**8825. Are there any special provisions available to allow the estate of a small business owner to defer payment of estate taxes?**

Section 6166 was added to the Internal Revenue Code to allow estates to pay estate taxes attributable to substantial closely-held business interests in installments. Prior to that time, the IRS had discretion to permit installment payments, but such discretion was rarely exercised. Consequently, Congress acted to provide certain estates with the right to defer estate tax payments if the requirements of Section 6166 were met.

In general, IRC Section 6166 provides for an elective five-year deferral, ten-year installment payment method of liquidating the estate tax liability. An estate is eligible for the Section 6166 election if the value of a closely-held business that is includible in the gross estate exceeds 35 percent of the adjusted gross estate.[[1]](#footnote-1)

If the Section 6166 election is made, no payments of the tax are required for an initial five-year period, though interest payments must be made.[[2]](#footnote-2) The estate tax liability itself may then be paid in ten equal annual installments in years six through fifteen, with interest continuing to run on the unpaid balance. Interest on the deferred amount is 2 percent (subject to a limitation discussed below).

This deferral treatment is allowed only for estates comprised of “interests in a closely-held business.” Whether or not the business interests contained in an estate meet this standard is determined by the “business interest test,” which is satisfied as follows:

(1) If the decedent was a sole proprietor the business interest test is satisfied;

(2) If the business was a partnership, the business interest test is satisfied only if either of the following are true:

(i) there were no more than 45 partners in the partnership, or

(ii) the decedent’s interest in partnership capital was at least 20 percent;

(3) If the business was a corporation, the business interest test is satisfied only if either:

(i) there were no more than 45 shareholders, or

(ii) the decedent’s ownership of voting stock was at least 20 percent.

Interests or shares owned by the decedent’s spouse, siblings, ancestors, and descendants are treated as owned by the decedent for purposes of applying the 45 partner or shareholder test. Interests owned jointly by a husband and wife are counted as one partner or shareholder.

In applying the 20 percent interest test, the estate may elect to have interests owned by the decedent’s spouse, siblings, ancestors, and descendants counted as part of the decedent’s interest. However, if this is the method through which decedent’s interest qualifies for the deferral, then

(1) the five-year deferral period is lost (i.e., the ten-year payment period starts immediately), and

(2) the favorable 2 percent interest rate is not available on deferred amounts.

The value of the business interest must be more than 35 percent of the “adjusted gross estate.” The adjusted gross estate is the gross estate minus deductions for expenses, debts, taxes, and losses.

**Planning Point:** An option to Sec. 6166 is a deferral of the estate tax under Section 6161. This code section permits a deferral of the estate tax for up twelve months, and for reasonable cause, up to ten years.

1. . IRC Sec. 6166(a)(1). [↑](#footnote-ref-1)
2. . IRC Sec. 6166(a)(3), (f)(1). [↑](#footnote-ref-2)