

Sec.	
2702.	Special valuation rules in case of transfers of interests in trusts.
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§ 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, reclassi-

fications, 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 times 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 transaction, 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.

(Added Pub. L. 101-508, title XI, § 11602(a), Nov. 5, 1990, 104 Stat. 1388-491; amended Pub. L. 104-188, title I, § 1702(f)(1)-(3)(B), (4)-(5)(B), (6)-(10), Aug. 20, 1996, 110 Stat. 1870-1872.)

AMENDMENTS

1996—Subsec. (a)(3)(B). Pub. L. 104-188, § 1702(f)(1)(B), inserted “certain” before “qualified” in heading.

Subsec. (a)(3)(C). Pub. L. 104-188, § 1702(f)(1)(A), added subpar. (C).

Subsec. (a)(4)(B)(i). Pub. L. 104-188, § 1702(f)(2), inserted “(or, to the extent provided in regulations, the rights as to either income or capital)” after “income and capital”.

Subsec. (b)(2)(C). Pub. L. 104-188, § 1702(f)(3)(A), added subpar. (C).

Subsec. (c)(1)(B)(i). Pub. L. 104-188, § 1702(f)(4), amended cl. (i) generally. Prior to amendment, cl. (i) read as follows: “a right to distributions with respect to any junior equity interest (as defined in subsection (a)(4)(B)(i)).”

Subsec. (c)(3)(C)(i). Pub. L. 104-188, § 1702(f)(5)(A), amended cl. (i) generally. Prior to amendment, cl. (i) read as follows:

“(i) WAIVER OF QUALIFIED PAYMENT TREATMENT.—A transferor or applicable family member may elect with respect to payments under any interest specified in such election to treat such payments as payments which are not qualified payments.”

Subsec. (c)(3)(C)(ii). Pub. L. 104-188, § 1702(f)(5)(B), amended first sentence generally. Prior to amendment, first sentence read as follows: “A transferor or any applicable family member may elect to treat any distribution right as a qualified payment, to be paid in the amounts and at the times specified in such election.”

Subsec. (d)(1). Pub. L. 104-188, § 1702(f)(1)(C), substituted “subsection (a)(3)(B) or (C)” for “subsection (a)(3)(B)”.

Subsec. (d)(3)(A)(iii). Pub. L. 104-188, § 1702(f)(6), struck out “the period ending on the date of” after “with respect to”.

Subsec. (d)(3)(B)(ii)(I). Pub. L. 104-188, § 1702(f)(7), inserted “or the exclusion under section 2503(b),” after “section 2523.”

Subsec. (d)(4)(A). Pub. L. 104-188, § 1702(f)(1)(C), substituted “subsection (a)(3)(B) or (C)” for “subsection (a)(3)(B)”.

Subsec. (d)(4)(C). Pub. L. 104-188, § 1702(f)(9), added subpar. (C).

Subsec. (e)(3). Pub. L. 104-188, § 1702(f)(3)(B), substituted “Attribution of indirect holdings and transfers” for “Attribution rules” in par. heading, struck out subpar. (A) designation and heading which read “Indirect holdings and transfers”, and struck out subpar. (B) which read as follows:

“(B) CONTROL.—For purposes of subsections (b)(1), an individual shall be treated as holding any interest held by the individual’s brothers, sisters, or lineal descendants.”

Subsec. (e)(5)(A). Pub. L. 104-188, § 1702(f)(8)(A), substituted “such transaction” for “such contribution to capital or such redemption, recapitalization, or other change”.

Subsec. (e)(5)(B). Pub. L. 104-188, § 1702(f)(8)(B), substituted “such transaction” for “the transfer”.

Subsec. (e)(6). Pub. L. 104-188, § 1702(f)(10), inserted “or to reflect the application of subsection (d)” before period at end.

EFFECTIVE DATE OF 1996 AMENDMENT

Amendment by Pub. L. 104-188 effective, except as otherwise expressly provided, as if included in the provision of the Revenue Reconciliation Act of 1990, Pub. L. 101-508, title XI, to which such amendment relates, see section 1702(i) of Pub. L. 104-188, set out as a note under section 38 of this title.

EFFECTIVE DATE

Pub. L. 101-508, title XI, § 11602(e)(1), Nov. 5, 1990, 104 Stat. 1388-500, provided that:

“(A) IN GENERAL.—The amendments made by subsection (a) [enacting this chapter]—

“(i) to the extent such amendments relate to sections 2701 and 2702 of the Internal Revenue Code of 1986 (as added by such amendments), shall apply to transfers after October 8, 1990.

“(ii) to the extent such amendments relate to section 2703 of such Code (as so added), shall apply to—

“(I) agreements, options, rights, or restrictions entered into or granted after October 8, 1990, and

“(II) agreements, options, rights, or restrictions which are substantially modified after October 8, 1990, and

“(iii) to the extent such amendments relate to section 2704 of such Code (as so added), shall apply to restrictions or rights (or limitations on rights) created after October 8, 1990.

“(B) EXCEPTION.—For purposes of subparagraph (A)(i), with respect to property transferred before October 9, 1990—

“(i) any failure to exercise a right of conversion,

“(ii) any failure to pay dividends, and

“(iii) any failure to exercise other rights specified in regulations, shall not be treated as a subsequent transfer.”

TIME FOR ELECTION UNDER SUBSECTION (c)(3)(C)(i)

Pub. L. 104-188, title I, §1702(f)(5)(C), Aug. 20, 1996, 110 Stat. 1871, provided that: “The time for making an election under the second sentence of section 2701(c)(3)(C)(i) of the Internal Revenue Code of 1986 (as amended by subparagraph (A)) shall not expire before the due date (including extensions) for filing the transferor’s return of the tax imposed by section 2501 of such Code for the first calendar year ending after the date of enactment [probably means the date of enactment of Pub. L. 104-188, Oct. 20, 1996].”

STUDY OF METHODS USED TO DISTORT VALUATION OF PROPERTY FOR PURPOSES OF ESTATE AND GIFT TAX

Pub. L. 101-508, title XI, §11602(d), Nov. 5, 1990, 104 Stat. 1388-500, provided that: “The Secretary of the Treasury shall conduct a study of—

“(1) the prevalence and types of options and agreements used to distort the valuation of property for purposes of subtitle B of the Internal Revenue Code of 1986, and

“(2) other methods using discretionary rights to distort the value of property for such purposes.

The Secretary shall, not later than December 31, 1992, report the results of such study, together with such legislative recommendations as the Secretary considers necessary, to the Committee on Finance of the Senate and the Committee on Ways and Means of the House of Representatives.”

§ 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