

Internal Revenue Code – Chapter 14

§ 2701 Special valuation rules in case of transfers of certain interests in corporations or partnerships.

(a) Valuation rules.

(1) In general.

Solely for purposes of determining whether a transfer of an interest in a corporation or partnership to (or for the benefit of) a member of the transferor's family is a gift (and the value of such transfer), the value of any right-

(A) which is described in subparagraph (A) or (B) of subsection (b)(1), and

(B) which is with respect to any applicable retained interest that is held by the transferor or an applicable family member immediately after the transfer.

shall be determined under paragraph (3). This paragraph shall not apply to the transfer of any interest for which market quotations are readily available (as of the date of transfer) on an established securities market.

(2) Exceptions for marketable retained interests, etc.

Paragraph (1) shall not apply to any right with respect to an applicable retained interest if-

(A) market quotations are readily available (as of the date of the transfer) for such interest on an established securities market,

(B) such interest is of the same class as the transferred interest, or

(C) such interest is proportionally the same as the transferred interest, without regard to nonlapsing differences in voting power (or, for a partnership, nonlapsing differences with respect to management and limitations on liability).

Subparagraph (C) shall not apply to any interest in a partnership if the transferor or an applicable family member has the right to alter the liability of the transferee of the transferred property. Except as provided by the Secretary, any difference described in subparagraph (C) which lapses by reason of any Federal

or State law shall be treated as a nonlapsing difference for purposes of such subparagraph .

(3) Valuation of rights to which paragraph (1) applies.

(A) In general. The value of any right described in paragraph (1) , other than a distribution right which consists of a right to receive a qualified payment, shall be treated as being zero.

(B) Valuation of certain qualified payments. If-

(i) any applicable retained interest confers a distribution right which consists of the right to a qualified payment, and

(ii) there are 1 or more liquidation, put, call, or conversion rights with respect to such interest,

the value of all such rights shall be determined as if each liquidation, put, call, or conversion right were exercised in the manner resulting in the lowest value being determined for all such rights.

(C) Valuation of qualified payments where no liquidation, etc. rights. In the case of an applicable retained interest which is described in subparagraph (B)(i) but not subparagraph (B)(ii) , the value of the distribution right shall be determined without regard to this section .

(4) Minimum valuation of junior equity.

(A) In general. In the case of a transfer described in paragraph (1) of a junior equity interest in a corporation or partnership, such interest shall in no event be valued at an amount less than the value which would be determined if the total value of all of the junior equity interests in the entity were equal to 10 percent of the sum of

(i) the total value of all of the equity interests in such entity, plus

(ii) the total amount of indebtedness of such entity to the transferor (or an applicable family member).

(B) Definitions. For purposes of this paragraph -

(i) Junior equity interest. The term "junior equity interest" means common stock or, in the case of a partnership, any partnership interest under which the rights as to income and capital (or, to the extent provided in regulations, the rights as to either income or capital) are junior to the rights of all other classes of equity interests.

(ii) Equity interest. The term "equity interest" means stock or any interest as a partner, as the case

may be.

(b) Applicable retained interests.

For purposes of this section -

(1) In general.

The term "applicable retained interest" means any interest in an entity with respect to which there is-

(A) a distribution right, but only if, immediately before the transfer described in subsection (a)(1), the transferor and applicable family members hold (after application of subsection (e)(3)), control of the entity, or

(B) a liquidation, put, call, or conversion right.

(2) Control.

For purposes of paragraph (1) -

(A) Corporations. In the case of a corporation, the term "control" means the holding of at least 50 percent (by vote or value) of the stock of the corporation.

(B) Partnerships. In the case of a partnership, the term "control" means-

(i) the holding of at least 50 percent of the capital or profits interests in the partnership, or

(ii) in the case of a limited partnership, the holding of any interest as a general partner.

(C) Applicable family member. For purposes of this subsection, the term "applicable family member" includes any lineal descendant of any parent of the transferor or the transferor's spouse.

(c) Distribution and other rights; qualified payments.

For purposes of this section -

(1) Distribution right.

(A) In general. The term "distribution right" means-

(i) a right to distributions from a corporation with respect to its stock, and

(ii) a right to distributions from a partnership with respect to a partner's interest in the partnership.

(B) Exceptions. The term "distribution right" does not include-

(i) a right to distributions with respect to any interest which is junior to the rights of the transferred interest,

(ii) any liquidation, put, call, or conversion right, or

(iii) any right to receive any guaranteed payment described in section 707(c) of a fixed amount.

(2) Liquidation, etc. rights.

(A) In general. The term "liquidation, put, call, or conversion right" means any liquidation, put, call, or conversion right, or any similar right, the exercise or nonexercise of which affects the value of the transferred interest.

(B) Exception for fixed rights.

(i) In general. The term "liquidation, put, call, or conversion right" does not include any right which must be exercised at a specific time and at a specific amount.

(ii) Treatment of certain rights. If a right is assumed to be exercised in a particular manner under subsection (a)(3)(B), such right shall be treated as so exercised for purposes of clause (i).

(C) Exception for certain rights to convert. The term "liquidation, put, call, or conversion right" does not include any right which-

(i) is a right to convert into a fixed number (or a fixed percentage) of shares of the same class of stock in a corporation as the transferred stock in such corporation under subsection (a)(1) (or stock which would be of the same class but for nonlapsing differences in voting power),

(ii) is nonlapsing,

(iii) is subject to proportionate adjustments for splits, combinations, reclassifications, and similar changes in the capital stock, and

(iv) is subject to adjustments similar to the adjustments under subsection (d) for accumulated but unpaid distributions.

A rule similar to the rule of the preceding sentence shall apply for partnerships.

(3) Qualified payment.

(A) In general. Except as otherwise provided in this paragraph, the term "qualified payment" means any dividend payable on a periodic basis under any cumulative preferred stock (or a comparable payment under any partnership interest) to the extent that such dividend (or comparable payment) is determined at a fixed rate.

(B) Treatment of variable rate payments. For purposes of subparagraph (A), a payment shall be treated as fixed as to rate if such payment is determined at a rate which bears a fixed relationship to a specified market interest rate.

(C) Elections.

(i) In general. Payments under any interest held by a transferor which (without regard to this subparagraph) are qualified payments shall be treated as qualified payments unless the transferor elects not to treat such payments as qualified payments. Payments described in the preceding sentence which are held by an applicable family member shall be treated as qualified payments only if such member elects to treat such payments as qualified payments.

(ii) Election to have interest treated as qualified payment. A transferor or applicable family member holding any distribution right which (without regard to this subparagraph) is not a qualified payment may elect to treat such right as a qualified payment, to be paid in the amounts and at the time specified in such election. The preceding sentence shall apply only to the extent that the amounts and times so specified are not inconsistent with the underlying legal instrument giving rise to such right.

(iii) Elections irrevocable. Any election under this subparagraph with respect to an interest shall, once made, be irrevocable.

(d) Transfer tax treatment of cumulative but unpaid distributions.

(1) In general.

If a taxable event occurs with respect to any distribution right to which subsection (a)(3)(B) or (C) applied, the following shall be increased by the amount determined under paragraph (2) :

(A) The taxable estate of the transferor in the case of a taxable event described in paragraph (3)(A)(i)

(B) The taxable gifts of the transferor for the calendar year in which the taxable event occurs in the case of a taxable event described in paragraph (3)(A)(ii) or (iii) .

(2) Amount of increase.

(A) In general. The amount of the increase determined under this paragraph shall be the excess (if any) of-

(i) the value of the qualified payments payable during the period beginning on the date of the transfer under subsection (a)(1) and ending on the date of the taxable event determined as if-

(I) all such payments were paid on the date payment was due, and

(II) all such payments were reinvested by the transferor as of the date of payment at a yield equal to the discount rate used in determining the value of the applicable retained interest described in subsection (a)(1) , over

(ii) the value of such payments paid during such period computed under clause (i) on the basis of the time when such payments were actually paid.

(B) Limitation on amount of increase.

(i) In general. The amount of the increase under subparagraph (A) shall not exceed the applicable percentage of the excess (if any) of-

(I) the value (determined as of the date of the taxable event) of all equity interests in the entity which are junior to the applicable retained interest, over

(II) the value of such interests (determined as of the date of the transfer to which subsection (a)(1) applied).

(ii) Applicable percentage. For purposes of clause (i) , the applicable percentage is the percentage determined by dividing-

(I) the number of shares in the corporation held (as of the date of the taxable event) by the transferor

which are applicable retained interests of the same class, by

(II) the total number of shares in such corporation (as of such date) which are of the same class as the class described in subclause (I) .

A similar percentage shall be determined in the case of interests in a partnership.

(iii) Definition. For purposes of this subparagraph , the term "equity interest" has the meaning given such term by subsection (a)(4)(B) .

(C) Grace period. For purposes of subparagraph (A) , any payment of any distribution during the 4-year period beginning on its due date shall be treated as having been made on such due date.

(3) Taxable events.

For purposes of this subsection -

(A) In general. The term "taxable event" means any of the following:

(i) The death of the transferor if the applicable retained interest conferring the distribution right is includible in the estate of the transferor.

(ii) The transfer of such applicable retained interest.

(iii) At the election of the taxpayer, the payment of any qualified payment after the period described in paragraph (2)(C) , but only with respect to such payment.

(B) Exception where spouse is transferee.

(i) Deathtime transfers. Subparagraph (A)(i) shall not apply to any interest includible in the gross estate of the transferor if a deduction with respect to such interest is allowable under section 2056 or 2106(a)(3) .

(ii) Lifetime transfers. A transfer to the spouse of the transferor shall not be treated as a taxable event under subparagraph (A)(ii) if such transfer does not result in a taxable gift by reason of-

(I) any deduction allowed under section 2523 , or the exclusion under section 2503(b) , or

(II) consideration for the transfer provided by the spouse.

(iii) Spouse succeeds to treatment of transferor. If an event is not treated as a taxable event by

reason of this subparagraph , the transferee spouse or surviving spouse (as the case may be) shall be treated in the same manner as the transferor in applying this subsection with respect to the interest involved.

(4) Special rules for applicable family members.

(A) Family member treated in same manner as transferor. For purposes of this subsection, an applicable family member shall be treated in the same manner as the transferor with respect to any distribution right retained by such family member to which subsection (a)(3)(B) or (C) applied.

(B) Transfer to applicable family member. In the case of a taxable event described in paragraph (3)(A)(ii) involving the transfer of an applicable retained interest to an applicable family member (other than the spouse of the transferor), the applicable family member shall be treated in the same manner as the transferor in applying this subsection to distributions accumulating with respect to such interest after such taxable event.

(C) Transfer to transferors. In the case of a taxable event described in paragraph (3)(A)(ii) involving a transfer of an applicable retained interest from an applicable family member to a transferor, this subsection shall continue to apply to the transferor during any period the transferor holds such interest.

(5) Transfer to include termination.

For purposes of this subsection , any termination of an interest shall be treated as a transfer.

(e) Other definitions and rules

For purposes of this section -

(1) Member of the family.

The term "member of the family" means, with respect to any transferor-

(A) the transferor's spouse,

(B) a lineal descendant of the transferor or the transferor's spouse, and

(C) the spouse of any such descendant.

(2) Applicable family member.

The term "applicable family member" means, with respect to any transferor-

- (A) the transferor's spouse,
- (B) an ancestor of the transferor or the transferor's spouse, and
- (C) the spouse of any such ancestor.

(3) Attribution of indirect holdings and transfers.

An individual shall be treated as holding any interest to the extent such interest is held indirectly by such individual through a corporation, partnership, trust, or other entity. If any individual is treated as holding any interest by reason of the preceding sentence, any transfer which results in such interest being treated as no longer held by such individual shall be treated as a transfer of such interest.

(4) Effect of adoption.

A relationship by legal adoption shall be treated as a relationship by blood.

(5) Certain changes treated as transfers.

Except as provided in regulations, a contribution to capital or a redemption, recapitalization, or other change in the capital structure of a corporation or partnership shall be treated as a transfer of an interest in such entity to which this section applies if the taxpayer or an applicable family member-

- (A) receives an applicable retained interest in such entity pursuant to such transaction, or
- (B) under regulations, otherwise holds, immediately after such transactions, an applicable retained interest in such entity.

This paragraph shall not apply to any transaction (other than a contribution to capital) if the interests in the entity held by the transferor, applicable family members, and members of the transferor's family before and after the transaction are substantially identical.

(6) Adjustments.

Under regulations prescribed by the Secretary, if there is any subsequent transfer, or inclusion in the gross estate, of any applicable retained interest which was valued under the rules of subsection (a) , appropriate adjustments shall be made for purposes of chapter 11, 12, or 13 to reflect the increase in the amount of any prior taxable gift made by the transferor or decedent by reason of such valuation or to

reflect the application of subsection (d)

(7) Treatment as separate interests.

The Secretary may by regulation provide that any applicable retained interest shall be treated as 2 or more separate interests for purposes of this section .

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§ 2702 Special valuation rules in case of transfers of interests in trusts.

(a) Valuation rules.

(1) In general.

Solely for purposes of determining whether a transfer of an interest in trust to (or for the benefit of) a member of the transferor's family is a gift (and the value of such transfer), the value of any interest in such trust retained by the transferor or any applicable family member (as defined in section 2701(e)(2)) shall be determined as provided in paragraph (2) .

(2) Valuation of retained interests.

(A) In general. The value of any retained interest which is not a qualified interest shall be treated as being zero.

(B) Valuation of qualified interest. The value of any retained interest which is a qualified interest shall be determined under section 7520 .

(3) Exceptions.

(A) In general. This subsection shall not apply to any transfer-

(i) if such transfer is an incomplete gift,

(ii) if such transfer involves the transfer of an interest in trust all the property in which consists of a residence to be used as a personal residence by persons holding term interests in such trust, or

(iii) to the extent that regulations provide that such transfer is not inconsistent with the purposes of this section .

(B) Incomplete gift. For purposes of subparagraph (A) , the term "incomplete gift" means any transfer which would not be treated as a gift whether or not consideration was received for such transfer.

(b) Qualified interest.

For purposes of this section , the term "qualified interest" means-

(1) any interest which consists of the right to receive fixed amounts payable not less frequently than

annually,

(2) any interest which consists of the right to receive amounts which are payable not less frequently than annually and are a fixed percentage of the fair market value of the property in the trust (determined annually), and

(3) any noncontingent remainder interest if all of the other interests in the trust consist of interests described in paragraph (1) or (2) .

(c) Certain property treated as held in trust.

For purposes of this section -

(1) In general. The transfer of an interest in property with respect to which there is 1 or more term interests shall be treated as a transfer of an interest in a trust.

(2) Joint purchases. If 2 or more members of the same family acquire interests in any property described in paragraph (1) in the same transaction (or a series of related transactions), the person (or persons) acquiring the term interests in such property shall be treated as having acquired the entire property and then transferred to the other persons the interests acquired by such other persons in the transaction (or series of transactions). Such transfer shall be treated as made in exchange for the consideration (if any) provided by such other persons for the acquisition of their interests in such property.

(3) Term interest.

The term "term interest" means-

(A) a life interest in property, or

(B) an interest in property for a term of years.

(4) Valuation rule for certain term interests.

If the nonexercise of rights under a term interest in tangible property would not have a substantial effect on the valuation of the remainder interest in such property-

(A) subparagraph (A) of subsection (a)(2) shall not apply to such term interest, and

(B) the value of such term interest for purposes of applying subsection (a)(1) shall be the amount

which the holder of the term interest establishes as the amount for which such interest could be sold to an unrelated third party.

(d) Treatment of transfers of interests in portion of trust.

In the case of a transfer of an income or remainder interest with respect to a specified portion of the property in a trust, only such portion shall be taken into account in applying this section to such transfer.

(e) Member of the family.

For purposes of this section , the term "member of the family" shall have the meaning given such term by section 2704(c)(2) .

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§ 2703 Certain rights and restrictions disregarded.

(a) General rule.

For purposes of this subtitle, the value of any property shall be determined without regard to-

- (1) any option, agreement, or other right to acquire or use the property at a price less than the fair market value of the property (without regard to such option, agreement, or right), or
- (2) any restriction on the right to sell or use such property.

(b) Exceptions.

Subsection (a) shall not apply to any option, agreement, right, or restriction which meets each of the following requirements:

- (1) It is a bona fide business arrangement.
- (2) It is not a device to transfer such property to members of the decedent's family for less than full and adequate consideration in money or money's worth.
- (3) Its terms are comparable to similar arrangements entered into by persons in an arms' length transaction.

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§ 2704 Treatment of certain lapsing rights and restrictions.

(a) Treatment of lapsed voting or liquidation rights.

(1) In general.

For purposes of this subtitle, if-

(A) there is a lapse of any voting or liquidation right in a corporation or partnership, and

(B) the individual holding such right immediately before the lapse and members of such individual's family hold, both before and after the lapse, control of the entity, such lapse shall be treated as a transfer by such individual by gift, or a transfer which is includible in the gross estate of the decedent, whichever is applicable, in the amount determined under paragraph (2).

(2) Amount of transfer.

For purposes of paragraph (1), the amount determined under this paragraph is the excess (if any) of-

(A) the value of all interests in the entity held by the individual described in paragraph (1) immediately before the lapse (determined as if the voting and liquidation rights were nonlapsing), over

(B) the value of such interests immediately after the lapse.

(3) Similar rights.

The Secretary may by regulations apply this subsection to rights similar to voting and liquidation rights.

(b) Certain restrictions on liquidation disregarded.

(1) In general.

For purposes of this subtitle, if-

(A) there is a transfer of an interest in a corporation or partnership to (or for the benefit of) a member of the transferor's family, and

(B) the transferor and members of the transferor's family hold, immediately before the transfer, control of the entity, any applicable restriction shall be disregarded in determining the value of the transferred interest.

(2) Applicable restriction.

For purposes of this subsection , the term "applicable restriction" means any restriction-

(A) which effectively limits the ability of the corporation or partnership to liquidate, and

(B) with respect to which either of the following applies:

(i) The restriction lapses, in whole or in part, after the transfer referred to in paragraph (1) .

(ii) The transferor or any member of the transferor's family, either alone or collectively, has the right after such transfer to remove, in whole or in part, the restriction.

(3) Exceptions.

The term "applicable restriction" shall not include-

(A) any commercially reasonable restriction which arises as part of any financing by the corporation or partnership with a person who is not related to the transferor or transferee, or a member of the family of either, or

(B) any restriction imposed, or required to be imposed, by any Federal or State law.

(4) Other restrictions.

The Secretary may by regulations provide that other restrictions shall be disregarded in determining the value of the transfer of any interest in a corporation or partnership to a member of the transferor's family if such restriction has the effect of reducing the value of the transferred interest for purposes of this subtitle but does not ultimately reduce the value of such interest to the transferee.

(c) Definitions and special rules.

For purposes of this section -

(1) Control.

The term "control" has the meaning given such term by section 2701(b)(2) .

(2) Member of the family.

The term "member of the family" means, with respect to any individual-

(A) such individual's spouse,

(B) any ancestor or lineal descendant of such individual or such individual's spouse,

(C) any brother or sister of the individual, and

(D) any spouse of any individual described in subparagraph (B) or (C) .

(3) Attribution.

The rule of section 2701(e)(3) shall apply for purposes of determining the interests held by any individual.

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