

**HOW TO PAY WHEN THE BILL COMES DUE –  
ESTATE LIQUIDITY IN 2022**

**HOUSTON BUSINESS & ESTATE PLANNING COUNCIL  
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Keri Brown serves as a trusted advisor to some of the nation’s most prominent individuals on complex federal estate, gift and income tax litigation and controversy matters, including disputes and litigation with the Department of Justice and the Internal Revenue Service. She counsels high net worth individuals and families in a variety of courts, including in the United States Tax Court, United States District Courts and United States Courts of Appeals. She also represents taxpayers in federal tax audits and administrative appeals and represents fiduciaries and beneficiaries of trusts and estates in state courts with respect to administration and fiduciary duty issues. Published cases in which Keri served as one of the taxpayer’s counsel include *Estate of Murphy*, *Steinberg*, *Estate of Petter*, *Hendrix*, and *Estate of Christiansen*.

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Richard Ramirez handles all aspects of estate planning and estate administration for high net worth individuals, representation of fiduciaries and beneficiaries in estate and trust administration, and representation of charities. He primarily focuses on preparation of wills and trusts, lifetime transfers of assets, and restructuring family owned businesses. His practice emphasizes the implementation of advanced asset transfer strategies that preserve estates by minimizing federal gift and estate taxes, as well as strategies to transition ownership of family businesses and legacy properties from one generation to the next.

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*Your client has been named the executor of an estate with a large amount of estate tax due, but little liquidity in the estate.*

*What are your client's payment options? What is your client's potential liability?*

## **I. Key points under I.R.C. § 6166 and § 6161**

- Family entities that carry on a trade or business may be eligible for the § 6166 election. This includes entities in which the decedent individually owns an interest, as well as entities in which the decedent owns an interest through a holding company.
- To obtain the § 6166 election, the aggregate value of the decedent's interests in the entities that are eligible for the election must exceed 35% of the value of the decedent's adjusted gross estate.
- The estate tax attributable to the value of a decedent's interests in the family entities can be deferred in 2 or more (but not more than 10) equal annual installments. Installment payments of estate tax attributable to the interests held by the decedent *individually* must begin no later than five years after the estate tax is due; while installment payments of estate tax attributable to the interests owned in a *holding company* must begin when the estate tax return is due.
- The interest rate on the deferred estate tax for the interests held by the decedent individually is 2% on the first \$1.64 million of the decedent's taxable estate (in 2022),<sup>1</sup> and 45% of the estate tax underpayment rate (currently 3%,<sup>2</sup> resulting in an interest rate of 1.35%) for the remaining value. The interest rate on the deferred estate tax for the interests held through a holding company is 45% of the estate tax underpayment rate.
- If an estate's interest in the entities at issue is sold while a § 6166 election is pending, the estate will lose the § 6166 election and the remaining estate tax must be paid upon notice and demand by the Internal Revenue Service.
- The estate should make a protective election under § 6161 in the event the § 6166 election is denied by the Service. This election would allow the estate to extend the time for payment of the estate tax "for a reasonable period not in excess of 10 years" upon a showing of reasonable cause.
- Section 6161(a) permits an executor to apply for an extension of time in which to pay the estate tax due. The extension is granted for up to twelve months, and an executor can apply annually for an additional extension of time, up to a total of ten years. The executor must reapply for the § 6161 extension annually.

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<sup>1</sup> Rev. Proc. 2021-45.

<sup>2</sup> For January through March 2022.

## **II. Facts to be used in [some of] our examples**

### **A. Decedent Y**

Decedent Y died on January 31, 2022. At his death, Decedent Y individually owned the following interests in various family entities:

- 50% limited partner interest in Family Partnership
- 99% member interest in HoldCo

In turn, HoldCo owns the following interests in manufacturing entities (“Manufacturing Entities”):

- 99% limited partner interest in Manufacturing Partnership
- 50% member interest in Management Company, LLC

Decedent Y’s interest in Family Partnership is valued at \$24,000,000 and his interest in HoldCo is valued at \$96,000,000 (with \$70,000,000 attributable to HoldCo’s ownership of Manufacturing Partnership and the remaining \$26,000,000 attributable to its ownership of Management Company, LLC).

### **B. Decedent Z**

Decedent Z died on June 2, 2022. At her death, Decedent Z individually owned a 5% interest in Corporation.

A trust includible in Decedent Y’s estate under § 2036 owned a 40% interest in Corporation.

Decedent Z’s interest held in Corporation directly and that interest held in the trust but includible in her estate have been valued at \$50,000,000. The remaining assets in her gross estate are valued at \$10,000,000.

## **III. Eligibility for the § 6166 election**

Section 6166(a) permits an executor to elect to pay estate tax in installments over time, rather than in one lump sum, subject to certain qualifications. *See* § 6166(a)(1). Section 6166(a) provides:

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

I.R.C. § 6166(a).

**A. What does “the value of an interest in a closely held business” mean?**

An interest in a closely held business is defined as follows:

- (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 estate of the decedent, or
    - (ii) the 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.

I.R.C. § 6166(b)(1). Estate tax cannot be deferred for passive assets. I.R.C. § 6166(b)(9).

**B. What does it mean to “exceed[] 35 percent of the adjusted gross estate”?**

For an estate to be eligible for the § 6166 election, the value of the interests in the entities that qualify for § 6166 consideration (owned both through the decedent individually and indirectly through holding companies) must exceed 35% of the decedent’s adjusted gross estate.

*Example 1:*

Decedent Y’s estate includes interests held both directly and indirectly in certain entities qualifying for § 6166 consideration (referred to below as the “**Family Y Entities**”). If the value of the assets included in the adjusted gross estate of Decedent Y that are not Family Y Entities have a value of \$40 million, then Decedent Y’s interests in Family Y Entities must be valued at a minimum of \$21.5 million (rounded), as follows:

<p><i>Minimum total value of adjusted gross estate:</i></p> $\$40,000,000 \div 65\% = \$61,538,462$ <p><i>Value that Decedent Y’s interest in the Family Y Entities must meet or exceed:</i></p> $\$61,538,462 - \$40,000,000 = \$21,538,462$
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The above example will be referred to as the “\$61 Million Estate.”

*Example 2:*

If we assume that Decedent Y’s interests in the Family Y Entities is valued at \$120 million, then the percentage qualifying for § 6166 is 75% (well in excess of the 35% requirement), as follows:

<p><i>Value of adjusted gross estate:</i></p> $\$120,000,000 + \$40,000,000 = \$160,000,000$ <p><i>Percent of adjusted gross estate attributed to value of Family Y Entities:</i></p> $\$120,000,000 \div \$160,000,000 = 75\%$
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The above example will be referred to as the “\$160 Million Estate.”

**C. “[T]he executor may elect to pay part or all of the [estate] tax . . . in 2 or more (but not exceeding 10) equal installments”**

This portion of the statute has two key exceptions.

**1. Percentage deferred**

First, the only part of the estate tax that can be deferred is the percentage that relates to the value of the closely held businesses. I.R.C. § 6166(a)(2). Thus, for the \$61 Million Estate example above, 35% of the tax due in the example (or \$8,540,000)<sup>3</sup> could be deferred. For the \$160 Million Estate example above, 75% of the tax due in the example (or \$48,000,000)<sup>4</sup> could be deferred.

**2. Deferral time**

For those entities held by a decedent personally and eligible for the § 6166 election, the executor of the decedent’s estate may defer the start of principal payments for five years, then make principal and interest payments in up to ten equal annual installments. This gives the estate fourteen years in which to pay the estate tax related to the decedent’s direct ownership of entities that are eligible for the § 6166 election. However, interest on the amount deferred must be paid annually, even while the estate is in the five-year deferral of principal payments. I.R.C. § 6166(f).

However, that deferral time is not permitted for interests in entities eligible for the § 6166 election that are not held by a decedent personally (*i.e.*, interests held indirectly through a holding company).

*Example:*

Decedent Y owned some of his interests in Family Y Entities indirectly through HoldCo. For those interests held through HoldCo, the Service would not permit the initial five-year deferral of principal payments. Instead, the first installment of estate tax attributable to the value of HoldCo must be made on the date the estate tax return is due, with up to nine equal annual installments following. I.R.C. § 6166(b)(8)(A)(ii).

Because Decedent Y died on January 31, 2022, the estate tax return is due on October 31, 2022. Applying the above rules, the first principal payment on the portion of the estate tax that is attributed to Decedent Y’s *direct* ownership would be October 31, 2027, and ending on October 31, 2036. However, the first principal payment on the portion of the estate tax that is attributed to Decedent Y via his ownership of HoldCo is due on October 31, 2022, and ending on October 9, 2031.

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<sup>3</sup> An estate of \$61 million (without consideration of allowable deduction) results in tax of \$24,400,000 (at a 40% rate). Thirty-five percent of that amount is \$8,540,000.

<sup>4</sup> An estate of \$160 million (without consideration of allowable deduction) results in tax of \$64,000,000. 75% of that amount is \$48,000,000.



Assuming that (1) 80% of the value of Decedent Y's interest in the Family Y Entities is held through HoldCo, (2) the remaining 20% is held by Decedent Y individually, and (3) the total estate tax attributable to the Family Y Entities is \$48,000,000 (40% of \$120,000,00), the following principal payments would be due.

<b>Date</b>	<b>Principal (Tax) Due</b>	<b>Explanation</b>
10/31/2022	\$960,000	HoldCo only
10/31/2023	\$960,000	HoldCo only
10/31/2024	\$960,000	HoldCo only
10/31/2025	\$960,000	HoldCo only
10/31/2026	\$960,000	HoldCo only
10/31/2027	\$4,800,000	HoldCo and Decedent Y individually
10/31/2028	\$4,800,000	HoldCo and Decedent Y individually
10/31/2029	\$4,800,000	HoldCo and Decedent Y individually
10/31/2030	\$4,800,000	HoldCo and Decedent Y individually
10/31/2031	\$4,800,000	HoldCo and Decedent Y individually
10/31/2032	\$3,840,000	Decedent Y individually
10/31/2033	\$3,840,000	Decedent Y individually
10/31/2034	\$3,840,000	Decedent Y individually
10/31/2035	\$3,840,000	Decedent Y individually
10/31/2036	\$3,840,000	Decedent Y individually
	\$48,000,000	<b>Total tax paid</b>

#### **IV. Interest rate for deferred tax**

##### **A. Entities owned by the decedent individually**

Section 6601(j) provides, in relevant part:

- (j) 2-PERCENT RATE ON CERTAIN PORTION OF ESTATE TAX EXTENDED UNDER SECTION 6166.—
  - (1) IN GENERAL.—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)—

- (A) interest on the 2-percent portion of such amount shall be paid at the rate of 2 percent, and
- (B) interest on so much of such amount as exceeds the 2-percent portion shall be paid at a rate equal to 45 percent of the annual rate provided by subsection (a).

For purposes of this subsection, the amount of any deficiency which is prorated to installments payable under section 6166 shall be treated as an amount of tax payable in installments under such section.

(2) 2-PERCENT PORTION.—For purposes of this subsection, the term “2-percent portion” means the lesser of—

- (A) (i) the amount of the tentative tax which would be determined under the rate schedule set forth in section 2001(c) if the amount with respect to which such tentative tax is to be computed were the sum of \$1,000,000 [adjusted for inflation] and the applicable exclusion amount in effect under section 2010(c), reduced by
  - (ii) the applicable credit amount in effect under section 2010(c), or
- (B) the amount of the tax imposed by chapter 11 which is extended as provided in section 6166.

Under § 6601(j), if a decedent’s estate makes a § 6166 election for the entities held by the decedent individually, the estate would pay an interest rate on the deferred tax equal to 2% on the first \$1.64 million of the taxable estate (after applying any available unified credit), and 45% of the applicable underpayment rate on the remainder of the value. The underpayment rate for the first quarter of 2022 is 3%; assuming this rate is also in effect at the time the estate tax return was due, the estate would pay 1.35% interest on the excess value. As recently as 2007, the interest rate for underpayments was 8%, which would translate to an interest rate of 3.6% under § 6166, which is still a favorable interest rate.

## **B. Entities owned indirectly**

The entities held indirectly through holding companies also receive a favorable interest rate, but the 2% interest rate does not apply to the value of assets held through a holding company. I.R.C. § 6166(b)(8)(A)(iii). Instead, the interest rate for the full amount of the tax owed in this scenario is 45% of the applicable underpayment rate, or 1.35% under the current 3% interest rate.

## **C. Interest on deferred tax payments is not deductible**

Because of the reduced interest rate applying to the deferred tax payments, the interest that is incurred on such tax payments is not deductible. I.R.C. § 2053(c)(1)(D).

## **V. How to make the § 6166 election**

The § 6166 election is made at the time the estate tax return is filed. The notice of election must contain the following information:

- (1) The decedent's name and taxpayer identification number as they appear on the estate tax return;
- (2) The amount of tax which is to be paid in installments;
- (3) The date selected for payment of the first installment;
- (4) The number of annual installments, including the first installment, in which the tax is to be paid;
- (5) The properties shown on the estate tax return which constitute the closely held business interest (identified by schedule and item number); and
- (6) The facts which form the basis for the executor's conclusion that the estate qualifies for payment of the estate tax in installments.

Treas. Reg. § 20.6166-1(b).

## **VI. Technical elements to remember**

### **A. Aggregation of interests**

It is not explicitly stated in the Code that the value of interests held directly by a decedent can be aggregated with the value of interests held indirectly by a decedent via a holding company to satisfy the "35% of the adjusted gross estate" requirement. However, it appears that this would be the case.

*Example:*

Decedent Y owned 20% or more of the total value of each of Family Partnership and HoldCo, and, as a result, the individual interests are treated as being an interest in a single

closely held business. *See* I.R.C. § 6166(c). Thus, the entities in which Decedent Y owned interests individually can be aggregated for purposes of satisfying the 35% test. *See id.*

With respect to HoldCo, § 6166(b)(8) allows Decedent Y's ownership of HoldCo to be treated as stock in a business company. A business company is defined as "any corporation carrying on a trade or business." I.R.C. § 6166(b)(8)(D)(ii). An "interest in a closely held business" is defined as "stock in a corporation carrying on a trade or business if . . . 20 percent or more in value of the voting stock of such corporation is included in determining the gross estate of the decedent." I.R.C. § 6166(b)(1)(C). HoldCo owns more than a 20% interest in each of the Manufacturing Entities. As discussed above, § 6166(c) provides that an estate can aggregate interests in two or more closely held businesses. Because HoldCo is deemed to be a closely-held business, it would appear that HoldCo can be aggregated with Decedent Y's interests held individually for purposes of the 35% test.

Even if the two types of interests can be aggregated, it appears that there would be two separate elections made: one for Decedent Y's direct ownership (privity to the 5-year deferral of principal) and one for Decedent Y's ownership through HoldCo (on which the estate would have to begin paying principal immediately).

However, if the overwhelming value of the Manufacturing Entities included in the estate is held through HoldCo, even making an election only with respect to the HoldCo interests would result in a substantial deferral of estate tax.

## **B. Acceleration of estate tax deferred**

Section 6166(g)(1)(A) provides:

(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.

I.R.C. § 6166(g)(1)(A).

*Example:*

If the executor of the estate of Decedent Y sells the estate's interest in HoldCo, the estate will lose its § 6166 election and will be responsible for payment of the remaining estate tax due upon the Service's notice and demand. *See also* I.R.C. § 6166(g)(1)(E) (providing that disposition of an interest in a holding company or withdrawal of money or other property from such holding company is treated as a disposition of, or withdrawal with respect to, stock qualifying under § 6166(a)(1)); I.R.C. § 6166(g)(1)(F) (providing for similar treatment with respect to a business company underlying a holding company).

### **C. What if the election doesn't work? Make a protective election under § 6161 when you file**

The Service may determine that an estate's § 6166 election is invalid. To protect an estate's ability to pay the estate tax over time, the estate should include with the filing of the estate tax return a protective election under § 6161. Section 6161 allows an estate to extend the time for payment of estate tax. The Service may extend the time for payment of estate tax "for a reasonable period not in excess of 10 years" from the date the tax is due, upon a showing of reasonable cause. I.R.C. § 6161(a)(2).

Whether an executor would be successful in applying for an extension of time in which to pay the estate tax under § 6161 generally will depend on the amount of the estate's liquidity as compared to the estate tax burden.

#### **1. Qualifying under § 6161**

To qualify for an extension of time, the executor must show reasonable cause or undue hardship for not paying the full amount of estate tax when due. The Treasury Regulation provides four examples of reasonable cause:

*Example (1).* An estate includes sufficient liquid assets to pay the estate tax when otherwise due. The liquid assets, however, are located in several jurisdictions and are not immediately subject to the control of the executor. Consequently, such assets cannot readily be marshaled by the executor, even with the exercise of due diligence.

*Example (2).* An estate is comprised in substantial part of assets consisting of rights to receive payments in the future (*i.e.*, annuities, copyright royalties, contingent fees, or accounts receivable). These assets provide insufficient present cash with which to pay the estate tax when otherwise due and the estate cannot borrow against these assets except upon terms which would inflict loss upon the estate.

*Example (3).* An estate includes a claim to substantial assets which cannot be collected without litigation. Consequently, the size of the gross estate is unascertainable as of the time the tax is otherwise due.

*Example (4).* An estate does not have sufficient funds (without borrowing at a rate of interest higher than that generally available) with which to pay the entire estate tax when otherwise due, to provide a reasonable allowance during the remaining period of administration of the estate for the decedent's widow and dependent children, and to satisfy claims against the estate that are due and payable. Furthermore, the executor has made a reasonable effort to convert assets in his possession (other than an interest in a closely held business to which section 6166 applies) into cash.

Treas. Reg. § 20.6161-1(a)(1).

The Treasury Regulations define “undue hardship” as follows:

The extension provided under this subparagraph on the basis of undue hardship to the estate will not be granted upon a general statement of hardship or merely upon a showing of reasonable cause. The term “undue hardship” means more than an inconvenience to the estate. A sale of property at a price equal to its current fair market value, where a market exists, is not ordinarily considered as resulting in an undue hardship to the estate.

Treas. Reg. § 20.6161-1(a)(2)(ii). At least one commentator has suggested that the undue hardship provision does not apply to the estate tax, but applies only to income or gift tax, because the test for undue hardship is more difficult to satisfy than the test for reasonable cause (in other words, if you have enough evidence to prove undue hardship, then you necessarily have enough evidence to show reasonable cause). See Marc S. Bekerman, “Estate Tax Payments and Liabilities: Sections 6161 and 6166,” 832-2nd Tax Mgmt. (BNA) Estates, Gifts, and Trusts, at A-49 n.413.

## **2. Possible arguments for the § 6161 extension**

### **a. The executor doesn't control the assets**

If an executor owes substantial estate tax attributable to assets held in a trust (and, thus, not within executor's control) and does not have sufficient liquid funds to pay the estate tax when due, the executor could argue that this ground constitutes reasonable cause. Example 4 in Treas. Reg. § 20.6161-1(a)(1) is most on-point in this regard.

It is likely that the Service would argue that because the estate's assets passing to the executor are within the executor's control, those assets should be converted into cash to the extent possible, and the funds received should be applied to the estate tax. However, the executor also should consider the amount of funds reasonably needed to administer the estate and pay any claims of the estate. Ultimately, the analysis turns on the estate's overall liquidity position relative to the amount of estate tax due.

**b. But for a technical provision in the Code, the estate likely would qualify for a § 6166 election**

The examples of undue hardship in the Treasury Regulation provide support for a § 6161 extension based on a failure of § 6166 to apply:

*Example (1).* A farm (or other closely held business) comprises a significant portion of an estate, but the percentage requirements of section 6166(a) (relating to an extension where the estate includes a closely held business) are not satisfied and, therefore, that section does not apply. Sufficient funds for the payment of the estate tax when otherwise due are not readily available. The farm (or closely held business) could be sold to unrelated persons at a price equal to its fair market value, but the executor seeks an extension of time to facilitate the raising of funds from other sources for the payment of the estate tax.

*Example (2).* The assets in the gross estate which must be liquidated to pay the estate tax can only be sold at a sacrifice price or in a depressed market if the tax is to be paid when otherwise due.

Treas. Reg. § 20.6161-1(a)(2)(ii).

*Example:*

Interests in a closely held corporation comprise most of the assets of Decedent Z's gross estate, but a subsidiary of that corporation is a publicly-traded holding company (as opposed to a not-readily tradable holding company, or a publicly-traded business company), so the estate appears not to qualify for a § 6166 election.

The executor also may have grounds for reasonable cause because of the estate's inability to qualify for a § 6166 election. If a technicality of § 6166 appears to disqualify the executor from making such an election despite the fact that all of the major requirements for § 6166 have been met, then, so long as the executor makes a reasonable effort to convert other assets in her possession into cash, she may have grounds for reasonable cause under § 6161.

**3. Applying for the § 6161 extension**

The request for extension of time should be made on a Form 4768, filed on or before the due date of the estate tax return. The executor is required to pay the estate tax that can be paid at the time (keeping in mind that the executor should retain funds for payment of administration expenses and claims against the estate, if any). The request must include a statement of reasonable cause, and if undue hardship also is asserted, the request should include an explanation of the undue hardship. Treas. Reg. § 20.6161-1(b). If the executor argues undue hardship, she also should argue reasonable cause in the alternative. *Id.*

Once the Service receives the application, the Service is supposed to examine the application and, if possible, grant, deny, or tentatively grant the application within 30 days.<sup>5</sup> *Id.* The Service has discretion on whether to grant the extension request. If denied, the executor can appeal the decision. *Id.*

#### **4. A bond may be required**

After receiving a § 6161 request, the Service can accept the request and also can require that the executor post a bond for the amount of estate tax that is subject to the extension. Treas. Reg. § 20.6165-1(a). The amount of the bond cannot exceed double the amount of the tax payment that is deferred. *Id.*

To satisfy the bond requirement, the taxpayer must complete the appropriate form and provide satisfactory surety. Treas. Reg. § 301.7101-1(a). “Satisfactory surety” includes a bond “executed by a surety company holding a certificate of authority from the Secretary as an acceptable surety on Federal bonds; or . . . secured by bonds or notes of the United States.”<sup>6</sup> I.R.C. § 301.7101-1(b)(1). The Service has the discretion to permit a bond to be executed with a corporate or individual surety under certain conditions. I.R.C. § 301.7101-1(b)(2).

### **VII. Liability for payment of estate tax**

Section 2002 provides that the federal estate tax “shall be paid by the executor.”<sup>7</sup> Thus, the executor has a duty to pay the total amount of federal estate tax due, regardless of whether the executor has possession of the entirety of the decedent’s gross estate or merely a fraction of the gross estate. Under most circumstances, the executor pays the estate tax (either by paying the tax when due or through filing an appropriate request for an extension of time in which to pay the tax and making the required payments). If the executor fails to pay the estate tax, the Service has a variety of options available to collect the tax, including (i) liens, (ii) personal liability of the executor, or (iii) transferee liability.

#### **A. Liens**

The Code imposes an automatic lien for estate tax under § 6324(a)(1) that continues for a period of ten years from the decedent’s death, unless the estate tax is paid before then or becomes unenforceable by reason of lapse of time (the “special lien”). The special lien attaches to all property included in the gross estate, except any part of the gross estate that is used to pay allowable charges against the estate and administration expenses. The special lien attaches to such property regardless of whether such property comes into the executor’s possession. Treas. Reg. § 301.6324-1(a)(1).

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<sup>5</sup> In a recent matter, our taxpayer did not receive communications from the IRS regarding their § 6166 election for nine months. In fairness, we are still in a pandemic and the IRS is still very behind in processing mail.

<sup>6</sup> A list of surety companies that are approved by the Treasury Department is available at [http://www.fms.treas.gov/c570/c570\\_a-z.html](http://www.fms.treas.gov/c570/c570_a-z.html).

<sup>7</sup> The “executor” means the “executor or administrator of the decedent, or, if there is no executor or administrator appointed, qualified, and acting within the United States, then any person in actual or constructive possession of any property of the decedent.” I.R.C. § 2203.



An additional lien arises under § 6321 and applies when any person liable to pay any tax neglects or refuses to pay the tax after demand (the “general lien”). These two liens are cumulative. Treas. Reg. § 301.6324-1(d). The only difference between the two liens is that the general lien applies to “all property and rights to property, whether real or personal, belonging to such person” upon assessment and demand, while the special lien attaches only to the assets comprising “the gross estate” at the date of death.

In enforcing the special lien, the Service simply can levy under § 6331. In addition, under § 7403(a), the government may file a civil action in district court to enforce the lien of the United States.

## **B. An executor’s personal liability**

Generally, the executor’s liability for estate tax is limited to the extent of the assets under the executor’s control. However, if the executor pays a debt or makes a distribution while the estate is insolvent, the executor is personally liable for the unpaid estate tax to the extent of such payment. 31 U.S.C. § 3713; Treas. Reg. § 20.2002-1. To impose personal liability on an executor under 31 U.S.C. § 3713 (the “insolvency statute”), each of the following elements must be present:

- (1) The executor must make a payment of a debt or a distribution to a beneficiary.<sup>8</sup>
- (2) The payment must be made at a time when the estate is insolvent, or the payment must render the estate insolvent.<sup>9</sup>
- (3) The payment must be made at a time that a claim is owing to the government.
- (4) The executor must have notice that the claim is owing to the government at the time of making the payment.

*See, e.g., United States v. Bartlett*, 89 A.F.T.R.2d 2002-1049 (2002); *United States v. Estate of Kime*, 950 F. Supp. 950 (D. Neb. 1996); *Allen v. Commissioner*, 78 T.C.M. (CCH) 828 (1999).

While the personal liability of the executor under the insolvency statute extends only to the extent of the payment made by the executor, the Service successfully has argued that the limitation in the insolvency statute does not eliminate the executor’s liability for interest on such payment. *See, e.g., Baptiste v. Commissioner*, 29 F.3d 1533, 1541-42 (11th Cir. 1994); *but*

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<sup>8</sup> The government’s priority under 31 U.S.C. § 3713 is subject to claims for funeral expenses, administrative expenses, and family allowance. Rev. Rul. 80-112, 1980-1 C.B. 306; *see also Estate of Frazier v. Commissioner*, 70 A.F.T.R.2d 92-6281 (1992); *United States v. Weisburn*, 48 F. Supp. 393 (E.D. Penn. 1943).

<sup>9</sup> “Insolvency” for purposes of 31 U.S.C. § 3713 generally refers to “balance sheet insolvency,” which occurs if the estate’s liabilities exceed its assets. In determining insolvency of the estate, only assets in the possession of the executor should be considered. I.R.S. Priv. Ltr. Rul. 8843011 (Oct. 28, 1988). In other words, the properties of the Trust should not be considered, as such properties are not in the executor’s possession.

*see Singleton v. Commissioner*, 71 T.C.M. (CCH) 3127 (1996) (holding that executor was not liable for interest beyond the amount paid out by executor).

The executor's liability under the insolvency statute may be assessed, paid, and collected as if it were a tax, even though 31 U.S.C. § 3713 is not within the Code. I.R.C. § 6901(a)(1)(B). However, the collection under § 6901 is alternative and not exclusive. Accordingly, the Service can assert personal liability under the insolvency statute either by assessing the executor under § 6901 or by instituting a separate action in U.S. District Court pursuant to § 7402(a).

### **C. Transferee liability**

If the estate tax is not paid when due, § 6424(a)(2) imposes personal liability for the tax on “the spouse, transferee, trustee . . . , surviving tenant, person in possession of the property by reason of the exercise, nonexercise, or release of a power of appointment, or beneficiary” who receives, or has on the date of the decedent's death, property included in the gross estate under §§ 2034 through 2042, to the extent of the value of the property at the decedent's death. I.R.C. § 6424(a)(2). This liability, referred to as “transferee liability,” extends to the *entire* unpaid estate tax and interest, not just the tax and interest attributable to the *particular* non-probate property interest.

Section 6424(a)(2) creates transferee liability and does not itself impose a lien on the property held by the transferee. (The lien on the property is created pursuant to § 6324(a)(1), discussed above.) Transferee liability is an independent liability created under federal law and is not dependent on state law.

The Service also may collect unpaid estate taxes from a transferee through the collection procedure established by § 6901. Section 6901 is a procedural statute and affords the Service with a summary procedure for enforcing an existing liability. It provides that a transferee is subject to the same assessment, payment, and collection procedures as apply to a transferor. I.R.C. § 6901(a).

#### *Example:*

For the estate of Decedent Z, the effect of § 6424(a)(2) is that the Service can assert transferee liability against the trustees of the trust includible in the estate under § 2036 of the Code if the executor does not pay the estate tax when due (or does not obtain an extension of time in which to pay the estate tax).

### **D. Apportionment of estate tax**

When the decedent's gross estate includes assets that are not actually held by the executor (*i.e.*, if a trust's assets are includible), there is a question relating to how the estate tax is apportioned. Both federal and state law come into play in this analysis. The analysis below assumes the decedent was a resident of Texas.

## 1. Federal law

As addressed above, while § 2002 places the duty to pay the federal estate tax on the executor, such duty does not determine who will bear the ultimate burden of the federal estate tax. There are five federal statutes that can impact the issue of who bears the burden of the federal estate tax:

- § 2205 (non-probate beneficiary may be entitled to reimbursement from the estate for taxes paid but otherwise apportioned to probate beneficiaries),
- § 2206 (executor may recover estate tax from the recipients of life insurance proceeds includible in the gross estate under § 2042),
- § 2207 (executor may recover estate tax from the recipients of power of appointment property includible in the gross estate under § 2041),
- § 2207A (executor may recover estate tax from QTIP marital trust property includible in the gross estate under § 2044), and
- § 2207B (executor may recover estate tax from the recipients of property includible in the gross estate under § 2036).

These materials primarily discuss § 2207B.

### a. Section 2207B

Section 2207B provides an executor with a right of reimbursement from a person receiving property that is included in the decedent's gross estate by reason of § 2036. Under § 2207B, the executor can recover the amount that bears the same ratio to the total tax that has been paid as the § 2036 property bears to the taxable estate, as well as interest and penalties attributable to such tax. I.R.C. §§ 2207B(a), (c).

#### *Example:*

As previously noted, the assets of a trust are includible in Decedent Z's gross estate by reason of § 2036. Let us further assume that the estate will receive a marital deduction and administration expense deductions such that the taxable estate consists entirely of the value of the property held in the trust. Thus, if § 2207B did apply, it would provide the executor with a right of reimbursement from the trustees of the trust for the full amount of the tax paid by the executor.

We have not seen any definitive tax case law or secondary sources that discuss the interplay between the apportionment of taxes and extensions of time to pay estate tax under § 6161, but at least one commentator has suggested that with respect to § 2207B (a federal reimbursement statute, not an apportionment statute) and deferred payments under § 6166 (extension of time for payment of estate tax where estate consists largely of interest in closely held business), an executor could recover estate tax and interest from the recipient of assets includible in the estate *after* the executor has paid such tax and interest. See A. JAMES CASNER AND JEFFREY N. PENNELL, ESTATE PLANNING 3131 (Barbara L. Post ed., CCH 2012).

**i. Waiver of federal law**

A decedent can waive the right of recovery under § 2207B in his will if he specifically indicates an intent to waive (i) the right of recovery under § 2207B or (ii) the right of recovery with respect to any property included in the gross estate of the decedent under § 2036. I.R.C. § 2207B(a)(2).

**ii. Effective date of § 2207B**

The effective date of § 2207B states that the statute only applies to properties *transferred after November 10, 1988*. This rule was highlighted in *Arzt v. Sacarese*, a lawsuit in which a decedent died holding interests in two irrevocable trusts (one created in 1935 and the other in 1970), both of which were included in the decedent's gross estate under § 2036. 36 F. Supp. 2d 653 (D. Del. 1999). The taxpayer in that case advanced several arguments under which the 1988 effective date would not preclude the application of § 2207B. *Id.* Each of the arguments revolved around the definition of "property transferred." *Id.* The taxpayer argued that "property transferred" referred to property transferred *at death* and that the § 2036 inclusion in the decedent's gross estate constituted a transfer at death for purposes of § 2207B. *Id.* The district court rejected the taxpayer's interpretation of the effective date of the statute and held that the effective date should be read literally. *Id.* Thus, the court reasoned that § 2207B does not apply to a transfer by the decedent to a trust on or before November 10, 1988. *Id.*

If a transfer to a trust was made prior to November 10, 1988, § 2207B may not provide the executor with a right of reimbursement from the trustees of the trust. However, § 2207B is not the executor's only recourse, as state law may have its own set of tax apportionment rules (and Texas is one state that does).

**2. Texas law**

Under Texas law, "[a] representative shall charge each person interested in the estate a portion of the total estate tax assessed against the estate." Texas Estates Code § 124.005(a). A "person interested in the estate" means a person, or a fiduciary on behalf of that person, who is entitled to receive or who has received, from a decedent or because of the death of the decedent, property included in the decedent's estate for purposes of the estate tax." *Id.* § 124.001(5). The portion charged to each such person "must represent the same ratio as the taxable value of that person's interest in the estate included in determining the amount of the tax bears to the total taxable value of all interests of all persons interested in the estate included in determining the amount of the tax." *Id.* § 124.005(a).

Texas law states that "[i]f the date for the payment of any portion of an estate tax is extended, the amount of the extended tax shall be apportioned to the persons who receive the specific property that gives rise to the extension and those persons are entitled to the benefits and shall bear the burdens of the extension." *Id.* § 124.010(a). Specifically, "interest on an extension of estate tax . . . shall be apportioned equitably to reflect the benefits and burdens of the extension." *Id.* § 124.010(c). If interest or penalties are assessed against an estate, such interest or penalties are apportioned in the same manner as provided in § 124.005(a). *Id.* § 124.011. However, if, on application by any person interested in the estate, the probate court determines that the

apportionment is not equitable or the assessment of penalties and interest was caused by a breach of fiduciary duty, then the probate court may “charge the [executor] with the amount of the interest and penalties assessed attributable to the [executor’s] conduct.” *Id.* §§ 124.011(a), (c).

If the property includible in the estate does not come into the possession of the executor (*e.g.*, non-probate property held in trust), the executor “shall recover from each person interested in the estate the amount of the estate tax apportioned to such person under [Texas law].” *Id.* § 124.014. However, if the executor cannot collect the estate tax apportioned to a person interested in the estate, the executor must apportion the uncollected estate tax among the remaining persons interested in the estate who are subject to apportionment; in that scenario, those who pay any portion of the estate tax have a right of reimbursement from the person who failed to pay the tax. *Id.* §§ 124.015(b), (c). Either the executor or the person who is charged with or pays the apportioned amount (by an assignment from the executor) can enforce the reimbursement right. *Id.* § 124.015(c). An executor who is required to recover unpaid amounts of estate tax under the above provisions is not required to initiate an action to recover unpaid amounts of estate tax apportioned to persons interested in the estate until the expiration of the 90th day after the date of the final determination by the Service of the amount of the estate tax. *Id.* § 124.016(a).

A decedent may waive or alter the Texas statutory rules by a specific provision in his will.

*Example:*

Decedent Z’s will is reasonably consistent with the default Texas approach, expressly referring to the residuary estate not being “charged” with any tax under § 2036 and also referring to the executor’s right to “recover” the tax from the trust. Under the plain language of the statute it appears that “recover” refers to a right to demand payment prior to the tax becoming due and is different from a “right of reimbursement.”<sup>10</sup>

Therefore, under Texas law and the facts stated above (the only taxable portion of the gross estate is the property of the trust), the executor appears to be entitled to recover from the trustees of the trust the entire estate tax owed by the estate. Additionally, the executor appears to be entitled to recover from the trustees of the trust any interest incurred pursuant to an extension of payment of tax under § 6161. If the trustees cannot or do not pay, then the executor likely would be required to apply the liquid assets of the estate toward paying the estate tax to the Service (pursuant to § 2002) and pursue her cause of action under Texas law against the trustees of the trust to be reimbursed for the estate tax paid. *Id.* § 124.015.

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<sup>10</sup> Texas Estates Code § 124.015(a) discusses the executor’s duty to “recover” the unpaid amount of estate tax apportioned to a person under Texas law, while § 124.015(c) states that anyone who pays another person’s portion of the estate tax has a “right of reimbursement” from the person who failed to pay the tax.

**APPENDIX A – FORM 4768**



**APPENDIX B – FORM 4422**



Form <b>4422</b> (February 2018)	Department of the Treasury—Internal Revenue Service <b>Application for Certificate Discharging Property          Subject to Estate Tax Lien</b>	OMB Number 1545-0328
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Name of decedent <i>(last name, first name, middle initial)</i>	Decedent's Social Security Number (SSN)	Date of death
Decedent's legal residence at time of death		Estate's Employer Identification Number (EIN)

As provided by Internal Revenue Code § 6325(c), I apply for a certificate discharging property subject to an estate tax lien. This property belongs to, or forms part of, the gross estate of the decedent named above.

If Form 706 has not been filed, provide estimate of tax due	If Form 706 has been filed, provide date	Amount of tax paid with filed or unfilled return
\$ _____	_____	\$ _____

Give the gross estate values and deductions as reported on Form 706. If Form 706 has not been filed, show approximate amounts.

Gross Estate Values		Gross Estate Values <i>(continued)</i>	
Real estate	\$ _____	All other property	
Stocks and bonds		Gifts that will be reported or have been reported on Form 709	\$ _____
Mortgages, notes, and cash		<b>Total Gross Estate</b>	<b>\$ _____</b>
Insurance on decedent's life		<b>Deductions</b>	
Jointly owned property		Funeral and administrative expenses	\$ _____
Transfers during decedent's life		Debts of decedent	
Powers of appointment		Marital deduction	
Annuities		Other deductions	
		Charitable gifts and bequests	
		<b>Total Deductions</b>	<b>\$ _____</b>

If property is to be sold, transferred, or mortgaged, complete the following and see additional instructions below.

a. Election made to value certain farm and business real property as provided by IRC § 2032A  <input type="checkbox"/> Yes <input type="checkbox"/> No	b. Request granted or will be requested to defer payment of estate taxes  <input type="checkbox"/> Yes <i>(Complete line c.)</i> <input type="checkbox"/> No	c. Payment deferred as provided by IRC § <i>(“X” applicable box)</i>  <input type="checkbox"/> 6161 <input type="checkbox"/> 6163 <input type="checkbox"/> 6166  Amount paid with Form 4768 \$ _____
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Name and address of the purchaser, transferee, or mortgagee	Relationship to applicant and decedent
	Consideration paid or to be paid
	\$ _____

Under penalties of perjury, I declare that I have examined this application, including accompanying schedules, exhibits, affidavits and statements, and to the best of my knowledge and belief, it is true, correct, and complete.

<b>Applicant Sign here</b>	Signature	Date signed
<b>Attorney for Applicant Sign here</b>	Signature	Date signed

Name and address of applicant		Name and address of attorney for applicant
Relationship of applicant to estate <i>(Executor, Administrator, or other title)</i>	Phone number of applicant ( _____ ) _____	Phone number of attorney for applicant ( _____ ) _____
Physical address of the property being sold		Fax number of attorney for applicant ( _____ ) _____
Title or Escrow Company used for settlement	Contact name	Phone number of contact ( _____ ) _____

**Instructions for Completing Form 4422,  
Application for Certificate Discharging Property Subject to Estate Tax Lien**

1. If property included in the gross estate is sold, the executor must request a discharge of the specified property from any applicable estate tax lien.  
  
Submit your application **at least 45 days before the transaction date** the certificate of discharge is needed. Doing so will allow sufficient time for review, determination, notification and the furnishing of any applicable documents by the transaction date. If you have any questions, contact the Advisory Estate Tax Lien Group at (408) 283-2062, this is not a toll free number.
2. Attach a statement giving your reasons for applying for this certificate.  
  
**NOTE:** If we have issued any other discharges on this estate, please include the dates and the amounts.
3. Attach a description of the property for which you want a certificate of discharge. Show the value of the property and the basis of the valuation. If the property consists of real estate, attach a separate legal description, the physical address of property being sold and a preliminary title report for **each** parcel.
4. To facilitate timely processing of the application, attach any of the following documents that apply:
  - Short form of letters testamentary,
  - Copy of will,
  - Copy of sale contract and closing statement (or proposed closing statement),
  - Copy of the current title report and appraisal,
  - Copy of the Form 706
  - If return is not filed a draft of Form 706, and/or a copy of the inventory and appraisal reflecting all assets of the estate.
  - Form 4768, Application for Extension of Time to File a return and/or Pay U.S. Estate (and Generation-Skipping Transfer) Taxes
5. Submit a Form 8821, Tax Information Authorization. Completing this form gives the Internal Revenue Service the authority to contact individuals or companies, if necessary, when determining if the discharge is appropriate.
6. Provide the name, address, telephone and fax number of the closing attorney or representative of the settlement company.
7. The Internal Revenue Service may request that you furnish additional information and will have your application investigated to determine whether to issue the certificate. You will be informed of the outcome.

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8. If Form 706 has not yet been filed or if the Internal Revenue Service has not completed our review of Form 706, we will determine on a case by case basis the amount of funds, if any, the estate will be required to either pre-pay from the sale proceeds or have held in escrow.

9. Submit the completed Form 4422 and all supporting documents to:

Internal Revenue Service  
Advisory Estate Tax Lien Group  
55 South Market St.  
Mail Stop 5350  
San Jose, CA 95113-2324  
Attn: Group Manager  
E-fax number: 877-477-9243

10. Requests for discharge of property described on lien Forms 668-H or 668-J will also be processed by the Advisory Estate Tax Lien Group, requests may be sent to the above address.

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#### Paperwork Reduction Act

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by section 6103.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated average time is: Preparing and sending the form to the IRS should involve 30 minutes. The estimated burden for individual taxpayers filing this form is approved under OMB control number 1545-0328. If you have comments concerning the accuracy of the time estimate or suggestions for making this form simpler, we would be happy to hear from you. You can send your comments to Internal Revenue Service, Tax Forms and Publications Division, 1111 Constitution Ave. NW, IR-6526, Washington, DC 20224. Do not send Form 4422 to this address.

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Catalog Number 41642G

[www.irs.gov](http://www.irs.gov)

Form **4422** (Rev. 2-2018)