

AEP® TECHNICAL ALERT

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IRS SHEDS LIGHT ON ESTATE TAX LIEN DISCHARGE PROCESS

Interim Guidance for Responsibility to Process all Requests for Discharge of the Estate Tax Lien (Apr. 5, 2017)

IRS's Small Business/Self Employed Division has provided interim guidance to its Special Collection Advisory group (Advisory) regarding procedures the group should follow with respect to requests for discharge of estate tax liens made after June 2016.

Background. Upon the death of a decedent, an estate tax lien immediately arises and attaches to all of the property included in the decedent's gross estate (whether or not such property is part of the probate estate). (Code Sec. 6324(a)) Unlike other tax liens, no assessment, no notice, and no demand for payment are necessary to create the estate tax lien. It attaches at the time of the decedent's death, before the tax is determined, and is security for any estate taxes that may be determined to be due. It is referred to as the "silent lien" and does not have to be recorded to be enforced. The estate tax lien is in addition to the regular federal tax lien under Code Sec. 6321, which arises upon assessment of the tax.

If IRS finds that the estate or gift tax liability is fully satisfied or provided for, IRS may issue a certificate of discharge of all or part of the property from the regular estate tax lien. (Code Sec. 6325(c); Reg. § 301.6325-1(c)) If an estate wants to sell property subject to the estate tax lien, a request for discharge of the estate tax lien may be filed on Form 4422, Application for Certificate Discharging Property Subject to Estate Tax Lien. Advisory is in charge of these discharge applications.

The primary purpose of the estate tax lien discharge is not to evidence payment or satisfaction of the estate tax, but to permit the transfer of property free from the lien in case it is necessary to clear title. The estate tax will be considered fully satisfied only when an investigation has been completed and payment of the tax, including any deficiency that has been determined, has been made. (Reg. § 301.6325-1(c)(1))

With respect to estate tax liens as well as other tax liens, the appropriate official may issue a certificate of discharge releasing particular parts of the property from the tax lien under various circumstances. (Code Sec. 6325(b)) For example, such an official may issue a certificate of discharge if, on a conservative estimate, he finds that the fair market value of the property not discharged is at least double the amount of the tax liability plus all prior liens. (Code Sec. 6325(b)(1))

If an estate is subject to federal estate tax and the executors are preparing to close a sale of real estate held by the estate, the buyer's title company typically requests that the executors procure a Discharge of Estate Tax Lien from IRS. Prior to June 1, 2016, practitioners would file Form 4422 requesting IRS to release the lien, that request would typically be granted within 10 days, and the closing could proceed as planned. Effective June 1, 2016, the procedure changed. Thereafter, once IRS accepts the Form 4422, the net proceeds of the sale must be deposited in escrow or with IRS, and the escrow agent or IRS, as the case may be, will release the net proceeds (less any amount used to pay federal estate tax due) after an estate tax closing letter is issued by IRS or, if earlier, after IRS determines that the return will not be audited.

IRS sets out discharge procedures and advice for its personnel. IRS has now issued interim guidance to Advisory personnel regarding requests for estate tax lien discharges made after June 2016:

General instructions/coordination with other IRS departments. When investigating requests for discharge, Advisory should review the Forms 4422, documents submitted by the estate, and internal and external records (such as market comparisons) to estimate or substantiate the tax liability in order to determine how much or if any of the sale proceeds must be held or paid over to IRS in exchange for a certificate of discharge. It may be necessary to request assistance from IRS Examination Estate & Gift using the Specialist Referral System (SRS) to estimate the estate tax liability, to provide input on the effect of any deductions on the tax computation, or when sales occur on properties that are claimed under special elections.

If Advisory or Examination Estate & Gift determines that the estate was not required to file an estate tax return, Advisory will not issue a discharge certificate. Instead, it will issue Letter 1352, Request for Discharge of Estate Tax Lien, and indicate that there is no estate tax return filing requirement.

If the Form 4422 indicates that the estate tax return will be non-taxable, based upon the estimated gross estate and estimated deductions, then a discharge without an escrow may be appropriate. However, if the Advisory representative has a question regarding the effect of any of the deductions on the tax computation, he should submit an SRS referral to Examination Estate & Gift before making a decision on the application. If a marital or charitable deduction is being claimed, additional documents should be obtained for review including the will and/or trust that authorize those deductions.

If the Form 4422 shows an estimated estate tax greater than the net proceeds from the property being sold, and no estimated payment has been made, then the net proceeds should be paid or escrowed before granting the discharge. For example, if the net proceeds are \$1 million and the estate tax is \$2 million, the escrow or payment would be \$1 million. An SRS referral to Examination Estate & Gift may

not be necessary in this situation. If the Form 4422 shows an estimated estate tax liability, and the estate has filed an extension to file the tax estate tax return (Form 4768) and paid the full estimated tax liability, then a discharge without an escrow may be appropriate. For example, if the extension request estimates \$1 million in taxes and the \$1 million was paid with the extension, Advisory may determine that an escrow or additional payment is unnecessary. However, if Advisory has a question regarding the effect of deductions on the estate tax liability computation, it should submit an SRS referral to Examination Estate & Gift before making a decision on the application.

If the Form 706 is filed and the reported tax is paid, then a discharge without an escrow may be appropriate. However, Advisory should submit an SRS referral to Examination Estate & Gift before making a decision on the application. For example, where the return reports the property's value as \$1 million, but the property is selling for \$3 million, Examination Estate & Gift could provide an opinion on the appropriate value on the return.

If a special election is claimed by the estate, or if special election qualifying property has been or is being sold, Advisory should submit an SRS referral to Examination Estate & Gift as needed.

Advisory should also coordinate with the Office of Chief Counsel when a deficiency has been proposed and is or may be the subject of litigation before making a decision on the discharge application.

Use of the criteria in Code Sec. 6325(b). The interim guidance provides that, in determining whether to grant a discharge under Code Sec. 6325(c), Advisory may refer to the rules in Code Sec. 6325(b) as a general guideline. It also notes that when making a discharge decision under Code Sec. 6325(c), Advisory need not refer to Code Sec. 6325(b) at all, and the specific requirements of Code Sec. 6325(b) are only possible guidelines in determining whether the estate tax liability is adequately provided for under the circumstances. For example, while filing compliance is required when considering a lien discharge under Code Sec. 6325(b) involving a Code Sec. 6321 lien, a filed return is not required when considering a discharge application under Code Sec. 6325(c).

The guidance then sets out instructions, etc. with respect to each of the Code Sec. 6325(b) paragraphs. For example, under Code Sec. 6325(b)(3), a certificate of discharge may be issued if property subject to a tax lien is sold and IRS determines that the proceeds of sale should be held in escrow as a fund subject to the tax lien in the same manner and with the same priority as the tax lien had with respect to the discharged property. The guidance provides that funds are held in escrow until the tax liability can be determined. IRS has discretion to allow distributions from escrow for allowable expenses of administering the estate before the tax liability is determined. Any excess proceeds will be released if it is later determined that the

estate tax liability is adequately provided for or after verification that all assessments (tax, interest and penalty) have been made and funds have been properly applied to the account.

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