

Section 2057.—Family-Owned Business Interests

Taxation of qualified family-owned business interest (QFOBI). A distribution in redemption of stock that is part of a QFOBI and that qualifies under section 303 of the Code: (1) does not affect the initial determination of whether the estate is eligible to make the QFOBI election, and (2) does not constitute a disposition under section 2057(f)(1)(B); thus under section 2057 no additional estate tax is imposed as a result of this distribution.

Rev. Rul. 2003-61

ISSUE

Does a distribution in redemption of stock that is part of a qualified family-owned business interest (QFOBI) and that qualifies under § 303 of the Internal Revenue Code: (1) affect the initial determination of whether the estate is eligible to make the QFOBI election, or (2) constitute a disposition under § 2057(f)(1)(B) that results in the imposition of an additional estate tax?

FACTS

At the time of *D*'s death, *D* owned shares of stock in *X* corporation with an adjusted value under § 2057(d) of \$3 million. No gift of *X* corporation stock was made or deemed made by *D* during *D*'s life. These shares passed to *D*'s children pursuant to the terms of *D*'s will. The value

of *D*'s adjusted gross estate under § 2057(c) was \$5 million. On the federal estate tax return filed for *D*'s estate, *D*'s executor elected to treat all of *D*'s stock in *X* corporation as a QFOBI under § 2057, filed the duly executed agreement referred to in § 2057(h), and claimed the maximum allowable deduction of \$675,000. In all respects, the election complied with the provisions of § 2057. In order to pay the federal and state estate taxes imposed by reason of *D*'s death, *D*'s executor caused *X* corporation to redeem one-third of the *X* corporation stock in a distribution that satisfied the requirements of § 303.

LAW AND ANALYSIS

In general, under § 303(a), a distribution of property to a shareholder by a corporation in redemption of part or all of the stock of the corporation that is included in determining the decedent's gross estate for federal estate tax purposes is treated as a distribution in full payment in exchange for the redeemed stock to the extent of the sum of certain taxes and expenses. These taxes and expenses are the estate, inheritance, legacy, and succession taxes (including any interest collected as a part of such taxes) imposed because of the decedent's death, and the amount of funeral and administration expenses allowable as deductions for federal estate tax purposes. In addition to the other limitations and rules in § 303, the treatment under § 303(a) applies only to the extent that the interest of the shareholder receiving the distribution is reduced directly (or through a binding obligation to contribute) by any payment of these amounts. Section 303(b)(3).

Section 2057(a)(1) provides that, in the case of an estate to which § 2057 applies, the value of the taxable estate is determined by deducting from the value of the gross estate the adjusted value of the QFOBI of the decedent. Under § 2057(a)(2), the deduction may not exceed \$675,000. One of the requirements of § 2057 is that the QFOBI either must be acquired by a qualified heir from the decedent or must pass to a qualified heir from the decedent. Section 2057(b)(2)(B).

Section 2057(f)(1) provides that additional estate tax is imposed if certain events occur within 10 years after the date of the decedent's death and before the date of the qualified heir's death. One of these events is the disposition by the qualified heir of

any portion of a QFOBI, other than by a disposition to a member of the qualified heir's family or through a qualified conservation contribution under § 170(h). Section 2057(f)(1)(B).

Section 2057(i)(3)(O) provides that rules similar to the rule in § 6166(g)(1)(B) shall apply for purposes of § 2057.

Section 6166(g)(1)(A) provides that the privilege of paying the estate tax in installments ceases and the unpaid tax becomes due upon notice and demand if: (i) any portion of an interest in a closely held business that qualifies under § 6166(a)(1) is distributed, sold, exchanged, or otherwise disposed of, or money and other property attributable to the interest is withdrawn from the trade or business, and (ii) the aggregate of the distributions, sales, exchanges, or other dispositions and withdrawals equals or exceeds 50 percent of the value of the interest.

Section 6166(g)(1)(B) provides that in the case of a distribution in redemption of stock to which § 303 (or so much of § 304 as relates to § 303) applies: (i) the redemption of the stock, and the withdrawal of money and other property distributed in the redemption, is not treated as a distribution or withdrawal for purposes of § 6166(g)(1)(A), and (ii) for purposes of § 6166(g)(1)(A), the value of the interest in the closely held business is considered to be its value reduced by the value of the redeemed stock. Thus, the reduction in the value of the interest pursuant to § 6166(g)(1)(B)(ii) is applicable in determining whether subsequent distributions, sales, exchanges, or other dispositions and withdrawals equal or exceed 50 percent of the value of the interest under § 6166(g)(1)(A)(ii) and does not affect the determination of whether the estate is initially eligible for the extension of time to pay under § 6166.

In applying rules similar to the rule in § 6166(g)(1)(B) for purposes of § 2057, a distribution in redemption of stock to which § 303 applies is not a disposition that triggers an additional estate tax with respect to a QFOBI and the redemption does not affect the initial determination of whether the estate is eligible to make the QFOBI election.

After the redemption caused by *D*'s executor of one-third of the *X* corporation stock in a distribution that satisfied the re-

quirements of § 303, the adjusted value of the QFOBI (\$2 million) no longer exceeds 50 percent of *D*'s adjusted gross estate (\$5 million). The QFOBI election made for *D*'s estate is not affected because the distribution in redemption of the *X* corporation stock does not affect the initial determination of whether *D*'s estate is eligible to make the QFOBI election. The distribution in redemption of the *X* corporation stock is not a disposition of a portion of the QFOBI that would trigger an additional estate tax.

HOLDING

A distribution in redemption of stock that is part of a QFOBI and that qualifies under § 303: (1) does not affect the initial determination of whether the estate is eligible to make the QFOBI election, and (2) does not constitute a disposition under § 2057(f)(1)(B); thus under § 2057 no additional estate tax is imposed as a result of this distribution.

DRAFTING INFORMATION

The principal authors of this revenue ruling are Corenna Howard and Lian Mito of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling, contact Ms. Howard or Ms. Mito at (202) 622-7830 (not a toll-free call).