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**Department of the Treasury**

**P.O. Box 7604**
**Ben Franklin Station**
**Washington, DC 20044**

**Person to Contact:**

**Telephone Number:**

**Refer Reply To:**
CC:DOM:P&SI:4 - PLR-104504-99
Date:
September 30, 1999

Re:

Legend:

Decedent -
M Corporation -

This is in reply to your letter dated February 25, 1999, in which you requested a ruling concerning the qualification of certain interest payments as an expense of administration that is deductible under § 2053(a)(2) of the Internal Revenue Code.

Decedent, a resident of , died testate in 1998, survived by two children and nine grandchildren. At the time of his death, Decedent owned approximately 67 percent of the outstanding stock in M Corporation, a closely-held corporation. The value of the M Corporation stock owned by Decedent at his death comprised approximately 70 percent of the value of Decedent's gross estate.

The executors propose to borrow sufficient funds to pay the federal estate taxes due with respect to Decedent's estate from a commercial bank. The loan will be for a term of ten years, and will carry a fixed market rate of interest for the entire term of the loan. Interest will be payable annually. A balloon payment of principal will be due at maturity. The loan agreement will provide that no amount of principal or interest can be prepaid. In addition, the terms of the loan agreement will provide that in the event of a default, in addition to the payment of principal, all interest which would have been otherwise paid under the terms of the Agreement and the Note, had default not occurred, will become due and payable at the time of the default. In addition, M Corporation will guarantee the estate's obligation under the loan agreement.

Article SEVENTH of Decedent's will provides that all estate, inheritance and other death taxes by whatever name called, including interest and penalties thereon, payable by reason of Decedent's death with respect to property included in the Decedent's gross estate, whether or not such property passes under the Decedent's will, are to be paid out of Decedent's testamentary estate as an expense of administration.

In addition to conferring upon Decedent's executor, "the rights, powers, privileges and discretions vested in executors by law...", Article EIGHTH confers upon the executor the power to "borrow money, to mortgage or pledge as security or otherwise encumber any property held hereunder."

The estate requests a ruling that a deduction may be claimed on the Federal estate tax return for the total amount of interest that will be paid over the term of the installment loan as an administration expense under § 2053(a)(2).

Section 2001(a) imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

Section 2051 provides that, for purposes of the tax imposed by § 2001, the value of the taxable estate is determined, in part, by deducting from the value of the gross estate the deductions provided for under §§ 2053.

Section 2053(a)(2) allows a deduction from the value of the gross estate for such amounts of administration expenses as are allowable by the laws of the jurisdiction under which the estate is being administered.

Section 2053(c)(1)(D) provides that, for decedents dying after December 31, 1997, no deduction shall be allowed for any interest payable under § 6601 on any unpaid portion of the federal estate tax for the period during which an extension of time for payment of the tax is in effect under § 6166.

Section 20.2053-1(a)(1) of the Estate Tax Regulations provides, in part, that for purposes of § 2053, the term "allowable by the laws of the jurisdiction" means allowable by the law governing the administration of decedents' estates.

Section 20.2053-3(a) provides that amounts deductible from a decedent's gross estate as "administration expenses" are limited to such expenses as are actually and necessarily incurred in the administration of the decedent's estate; that is, in the collection of assets, payment of debts, and distribution of property to persons entitled to it. The expenses contemplated are only expenses that attend the settlement of the estate and the transfer of the property of the estate to the individual beneficiaries or to a trustee. Expenditures not essential to the proper settlement of the estate, but incurred for the individual benefit of the heirs, legatees, or devisees, may not be taken as deductions.

This regulation imposes a separate federal requirement that expenses must be "actually and necessarily" incurred in order to

be deductible and, in addition, must satisfy the statutory requirement that the expense be allowable under local law. See Estate of Millikin v. Commissioner, 125 F.3d 339 (6th Cir. 1997).

Section 20.2053-1(b)(3) provides that an item may be entered on a return for deduction though its exact amount is not then known, provided it is ascertainable with reasonable certainty, and will be paid. No deduction may be taken upon the basis of a vague or uncertain estimate. If the amount of the liability was not ascertainable at the time of final audit of the return by the district director and, as a consequence, it was not allowed as a deduction in the audit, and subsequently the amount of the liability is ascertained, relief may be sought by a petition to the Tax Court or a claim for refund as provided by §§ 6213(a) and 6511, respectively.

In Rev. Rul. 84-75, 1984-1 C.B. 193, in order to avoid a forced sale of estate assets, the executor borrowed funds to pay the estate tax. The revenue ruling concludes that because the loan was obtained to avoid a forced sale of estate assets, the loan was reasonably and necessarily incurred in administering the estate. Therefore, interest incurred on the loan is deductible as an expense of administration under § 2053(a)(2). However, because the estate's obligation to make payments on the loan could be accelerated (because, for example, the estate might prepay the loan or the estate might default), the amount of interest the estate might pay in the future is uncertain within the meaning of § 20.2053-1(b)(3). Accordingly, the ruling concludes that the interest is deductible by the estate only after it accrues and any estimated amount of interest to accrue in the future is not deductible. See also, Rev. Rul. 80-250, 1980-2 C.B. 278, holding that interest incurred when payment of tax is deferred under § 6166 (prior to the enactment of § 2053(c)(1)(D)) is deductible only as the interest accrues, since the tax liability could be prepaid at any time.

In Estate of Graegin v. Commissioner, T.C. Memo. 1988-477, the executors of the decedent's estate borrowed funds from the decedent's closely-held corporation to pay the estate's federal estate tax liability. The loan, which had been approved by the appropriate local court, was evidenced by a note bearing interest at 15 percent per year, payable in one single payment of both interest and principal at the end of 15 years. The note prohibited the prepayment of principal or interest. The term of the note was calculated to coincide with the surviving spouse's life expectancy because, at that spouse's death, the funds from her trust, along with the dividends paid over the term of the note, would be available to satisfy the obligation. The decedent's estate deducted the full amount of the single interest payment due on maturity of the note in 15 years as an expense of administration under § 2053(a)(2). The court concluded that the

loan was reasonably and necessarily incurred in the administration of the estate. Further, the court concluded that, in view of the terms of the loan (interest and principal due at the end of the 15 year term with prepayment of principal and interest prohibited) the entire amount of the interest on the note was deductible as an administration expense. The court also concluded that the note was a genuine indebtedness and that, in view of the terms of the note, the amount of the interest to be paid was ascertainable with reasonable certainty and would be paid.

Accordingly, in the present case, in view of the terms of the loan as described above, we conclude that a deduction may be claimed on the Form 706 for the entire amount of the post-death interest expense to be incurred by the estate, provided the expense is necessarily incurred in the administration of the estate within the meaning of § 20.2053-3(a) and is allowable under local law. We are specifically not ruling on whether the expense is allowable under local law and whether the interest expense will be necessarily incurred in the administration of the estate.

Except as we have specifically ruled herein, we express no opinion on the federal tax consequences of the transaction under the cited provisions of the Code or under any other provisions of the Code.

In accordance with the power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,

Assistant Chief Counsel
(Passthroughs and Special Industries)

By _____
George Masnik
Branch Chief
Branch 4

Enclosure
Copy for § 6110 purposes