

## Update on New IRS Release of Estate Tax Lien Requirements

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In June 2016, practitioners began to report that without notice, and with limited written guidance, the IRS had begun imposing additional requirements before it would issue a Certificate Discharging Property Subject to Estate Tax Lien (a “Release of Lien”). A Release of Lien will generally be needed in connection with the sale of residential real estate or a cooperative apartment by an estate. As a result, these new IRS rules added further complexity to what could potentially already be a difficult sales process.

Not surprisingly, practitioners and other commentators quickly took issue with these new requirements, seeking to have them modified or clarified. These efforts included an article published by the authors earlier this year in the March/April issue of *Probate & Property* magazine. Shaina S. Kamen & Michael S. Schwartz, *New IRS Release of Estate Tax Lien Requirements: The Sale of Homes or Apartments by an Estate Just Became a Little More Complicated*, Prob. & Prop., March/April 2017, at 20. Of particular concern was the new requirement that either the net proceeds of the sale be paid over to the IRS or the estate enter into an escrow agreement under which an escrow agent would retain the funds until the completion of the IRS audit process for the estate’s federal estate tax return.

In response to this outcry, on April 5, 2017, the IRS released a memorandum providing interim guidance for agency officials on implementation of the new IRS rules. Memorandum SBSE- 05-0417-0011 (Apr. 5, 2017), [www.irs.gov/pub/foia/ig/spder/sbse\\_05\\_0417\\_0011.pdf](http://www.irs.gov/pub/foia/ig/spder/sbse_05_0417_0011.pdf) (hereinafter Interim Guidance). The Interim Guidance attempts to clarify the process for obtaining a Release of Lien, the result of which is to potentially lessen the burden on a selling estate.

### Requirements Before June 2016

As discussed in the authors’ earlier article, an automatic estate tax lien is imposed on a decedent’s property at the moment of death under IRC § 6324(a). The estate tax lien attaches to all assets of the estate and, unlike other forms of tax lien, does not have to be recorded to be valid. And although a “closing letter” or account transcript from the IRS should be sufficient to evidence the full payment of federal estate tax, an estate may wish to sell estate property such as real estate before receipt of a closing letter, for a variety of reasons, including the need for liquidity.

In general, the estate tax lien will remain attached to the estate property, which can create risks for purchasers. To that end, IRC § 6325(c) provides the IRS with the ability to release the estate tax lien for such property and provides that “the Secretary may issue a certificate of discharge of any or all of the property subject to any lien imposed by section 6324 if the Secretary finds that the liability secured by such lien has been fully satisfied or provided for.” 26 U.S.C. § 6325(c).

Before June 2016, it was relatively simple to obtain a Release of Lien for an estate selling real estate or a cooperative apartment. The applicant—usually the executor or other fiduciary of an estate—would file Form 4422, “Application for Certificate Discharging Property Subject to Estate Tax Lien,” with the IRS. The instructions in effect at that time directed the applicant to include copies of the decedent’s Last Will and Testament, Letters Testamentary (that evidence the appointment of the executor or other authorized representative of the estate), contract of sale and proposed closing statement, Form 706, “United States Estate (and Generation-Skipping Transfer) Tax Return,” and an estate inventory. Once the application was reviewed by an IRS agent (and usually with limited further contact with the applicant), the IRS issued the Release of Lien, which the executor could use at the closing of the sale.

In addition, before June 2016, the responsibility for processing Release of Lien applications was shared between two different groups within the IRS: Specialty Collection, Offers, Liens and Advisory (“Advisory”), and Specialty Examination Estate & Gift Tax (“Examination Estate & Gift”).

### **New Requirements in June 2016**

In early summer 2016, practitioners began to report that the IRS was requesting additional documentation beyond what was explicitly required by the instructions to Form 4422. It was later revealed that this change occurred at or around the same time that responsibility for processing applications for Releases of Lien was centralized with Advisory. Advisory is generally less familiar than Examination Estate & Gift when it comes to the unique issues associated with estate administration.

These new requirements were detailed in the authors’ earlier article. Of particular note, the IRS began to require either that the net proceeds of the sale be paid over to the IRS or that the estate enter into an escrow agreement with the IRS under which the escrow agent would retain the funds until the time that the federal estate tax return is filed and the IRS completes its review of the return.

Payment of the net proceeds to the IRS is a fairly straightforward option. It may not make sense, however, to have the entirety of the net proceeds tied up with the IRS until it finishes its examination of the estate tax return.

The alternative, retaining an escrow agent to hold the sales proceeds, presents numerous complications. For starters, the escrow process adds an additional task that must be completed in a fairly limited window of time. Entering into an escrow agreement necessitates identifying and hiring an escrow agent. The escrow agent will have to agree to enter into the IRS-prescribed escrow agreement, which must be signed and submitted to the IRS to obtain the Release of Lien. As outlined in more detail in the authors’ previous article, there are numerous potentially problematic provisions in the IRS escrow agreement.

Although IRS agents have indicated that it may be possible to make changes to the prescribed form, making any changes to that form may prove difficult in practice and may delay approval because changes must be vetted by IRS counsel.

In addition, the IRS's form escrow agreement requires that the funds be held at a federally insured U.S. commercial bank, credit union, or savings and loan institution in an account with the "highest rate of interest." Interest rates on savings accounts (even the highest ones available) are currently at very low levels, and the federal estate tax process can often take several years. Requiring that net proceeds be held and invested entirely in low interest-bearing accounts may not be in the best interest of the estate beneficiaries. Add to this the fees that the IRS escrow agreement form allows the escrow agent to charge, and the escrow process can result in a burdensome and costly undertaking.

### **The New IRS Guidance**

As discussed above, once the new June 2016 requirements became known, practitioners and other commentators quickly took issue with them. In response, the IRS recently issued the Interim Guidance to try to clarify the Release of Lien application requirements and to assist Advisory in processing those applications.

The Interim Guidance states that decisions regarding all Release of Lien applications should be made "as expeditiously as possible," while also "protecting the government's interest in collecting the estate tax liability." Interim Guidance, at 3. This direction to process applications quickly is a welcome one, as a primary concern regarding the new procedures was the additional delay they would cause to the already time-sensitive process of selling real estate or a cooperative apartment.

On the thorny topic of when an escrow agreement will be required, the Interim Guidance provides certain examples to assist Advisory. Of particular welcome note, the Interim Guidance provides that Advisory should consult with Examination Estate & Gift, and in some cases, the Office of Chief Counsel, in certain situations in which Advisory may not have the requisite expertise to determine whether an escrow agreement should be needed. *Id.* at 3. By ensuring that these more experienced and knowledgeable groups be involved in the process, this will hopefully result in more expeditious, consistent, and rational implementation of any additional requirements needed to obtain the Release of Lien.

In particular, the following situations were highlighted by the Interim Guidance:

1. *1. Non-Taxable Estate*—If the estate will not be subject to estate tax based on the estimated gross estate and deductions as listed on Form 4422, issuance of a Release of Lien without an escrow agreement may be appropriate. The Interim Guidance encourages consultation with Examination Estate & Gift if there are any questions and also flags that additional information may be required if a marital or charitable deduction is being claimed. *Id.* at 4.
2. *2. Anticipated Estate Tax, But No Filed Return*—The Interim Guidance provides two common scenarios in which no estate tax return has yet been filed but in which estimated estate tax will be due and owing. If no estimated estate tax payment has yet been made, and the net proceeds of the sale are anticipated to be less than the estimated estate tax, then the sale proceeds either must be paid

to the IRS or placed in escrow. *Id.* If, however, the full estimated estate tax liability has been paid together with the estate's application for an extension of time to file the estate tax return (Form 4768), the Release of Lien may be issued without an escrow agreement. *Id.* Again, the Interim Guidance encourages consultation with Examination Estate & Gift if there are any questions.

3. *3. Estate Tax Return Already Filed*—If the estate tax return is filed and reported tax paid, again, the Release of Lien may be issued without an escrow agreement. *Id.* The Interim Guidance suggests consultation with Examination Estate & Gift. This seems to be especially true if the sales proceeds of the property exceed the value listed on the estate tax return or when there may be questions about any of the deductions on the estate tax return.
4. *4. Special Elections or Qualifying Property*—In the case of an estate that claims a special election or if qualifying property has been or is being sold, the Interim Guidance provides that Examination Estate & Gift should be consulted. *Id.* at 5.

In addition, on the question of whether a Release of Lien should be issued, the Interim Guidance looks to the criteria in IRC § 6325(b) for possible further guidance. *Id.* In particular, the Interim Guidance flags the following criteria that may be useful for Advisory to consider:

1. *1. Property Double the Amount of the Liability*—A Release of Lien can be issued if the remaining estate property subject to an estate tax lien has a fair market value of at least double the amount of the unsatisfied liability that is secured by the estate tax lien plus the amount of all other liens on such property that have priority over the estate tax lien. *Id.*
2. *2. Part Payment*—A Release of Lien can be issued for any part of the property subject to an estate tax lien if an adequate amount has been paid in partial satisfaction of the estate tax liability secured by the lien. The amount cannot be less than the value of the government's interest in the property to be discharged. *Id.*
3. *3. No Value*—A Release of Lien can be issued if the government's interest in the property is determined to have no value, after considering all facts and circumstances, including all other liens and encumbrances with priority over the federal tax lien. *Id.* at 6.
4. *4. Substitution of Proceeds of Sale (Escrow Agreement)*—A Release of Lien can be issued if the property subject to the estate tax lien is sold, and the IRS determines that the sales proceeds should be held in escrow as a fund subject to the estate tax lien in the same manner and with the same priority as the estate tax lien had for the discharged property. *Id.* The decision on whether to require escrow and the amount of the escrow is in the IRS's discretion based on the relevant facts and circumstances. As practitioners previously reported, changes to the IRS prescribed escrow form will need to be reviewed by IRS counsel before being accepted. Reasonable and necessary sale expenses or expenses incurred in the administration of the sale proceeds will be paid from the sale proceeds before the satisfaction of any claims. The escrow funds are to be held until the tax liability is determined, but the IRS also has discretion to allow distributions to pay expenses of estate administration.
5. *5. Right of Substitution of Value*—A Release of Lien can be obtained for property subject to an estate tax lien if the owner deposits with the IRS an amount equal to the value of the government's interest in the property or furnishes an acceptable bond. *Id.*

The Interim Guidance makes clear that the provisions of IRC § 6325(b) are not dispositive and should be used only as possible guidelines in determining whether the issuance of a Release of Lien would be appropriate. *Id.* at 5.

It is hoped that all of the examples described in the Interim Guidance will help Advisory to become more sophisticated and informed about the Release of Lien process and will provide practitioners and taxpayers with much needed certainty and clarity about what will be required. But, while this guidance is certainly a step in the right direction, there are still some situations in which the new requirements may continue to be problematic. In particular, a highly illiquid estate that needs to generate proceeds from the sale of property to pay administration expenses or state and local taxes may run into problems under these guidelines, depending on the value of the property in relation to the value of the estate. This is because the estate may be required to place the proceeds of the sale in escrow or deposit them with the IRS, even under this updated guidance.

### **Conclusion**

The Interim Guidance is generally very helpful, and it goes a long way to alleviate some of the concerns that practitioners and commentators had flagged with respect to the new Release of Lien procedures. In particular, by providing Advisory with more specific guidance on situations in which requiring an escrow agreement may not be necessary and by re-involving the more experienced Examination Estate & Gift to make a determination in a variety of more complex situations, practitioners and taxpayers can expect a more predictable, reasonable, and expedient process for obtaining a Release of Lien. But there are still some situations in which the new requirements appear to be unnecessarily onerous. In addition, practitioners should still anticipate the possibility of complications and delay in this area, at least until Advisory becomes more familiar with and knowledgeable about the relevant considerations. For now, practitioners should continue to be mindful of the potentially problematic requirements that may be needed before obtaining a Release of Lien and should continue to consider the strategies suggested in the authors' earlier article for minimizing the associated potential burdens. n