subsection, the deficiency shall (subject to the limitation provided by subsection (a)(2)) be prorated to the installments which would have been due if an election had been timely made under subsection (a) at the time the estate tax return for the taxable termination was filed. The part of the deficiency so prorated to any installment the date for payment of which would have arrived shall be paid at the time of the making of the election under this subsection. The portion of the deficiency so prorated to installments the date for payment of which would not have so arrived shall be paid at the time such installments would have been due if such an election had been made.

(i) Special Rule for Certain Direct Skips

To

(i) Application of other code sections

(1) Application of section 6324A

~~In the event that an interest in a closely held business is the subject of a direct skip (within the meaning of section 2612(c)) occurring at the same time as and generation-skipping transfer tax payable as a result of the taxable termination,~~
is made under this section, rules similar to those provided under section 6324A with respect to the special lien for estate taxes deferred under section 6166 shall be applicable to the meaning of section 2612(c) occurring at the same time as and generation-skipping transfer tax payable as a result of the taxable termination.

(2) Application of section 6503(d)

~~In the event that an election is made under this section, rules similar to those provided under section 6503(d) with respect to the extension of the period of limitation for the estate tax payable under section 6166 shall apply.~~
In the event that an election is made under this section, rules similar to those provided under section 6503(d) with respect to the extension of the period of limitation for the estate tax payable under section 6166 shall apply.

(3) Application of section 6601(j)

~~In the event that an election is made under this section, rules similar to those provided under section 6601(j) with respect to the payment of interest on the tax payable in installments under section 6166 shall apply.~~
In the event that an election is made under this section, rules similar to those provided under section 6601(j) with respect to the payment of interest on the tax payable in installments under section 6166 shall apply.

(4) ~~decedent's death, then~~ Application of section 303(b)(1)(c)

~~In the event that an election is made under this section, rules similar to those provided under section 303(b)(1)(c) with respect to the period for distribution in the case of an election under section 6166 shall apply for purposes of this section any tax imposed by section 2601 on the transfer of such interest shall be treated as if it were additional tax imposed by section 2001~~
In the event that an election is made under this section, rules similar to those provided under section 303(b)(1)(c) with respect to the period for distribution in the case of an election under section 6166 shall apply for purposes of this section any tax imposed by section 2601 on the transfer of such interest shall be treated as if it were additional tax imposed by section 2001 section 303.

(j) Regulations

The Secretary shall prescribe such regulations as may be necessary to the application of this section.

(k) Cross ~~references~~reference

~~(1) Security~~

For authority of the Secretary to require security in the case of an extension under this section, see section ~~6165.6165.~~

~~(2) Lien~~

~~For special lien (in lieu of bond) in the case of an extension under this section, see section 6324A.~~

~~(3) Period of Limitation~~

~~For extension of the period of limitation in the case of an extension under this section, see section 6503(d).~~

~~(4) Interest~~

~~For provisions relating to interest on tax payable in installments under this section, see subsection (j) of section 6601.~~

~~(5) Transfers Within 3 Years of Death~~

~~For special rule for qualifying an estate under this section where property has been transferred within 3 years of decedent's death, see section 2035(c)(2).~~