§ 2032A(e)(7)(A) and § 20.2032A–4(e) of the Estate Tax Regulations, to be used under § 2032A(e)(7)(A)(ii), are set forth in the accompanying Table of Interest Rates (Table 1). The states within each Farm Credit System Bank Chartered Territory are set forth in the accompanying Table of Farm Credit System Bank Chartered Territories (Table 2).

Rev. Rul. 81–170, 1981–1 C.B. 454, contains an illustrative computation of an average annual effective interest rate. The rates applicable for valuation in 2005 are in Rev. Rul. 2005–41, 2005–28 I.R.B. 69. For rate information for years prior to 2005, see Rev. Rul. 2004–63, 2004–2 C.B. 6, and other revenue rulings that are referenced therein.

DRAFTING INFORMATION

The principal author of this revenue ruling is Lane Damazo of the Office of the Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling, contact Lane Damazo at (202) 622–3090 (not a toll-free call).

REV. RUL. 2006–32 TABLE 1

TABLE OF INTEREST RATES
(Year of Valuation 2006)

Farm Credit System Bank Servicing State in Which Property is Located	Rate
AgFirst, FCB	7.13
AgriBank, FCB	6.02
CoBank, ACB	5.19
Texas, FCB	5.76
U.S. AgBank, FCB	5.73

REV. RUL. 2006–32 TABLE 2

TABLE OF FARM CREDIT SYSTEM BANK CHARTERED TERRITORIES

Farm Credit System Bank	Location of Property
AgFirst, FCB	Delaware, District of Columbia, Florida, Georgia, Maryland, North Carolina, Pennsylvania, South Carolina, Virginia, West Virginia.
AgriBank, FCB	Arkansas, Illinois, Indiana, Iowa, Kentucky, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Ohio, South Dakota, Tennessee, Wisconsin, Wyoming.
CoBank, ACB	Alaska, Connecticut, Idaho, Maine, Massachusetts, Montana, New Hampshire, New Jersey, New York, Oregon, Rhode Island, Vermont, Washington.
Texas, FCB	Alabama, Louisiana, Mississippi, Texas.
U.S. Agbank, FCB	Arizona, California, Colorado, Hawaii, Kansas, New Mexico, Nevada, Oklahoma, Utah.

Section 6012.—Persons Required to Make Returns of Income

Temporary and proposed regulations simplify, clarify, or eliminate taxpayer reporting burdens. They also eliminate regulatory impediments to the electronic filing of certain statements that taxpayers are required to include on or with their Federal income tax returns. See T.D. 9264, page 1150. See REG-134317-05, page 1184.

Section 6166.—Extension of Time for Payment of Estate Tax Where Estate Consists Largely of Interest in Closely Held Business

26 CFR 20.6166–2: Definition of an interest in a closely held business.

Real property interests; closely held business. This ruling updates the guidance provided by Rev. Ruls. 75–365, 75–366,

and 75–367, and provides certain safe harbors and a non-exclusive list of factors that are likely to be relevant in determining whether a deceased owner's activities with regard to certain real property were sufficiently active to support a finding that the real property interest constitutes a closely held business interest for purposes of section 6166 of the Code. Rev. Rul. 75–365 revoked and Rev. Rul. 75–367 revoked in part.

Rev. Rul. 2006–34

ISSUE

Whether the real property interests described in the situations below constitute interests in a closely held business for purposes of section 6166 of the Internal Revenue Code.

FACTS

In each situation, the real property interests are included in the decedent's gross estate and aggregate in value more than 35 percent of the decedent's adjusted gross estate within the meaning of section 6166(b)(6). Further, in each situation the only assets that might be part of a closely held business are the interests described. In each situation, the eligibility requirements of section 6166(b) regarding the number of partners, members, or shareholders or the percentage of capital interest in the partnership or LLC or voting stock in the corporation are satisfied.

Situation 1. A died on January 1, 2005. At the time of death, A owned a ten store strip mall titled in A's name. A personally handled the day-to-day operation, management and maintenance of the strip mall. A also personally handled most repairs. When A was unable to personally perform a repair, A hired a third party independent contractor. A selected the contractor and reviewed and approved the work performed.

Situation 2. B died on February 1, 2005. At the time of death, B owned a small office park titled in B's name. The office park consisted of five separate two-story buildings, each of which had multiple tenants. B hired DEF Management Corporation (DEF), a property management company in which B had no ownership interest, to lease, manage, and maintain the office park, and B relied entirely on DEF to provide all necessary services. The primary duties of DEF's employees consisted of advertising to attract new tenants, showing the property to prospective tenants, negotiating and administering leases, collecting the monthly rent, and arranging for independent contractors to provide all necessary services to maintain the buildings and grounds of the office park, including snow removal, security, and janitorial services. DEF provided a monthly accounting statement to B, along with a check for the rental income, net of expenses and fees.

Situation 3. Same as Situation 2 except that B owned 20 percent in value of the stock of DEF.

Situation 4. C died on April 1, 2005. At the time of death, C's assets included the one percent general partner interest and a 20 percent limited partnership interest in a limited partnership. The limited partnership owned three strip malls that, collectively, constituted 85 percent of the value of the limited partnership's assets. The partnership agreement required C, as the general partner, to provide the limited partnership with all services necessary to operate the limited partnership's business, including daily maintenance to and repairs of the strip malls. From 1992 until death, C received an annual salary from the limited partnership for C's services as general partner. In performance of C's obligations under the limited partnership agreement, C (either personally or with the assistance of employees or agents) performed substantial management functions, including collecting rental payments and negotiating leases, performing daily maintenance and repairs (or hiring, reviewing and approving the work of third party independent contractors for such work), and making decisions regarding periodic renovations of the three strip malls.

Situation 5. D died on May 1, 2005. At the time of death, D owned 100 percent of the stock in MNO Corporation (MNO), a dealership in the business of selling automobiles, automotive parts and related supplies, and repair services. D made all decisions regarding MNO, including the approval of all advertising and marketing promotions, management and acquisition of inventory, and matters relating to dealership personnel. D also supervised all employees of MNO. In addition to the stock of MNO, D directly owned Real Property P. Real Property P was constructed for MNO and contained unique features tailored to an automobile dealership, including a showroom and office space and areas for servicing automobiles and storing inventory. D leased Real Property P to MNO under a net lease, and MNO's employees performed all maintenance of and repairs to Real Property P.

LAW

Section 6166(a)(1) of the Code permits an executor to elect to pay part or all of the estate tax imposed by section 2001 in two or more (but not exceeding ten) equal installments if a decedent was a citizen or resident of the United States on the date of death, and if the value of an interest in a closely held business (the "closely held business amount" as defined in section 6166(b)(5)) which is included in the decedent's gross estate exceeds 35 percent of the adjusted gross estate.

Section 6166(b)(1) defines the term "interest in a closely held business" to mean:

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.

I.R.C. § 6166(b)(1). The determination as to whether an interest qualifies as an interest in a closely held business under section 6166(b)(1) shall be made as of the time immediately before the decedent's death. I.R.C. § 6166(b)(2)(A). Thus, a decedent must own an interest in a closely held business immediately before death to be eligible for an extension of time for payment under section 6166.

Under section 6166(b)(9)(A), for purposes of section 6166(a)(1) and determining the closely held business amount, the value of an interest in a business does not include the value of that portion of the interest that is attributable to passive assets

held by the business. The term "passive asset" is defined in section 6166(b)(9)(B)(i) as any asset other than an asset used in carrying on a trade or business.

Revenue Ruling 75–366, 1975–2 C.B. 472, involved a decedent whose gross estate included farm real estate operated by tenant farmers. The decedent paid 40 percent of the expenses, received 40 percent of the crops, and actively participated in important management decisions of the tenant farms. The decedent made almost daily visits to inspect and discuss farm operations, and occasionally delivered supplies to the tenants. The ruling held that farming under these circumstances was a productive enterprise like a manufacturing enterprise and was distinguishable from the mere management of investment assets. Therefore, the decedent's farm assets constituted an interest in a closely held business for purposes of section 6166.

Revenue Ruling 75–365, 1975–2 C.B. 471, also involved a decedent's interest in real estate. In that ruling, the Service considered a situation in which the decedent individually maintained a fully equipped business office to collect rental payments on commercial and farm rental properties, receive payments on notes receivable, negotiate leases, make occasional loans, and direct by contract the maintenance of the properties. The ruling held that the decedent was merely an owner managing investment assets to obtain the income ordinarily expected from them, and was not conducting a trade or business. Therefore, the commercial and farm rental properties and notes receivable included in the decedent's gross estate did not constitute an interest in a closely held business for purposes of section 6166.

Revenue Ruling 75–367, 1975–2 C.B. 472, held that a decedent's ownership of 100 percent of the stock of an electing small business corporation that built homes on land owned and developed by the decedent, together with a business office and warehouse used both by the corporation and by the decedent in the land development activities constituted an interest in a closely held business. The ruling held, however, that the eight homes that were owned by the decedent and rented to tenants and for which the decedent collected rents, made the mortgage payments, and performed necessary repairs and maintenance, did not constitute an interest in a closely held business because the decedent's interest in those homes merely represented an investment.

ANALYSIS

In order for an interest in a business to qualify as an interest in a closely held business under section 6166, a decedent must conduct an active trade or business, or must hold an interest in a partnership, LLC, or corporation that itself carries on an active trade or business. Based on the definition of a passive asset in section 6166(b)(9)(B)(i), section 6166 applies only with regard to an active trade or business, as distinguished from the mere management of investment assets.

In determining whether the activities of the decedent, partnership, LLC or corporation constitute an active trade or business, the activities of agents and employees of the decedent, the partnership, LLC or corporation are also taken into consideration. The fact that some of the activities are conducted by third parties such as independent contractors who are neither agents nor employees of the decedent, partnership, LLC or corporation, will not prevent the business from qualifying as an active trade or business so long as these third-party activities are not of such a nature that the activities of the decedent, partnership, LLC or corporation (and their respective agents and employees) are reduced to the level of merely holding investment property.

Often, day-to-day real estate operations and activities are performed by independent contractors, such as property management companies. If a decedent, partnership, LLC, or corporation uses an unrelated property management company to perform most of the activities associated with the real estate interests, that fact suggests that an active trade or business does not exist.

To determine whether a decedent's interest in real property is an interest in an asset used in an active trade or business, the Service will consider all the facts and circumstances, including the activities of agents and employees, the activities of management companies or other third parties, and the decedent's ownership interest in any management company or other third party. The Service will consider the following nonexclusive list of factors:

- The amount of time the decedent (or agents and employees of the decedent, partnership, LLC, or corporation) devoted to the trade or business;
- Whether an office was maintained from which the activities of the decedent, partnership, LLC, or corporation were conducted or coordinated, and whether the decedent (or agents and employees of the decedent, partnership, LLC, or corporation) maintained regular business hours for that purpose;
- The extent to which the decedent (or agents and employees of the decedent, partnership, LLC, or corporation) was actively involved in finding new tenants and negotiating and executing leases;
- The extent to which the decedent (or agents and employees of the decedent, partnership, LLC, or corporation) provided landscaping, grounds care, or other services beyond the mere furnishing of leased premises;
- The extent to which the decedent (or agents and employees of the decedent, partnership, LLC, or corporation) personally made, arranged for, performed, or supervised repairs and maintenance to the property (whether or not performed by independent contractors), including without limitation painting, carpentry, and plumbing; and
- The extent to which the decedent (or agents and employees of the decedent, partnership, LLC, or corporation) handled tenant repair requests and complaints.

No single factor is dispositive of whether a decedent's activities with respect to the real property (or the activities of a partnership, LLC, or corporation through which decedent owns the real property) constitute an interest in a closely held business for purposes of section 6166.

HOLDINGS

(1) In *Situation 1*, A provided significant services to the strip mall tenants. A personally handled the day-to-day operation, management and maintenance of

the strip mall. A's activities went beyond those of a mere investor collecting profits from a passive asset. Moreover, even in situations in which A hired independent contractors to perform repairs that A could not perform personally, A was involved in the selection of the contractors and reviewed and approved the work performed. Under these circumstances, the use of independent contractors on occasions when A could not personally perform the work does not prevent A's activities from rising to the level of the conduct of an active trade or business. Thus, A's ownership of the strip mall qualifies as an interest in a closely held business for purposes of section 6166. (The result would be the same if the strip mall had instead been held in a single-member LLC owned by A, and the LLC were disregarded as an entity that is separate from its owner under §§301.7701–1 through 3 of the Procedure and Administration Regulations.)

(2) In *Situation 2*, in determining whether B was a proprietor carrying on an active trade or business with respect to B's interest in the office park, the activities of DEF Management Corporation (DEF) and its relationship with B are taken into account. DEF and its employees provided all necessary services for B's office park. B had no ownership interest in DEF. B's reliance on DEF to perform all necessary services, B's lack of any significant participation in the management or oversight of the property, and B's lack of any ownership interest in DEF are all factors that weigh heavily against a finding that the office park was used by B in an active trade or business. Thus, B was not a proprietor in an active trade or business and B's interest in the office park does not qualify as an interest in a closely held business for purposes of section 6166.

(3) In *Situation 3*, DEF provided all necessary services with regard to the management and maintenance of the office park, including advertising to attract new tenants, showing the property to prospective tenants, negotiating and administering leases, collecting the monthly rent, and arranging for third party independent contractors to provide all necessary services to maintain the buildings and grounds of the office park, including snow removal, security, and janitorial services. These activities are sufficient to conclude that DEF was actively managing the office park. Because B owned a significant interest in DEF, the activities of DEF with regard to the office park allow B's interest in the office park to qualify as an interest in a closely held business for purposes of section 6166.

(4) In *Situation 4*, the determination of whether the limited partnership was carrying on a trade or business for purposes of section 6166 is made with reference to the partnership's activities. Because the limited partnership, rather than C, owned the interest in the strip malls, the nature and level of the activities of the limited partnership must be evaluated. The limited partnership, acting through its general partner C, handled the day-to-day operations and management of the strip malls. The activities of C on behalf of the limited partnership included (either personally or with the assistance of employees or agents) performing daily maintenance of and repairs to the strip malls (or hiring, reviewing and approving the work of third party independent contractors for such work), collecting rental payments, negotiating leases, and making decisions regarding periodic renovations of the strip malls. Thus, the limited partnership carried on an active trade or business. Because the strip malls were used in carrying on the partnership's active trade or business, they are not passive assets under section 6166(b)(9) and their value is not excluded from the value of C's interest in the partnership for purposes of section 6166. C's interest in the limited partnership qualifies as an interest in a closely held business for purposes of section 6166. (Because C owned at least 20 percent of the partnership, the conclusion would be the same even if C's activities were instead performed by another employee, partner or agent of the partnership).

(5) In *Situation 5*, MNO was engaged in an automobile dealership business. Thus, MNO was conducting an active trade or business at the time of D's death. Consequently, D's 100 percent stock interest in MNO qualifies as an interest in a closely held business. In addition, Real Property P was used exclusively in the business of MNO under a net lease from D. As in Situation 3, because D owned a significant interest in MNO, whose activities with regard to Real Property P constituted active management, D's interest in Real Property P also qualifies as an interest in a closely held business.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 75–365, 1975–2 C.B. 471, is revoked, and the portion of Rev. Rul. 75–367, 1975–2 C.B. 472, relating to the eight rental homes is revoked.

DRAFTING INFORMATION

The principal author of this revenue ruling is Tracey B. Leibowitz of the Office of the Associate Chief Counsel, Procedure and Administration (Administrative Provisions and Judicial Practice Division). For further information regarding this revenue ruling, contact Laura R. Urich at (202) 622–4940 (not a toll-free call).