

PART 22—TEMPORARY ESTATE TAX REGULATIONS UNDER THE ECONOMIC RECOVERY TAX ACT OF 1981

AUTHORITY: 26 U.S.C. 7805.

§ 22.0 Certain elections under the Economic Recovery Tax Act of 1981.

(a) *Election of special rules for woodlands*—(1) *In general.* This paragraph applies to the election of special rules for woodlands under section 2032A(e)(13) of the Code, as added by section 421(h) of the Economic Recovery Tax Act of 1981. The executor shall make this election for an estate by attaching to the estate tax return a statement that—

(i) Contains the decedent's name and taxpayer identification number as they appear on the estate tax return,

(ii) Identifies the election as an election under section 2032A(e)(13) of the Code,

(iii) Specifies the property with respect to which the election is made, and

(iv) Provides all information necessary to show that the executor is entitled to make the election.

(2) *Additional information required.* If later regulations issued under section 2032A(e)(13) require the executor to furnish information in addition to that required under paragraph (a)(1) of this section and an office of the Internal Revenue Service requests the executor to furnish the additional information, the executor shall furnish the additional information in a statement filed with that office of the Internal Revenue Service within 60 days after the request is made. The statement shall also contain the information required by paragraphs (a)(1) (i), (ii), and (iii) of this section. If the additional information is not provided within 60 days after the request is made, the election may, at the discretion of the Commissioner, be held invalid.

(b) *Election of special use valuation for qualified real property.* This paragraph applies to the election of special use valuation for qualified real property under section 2032A(d)(1) of the Code, as amended by section 421(j)(3) of the Economic Recovery Tax Act of 1981.

This election shall be made in the manner prescribed in § 20.2032A-8(a)(3), except that the election shall be valid even if the estate tax return is not timely filed.

(c) *Elections irrevocable.* Elections to which this section applies may not be revoked.

(d) *Effective date.* The elections described in this section are available with respect to the estates of decedents dying after 1981.

[T.D. 7793, 46 FR 54540, Nov. 3, 1981]

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AUTHORITY: 26 U.S.C. 7805.

Section 25.2505-2T also issued under 26 U.S.C. 2010(c)(6).

Section 25.2512-5 also issued under 26 U.S.C. 7520(c)(2).

Section 25.2512-5A also issued under 26 U.S.C. 7520(c)(2).

Section 25.2518-2 is also issued under 26 U.S.C. 2518(b).

Section 25.6060-1 also issued under 26 U.S.C. 6060(a).

Section 25.6081-1 also issued under the authority of 26 U.S.C. 6081(a).

Section 25.6109-2 also issued under 26 U.S.C. 6109(a).

Section 25.6302-1 also issued under 26 U.S.C. 6302(a) and (h).

Section 25.6695-1 also issued under 26 U.S.C. 6695(b).

Section 25.7520-1 also issued under 26 U.S.C. 7520(c)(2).

Section 25.7520-2 also issued under 26 U.S.C. 7520(c)(2).

Section 25.7520-3 also issued under 26 U.S.C. 7520(c)(2).

Section 25.7520-4 also issued under 26 U.S.C. 7520(c)(2).

EDITORIAL NOTE: At 74 FR 5105, Jan. 29, 2009, the authority citation to part 25 was amended; however, a portion of the amendment could not be incorporated due to inaccurate amendatory instruction.

SOURCE: T.D. 6334, 23 FR 8904, Nov. 15, 1958; 25 FR 14021, Dec. 31, 1960, unless otherwise noted.

GIFT TAX

§ 25.0-1 Introduction.

(a) *In general.* (1) The regulations in this part are designated "Gift Tax Regulations." These regulations pertain to (i) the gift tax imposed by Chapter 12 of Subtitle B of the Internal Revenue Code on the transfer of property by gift by individuals in the calendar year 1955, in subsequent calendar years beginning before the calendar year 1971, in calendar quarters beginning with

the first calendar quarter of calendar year 1971 through the last calendar quarter of the calendar year 1981, and in calendar years beginning with the calendar year 1982, and (ii) certain related administrative provisions of Subtitle F of the Code. It should be noted that the application of some of the provisions of these regulations may be affected by the provisions of an applicable gift tax convention with a foreign country. Unless otherwise indicated, references in these regulations to the "Internal Revenue Code" or the "Code" are references to the Internal Revenue Code of 1954, as amended, and references to a section or other provision of law are references to a section or other provision of the Internal Revenue Code of 1954, as amended. The Gift Tax Regulations are applicable to the transfer of property by gift by individuals in calendar years 1955 through 1970, in calendar quarters beginning with the first calendar quarter of calendar year 1971 through the last calendar quarter of the calendar year 1981, and in calendar years beginning with the calendar year 1982, and supersede the regulations contained in part 86, subchapter B, Chapter 1, title 26, Code of Federal Regulations (1939) (Regulations 108, Gift Tax (8 FR 10858)), as prescribed and made applicable to the Internal Revenue Code of 1954 by Treasury Decision 6091, signed August 16, 1954 (19 FR 5167, Aug. 17, 1954).

(2) Section 2501(b) makes the provisions of Chapter 12 of the Code apply in the case of gifts made after September 2, 1958, by certain citizens of the United States who were residents of a possession thereof at the time the gifts were made. Section 2501(c) makes the provisions of Chapter 12 apply in the case of gifts made after September 14, 1960, by certain other citizens of the United States who were residents of a possession thereof at the time the gifts were made. See paragraphs (c) and (d) of § 25.2501-1. Except as otherwise provided in paragraphs (c) and (d) of § 25.2501-1, the provisions of these regulations do not apply to the making of gifts by such citizens.

(b) *Nature of tax.* The gift tax is not a property tax. It is a tax imposed upon the transfer of property by individuals. It is not applicable to transfers by cor-

porations or persons other than individuals. However, see paragraph (h)(1) of § 25.2511-1 with respect to the extent to which a transfer by or to a corporation is considered a transfer by or to its shareholders.

(c) *Scope of regulations*—(1) *Determination of tax liability.* subchapter A of Chapter 12 of the Code pertains to the determination of tax liability. The regulations pursuant to subchapter A are set forth in §§ 25.2501-1 through 25.2504-2. Sections 25.2701-5 and 25.2702-6 contain rules that provide additional adjustments to mitigate double taxation where the amount of the transferor's property was previously determined under the special valuation provisions of sections 2701 and 2702.

(2) *Transfer.* Subchapter B of chapter 12 and chapter 14 of the Internal Revenue Code pertain to the transfers which constitute the making of gifts and the valuation of those transfers. The regulations pursuant to subchapter B are set forth in §§ 25.2511-1 through 25.2518-3. The regulations pursuant to chapter 14 are set forth in §§ 25.2701-1 through 25.2704-3.

(3) *Deductions.* Subchapter C of Chapter 12 of the Code pertains to the deductions which are allowed in determining the amount of taxable gifts. The regulations pursuant to Subchapter C are set forth in §§ 25.2521-1 through 25.2524-1.

(4) *Procedure and administration provisions.* Subtitle F of the Internal Revenue Code contains some sections which are applicable to the gift tax. The regulations pursuant to those sections are set forth in §§ 25.6001-1 through 25.7101-1. Such regulations do not purport to be all the regulations on procedure and administration which are pertinent to gift tax matters. For the remainder of the regulations on procedure and administration which are pertinent to gift tax matters, see part 301 of this chapter (Regulations on Procedure and Administration).

(d) *Arrangement and numbering.* Each section of the regulations in this part (other than this section) is designated by a number composed of the part number followed by a decimal point (25.); the section of the Internal Revenue Code which it interprets; a hyphen (-); and a number identifying this

section. By use of these designations one can ascertain the sections of the regulations relating to a provision of the Code. For example, the regulations pertaining to section 2521 of the Code are designated § 25.2521-1.

[T.D. 6334, 23 FR 8904, Nov. 15, 1958, as amended by T.D. 6542, 26 FR 548, Jan. 20, 1961; 45 FR 6089, Jan. 25, 1980; T.D. 7910, 48 FR 40372, Sept. 7, 1983; T.D. 8395, 57 FR 4254, Feb. 4, 1992]

DETERMINATION OF TAX LIABILITY

§ 25.2207A-1 Right of recovery of gift taxes in the case of certain marital deduction property.

(a) *In general.* If an individual is treated as transferring an interest in property by reason of section 2519, the individual or the individual's estate is entitled to recover from the *person receiving the property* (as defined in paragraph (e) of this section) the amount of gift tax attributable to that property. The value of property to which this paragraph (a) applies is the value of all interests in the property other than the qualifying income interest. There is no right of recovery from any person for the property received by that person for which a deduction was allowed from the total amount of gifts, if no Federal gift tax is attributable to the property. The right of recovery arises at the time the Federal gift tax is actually paid by the transferor subject to section 2519.

(b) *Failure of a person to exercise the right of recovery.* (1) The failure of a person to exercise a right of recovery provided by section 2207A(b) upon a lifetime transfer subject to section 2519 is treated as a transfer for Federal gift tax purposes of the unrecovered amounts to the person(s) from whom the recovery could have been obtained. See § 25.2511-1. The transfer is considered to be made when the right to recovery is no longer enforceable under applicable law and is treated as a gift even if recovery is impossible. A delay in the exercise of the right of recovery without payment of sufficient interest is a below-market loan. Section 1.7872-5T of this chapter describes factors that are used to determine, based on the facts and circumstances of a particular case, whether a loan otherwise subject to imputation under section

7872 (relating to the treatment of below-market loans) is exempted from its provisions.

(2) The transferor subject to section 2519 may execute a written waiver of the right of recovery arising under section 2207A before that right of recovery becomes unenforceable. If a waiver is executed, the transfer of the unrecovered amounts by the transferor is considered to be made on the later of—

(i) The date of the valid and irrevocable waiver rendering the right of recovery no longer enforceable; or

(ii) The date of the payment of the tax by the transferor.

(c) *Amount of gift tax attributable to all properties.* The amount of Federal gift tax attributable to all properties includible in the total amount of gifts under section 2519 made during the calendar year is the amount by which the total Federal gift tax for the calendar year (including penalties and interest attributable to the tax) under chapter 12 of the Internal Revenue Code which has been paid, exceeds the total Federal gift tax for the calendar year (including penalties and interest attributable to the tax) under chapter 12 of the Internal Revenue Code which would have been paid if the value of the properties includible in the total amount of gifts by reason of section 2519 had not been included.

(d) *Amount of gift tax attributable to a particular property.* A person's right of recovery with respect to a particular property is an amount equal to the amount determined in paragraph (c) of this section multiplied by a fraction. The numerator of the fraction is the value of the particular property included in the total amount of gifts made during the calendar year by reason of section 2519, less any deduction allowed with respect to the property. The denominator of the fraction is the total value of all properties included in the total amount of gifts made during the calendar year by reason of section 2519, less any deductions allowed with respect to those properties.

(e) *Person receiving the property.* If the property is in a trust at the time of the transfer, the *person receiving the property* is the trustee, and any person who has received a distribution of the property prior to the expiration of the right

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of recovery if the property does not remain in trust. This paragraph (e) does not affect the right, if any, under local law, of any person with an interest in property to reimbursement or contribution from another person with an interest in the property.

(f) *Example.* The following example illustrates the application of paragraphs (a) through (e) of this section.

Example. D created an inter vivos trust during 1994 with certain income producing assets valued at \$1,000,000. The trust provides that all income is payable to D's wife, S, for S's life, with the remainder at S's death to be divided equally among their four children. In computing taxable gifts during calendar year 1994, D deducted, pursuant to section 2523(f), \$1,000,000 from the total amount of gifts made. In addition, assume that S received no other transfers from D and that S made a gift during 1996 of the entire life interest to one of the children, at which time the value of trust assets was \$1,080,000 and the value of S's life interest was \$400,000. Although the entire value of the trust assets (\$1,080,000) is, pursuant to sections 2511 and 2519, included in the total amount of S's gifts for calendar year 1996, S is only entitled to reimbursement for the Federal gift tax attributable to the value of the remainder interest, that is, the Federal gift tax attributable to \$680,000 (\$1,080,000 less \$400,000). The Federal gift tax attributable to \$680,000 is equal to the amount by which the total Federal gift tax (including penalties and interest) paid for the calendar year exceeds the federal gift tax (including penalties and interest) that would have been paid if the total amount of gifts during 1996 had been reduced by \$680,000. That amount of tax may be recovered by S from the trust.

[T.D. 8522, 59 FR 9655, Mar. 1, 1994, as amended by T.D. 9077, 68 FR 42595, July 18, 2003]

§ 25.2207A-2 Effective date.

The provisions of § 25.2207A-1 are effective with respect to dispositions made after March 1, 1994. With respect to gifts made on or before such date, the donor may rely on any reasonable interpretation of the statutory provisions. For these purposes, the provisions of § 25.2207A-1 (as well as project LR-211-76, 1984-1 C.B., page 598, see § 601.601(d)(2)(ii)(b) of this chapter), are considered a reasonable interpretation of the statutory provisions.

[T.D. 8522, 59 FR 9656, Mar. 1, 1994]

26 CFR Ch. I (4-1-13 Edition)

§ 25.2501-1 Imposition of tax.

(a) *In general.* (1) The tax applies to all transfers by gift of property, wherever situated, by an individual who is a citizen or resident of the United States, to the extent the value of the transfers exceeds the amount of the exclusions authorized by section 2503 and the deductions authorized by sections 2521 (as in effect prior to its repeal by the Tax Reform Act of 1976), 2522, and 2523. For each "calendar period" (as defined in § 25.2502-1(c)(1)), the tax described in this paragraph (a) is imposed on the transfer of property by gift during such calendar period.

(2) The tax does not apply to a transfer by gift of intangible property before January 1, 1967, by a nonresident not a citizen of the United States, unless the donor was engaged in business in the United States during the calendar year in which the transfer was made.

(3)(i) The tax does not apply to any transfer by gift of intangible property on or after January 1, 1967, by a nonresident not a citizen of the United States (whether or not he was engaged in business in the United States), unless the donor is an expatriate who lost his U.S. citizenship after March 8, 1965, and within the 10-year period ending with the date of transfer, and the loss of citizenship—

(a) Did not result from the application of section 301(b), 350, or 355 of the Immigration and Nationality Act, as amended (8 U.S.C. 1401(b), 1482, or 1487) (For a summary of these sections, see paragraph (d)(1) of § 20.2107-1 of this chapter (estate tax regulations)), and

(b) Had for one of its principal purposes (but not necessarily its only principal purpose) the avoidance of Federal income, estate, or gift tax.

(ii) In determining for purposes of subdivision (i)(b) of this subparagraph whether a principal purpose for the loss of U.S. citizenship by a donor was the avoidance of Federal income, estate, or gift tax, the Commissioner must first establish that it is reasonable to believe that the donor's loss of U.S. citizenship would, but for section 2501(a)(3) and this subparagraph, result in a substantial reduction for the calendar period (as defined in § 25.2502-1(c)(1)) in the sum of (a) the Federal gift tax and (b) all gift taxes imposed by foreign

countries and political subdivisions thereof, in respect of the transfer of property by gift. Once the Commissioner has so established, the burden of proving that the loss of citizenship by the donor did not have for one of its principal purposes the avoidance of Federal income, estate, or gift tax shall be on the donor. In the absence of complete factual information, the Commissioner may make a tentative determination, based on the information available, that the donor's loss of U.S. citizenship would, but for section 250(a)(3) and this subparagraph, result in a substantial reduction for the calendar period in the sum of the Federal and foreign gift taxes described in (a) and (b) of this subdivision on the transfer of property by gift. This tentative determination may be based upon the fact that the laws of the foreign country of which the donor became a citizen and the laws of the foreign country of which the donor was a resident at the time of the transfer, including the laws of any political subdivision of those foreign countries, would ordinarily result, in the case of a nonexpatriate donor having the same citizenship and residence as the donor, in liability for total gift taxes under such laws for the calendar period substantially lower than the amount of the Federal gift tax which would be imposed for such period on an amount of comparable gifts by a citizen of the United States. In the absence of a preponderance of evidence to the contrary, this tentative determination shall be sufficient to establish that it is reasonable to believe that the donor's loss of U.S. citizenship would, but for section 2501(a)(3) and this subparagraph, result in a substantial reduction for the calendar period in the sum of the Federal and foreign gift taxes described in (a) and (b) of this subdivision on the transfer of property by gift.

(4) For additional rules relating to the application of the tax to transfers by nonresidents not citizens of the United States, see section 2511 and § 25.2511-3.

(5) The general rule of this paragraph (a) shall not apply to a transfer after May 7, 1974, of money or other property to a political organization for the use of that organization. However, this ex-

ception to the general rule applies solely to a transfer to a political organization as defined in section 527(e)(1) and including a newsletter fund to the extent provided under section 527(g). The general rule governs a transfer of property to an organization other than a political organization as so defined.

(b) *Resident.* A resident is an individual who has his domicile in the United States at the time of the gift. For this purpose the United States includes the States and the District of Columbia. The term also includes the Territories of Alaska and Hawaii prior to admission as a State. See section 7701(a)(9). All other individuals are nonresidents. A person acquires a domicile in a place by living there, for even a brief period of time, with no definite present intention of moving therefrom. Residence without the requisite intention to remain indefinitely will not constitute domicile, nor will intention to change domicile effect such a change unless accompanied by actual removal.

(c) *Certain residents of possessions considered citizens of the United States.* As used in this part, the term "citizen of the United States" includes a person who makes a gift after September 2, 1958 and who, at the time of making the gift, was domiciled in a possession of the United States and was a United States citizen, and who did not acquire his United States citizenship solely by reason of his being a citizen of such possession or by reason of his birth or residence within such possession. The gift of such a person is, therefore, subject to the tax imposed by section 2501 in the same manner in which a gift made by a resident of the United States is subject to the tax. See paragraph (a) of § 25.01 and paragraph (d) of this section for further information relating to the application of the Federal gift tax to gifts made by persons who were residents of possessions of the United States. The application of this paragraph may be illustrated by the following example and the examples set forth in paragraph (d) of this section:

Example. A, a citizen of the United States by reason of his birth in the United States at San Francisco, established residence in

Puerto Rico and acquired Puerto Rican citizenship. A makes a gift of stock of a Spanish corporation on September 4, 1958, while a citizen and domiciliary of Puerto Rico. A's gift is, by reason of the provisions of section 2501(b) subject to the tax imposed by section 2501 inasmuch as his United States citizenship is based on birth in the United States and is not based solely on being a citizen of a possession or solely on birth or residence in a possession.

(d) *Certain residents of possessions considered nonresidents not citizens of the United States.* As used in this part, the term "nonresident not a citizen of the United States" includes a person who makes a gift after September 14, 1960, and who at the time of making the gift, was domiciled in a possession of the United States and was a United States citizen, and who acquired his United States citizenship solely by reason of his being a citizen of such possession or by reason of his birth or residence within such possession. The gift of such a person, is, therefore, subject to the tax imposed by section 2501 in the same manner in which a gift is subject to the tax when made by a donor who is a "nonresident not a citizen of the United States." See paragraph (a) of § 25.01 and paragraph (c) of this section for further information relating to the application of the Federal gift tax to gifts made by persons who were residents of possessions of the United States. The application of this paragraph may be illustrated by the following examples and the example set forth in paragraph (c) of this section. In each of the following examples the person who makes the gift is deemed a "nonresident not a citizen of the United States" and his gift is subject to the tax imposed by section 2501 in the same manner in which a gift is subject to the tax when made by a donor who is a nonresident not a citizen of the United States, since he made the gift after September 14, 1960, but would not have been so deemed and subject to such tax if the person who made the gift had made it on or before September 14, 1960.

Example (1). C, who acquired his United States citizenship under section 5 of the Act of March 2, 1917 (39 Stat. 953), by reason of being a citizen of Puerto Rico, while domiciled in Puerto Rico makes a gift on October 1, 1960, of real estate located in New York. C

is considered to have acquired his United States citizenship solely by reason of his being a citizen of Puerto Rico.

Example (2). E, whose parents were United States citizens by reason of their birth in Boston, was born in the Virgin Islands on March 1, 1927. On September 30, 1960, while domiciled in the Virgin Islands, he made a gift of tangible personal property situated in Kansas. E is considered to have acquired his United States citizenship solely by reason of his birth in the Virgin Islands (section 306 of the Immigration and Nationality Act (66 Stat. 237, 8 U.S.C. 1406)).

Example (3). N, who acquired United States citizenship by reason of being a native of the Virgin Islands and a resident thereof on June 28, 1932 (section 306 of the Immigration and Nationality Act (66 Stat. 237, 8 U.S.C. 1406)), made a gift on October 1, 1960, at which time he was domiciled in the Virgin Islands, of tangible personal property situated in Wisconsin. N is considered to have acquired his United States citizenship solely by reason of his birth or residence in the Virgin Islands.

Example (4). P, a former Danish citizen, who on January 17, 1917, resided in the Virgin Islands, made the declaration to preserve his Danish citizenship required by Article 6 of the treaty entered into on August 4, 1916, between the United States and Denmark. Subsequently P acquired United States citizenship when he renounced such declaration before a court of record (section 306 of the Immigration and Nationality Act (66 Stat. 237, 8 U.S.C. 1406)). P, while domiciled in the Virgin Islands, made a gift on October 1, 1960, of tangible personal property situated in California. P is considered to have acquired his United States citizenship solely by reason of his birth or residence in the Virgin Islands.

Example (5). R, a former French citizen, acquired his United States citizenship through naturalization proceedings in a court located in the Virgin Islands after having qualified for citizenship by residing in the Virgin Islands for 5 years. R, while domiciled in the Virgin Islands, made a gift of tangible personal property situated in Hawaii on October 1, 1960. R is considered to have acquired his United States citizenship solely by reason of his birth or residence within the Virgin Islands.

[T.D. 6334, 23 FR 8904, Nov. 15, 1958, as amended by T.D. 6542, 26 FR 549 Jan. 20 1961; T.D. 7296, 38 FR 34201, Dec. 12, 1973; T.D. 7871, 45 FR 8004, Feb. 6, 1980; T.D. 7910, 48 FR 40372, Sept. 7, 1983]

§ 25.2502-1 Rate of tax.

(a) *Computation of tax.* The rate of tax is determined by the total of all gifts made by the donor during the calendar period and all the preceding calendar

periods since June 6, 1932. See § 25.2502-1(c)(1) for the definition of "calendar period" and § 25.2502-1(c)(2) for the definition of "preceding calendar periods." The following six steps are to be followed in computing the tax:

(1) *First step.* Ascertain the amount of the "taxable gifts" (as defined in § 25.2503-1) for the calendar period for which the return is being prepared.

(2) *Second step.* Ascertain "the aggregate sum of the taxable gifts for each of the preceding calendar periods" (as defined in § 25.2504-1), considering only those gifts made after June 6, 1932.

(3) *Third step.* Ascertain the total amount of the taxable gifts, which is the sum of the amounts determined in the first and second steps. See § 25.2702-6 for an adjustment to the total amount of an individual's taxable gifts where the individual's current taxable gifts include the transfer of certain interests in trust that were previously valued under the provisions of section 2702.

(4) *Fourth step.* Compute the tentative tax on the total amount of taxable gifts (as determined in the third step) using the rate schedule in effect at the time the gift (for which the return is being filed) is made.

(5) *Fifth step.* Compute the tentative tax on the aggregate sum of the taxable gifts for each of the preceding calendar periods (as determined in the second step), using the same rate schedule set forth in the fourth step of this paragraph (a).

(6) *Sixth step.* Subtract the amount determined in the fifth step from the amount determined in the fourth step. The amount remaining is the gift tax for the calendar period for which the return is being prepared.

(b) *Rate of tax.* The tax is computed in accordance with the rate schedule in effect at the time the gift was made as set forth in section 2001(c) or corresponding provisions of prior law.

(c) *Definitions.* (1) The term "calendar period" means:

(i) Each calendar year for the calendar years 1932 (but only that portion of such year after June 6, 1932) through 1970;

(ii) Each calendar quarter for the first calendar quarter of the calendar

year 1971 through the last calendar quarter of calendar year 1981; or

(iii) Each calendar year for the calendar year 1982 and each succeeding calendar year.

(2) The term "preceding calendar periods" means all calendar periods ending prior to the calendar period for which the tax is being computed.

(d) *Examples.* The following examples illustrate the application of this section with respect to gifts made by citizens or residents of the United States:

Example 1. Assume that in 1955 the donor made taxable gifts, as ascertained under the first step (paragraph (a)(2) of this section), of \$62,500 and that there were no taxable gifts for prior years, with the result that the amount ascertainable under the third step is \$62,500. Under the fourth step a tax is computed on this amount. Reference to the tax rate schedule in effect in the year 1955 discloses that the tax on this amount is \$7,650.

Example 2. A donor makes gifts (other than gifts of future interests in property) during the calendar year 1955 of \$30,000 to A and \$33,000 to B. Two exclusions of \$3,000 each are allowable, in accordance with the provisions of section 2503(b), which results in included gifts for 1955 of \$57,000. Specific exemption was claimed and allowed in a total amount of \$50,000 in the donor's gift tax returns for the calendar years 1934 and 1935 so there remains no specific exemption available for the donor to claim for 1955. The total amount of gifts made by the donor during preceding years, after excluding \$5,000 for each donee for each calendar year in accordance with the provisions of section 1003(b)(1) of the 1939 Code, is computed as follows:

| | |
|--------------------------|-----------|
| Calendar year 1934 | \$120,000 |
| Calendar year 1935 | 25,000 |

| | |
|---|---------|
| Total amount of included gifts for preceding calendar years | 145,000 |
|---|---------|

The aggregate sum of the taxable gifts for preceding calendar years is \$115,000, which is determined by deducting a specific exemption of \$30,000 from \$145,000, the total amount of included gifts for preceding calendar years. The deduction from the 1934 and 1935 gifts for the specific exemption cannot exceed \$30,000 for purposes of computing the tax on the 1955 gifts even though a specific exemption in a total amount of \$50,000 was allowed in computing the donor's gift tax liability for 1934 and 1935. (See paragraph (b) of § 25.2504-1.) The computation of the tax for the calendar year 1955 (following the steps set forth in paragraph (a) of this section) is shown below:

| | |
|---|----------|
| (1) Amount of taxable gifts for year | \$57,000 |
| (2) Total amount of taxable gifts for preceding years | 115,000 |

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| | |
|---|---------|
| (3) Total taxable gifts | 172,000 |
| (4) Tax computed on item 3 (in accordance with the rate schedule in effect for the year 1955) ... | 31,725 |
| (5) Tax computed on item 2 (using same rate schedule) | 18,900 |
| (6) Tax for year 1955 (item 4 minus item 5) | 12,825 |

Example 3. (i) Facts. During the calendar year 1955, H makes the following gifts of present interests:

| | |
|------------------------------------|----------|
| To his daughter | \$40,000 |
| To his son | 5,000 |
| To W, his wife | 5,000 |
| To a charitable organization | 10,000 |

The gifts to W qualify for the marital deduction, and, pursuant to the provisions of section 2513 (see § 25.2513-1), H and W consent to treat the gifts to third parties as having been made one-half by each spouse. The amount of H's taxable gifts for preceding years is \$50,000. Only \$25,000 of H's specific exemption provided under section 2521, which was in effect at the time, was claimed and allowed in preceding years. H's remaining specific exemption of \$5,000 is claimed for the calendar year of 1955. See § 25.2521-1. W made no gifts during the calendar year 1955 nor during any preceding calendar year. W claims sufficient specific exemption on her return to eliminate tax liability.

(ii) *Computation of H's tax for the calendar year 1955—(a) H's taxable gifts for year.*

| | |
|--|----------|
| Total gifts of H | \$60,000 |
| Less: Portion of items to be reported by spouse (one-half of total gifts to daughter, son and charity) | 27,500 |
| Balance | 32,500 |
| Less: Exclusions (three of \$3,000 each for daughter, wife and charity and one of \$2,500 for son) | 11,500 |
| Total included amount of gifts for year | 21,000 |
| Less: Deductions: | |
| Charity | \$2,000 |
| Marital | 2,000 |
| Specific exemption | 5,000 |
| Total deductions | 9,000 |
| Amount of taxable gifts for year | 12,000 |

(b) *Computation of tax.* The steps set forth in paragraph (a) of this section are followed.

| | |
|---|----------|
| (1) Amount of taxable gifts for year | \$12,000 |
| (2) Total taxable gifts for preceding years | 50,000 |
| (3) Total taxable gifts (item (1) plus item (2)) | 62,000 |
| (4) Tax computed on item (3) (in accordance with the rate schedule in effect for the year 1955) | 7,545 |
| (5) Tax computed in item (2) (in accordance with the rate schedule in effect for the year 1955) | 5,250 |
| (6) Tax for the calendar year (item (4) minus item (5)) | 2,295 |

(iii) *Computation of W's tax for calendar year 1955—(a) W's taxable gifts for year.*

| | |
|---|---|
| Total gifts of W | 0 |
| Less: Portion of items to be reported by spouse | 0 |
| Balance | 0 |

| | |
|--|----------|
| Gifts of spouse to be included | \$27,500 |
| Total gifts for year | 27,500 |
| Less: Exclusions (two of \$3,000 each for daughter and charity and one of \$2,500 for son) | \$8,500 |
| Balance | 19,000 |
| Less—Deductions: | |
| Charity | \$2,000 |
| Marital | 0 |
| Specific exemption | 17,000 |
| Total deductions | \$19,000 |
| Amount of taxable gifts for year | 0 |

(b) *Computation of tax.* Since W had no "taxable gifts" during the year, there is no tax.

Example 4. (i) Facts. The facts are the same as in example 3 except that W made outright gifts of \$10,000 to her niece and \$20,000 to H at various times during the year. The amount of taxable gifts made by W in preceding calendar years is \$75,000, and only \$20,000 of her specific exemption provided under section 2521, which was in effect at the time, was claimed and allowed for preceding years. See § 25.2521-1. The remaining specific exemption of \$10,000 is claimed for the calendar year 1955.

(ii) *Computation of H's tax for the calendar year 1955—(a) H's taxable gifts for year.*

| | |
|--|----------|
| Total gifts of H | \$60,000 |
| Less: Portion of items to be reported by spouse | 27,500 |
| Balance | 32,500 |
| Gifts of spouse to be included | 5,000 |
| Total gifts for year | 37,500 |
| Less: Exclusions (\$11,500 as shown in example (3) plus \$3,000 exclusion for gift to niece) | 14,500 |
| Total included amount of gifts for year | 23,000 |
| Deductions: | |
| Charity | \$2,000 |
| Marital | 2,000 |
| Specific exemption | 5,000 |
| Total deductions | 9,000 |
| Amount of taxable gifts for year | 14,000 |

(b) *Computation of tax.*

| | |
|--|----------|
| (1) Amount of taxable gifts for year | \$14,000 |
| (2) Total taxable gifts for preceding years | 50,000 |
| (3) Total taxable gifts (item (1) plus item (2)) | 64,000 |
| (4) Tax computed on item (3) | 7,965 |
| (5) Tax computed on item (2) | 5,250 |
| (6) Tax for year (item (4) minus item (5)) | 2,715 |

(iii) *Computation of W's tax for the calendar year 1955—(a) W's taxable gifts for year.*

| | |
|--|----------|
| Total gifts of W | \$30,000 |
| Less: Portion of item—to be reported by spouse (one-half of gift to niece) | 5,000 |
| Balance | 25,000 |
| Gifts of spouse to be included | 27,500 |
| Total gifts for year | 52,500 |

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| | |
|--|----------|
| Less: Exclusions (four of \$3,000 each for daughter, husband, niece and charity, and one of \$2,500 for son) | \$14,500 |
| Total included amount of gifts for year | 38,000 |
| Deductions: | |
| Charity | \$2,000 |
| Marital | 10,000 |
| Specific exemption | 10,000 |
| Total deductions | 22,000 |
| Amount of taxable gifts for year | \$16,000 |

(b) Computation of tax.

| | |
|---|--------|
| (1) Amount of taxable gifts for year | 16,000 |
| (2) Total taxable gifts for preceding years | 75,000 |
| (3) Total taxable gifts | 91,000 |
| (4) Tax computed on item (3) | 13,635 |
| (5) Tax computed on item (2) | 10,275 |
| (6) Tax for year (item (4) minus item (5)) | 3,360 |

Example 5. A makes gifts (other than gifts of future interests in property) to B in the first quarter of 1971 of \$43,000 and in the second quarter of 1971 of \$60,000. A gave to C in the second quarter of 1971 land valued at \$11,000. The full amount of A's specific exemption provided under section 2521 was claimed and allowed in 1956. In 1966, A made taxable gifts totaling \$21,000 on which gift tax was timely paid and no other taxable gifts were made by A in any other year preceding 1971. The gift tax return due for the first calendar quarter of 1971 was timely filed and the tax paid. With respect to the gifts made to B in 1971, the \$3,000 annual gift tax exclusion provided by section 2503(b) is applied in its entirety against the \$43,000 gift made to B in the first quarter and therefore is not available to offset the \$60,000 gift made to B in the second quarter (See § 25.2503-2(b)). A further \$3,000 annual gift tax exclusion is available, however, to offset the \$11,000 gift made to C in the second quarter of 1971. The computation of the gift tax for the second calendar quarter of 1971 due on August 15, 1971 (following the steps set forth in paragraph (a) of this section) is shown below:

| | |
|---|----------|
| (1) Amount of taxable gifts for the second calendar quarter of 1971 (\$60,000+\$11,000 - \$3,000) | \$68,000 |
| (2) Total amount of taxable gifts for preceding calendar periods (\$43,000 - \$3,000+\$21,000) | 61,000 |
| (3) Total taxable gifts | 129,000 |
| (4) Tax computed on item 3 (in accordance with rate schedule in effect for the year 1971) | 22,050 |
| (5) Tax computed on item 2 (using same rate schedule) | 7,335 |
| (6) Tax for second calendar quarter of 1971 (item 4 minus item 5) | 14,715 |

Example 6. A makes gifts (other than gifts of future interests in property) during the calendar year 1982 of \$160,000 to B and \$100,000 to C. Two exclusions of \$10,000 each are allowable, in accordance with the provisions of section 2503(b), which results in taxable gifts

for 1982 of \$240,000. In the first calendar quarter of 1978, A made taxable gifts totaling \$100,000 on which gift tax was paid. For the calendar year 1969, A made taxable gifts totaling \$50,000. The full amount of A's specific exemption provided under section 2521, which was in effect at the time, was claimed and allowed in 1968. The computation of the gift tax for the calendar period 1982 (following the steps set forth in paragraph (a) of this section) is shown below.

- (1) Amount of taxable gifts for the calendar year 1982, \$240,000.
- (2) Total amount of taxable gifts for preceding calendar periods (\$100,000+\$50,000), \$150,000.
- (3) Total taxable gifts, \$390,000.
- (4) Tax computed on item 3 (in accordance with the rate schedule in effect for the year 1982), \$118,400.
- (5) Tax computed on item 2 (using same rate schedule), \$38,800.
- (6) Tax for year 1982 (item 4 minus item 5), \$79,600.

[T.D. 6334, 23 FR 8904, Nov. 15, 1958, as amended by T.D. 7238, 37 FR 28725, Dec. 29, 1972; T.D. 7910, 48 FR 40372, Sept. 7, 1983; T.D. 8395, 57 FR 4255, Feb. 4, 1992]

§ 25.2502-2 Donor primarily liable for tax.

Section 2502(d) provides that the donor shall pay the tax. If the donor dies before the tax is paid the amount of the tax is a debt due the United States from the decedent's estate and his executor or administrator is responsible for its payment out of the estate. (See § 25.6151-1 for the time and place for paying the tax.) If there is no duly qualified executor or administrator, the heirs, legatees, devisees, and distributees are liable for and required to pay the tax to the extent of the value of their inheritances, bequests, devises, or distributive shares of the donor's estate. If a husband and wife effectively signify consent, under section 2513, to have gifts made to a third party during any "calendar period" (as defined in § 25.2502-1(c)(1)) considered as made one-half by each, the liability with respect to the gift tax of each spouse for that calendar period is joint and several (see § 25.2513-4). As to the personal liability of the donee, see paragraph (b) of § 301.6324-1 of this chapter (Regulations on Procedure and Administration). As to the

personal liability of the executor or administrator, see section 3467 of the Revised Statutes (31 U.S.C. 192), which reads as follows:

Every executor, administrator, or assignee, or other person, who pays, in whole or in part, any debt due by the person or estate for whom or for which he acts before he satisfies and pays the debts due to the United States from such person or estate, shall become answerable in his own person and estate to the extent of such payments for the debts so due to the United States, or for so much thereof as may remain due and unpaid.

As used in such section 3467, the word "debt" includes a beneficiary's distributive share of an estate. Thus if an executor pays a debt due by the estate which is being administered by him or distributes any portion of the estate before there is paid all of the gift tax which he has a duty to pay, the executor is personally liable, to the extent of the payment or distribution, for so much of the gift tax as remains due and unpaid.

[T.D. 7238, 37 FR 28726, Dec. 29, 1972, as amended by T.D. 7910, 48 FR 40373, Sept. 7, 1983]

§ 25.2503-1 General definitions of "taxable gifts" and of "total amount of gifts."

The term *taxable gifts* means the "total amount of gifts" made by the donor during the "calendar period" (as defined in § 25.2502-1(c)(1)) less the deductions provided for in sections 2521 (as in effect before its repeal by the Tax Reform Act of 1976), 2522, and 2523 (specific exemption, charitable, etc., gifts and the marital deduction, respectively). The term "total amount of gifts" means the sum of the values of the gifts made during the calendar period less the amounts excludable under section 2503(b). See § 25.2503-2. The entire value of any gift of a future interest in property must be included in the total amount of gifts for the calendar period in which the gift is made. See § 25.2503-3.

[T.D. 7910, 48 FR 40373, Sept. 7, 1983]

§ 25.2503-2 Exclusions from gifts.

(a) Except as provided in paragraph (f) of this section (involving gifts to a noncitizen spouse), the first \$10,000 of gifts made to any one donee during the

calendar year 1982 or any calendar year thereafter, except gifts of future interests in property as defined in §§ 25.2503-3 and 25.2503-4, is excluded in determining the total amount of gifts for the calendar year. In the case of a gift in trust the beneficiary of the trust is the donee.

(b) *Gifts made after December 31, 1970 and before January 1, 1982.* In computing taxable gifts for the calendar quarter, in the case of gifts (other than gifts of future interests in property) made to any person by the donor during any calendar quarter of the calendar year 1971 or any subsequent calendar year, \$3,000 of such gifts to such person less the aggregate of the amounts of such gifts to such person during all preceding calendar quarters of any such calendar year shall not be included in the total amount of gifts made during such quarter. Thus, the first \$3,000 of gifts made to any one donee during the calendar year 1971 or any calendar year thereafter, except gifts of future interests in property as defined in §§ 25.2503-3 and 25.2503-4, is excluded in determining the total amount of gifts for a calendar quarter. In the case of a gift in trust the beneficiary of the trust is the donee. The application of this paragraph may be illustrated by the following examples:

Example (1). A made a gift of \$3,000 to B on January 8, 1971, and on April 20, 1971, gave B an additional gift of \$10,000. A made no other gifts in 1971. The total amount of gifts made by A during the second quarter of 1971 is \$10,000 because the \$3,000 exclusion provided by section 2503(b) is first applied to the January 8th gift.

Example (2). A gave \$2,000 to B on January 8, 1971, and on April 20, 1971, gave him \$10,000. The total amount of gifts made by A during the second quarter of 1971 is \$9,000 because only \$2,000 of the \$3,000 exclusion provided by section 2503(b) was applied against the January 8th gift; \$1,000 was available to offset other gifts (except gifts of a future interest) made to B during 1971.

(c) *Gifts made before January 1, 1971.* The first \$3,000 of gifts made to any one donee during the calendar year 1955, or 1970, or any calendar year intervening between calendar year 1955 and calendar year 1970, except gifts of future interests in property as defined in §§ 25.2503-3 and 25.2503-4, is excluded in determining the total amount of gifts

for the calendar year. In the case of a gift in trust the beneficiary of the trust is the donee.

(d) *Transitional rule.* The increased annual gift tax exclusion as defined in section 2503(b) shall not apply to any gift subject to a power of appointment granted under an instrument executed before September 12, 1981, and not amended on or after that date, provided that: (1) The power is exercisable after December 31, 1981, (2) the power is expressly defined in terms of, or by reference to, the amount of the gift tax exclusion under section 2503(b) (or the corresponding provision of prior law), and (3) there is not enacted a State law applicable to such instrument which construes the power of appointment as referring to the increased annual gift tax exclusion provided by the Economic Recovery Tax Act of 1981.

(e) *Examples.* The provisions of paragraph (d) of this section may be illustrated by the following examples:

Example (1). A executed an instrument to create a trust for the benefit of B on July 2, 1981. The trust granted to B the power, for a period of 90 days after any transfer of cash to the trust, to withdraw from the trust the lesser of the amount of the transferred cash or the amount equal to the section 2503(b) annual gift tax exclusion. The trust was not amended on or after September 12, 1981. No state statute has been enacted which construes the power of appointment as referring to the increased annual gift tax exclusion provided by the Economic Recovery Tax Act of 1981. Accordingly, the maximum annual gift tax exclusion applicable to any gift subject to the exercise of the power of appointment is \$3,000.

Example (2). Assume the same facts as in example (1) except that the power of appointment granted in the trust refers to section 2503(b) as amended at any time. The maximum annual gift tax exclusion applicable to any gift subject to the exercise of the power of appointment is \$10,000.

(f) *Special rule in the case of gifts made on or after July 14, 1988, to a spouse who is not a United States citizen—(1) In general.* Subject to the special rules set forth at § 20.2056A-1(c) of this chapter, in the case of gifts made on or after July 14, 1988, if the donee of the gift is the donor's spouse and the donee spouse is not a citizen of the United States at the time of the gift, the first \$100,000 of gifts made during the calendar year to the donee spouse (except

gifts of future interests) is excluded in determining the total amount of gifts for the calendar year. The rule of this paragraph (f) applies regardless of whether the donor is a citizen or resident of the United States for purposes of chapter 12 of the Internal Revenue Code.

(2) *Gifts made after June 29, 1989.* In the case of gifts made after June 29, 1989, the \$100,000 exclusion provided in paragraph (f)(1) of this section applies only if the gift in excess of the otherwise applicable annual exclusion is in a form that qualifies for the gift tax marital deduction under section 2523(a) but for the provisions of section 2523(i)(1) (disallowing the marital deduction if the donee spouse is not a United States citizen.) See § 25.2523(i)-1(d), *Example 4*.

(3) *Effective date.* This paragraph (f) is effective with respect to gifts made after August 22, 1995.

[T.D. 7238, 37 FR 28727, Dec. 29, 1972, as amended by T.D. 7910, 48 FR 40373, Sept. 7, 1983; T.D. 7978, 49 FR 38541, Oct. 1, 1984; T.D. 8612, 60 FR 43552, Aug. 22, 1995]

§ 25.2503-3 Future interests in property.

(a) No part of the value of a gift of a future interest may be excluded in determining the total amount of gifts made during the "calendar period" (as defined in § 25.2502-1(c)(1)). "Future interest" is a legal term, and includes reversions, remainders, and other interests or estates, whether vested or contingent, and whether or not supported by a particular interest or estate, which are limited to commence in use, possession, or enjoyment at some future date or time. The term has no reference to such contractual rights as exist in a bond, note (though bearing no interest until maturity), or in a policy of life insurance, the obligations of which are to be discharged by payments in the future. But a future interest or interests in such contractual obligations may be created by the limitations contained in a trust or other instrument of transfer used in effecting a gift.

(b) An unrestricted right to the immediate use, possession, or enjoyment

of property or the income from property (such as a life estate or term certain) is a present interest in property. An exclusion is allowable with respect to a gift of such an interest (but not in excess of the value of the interest). If a donee has received a present interest in property, the possibility that such interest may be diminished by the transfer of a greater interest in the same property to the donee through the exercise of a power is disregarded in computing the value of the present interest, to the extent that no part of such interest will at any time pass to any other person (see example (4) of paragraph (c) of this section). For an exception to the rule disallowing an exclusion for gifts of future interests in the case of certain gifts to minors, see § 25.2503-4.

(c) The operation of this section may be illustrated by the following examples:

Example (1). Under the terms of a trust created by A the trustee is directed to pay the net income to B, so long as B shall live. The trustee is authorized in his discretion to withhold payments of income during any period he deems advisable and add such income to the trust corpus. Since B's right to receive the income payments is subject to the trustee's discretion, it is not a present interest and no exclusion is allowable with respect to the transfer in trust.

Example (2). C transfers certain insurance policies on his own life to a trust created for the benefit of D. Upon C's death the proceeds of the policies are to be invested and the net income therefrom paid to D during his lifetime. Since the income payments to D will not begin until after C's death the transfer in trust represents a gift of a future interest in property against which no exclusion is allowable.

Example (3). Under the terms of a trust created by E the net income is to be distributed to E's three children in such shares as the trustee, in his uncontrolled discretion deems advisable. While the terms of the trust provide that all of the net income is to be distributed, the amount of income any one of the three beneficiaries will receive rests entirely within the trustee's discretion and cannot be presently ascertained. Accordingly, no exclusions are allowable with respect to the transfers to the trust.

Example (4). Under the terms of a trust the net income is to be paid to F for life, with the remainder payable to G on F's death. The trustee has the uncontrolled power to pay over the corpus to F at any time. Although F's present right to receive the in-

come may be terminated, no other person has the right to such income interest. Accordingly, the power in the trustee is disregarded in determining the value of F's present interest. The power would not be disregarded to the extent that the trustee during F's life could distribute corpus to persons other than F.

Example (5). The corpus of a trust created by J consists of certain real property, subject to a mortgage. The terms of the trust provide that the net income from the property is to be used to pay the mortgage. After the mortgage is paid in full the net income is to be paid to K during his lifetime. Since K's right to receive the income payments will not begin until after the mortgage is paid in full the transfer in trust represents a gift of a future interest in property against which no exclusion is allowable.

Example (6). L pays premiums on a policy of insurance on his life, all the incidents of ownership in the policy (including the right to surrender the policy) are vested in M. The payment of premiums by L constitutes a gift of a present interest in property.

[T.D. 6334, 23 FR 8904, Nov. 15, 1958, as amended by T.D. 7238, 37 FR 28727, Dec. 29, 1972; T.D. 7910, 48 FR 40373, Sept. 7, 1983]

§ 25.2503-4 Transfer for the benefit of a minor.

(a) Section 2503(c) provides that no part of a transfer for the benefit of a donee who has not attained the age of 21 years on the date of the gift will be considered a gift of a future interest in property if the terms of the transfer satisfy all of the following conditions:

(1) Both the property itself and its income may be expended by or for the benefit of the donee before he attains the age of 21 years;

(2) Any portion of the property and its income not disposed of under subparagraph (1) of this paragraph will pass to the donee when he attains the age of 21 years; and

(3) Any portion of the property and its income not disposed of under subparagraph (1) of this paragraph will be payable either to the estate of the donee or as he may appoint under a general power of appointment as defined in section 2514(c) if he dies before attaining the age of 21 years.

(b) Either a power of appointment exercisable by the donee by will or a power of appointment exercisable by the donee during his lifetime will satisfy the conditions set forth in paragraph (a)(3) of this section. However, if

the transfer is to qualify for the exclusion under this section, there must be no restrictions of substance (as distinguished from formal restrictions of the type described in paragraph (g)(4) of § 25.2523(e)-1 by the terms of the instrument of transfer on the exercise of the power by the donee. However, if the minor is given a power of appointment exercisable during lifetime or is given a power of appointment exercisable by will, the fact that under the local law a minor is under a disability to exercise an intervivos power or to execute a will does not cause the transfer to fail to satisfy the conditions of section 2503(c). Further, a transfer does not fail to satisfy the conditions of section 2503(c) by reason of the mere fact that—

(1) There is left to the discretion of a trustee the determination of the amounts, if any, of the income or property to be expended for the benefit of the minor and the purpose for which the expenditure is to be made, provided there are no substantial restrictions under the terms of the trust instrument on the exercise of such discretion;

(2) The donee, upon reaching age 21, has the right to extend the term of the trust; or

(3) The governing instrument contains a disposition of the property or income not expended during the donee's minority to persons other than the donee's estate in the event of the default of appointment by the donee.

(c) A gift to a minor which does not satisfy the requirements of section 2503(c) may be either a present or a future interest under the general rules of § 25.2503-3. Thus, for example, a transfer of property in trust with income required to be paid annually to a minor beneficiary and corpus to be distributed to him upon his attaining the age of 25 is a gift of a present interest with respect to the right to income but is a gift of a future interest with respect to the right to corpus.

§ 25.2503-6 Exclusion for certain qualified transfer for tuition or medical expenses.

(a) *In general.* Section 2503(e) provides that any qualified transfer after December 31, 1981, shall not be treated as

a transfer of property by gift for purposes of Chapter 12 of Subtitle B of the Code. Thus, a qualified transfer on behalf of any individual is excluded in determining the total amount of gifts in calendar year 1982 and subsequent years. This exclusion is available in addition to the \$10,000 annual gift tax exclusion. Furthermore, an exclusion for a qualified transfer is permitted without regard to the relationship between the donor and the donee.

(b) *Qualified transfers—(1) Definition.* For purposes of this paragraph, the term “qualified transfer” means any amount paid on behalf of an individual—

(i) As tuition to a qualifying educational organization for the education or training of that individual, or

(ii) To any person who provides medical care with respect to that individual as payment for the qualifying medical expenses arising from such medical care.

(2) *Tuition expenses.* For purposes of paragraph (b)(1)(i) of this section, a qualifying educational organization is one which normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on. See section 170(b)(1)(A)(ii) and the regulations thereunder. The unlimited exclusion is permitted for tuition expenses of full-time or part-time students paid directly to the qualifying educational organization providing the education. No unlimited exclusion is permitted for amounts paid for books, supplies, dormitory fees, board, or other similar expenses which do not constitute direct tuition costs.

(3) *Medical expenses.* For purposes of paragraph (b)(1)(ii) of this section, qualifying medical expenses are limited to those expenses defined in section 213(d) (section 213(e) prior to January 1, 1984) and include expenses incurred for the diagnosis, cure, mitigation, treatment or prevention of disease, or for the purpose of affecting any structure or function of the body or for transportation primarily for and essential to medical care. In addition, the unlimited exclusion from the gift tax

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includes amounts paid for medical insurance on behalf of any individual. The unlimited exclusion from the gift tax does not apply to amounts paid for medical care that are reimbursed by the donee's insurance. Thus, if payment for a medical expense is reimbursed by the donee's insurance company, the donor's payment for that expense, to the extent of the reimbursed amount, is not eligible for the unlimited exclusion from the gift tax and the gift is treated as having been made on the date the reimbursement is received by the donee.

(c) *Examples.* The provisions of paragraph (b) of this section may be illustrated by the following examples.

Example (1). In 1982, A made a tuition payment directly to a foreign university on behalf of B. A had no legal obligation to make this payment. The foreign university is described in section 170(b)(1)(A)(ii) of the Code. A's tuition payment is exempt from the gift tax under section 2503(e) of the Code.

Example (2). A transfers \$100,000 to a trust the provisions of which state that the funds are to be used for tuition expenses incurred by A's grandchildren. A's transfer to the trust is a completed gift for Federal gift tax purposes and is not a direct transfer to an educational organization as provided in paragraph (b)(2) of this section and does not qualify for the unlimited exclusion from gift tax under section 2503(e).

Example (3). C was seriously injured in an automobile accident in 1982. D, who is unrelated to C, paid C's various medical expenses by checks made payable to the physician. D also paid the hospital for C's hospital bills. These medical and hospital expenses were types described in section 213 of the Code and were not reimbursed by insurance or otherwise. Because the medical and hospital bills paid in 1982 for C were medical expenses within the meaning of section 213 of the Code, and since they were paid directly by D to the person rendering the medical care, they are not treated as transfers subject to the gift tax.

Example (4). Assume the same facts as in example (2) except that instead of making the payments directly to the medical service provider, D reimbursed C for the medical expenses which C had previously paid. The payments made by D to C do not qualify for the exclusion under section 2503(e) of the Code and are subject to the gift tax on the date the reimbursement is received by C to the extent the reimbursement and all other gifts from D to C during the year of the reim-

bursement exceed the \$10,000 annual exclusion provided in section 2503(b).

[T.D. 7978, 49 FR 38541, Oct. 1, 1984; 49 FR 39843, Oct. 11, 1984]

§ 25.2504-1 Taxable gifts for preceding calendar periods.

(a) In order to determine the correct gift tax liability for any calendar period it is necessary to ascertain the correct amount, if any, of the aggregate sum of the taxable gifts for each of the "preceding calendar periods" (as defined in § 25.2502-1(c)(2)). See paragraph (a) of § 25.2502-1. The term "aggregate sum of the taxable gifts for each of the preceding calendar periods" means the correct aggregate of such gifts, not necessarily that returned for those calendar periods and in respect of which tax was paid. All transfers that constituted gifts in prior calendar periods under the laws, including the provisions of law relating to exclusions from gifts, in effect at the time the transfers were made are included in determining the amount of taxable gifts for preceding calendar periods. The deductions other than for the specific exemption (see paragraph (b) of this section) allowed by the laws in effect at the time the transfers were made also are taken into account in determining the aggregate sum of the taxable gifts for preceding calendar periods. (The allowable exclusion from a gift is \$5,000 for years before 1939, \$4,000 for the calendar years 1939 through 1942, \$3,000 for the calendar years 1943 through 1981, and \$10,000 thereafter.)

(b) In determining the aggregate sum of the taxable gifts for the "preceding calendar periods" (as defined in § 25.2502-1(c)(2)), the total of the amounts allowed as deductions for the specific exemption, under section 2521 (as in effect prior to its repeal by the Tax Reform Act of 1976) and the corresponding provisions of prior laws, shall not exceed \$30,000. Thus, if the only prior gifts by a donor were made in 1940 and 1941 (at which time the specific exemption allowable was \$40,000), and if in the donor's returns for those years the donor claimed deductions totaling \$40,000 for the specific exemption and reported taxable gifts totaling \$110,000, then in determining the aggregate sum of the taxable gifts for the

preceding calendar periods, the deductions for the specific exemption cannot exceed \$30,000, and the donor's taxable gifts for such periods will be \$120,000 (instead of the \$110,000 reported on the donor's returns). (The allowable deduction for the specific exemption was \$50,000 for calendar years before 1936, \$40,000 for calendar years 1936 through 1942, and \$30,000 for 1943 through 1976.)

(c) If the donor and the donor's spouse consented to have gifts made to third parties considered as made one-half by each spouse, pursuant to the provisions of section 2513 or section 1000(f) of the Internal Revenue Code of 1939 (which corresponds to section 2513), these provisions shall be taken into account in determining the aggregate sum of the taxable gifts for the preceding calendar periods (under paragraph (a) of this section).

(d) If interpretations of the gift tax law in preceding calendar periods resulted in the erroneous inclusion of property for gift tax purposes that should have been excluded, or the erroneous exclusion of property that should have been included, adjustments must be made in order to arrive at the correct aggregate of taxable gifts for the preceding calendar periods (under paragraph (a) of this section). However, see section 1000 (e) and (g) of the 1939 Code relating to certain discretionary trusts and reciprocal trusts. However, see § 25.2504-2(b) regarding certain gifts made after August 5, 1997.

[T.D. 7238, 37 FR 28727, Dec. 29, 1972, as amended by T.D. 7910, 48 FR 40373, Sept. 7, 1983; T.D. 8845, 64 FR 67770, Dec. 3, 1999]

§ 25.2504-2 Determination of gifts for preceding calendar periods.

(a) *Gifts made before August 6, 1997.* If the time has expired within which a tax may be assessed under chapter 12 of the Internal Revenue Code (or under corresponding provisions of prior laws) on the transfer of property by gift made during a preceding calendar period, as defined in § 25.2502-1(c)(2), the gift was made prior to August 6, 1997, and a tax has been assessed or paid for such prior calendar period, the value of the gift, for purposes of arriving at the correct amount of the taxable gifts for the preceding calendar periods (as defined under § 25.2504-1(a)), is the value

used in computing the tax for the last preceding calendar period for which a tax was assessed or paid under chapter 12 of the Internal Revenue Code or the corresponding provisions of prior laws. However, this rule does not apply where no tax was paid or assessed for the prior calendar period. Furthermore, this rule does not apply to adjustments involving issues other than valuation. See § 25.2504-1(d).

(b) *Gifts made or section 2701(d) taxable events occurring after August 5, 1997.* If the time has expired under section 6501 within which a gift tax may be assessed under chapter 12 of the Internal Revenue Code (or under corresponding provisions of prior laws) on the transfer of property by gift made during a preceding calendar period, as defined in § 25.2502-1(c)(2), or with respect to an increase in taxable gifts required under section 2701(d) and § 25.2701-4, and the gift was made, or the section 2701(d) taxable event occurred, after August 5, 1997, the amount of the taxable gift or the amount of the increase in taxable gifts, for purposes of determining the correct amount of taxable gifts for the preceding calendar periods (as defined in § 25.2504-1(a)), is the amount that is finally determined for gift tax purposes (within the meaning of § 20.2001-1(c) of this chapter) and such amount may not be thereafter adjusted. The rule of this paragraph (b) applies to adjustments involving all issues relating to the gift including valuation issues and legal issues involving the interpretation of the gift tax law. For purposes of determining if the time has expired within which a gift tax may be assessed, see § 301.6501(c)-1(e) and (f) of this chapter.

(c) *Examples.* The following examples illustrate the rules of paragraphs (a) and (b) of this section:

Example 1. (i) *Facts.* In 1996, A transferred closely-held stock in trust for the benefit of B, A's child. A timely filed a Federal gift tax return reporting the 1996 transfer to B. No gift tax was assessed or paid as a result of the gift tax annual exclusion and the application of A's available unified credit. In 2001, A transferred additional closely-held stock to the trust. A's Federal gift tax return reporting the 2001 transfer was timely filed and the transfer was adequately disclosed under § 301.6501(c)-1(f)(2) of this chapter. In computing the amount of taxable gifts, A claimed annual exclusions with respect to

the transfers in 1996 and 2001. In 2003, A transfers additional property to B and timely files a Federal gift tax return reporting the gift. (ii) *Application of the rule limiting adjustments to prior gifts.* Under section 2504(c), in determining A's 2003 gift tax liability, the amount of A's 1996 gift can be adjusted for purposes of computing prior taxable gifts, since that gift was made prior to August 6, 1997, and therefore, the provisions of paragraph (a) of this section apply. Adjustments can be made with respect to the valuation of the gift and legal issues presented (for example, the availability of the annual exclusion with respect to the gift). However, A's 2001 transfer was adequately disclosed on a timely filed gift tax return and, thus, under paragraph (b) of this section, the amount of the 2001 taxable gift by A may not be adjusted (either with respect to the valuation of the gift or any legal issue) for purposes of computing prior taxable gifts in determining A's 2003 gift tax liability.

Example 2. (i) *Facts.* In 1996, A transferred closely-held stock to B, A's child. A timely filed a Federal gift tax return reporting the 1996 transfer to B and paid gift tax on the value of the gift reported on the return. On August 1, 1997, A transferred additional closely-held stock to B in exchange for a promissory note signed by B. Also, on September 10, 1997, A transferred closely-held stock to C, A's other child. On April 15, 1998, A timely filed a gift tax return for 1997 reporting the September 10, 1997, transfer to C and, under §301.6501(c)-1(f)(2) of this chapter, adequately disclosed that transfer and paid gift tax with respect to the transfer. However, A believed that the transfer to B on August 1, 1997, was for full and adequate consideration and A did not report the transfer to B on the 1997 Federal gift tax return. In 2002, A transfers additional property to B and timely files a Federal gift tax return reporting the gift.

(ii) *Application of the rule limiting adjustments to prior gifts.* Under section 2504(c), in determining A's 2002 gift tax liability, the value of A's 1996 gift cannot be adjusted for purposes of computing the value of prior taxable gifts, since that gift was made prior to August 6, 1997, and a timely filed Federal gift tax return was filed on which a gift tax was assessed and paid. However, A's prior taxable gifts can be adjusted to reflect the August 1, 1997, transfer because, although a gift tax return for 1997 was timely filed and gift tax was paid, under §301.6501(c)-1(f) of this chapter the period for assessing gift tax with respect to the August 1, 1997, transfer did not commence to run since that transfer was not adequately disclosed on the 1997 gift tax return. Accordingly, a gift tax may be assessed with respect to the August 1, 1997, transfer and the amount of the gift would be reflected in prior taxable gifts for purposes of computing A's gift tax liability for 2002. A's Sep-

tember 10, 1997, transfer to C was adequately disclosed on a timely filed gift tax return and, thus, under paragraph (b) of this section, the amount of the September 10, 1997, taxable gift by A may not be adjusted for purposes of computing prior taxable gifts in determining A's 2002 gift tax liability.

Example 3. (i) *Facts.* In 1994, A transferred closely-held stock to B and C, A's children. A timely filed a Federal gift tax return reporting the 1994 transfers to B and C and paid gift tax on the value of the gifts reported on the return. Also in 1994, A transferred closely-held stock to B in exchange for a bona fide promissory note signed by B. A believed that the transfer to B in exchange for the promissory note was for full and adequate consideration and A did not report that transfer to B on the 1994 Federal gift tax return. In 2002, A transfers additional property to B and timely files a Federal gift tax return reporting the gift.

(ii) *Application of the rule limiting adjustments to prior gifts.* Under section 2504(c), in determining A's 2002 gift tax liability, the value of A's 1994 gifts cannot be adjusted for purposes of computing prior taxable gifts because those gifts were made prior to August 6, 1997, and a timely filed Federal gift tax return was filed with respect to which a gift tax was assessed and paid, and the period of limitations on assessment has expired. The provisions of paragraph (a) of this section apply to the 1994 transfers. However, for purposes of determining A's adjusted taxable gifts in computing A's estate tax liability, the gifts may be adjusted. See §20.2001-1(a) of this chapter.

(d) *Effective dates.* Paragraph (a) of this section applies to transfers of property by gift made prior to August 6, 1997. Paragraphs (b) and (c) of this section apply to transfers of property by gift made after August 5, 1997, if the gift tax return for the calendar period in which the transfer is reported is filed after December 3, 1999.

[T.D. 8845, 64 FR 67770, Dec. 3, 1999]

§ 25.2505-0T Table of contents (temporary).

This section lists the table of contents for §§ 25.2505-1T and 25.2505-2T.

§ 25.2505-1T Unified credit against gift tax; in general (temporary).

- (a) General rule.
- (b) Applicable rate of tax.
- (c) Special rule in case of certain gifts made before 1977.
- (d) Credit limitation.
- (e) Effective/applicability date.
- (f) Expiration date.

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§ 25.2505-2T

§ 25.2505-2T Gifts made by a surviving spouse having a DSUE amount available (temporary).

(a) Donor who is surviving spouse is limited to DSUE amount of last deceased spouse.

(1) In general.

(2) No DSUE amount available from last deceased spouse.

(3) Identity of last deceased spouse unchanged by subsequent marriage or divorce.

(b) Manner in which DSUE amount is applied.

(c) Special rule in case of multiple deceased spouses and previously-applied DSUE amount.

(1) In general.

(2) Example.

(d) Date DSUE amount taken into consideration by donor who is a surviving spouse.

(1) General rule.

(2) Special rule when property passes to surviving spouse in a qualified domestic trust.

(e) Authority to examine returns of deceased spouses.

(f) Availability of DSUE amount for non-residents who are not citizens.

(g) Effective/applicability date.

(h) Expiration date.

[T.D. 9593, 77 FR 36161, June 18, 2012]

§ 25.2505-1T Unified credit against gift tax; in general (temporary).

(a) *General rule.* Section 2505(a) allows a citizen or resident of the United States a credit against the tax imposed by section 2501 for each calendar year. The allowable credit is the applicable credit amount in effect under section 2010(c) that would apply if the donor died as of the end of the calendar year, reduced by the sum of the amounts allowable as a credit against the gift tax due for all preceding calendar periods. See §§ 25.2505-2T, 20.2010-1T, and 20.2010-2T of this chapter for additional rules and definitions related to determining the applicable credit amount in effect under section 2010(c).

(b) *Applicable rate of tax.* In determining the amounts allowable as a credit against the gift tax due for all preceding calendar periods, the unified rate schedule under section 2001(c) in effect for such calendar year applies instead of the rates of tax actually in effect for preceding calendar periods. See sections 2505(a) and 2502(a)(2).

(c) *Special rule in case of certain gifts made before 1977.* The applicable credit amount allowable under paragraph (a)

of this section must be reduced by an amount equal to 20 percent of the aggregate amount allowed as a specific exemption under section 2521 (as in effect before its repeal by the Tax Reform Act of 1976) for gifts made by the decedent after September 8, 1976, and before January 1, 1977.

(d) *Credit limitation.* The applicable credit amount allowed under paragraph (a) of this section for any calendar year shall not exceed the amount of the tax imposed by section 2501 for such calendar year.

(e) *Effective/applicability date.* Paragraph (a) of this section applies to gifts made on or after January 1, 2011. Paragraphs (b), (c), and (d) of this section apply to gifts made on or after June 15, 2012.

(f) *Expiration date.* The applicability of this section expires on or before June 15, 2015.

[T.D. 9593, 77 FR 36161, June 18, 2012]

§ 25.2505-2T Gifts made by a surviving spouse having a DSUE amount available (temporary).

(a) *Donor who is surviving spouse is limited to DSUE amount of last deceased spouse—(1) In general.* In computing a surviving spouse's gift tax liability with regard to a transfer subject to the tax imposed by section 2501 (taxable gift), a deceased spousal unused exclusion (DSUE) amount of a decedent, computed under § 20.2010-2T(c) of this chapter, is included in determining the surviving spouse's applicable exclusion amount under section 2010(c)(2), provided:

(i) Such decedent is the last deceased spouse of such surviving spouse within the meaning of § 20.2010-1T(d)(5) of this chapter at the time of the surviving spouse's taxable gift; and

(ii) The executor of the decedent's estate elected portability (see § 20.2010-2T(a) and (b) of this chapter for applicable requirements).

(2) *No DSUE amount available from last deceased spouse.* If on the date of the surviving spouse's taxable gift the last deceased spouse of such surviving spouse had no DSUE amount or if the executor of the estate of such last deceased spouse did not elect portability, the surviving spouse has no DSUE amount (except as and to the extent

provided in paragraph (c)(1)(ii) of this section) to be included in determining his or her applicable exclusion amount, even if the surviving spouse previously had a DSUE amount available from another decedent who, prior to the death of the last deceased spouse, was the last deceased spouse of such surviving spouse. See paragraph (c) of this section for a special rule in the case of multiple deceased spouses.

(3) *Identity of last deceased spouse unchanged by subsequent marriage or divorce.* A decedent is the last deceased spouse (as defined in § 20.2010-1T(d)(5) of this chapter) of a surviving spouse even if, on the date of the surviving spouse's taxable gift, the surviving spouse is married to another (then-living) individual. If a surviving spouse marries again and that marriage ends in divorce or an annulment, the subsequent death of the divorced spouse does not end the status of the prior deceased spouse as the last deceased spouse of the surviving spouse. The divorced spouse, not being married to the surviving spouse at death, is not the last deceased spouse as that term is defined in § 20.2010-1T(d)(5) of this chapter.

(b) *Manner in which DSUE amount is applied.* If a donor who is a surviving spouse makes a taxable gift and a DSUE amount is included in determining the surviving spouse's applicable exclusion amount under section 2010(c)(2), such surviving spouse will be considered to apply such DSUE amount to the taxable gift before the surviving spouse's own basic exclusion amount.

(c) *Special rule in case of multiple deceased spouses and previously-applied DSUE amount—(1) In general.* A special rule applies to compute the DSUE amount included in the applicable exclusion amount of a surviving spouse who previously has applied the DSUE amount of one or more deceased spouses. If a surviving spouse applied the DSUE amount of one or more last deceased spouses to the surviving spouse's previous lifetime transfers, and if any of those last deceased spouses is different from the surviving spouse's last deceased spouse as defined in § 20.2010-1T(d)(5) of this chapter at the time of the current taxable gift by the surviving spouse, then the DSUE amount to be included in determining

the applicable exclusion amount of the surviving spouse that will be applicable at the time of the current taxable gift is the sum of—

(i) The DSUE amount of the surviving spouse's last deceased spouse as described in paragraph (a)(1) of this section; and

(ii) The DSUE amount of each other deceased spouse of the surviving spouse to the extent that such amount was applied to one or more previous taxable gifts of the surviving spouse.

(2) *Example.* The following example, in which all described individuals are US citizens, illustrates the application of this paragraph (c):

Example. (i) Facts.

Husband 1 (H1) dies on January 15, 2011, survived by Wife (W). Neither has made any taxable gifts during H1's lifetime. H1's executor elects portability of H1's deceased spousal unused exclusion (DSUE) amount. The DSUE amount of H1 as computed on the estate tax return filed on behalf of H1's estate is \$5,000,000. On December 31, 2011, W makes taxable gifts to her children valued at \$2,000,000. W reports the gifts on a timely-filed gift tax return. W is considered to have applied \$2,000,000 of H1's DSUE amount to the 2011 taxable gifts, in accordance with paragraph (b) of this section, and, therefore, W owes no gift tax. W is considered to have an applicable exclusion amount remaining in the amount of \$8,000,000 (\$3,000,000 of H1's remaining DSUE amount plus W's own \$5,000,000 basic exclusion amount). After the death of H1, W marries Husband 2 (H2). H2 dies on June 30, 2012. H2's executor elects portability of H2's DSUE amount, which is properly computed on H2's estate tax return to be \$2,000,000.

(ii) *Application.* The DSUE amount to be included in determining the applicable exclusion amount available to W for gifts during the second half of 2012 is \$4,000,000, determined by adding the \$2,000,000 DSUE amount of H2 and the \$2,000,000 DSUE amount of H1 that was applied by W to W's 2011 taxable gifts. Thus, W's applicable exclusion amount during the balance of 2012 is \$9,000,000.

(d) *Date DSUE amount taken into consideration by donor who is a surviving spouse—(1) General rule.* A portability election made by an executor of a decedent's estate (see § 20.2010-2T(a) and (b) of this chapter for applicable requirements) applies as of the date of the decedent's death. Thus, the decedent's DSUE amount is included in the applicable exclusion amount of the decedent's surviving spouse under section

2010(c)(2) and will be applicable to transfers made by the surviving spouse after the decedent's death. However, such decedent's DSUE amount will not be included in the applicable exclusion amount of the surviving spouse, even if the surviving spouse had made a taxable gift in reliance on the availability or computation of the decedent's DSUE amount:

(i) If the executor of the decedent's estate supersedes the portability election by filing a subsequent estate tax return in accordance with § 20.2010-2T(a)(4) of this chapter;

(ii) To the extent that the DSUE amount subsequently is reduced by a valuation adjustment or the correction of an error in calculation; or

(iii) To the extent that the DSUE amount claimed on the decedent's return cannot be determined.

(2) *Special rule when property passes to surviving spouse in a qualified domestic trust*—(i) *In general.* When property passes from a decedent for the benefit of a surviving spouse in one or more qualified domestic trusts (QDOT) as defined in section 2056A(a) and the decedent's executor elects portability, the DSUE amount available to be included in the applicable exclusion amount of the surviving spouse under section 2010(c)(2) is the DSUE amount of the decedent as redetermined in accordance with § 20.2010-2T(c)(4) of this chapter. The earliest date on which the decedent's DSUE amount may be included in the applicable exclusion amount of the surviving spouse under section 2010(c)(2) is the date of the occurrence of the final QDOT distribution or final other event (generally, the death of the surviving spouse or the earlier termination of all QDOTs for that surviving spouse) on which tax under section 2056A is imposed. However, the decedent's DSUE amount as redetermined in accordance with § 20.2010-2T(c)(4) of this chapter may be applied to the surviving spouse's taxable gifts made in the year of the surviving spouse's death, or if the terminating event occurs prior to the surviving spouse's death, then in the year of that terminating event and/or any subsequent year during the surviving spouse's life.

(ii) *Example.* The following example illustrates the application of this paragraph (d)(2):

Example. (i) *Facts.* Husband (H), a US citizen, dies in January 2011 having made no taxable gifts during his lifetime. H's gross estate is \$3,000,000. H's wife (W) is a US resident but not a citizen of the United States and, under H's will, a pecuniary bequest of \$2,000,000 passes to a QDOT for the benefit of W. H's executor timely files an estate tax return and makes the QDOT election for the property passing to the QDOT, and H's estate is allowed a marital deduction of \$2,000,000 under section 2056(d) for the value of that property. H's taxable estate is \$1,000,000. On H's estate tax return, H's executor computes H's preliminary DSUE amount to be \$4,000,000. No taxable events within the meaning of section 2056A occur during W's lifetime with respect to the QDOT. W makes a taxable gift of \$1,000,000 to X in December 2011 and a taxable gift of \$1,000,000 to Y in January 2012. W dies in September 2012, not having married again, when the value of the assets of the QDOT is \$2,200,000.

(ii) *Application.* H's DSUE amount is redetermined to be \$1,800,000 (the lesser of the \$5,000,000 basic exclusion amount in 2011, or the excess of H's \$5,000,000 applicable exclusion amount over \$3,200,000 (the sum of the \$1,000,000 taxable estate augmented by the \$2,200,000 of QDOT assets)). On W's gift tax return filed for 2011, W cannot apply any DSUE amount to the gift made to X. However, because W's gift to Y was made in the year that W died, W's executor will apply \$1,000,000 of H's redetermined DSUE amount to the gift on W's gift tax return filed for 2012. The remaining \$800,000 of H's redetermined DSUE amount is included in W's applicable exclusion amount to be used in computing W's estate tax liability.

(e) *Authority to examine returns of deceased spouses.* For the purpose of determining the DSUE amount to be included in the applicable exclusion amount of the surviving spouse, the Internal Revenue Service (IRS) may examine returns of each of the surviving spouse's deceased spouses whose DSUE amount is claimed to be included in the surviving spouse's applicable exclusion amount, regardless of whether the period of limitations on assessment has expired for any such return. The IRS's authority to examine returns of a deceased spouse applies with respect to each transfer by the surviving spouse to which a DSUE amount is or has been applied. Upon examination, the IRS may adjust or eliminate the DSUE amount reported on such a return;

however, the IRS may assess additional tax on that return only if that tax is assessed within the period of limitations on assessment under section 6501 applicable to the tax shown on that return. See also section 7602 for the IRS's authority, when ascertaining the correctness of any return, to examine any returns that may be relevant or material to such inquiry.

(f) *Availability of DSUE amount for nonresidents who are not citizens.* A non-resident surviving spouse who was not a citizen of the United States at the time of making a transfer subject to tax under chapter 12 of the Internal Revenue Code shall not take into account the DSUE amount of any deceased spouse except to the extent allowed under any applicable treaty obligation of the United States. See section 2102(b)(3).

(g) *Effective/applicability date.* This section applies to gifts made in calendar year 2011 or in a subsequent year in which the applicable exclusion amount is determined under section 2010(c) of the Code by adding the basic exclusion amount and, in the case of a surviving spouse, the DSUE amount.

(h) *Expiration date.* The applicability of this section expires on or before June 15, 2015.

[T.D. 9593, 77 FR 36161, June 18, 2012]

TRANSFERS

§ 25.2511-1 Transfers in general.

(a) The gift tax applies to a transfer by way of gift whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible. For example, a taxable transfer may be effected by the creation of a trust, the forgiving of a debt, the assignment of a judgment, the assignment of the benefits of an insurance policy, or the transfer of cash, certificates of deposit, or Federal, State or municipal bonds. Statutory provisions which exempt bonds, notes, bills and certificates of indebtedness of the Federal Government or its agencies and the interest thereon from taxation are not applicable to the gift tax, since the gift tax is an excise tax on the transfer, and is not a tax on the subject of the gift.

(b) In the case of a gift by a non-resident not a citizen of the United States—

(1) If the gift was made on or after January 1, 1967, by a donor who was not an expatriate to whom section 2501(a)(2) was inapplicable on the date of the gift by reason of section 2501(a)(3) and paragraph (a)(3) of § 25.2501-1, or

(2) If the gift was made before January 1, 1967, by a donor who was not engaged in business in the United States during the calendar year in which the gift was made, the gift tax applies only if the gift consisted of real property or tangible personal property situated within the United States at the time of the transfer. See §§ 25.2501-1 and 25.2511-3.

(c)(1) The gift tax also applies to gifts indirectly made. Thus, any transaction in which an interest in property is gratuitously passed or conferred upon another, regardless of the means or device employed, constitutes a gift subject to tax. See further § 25.2512-8 relating to transfers for insufficient consideration. However, in the case of a transfer creating an interest in property (within the meaning of § 25.2518-2(c)(3) and (c)(4)) made after December 31, 1976, this paragraph (c)(1) shall not apply to the donee if, as a result of a qualified disclaimer by the donee, the interest passes to a different donee. Nor shall it apply to a donor if, as a result of a qualified disclaimer by the donee, a completed transfer of an interest in property is not effected. See section 2518 and the corresponding regulations for rules relating to a qualified disclaimer.

(2) In the case of taxable transfers creating an interest in the person disclaiming made before January 1, 1977, where the law governing the administration of the decedent's estate gives a beneficiary, heir, or next-of-kin a right completely and unqualifiedly to refuse to accept ownership of property transferred from a decedent (whether the transfer is effected by the decedent's will or by the law of descent and distribution), a refusal to accept ownership does not constitute the making of a gift if the refusal is made within a reasonable time after knowledge of the existence of the transfer. The refusal

must be unequivocal and effective under the local law. There can be no refusal of ownership of property after its acceptance. In the absence of the facts to the contrary, if a person fails to refuse to accept a transfer to him of ownership of a decedent's property within a reasonable time after learning of the existence of the transfer, he will be presumed to have accepted the property. Where the local law does not permit such a refusal, any disposition by the beneficiary, heir, or next-of-kin whereby ownership is transferred gratuitously to another constitutes the making of a gift by the beneficiary, heir, or next-of-kin. In any case where a refusal is purported to relate to only a part of the property, the determination of whether or not there has been a complete and unqualified refusal to accept ownership will depend on all of the facts and circumstances in each particular case, taking into account the recognition and effectiveness of such a purported refusal under the local law. In illustration, if Blackacre was devised to A under the decedent's will (which also provided that all lapsed legacies and devises shall go to B, the residuary beneficiary), and under the local law A could refuse to accept ownership in which case title would be considered as never having passed to A, A's refusal to accept Blackacre within a reasonable time of learning of the devise will not constitute the making of a gift by A to B. However, if a decedent who owned Greenacre died intestate with C and D as his only heirs, and under local law the heir of a decedent cannot, by refusal to accept, prevent himself from becoming an owner of intestate property, any gratuitous disposition by C (by whatever term it is known) whereby he gives up his ownership of a portion of Greenacre and D acquires the whole thereof constitutes the making of a gift by C to D.

(3) The fourth sentence of paragraph (c)(1) of this section is applicable for transfers creating an interest to be disclaimed made on or after December 31, 1997.

(d) If a joint income tax return is filed by a husband and wife for a taxable year, the payment by one spouse of all or part of the income tax liability for such year is not treated as re-

sulting in a transfer that is subject to gift tax. The same rule is applicable to the payment of gift tax for a "calendar period" (as defined in § 25.2502-1(c)(1)) in the case of a husband and wife who have consented to have the gifts made considered as made half by each of them in accordance with the provisions of section 2513.

(e) If a donor transfers by gift less than his entire interest in property, the gift tax is applicable to the interest transferred. The tax is applicable, for example, to the transfer of an undivided half interest in property, or to the transfer of a life estate when the grantor retains the remainder interest, or vice versa. However, if the donor's retained interest is not susceptible of measurement on the basis of generally accepted valuation principles, the gift tax is applicable to the entire value of the property subject to the gift. Thus if a donor, aged 65 years, transfers a life estate in property to A, aged 25 years, with remainder to A's issue, or in default of issue, with reversion to the donor, the gift tax will normally be applicable to the entire value of the property.

(f) If a donor is the owner of only a limited interest in property, and transfers his entire interest, the interest is in every case to be valued by the rules set forth in §§ 25.2512-1 through 25.2512-7. If the interest is a remainder or reversion or other future interest, it is to be valued on the basis of actuarial principles set forth in § 25.2512-5, or if it is not susceptible of valuation in that manner, in accordance with the principles set forth in § 25.2512-1.

(g)(1) Donative intent on the part of the transferor is not an essential element in the application of the gift tax to the transfer. The application of the tax is based on the objective facts of the transfer and the circumstances under which it is made, rather than on the subjective motives of the donor. However, there are certain types of transfers to which the tax is not applicable. It is applicable only to a transfer of a beneficial interest in property. It is not applicable to a transfer of bare legal title to a trustee. A transfer by a trustee of trust property in which he has no beneficial interest does not constitute a gift by the trustee (but such a

transfer may constitute a gift by the creator of the trust, if until the transfer he had the power to change the beneficiaries by amending or revoking the trust). The gift tax is not applicable to a transfer for a full and adequate consideration in money or money's worth, or to ordinary business transactions, described in § 25.2512-8.

(2) If a trustee has a beneficial interest in trust property, a transfer of the property by the trustee is not a taxable transfer if it is made pursuant to a fiduciary power the exercise or nonexercise of which is limited by a reasonably fixed or ascertainable standard which is set forth in the trust instrument. A clearly measurable standard under which the holder of a power is legally accountable is such a standard for this purpose. For instance, a power to distribute corpus for the education, support, maintenance, or health of the beneficiary; for his reasonable support and comfort; to enable him to maintain his accustomed standard of living; or to meet an emergency, would be such a standard. However, a power to distribute corpus for the pleasure, desire, or happiness of a beneficiary is not such a standard. The entire context of a provision of a trust instrument granting a power must be considered in determining whether the power is limited by a reasonably definite standard. For example, if a trust instrument provides that the determination of the trustee shall be conclusive with respect to the exercise or nonexercise of a power, the power is not limited by a reasonably definite standard. However, the fact that the governing instrument is phrased in discretionary terms is not in itself an indication that no such standard exists.

(h) The following are examples of transactions resulting in taxable gifts and in each case it is assumed that the transfers were not made for an adequate and full consideration in money or money's worth:

(1) A transfer of property by a corporation to B is a gift to B from the stockholders of the corporation. If B himself is a stockholder, the transfer is a gift to him from the other stockholders but only to the extent it exceeds B's own interest in such amount as a shareholder. A transfer of property

by B to a corporation generally represents gifts by B to the other individual shareholders of the corporation to the extent of their proportionate interests in the corporation. However, there may be an exception to this rule, such as a transfer made by an individual to a charitable, public, political or similar organization which may constitute a gift to the organization as a single entity, depending upon the facts and circumstances in the particular case.

(2) The transfer of property to B if there is imposed upon B the obligation of paying a commensurate annuity to C is a gift to C.

(3) The payment of money or the transfer of property to B in consideration of B's promise to render a service to C is a gift to C, or to both B and C, depending on whether the service to be rendered to C is or is not an adequate and full consideration in money or money's worth for that which is received by B. See section 2512(b) and the regulations thereunder.

(4) If A creates a joint bank account for himself and B (or a similar type of ownership by which A can regain the entire fund without B's consent), there is a gift to B when B draws upon the account for his own benefit, to the extent of the amount drawn without any obligation to account for a part of the proceeds to A. Similarly, if A purchases a United States savings bond registered as payable to "A or B," there is a gift to B when B surrenders the bond for cash without any obligation to account for a part of the proceeds to A.

(5) If A with his own funds purchases property and has the title conveyed to himself and B as joint owners, with rights of survivorship (other than a joint ownership described in example (4) but which rights may be defeated by either party severing his interest, there is a gift to B in the amount of half the value of the property. However, see § 25.2515-1 relative to the creation of a joint tenancy (or tenancy by the entirety) between husband and wife in real property with rights of survivorship which, unless the donor elects otherwise is not considered as a transfer includible for Federal gift tax purposes at the time of the creation of the

joint tenancy. See § 25.2515-2 with respect to determining the extent to which the creation of a tenancy by the entirety constitutes a taxable gift if the donor elects to have the creation of the tenancy so treated. See also § 25.2523(d)-1 with respect to the marital deduction allowed in the case of the creation of a joint tenancy or a tenancy by the entirety.

(6) If A is possessed of a vested remainder interest in property, subject to being divested only in the event he should fail to survive one or more individuals or the happening of some other event, an irrevocable assignment of all or any part of his interest would result in a transfer includible for Federal gift tax purposes. See especially § 25.2512-5 for the valuation of an interest of this type.

(7) If A, without retaining a power to revoke the trust or to change the beneficial interests therein, transfers property in trust whereby B is to receive the income for life and at his death the trust is to terminate and the corpus is to be returned to A, provided A survives, but if A predeceases B the corpus is to pass to C, A has made a gift equal to the total value of the property less the value of his retained interest. See § 25.2512-5 for the valuation of the donor's retained interest.

(8) If the insured purchases a life insurance policy, or pays a premium on a previously issued policy, the proceeds of which are payable to a beneficiary or beneficiaries other than his estate, and with respect to which the insured retains no reversionary interest in himself or his estate and no power to revert the economic benefits in himself or his estate or to change the beneficiaries or their proportionate benefits (or if the insured relinquishes by assignment, by designation of a new beneficiary or otherwise, every such power that was retained in a previously issued policy), the insured has made a gift of the value of the policy, or to the extent of the premium paid, even though the right of the assignee or beneficiary to receive the benefits is conditioned upon his surviving the insured. For the valuation of life insurance policies see § 25.2512-6.

(9) Where property held by a husband and wife as community property is

used to purchase insurance upon the husband's life and a third person is revocably designated as beneficiary and under the State law the husband's death is considered to make absolute the transfer by the wife, there is a gift by the wife at the time of the husband's death of half the amount of the proceeds of such insurance.

(10) If under a pension plan (pursuant to which he has an unqualified right to an annuity) an employee has an option to take either a retirement annuity for himself alone or a smaller annuity for himself with a survivorship annuity payable to his wife, an irrevocable election by the employee to take the reduced annuity in order that an annuity may be paid, after the employee's death, to his wife results in the making of a gift. However, see section 2517 and the regulations thereunder for the exemption from gift tax of amounts attributable to employers' contributions under qualified plans and certain other contracts.

[T.D. 6334, 23 FR 8904, Nov. 15, 1958, as amended by T.D. 7150, 36 FR 22900, Dec. 2, 1971; T.D. 7238, 37 FR 28728, Dec. 29, 1972; T.D. 7296, 38 FR 34202, Dec. 12, 1973; T.D. 7910, 48 FR 40374, Sept. 7, 1983; T.D. 8095, 51 FR 28369, Aug. 7, 1986; T.D. 8540, 59 FR 30103, June 10, 1994; T.D. 8744, 62 FR 68185, Dec. 31, 1997]

§ 25.2511-2 Cessation of donor's dominion and control.

(a) The gift tax is not imposed upon the receipt of the property by the donee, nor is it necessarily determined by the measure of enrichment resulting to the donee from the transfer, nor is it conditioned upon ability to identify the donee at the time of the transfer. On the contrary, the tax is a primary and personal liability of the donor, is an excise upon his act of making the transfer, is measured by the value of the property passing from the donor, and attaches regardless of the fact that the identity of the donee may not then be known or ascertainable.

(b) As to any property, or part thereof or interest therein, of which the donor has so parted with dominion and control as to leave in him no power to change its disposition, whether for his own benefit or for the benefit of another, the gift is complete. But if upon a transfer of property (whether in trust

or otherwise) the donor reserves any power over its disposition, the gift may be wholly incomplete, or may be partially complete and partially incomplete, depending upon all the facts in the particular case. Accordingly, in every case of a transfer of property subject to a reserved power, the terms of the power must be examined and its scope determined. For example, if a donor transfers property to another in trust to pay the income to the donor or accumulate it in the discretion of the trustee, and the donor retains a testamentary power to appoint the remainder among his descendants, no portion of the transfer is a completed gift. On the other hand, if the donor had not retained the testamentary power of appointment, but instead provided that the remainder should go to X or his heirs, the entire transfer would be a completed gift. However, if the exercise of the trustee's power in favor of the grantor is limited by a fixed or ascertainable standard (see paragraph (g)(2) of § 25.2511-1), enforceable by or on behalf of the grantor, then the gift is incomplete to the extent of the ascertainable value of any rights thus retained by the grantor.

(c) A gift is incomplete in every instance in which a donor reserves the power to revest the beneficial title to the property in himself. A gift is also incomplete if and to the extent that a reserved power gives the donor the power to name new beneficiaries or to change the interests of the beneficiaries as between themselves unless the power is a fiduciary power limited by a fixed or ascertainable standard. Thus, if an estate for life is transferred but, by an exercise of a power, the estate may be terminated or cut down by the donor to one of less value, and without restriction upon the extent to which the estate may be so cut down, the transfer constitutes an incomplete gift. If in this example the power was confined to the right to cut down the estate for life to one for a term of five years, the certainty of an estate for not less than that term results in a gift to that extent complete.

(d) A gift is not considered incomplete, however, merely because the donor reserves the power to change the manner or time of enjoyment. Thus,

the creation of a trust the income of which is to be paid annually to the donee for a period of years, the corpus being distributable to him at the end of the period, and the power reserved by the donor being limited to a right to require that, instead of the income being so payable, it should be accumulated and distributed with the corpus to the donee at the termination of the period, constitutes a completed gift.

(e) A donor is considered as himself having a power if it is exercisable by him in conjunction with any person not having a substantial adverse interest in the disposition of the transferred property or the income therefrom. A trustee, as such, is not a person having an adverse interest in the disposition of the trust property or its income.

(f) The relinquishment or termination of a power to change the beneficiaries of transferred property, occurring otherwise than by the death of the donor (the statute being confined to transfers by living donors), is regarded as the event that completes the gift and causes the tax to apply. For example, if A transfers property in trust for the benefit of B and C but reserves the power as trustee to change the proportionate interests of B and C, and if A thereafter has another person appointed trustee in place of himself, such later relinquishment of the power by A to the new trustee completes the gift of the transferred property, whether or not the new trustee has a substantial adverse interest. The receipt of income or of other enjoyment of the transferred property by the transferee or by the beneficiary (other than by the donor himself) during the interim between the making of the initial transfer and the relinquishment or termination of the power operates to free such income or other enjoyment from the power, and constitutes a gift of such income or of such other enjoyment taxable as of the "calendar period" (as defined in § 25.2502-1(c)(1)) of its receipt. If property is transferred in trust to pay the income to A for life with remainder to B, powers to distribute corpus to A, and to withhold income from A for future distribution to B, are powers to change the beneficiaries of the transferred property.

(g) If a donor transfers property to himself as trustee (or to himself and some other person, not possessing a substantial adverse interest, as trustees), and retains no beneficial interest in the trust property and no power over it except fiduciary powers, the exercise or nonexercise of which is limited by a fixed or ascertainable standard, to change the beneficiaries of the transferred property, the donor has made a completed gift and the entire value of the transferred property is subject to the gift tax.

(h) If a donor delivers a properly indorsed stock certificate to the donee or the donee's agent, the gift is completed for gift tax purposes on the date of delivery. If the donor delivers the certificate to his bank or broker as his agent, or to the issuing corporation or its transfer agent, for transfer into the name of the donee, the gift is completed on the date the stock is transferred on the books of the corporation.

(i) [Reserved]

(j) If the donor contends that a power is of such nature as to render the gift incomplete, and hence not subject to the tax as of the calendar period (as defined in § 25.2502-1(c)(1)) of the initial transfer, see § 301.6501(c)-1(f)(5) of this chapter.

[T.D. 6334, 23 FR 8904, Nov. 15, 1958, as amended by T.D. 7238, 37 FR 28728, Dec. 29, 1972; T.D. 7910, 48 FR 40374, Sept. 7, 1983; T.D. 8845, 64 FR 67771, Dec. 3, 1999]

§ 25.2511-3 Transfers by nonresidents not citizens.

(a) *In general.* Sections 2501 and 2511 contain rules relating to the taxation of transfers of property by gift by a donor who is a nonresident not a citizen of the United States. (See paragraph (b) of § 25.2501-1 for the definition of the term "resident" for purposes of the gift tax.) As combined these rules are:

(1) The gift tax applies only to the transfer of real property and tangible personal property situated in the United States at the time of the transfer if either—

(i) The gift was made on or after January 1, 1967, by a nonresident not a citizen of the United States who was not an expatriate to whom section 2501(a)(2) was inapplicable on the date

of the gift by reason of section 2501(a)(3) and paragraph (a)(3) of § 25.2501-1, or

(ii) The gift was made before January 1, 1967, by a nonresident not a citizen of the United States who was not engaged in business in the United States during the calendar year in which the gift was made.

(2) The gift tax applies to the transfer of all property (whether real or personal, tangible or intangible) situated in the United States at the time of the transfer if either—

(i) The gift was made on or after January 1, 1967, by a nonresident not a citizen of the United States who was an expatriate to whom section 2501(a)(2) was inapplicable on the date of the gift by reason of section 2501(a)(3) and paragraph (a)(3) of § 25.2501-1, or

(ii) The gift was made before January 1, 1967, by a nonresident not a citizen of the United States who was engaged in business in the United States during the calendar year in which the gift was made.

(b) *Situs of property.* For purposes of applying the gift tax to the transfer of property owned and held by a nonresident not a citizen of the United States at the time of the transfer—

(1) *Real property and tangible personal property.* Real property and tangible personal property constitute property within the United States only if they are physically situated therein.

(2) *Intangible personal property.* Except as provided otherwise in subparagraphs (3) and (4) of this paragraph, intangible personal property constitutes property within the United States if it consists of a property right issued by or enforceable against a resident of the United States or a domestic corporation (public or private), irrespective of where the written evidence of the property is physically located at the time of the transfer.

(3) *Shares of stock.* Irrespective of where the stock certificates are physically located at the time of the transfer—

(i) Shares of stock issued by a domestic corporation constitute property within the United States, and

(ii) Shares of stock issued by a corporation which is not a domestic corporation constitute property situated outside the United States.

(4) *Debt obligations.* (i) In the case of gifts made on or after January 1, 1967, a debt obligation, including a bank deposit, the primary obligor of which is a United States person (as defined in section 7701(a)(30)), the United States, a State, or any political subdivision thereof, the District of Columbia, or any agency or instrumentality of any such government constitutes property situated within the United States. This subdivision applies—

(a) In the case of a debt obligation of a domestic corporation, whether or not any interest on the obligation would be treated under section 862(a)(1) as income from sources without the United States by reason of section 861(a)(1)(B) (relating to interest received from a domestic corporation less than 20 percent of whose gross income for a 3-year period was derived from sources within the United States) and the regulations thereunder;

(b) In the case of an amount described in section 861(c) (relating to certain bank deposits, withdrawable accounts, and amounts held by an insurance company under an agreement to pay interest), whether or not any interest thereon would be treated under section 862(a)(1) as income from sources without the United States by reason of section 861(a)(1)(A) (relating to interest on amounts described in section 861(c) which is not effectively connected with the conduct of a trade or business within the United States) and the regulations thereunder;

(c) In the case of a deposit with a domestic corporation or domestic partnership, whether or not the deposit is with a foreign branch thereof engaged in the commercial banking business; and

(d) Irrespective of where the written evidence of the debt obligation is physically located at the time of the transfer.

For purposes of this subdivision, a debt obligation on which there are two or more primary obligors shall be apportioned among such obligors, taking into account to the extent appropriate under all the facts and circumstances

any choate or inchoate rights of contribution existing among such obligors with respect to the indebtedness. The term “agency or instrumentality”, as used in this subdivision, does not include a possession of the United States or an agency or instrumentality of a possession.

(ii) In the case of gifts made on or after January 1, 1967, a debt obligation, including a bank deposit, not deemed under subdivision (i) of this subparagraph to be situated within the United States, constitutes property situated outside the United States.

(iii) In the case of gifts made before January 1, 1967, a debt obligation the written evidence of which is treated as being the property itself constitutes property situated within the United States if the written evidence of the obligation is physically located in the United States at the time of the transfer, irrespective of who is the primary obligor on the debt. If the written evidence of the obligation is physically located outside the United States, the debt obligation constitutes property situated outside the United States.

(iv) Currency is not a debt obligation for purposes of this subparagraph.

[T.D. 7296, 38 FR 34202, Dec. 12, 1973]

§ 25.2512-0 Table of contents.

This section lists the section headings that appear in the regulations under section 2512.

- § 25.2512-1 Valuation of property; in general.
- § 25.2512-2 Stocks and bonds.
- § 25.2512-3 Valuation of interests in businesses.
- § 25.2512-4 Valuation of notes.
- § 25.2512-5 Valuation of annuities, unitrust interests, interests for life or term of years, and remainder or reversionary interests.
- § 25.2512-6 Valuation of certain life insurance and annuity contracts; valuation of shares in an open-end investment company.
- § 25.2512-7 Effect of excise tax.
- § 25.2512-8 Transfers for insufficient consideration.

Actuarial Tables Applicable Before May 1, 2009

- § 25.2512-5A Valuation of annuities, unitrust interests, interests for life or term of

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years, and remainder or reversionary interests transferred before May 1, 2009.

[T.D. 9448, 74 FR 21512, May 7, 2009; T.D. 9540, 76 FR 49638, Aug. 10, 2011]

§ 25.2512-1 Valuation of property; in general.

Section 2512 provides that if a gift is made in property, its value at the date of the gift shall be considered the amount of the gift. The value of the property is the price at which such property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell, and both having reasonable knowledge of relevant facts. The value of a particular item of property is not the price that a forced sale of the property would produce. Nor is the fair market value of an item of property the sale price in a market other than that in which such item is most commonly sold to the public, taking into account the location of the item wherever appropriate. Thus, in the case of an item of property made the subject of a gift, which is generally obtained by the public in the retail market, the fair market value of such an item of property is the price at which the item or a comparable item would be sold at retail. For example, the value of an automobile (an article generally obtained by the public in the retail market) which is the subject of a gift, is the price for which an automobile of the same or approximately the same description, make, model, age, condition, etc., could be purchased by a member of the general public and not the price for which the particular automobile of the donor would be purchased by a dealer in used automobiles. Examples of items of property which are generally sold to the public at retail may be found in § 25.2512-6. The value is generally to be determined by ascertaining as a basis the fair market value at the time of the gift of each unit of the property. For example, in the case of shares of stocks or bonds, such unit of property is generally a share or a bond. Property shall not be returned at the value at which it is assessed for local tax purposes unless that value represents the fair market value thereof on the date of the gift. All relevant facts and elements of value as of the

time of the gift shall be considered. Where the subject of a gift is an interest in a business, the value of items of property in the inventory of the business generally should be reflected in the value of the business. For valuation of interests in businesses, see § 25.2512-3. See § 25.2512-2 and §§ 25.2512-4 through 25.2512-6 for further information concerning the valuation of other particular kinds of property. See § 25.2702-6 for an adjustment to the total amount of an individual's taxable gifts where the individual's current taxable gifts include the transfer of certain interests in trust that were previously valued under the provisions of section 2702.

[T.D. 6826, 30 FR 7709, June 15, 1965; as amended by T.D. 8395, 57 FR 4254, Feb. 4, 1992]

§ 25.2512-2 Stocks and bonds.

(a) *In general.* The value of stocks and bonds is the fair market value per share or bond on the date of the gift.

(b) *Based on selling prices.* (1) In general, if there is a market for stocks or bonds, on a stock exchange, in an over-the-counter market or otherwise, the mean between the highest and lowest quoted selling prices on the date of the gift is the fair market value per share or bond. If there were no sales on the date of the gift but there were sales on dates within a reasonable period both before and after the date of the gift, the fair market value is determined by taking a weighted average of the means between the highest and lowest sales on the nearest date before and the nearest date after the date of the gift. The average is to be weighted inversely by the respective numbers of trading days between the selling dates and the date of the gift. If the stocks or bonds are listed on more than one exchange, the records of the exchange where the stocks or bonds are principally dealt in should be employed if such records are available in a generally available listing or publication of general circulation. In the event that such records are not so available and such stocks or bonds are listed on a composite listing of combined exchanges available in a generally available listing or publication of general circulation, the records of such combined exchanges should be employed. In valuing listed securities,

the donor should be careful to consult accurate records to obtain values as of the date of the gift. If quotations of unlisted securities are obtained from brokers, or evidence as to their sale is obtained from the officers of the issuing companies, copies of letters furnishing such quotations or evidence of sale should be attached to the return.

(2) If it is established with respect to bonds for which there is a market on a stock exchange, that the highest and lowest selling prices are not available for the date of the gift in a generally available listing or publication of general circulation but that closing prices are so available, the fair market value per bond is the mean between the quoted closing selling price on the date of the gift and the quoted closing selling price on the trading day before the date of the gift. If there were no sales on the trading day before the date of the gift but there were sales on dates within a reasonable period before the date of the gift, the fair market value is determined by taking a weighted average of the quoted closing selling prices on the date of the gift and the nearest date before the date of the gift. The closing selling price for the date of the gift is to be weighted by the respective number of trading days between the previous selling date and the date of the gift. If there were no sales within a reasonable period before the date of the gift but there were sales on the date of the gift, the fair market value is the closing selling price on the date of the gift. If there were no sales on the date of the gift but there were sales within a reasonable period both before and after the date of the gift, the fair market value is determined by taking a weighted average of the quoted closing selling prices on the nearest date before and the nearest date after the date of the gift. The average is to be weighed inversely by the respective numbers of trading days between the selling dates and the date of the gift. If the bonds are listed on more than one exchange, the records of the exchange where the bonds are principally dealt in should be employed. In valuing listed securities, the donor should be careful to consult accurate records to obtain values as of the date of the gift.

(3) The application of this paragraph may be illustrated by the following examples:

Example (1). Assume that sales of stock nearest the date of the gift (Friday, June 15) occurred two trading days before (Wednesday, June 13) and three trading days after (Wednesday, June 20) and on these days the mean sale prices per share were \$10 and \$15, respectively. The price of \$12 is taken as representing the fair market value of a share of stock as of the date of the gift

$$[(3 \times 10) + (2 \times 15)] / 5$$

Example (2). Assume the same facts as in example 1 except that the mean sale prices per share on June 13 and June 20 were \$15 and \$10 respectively. The price of \$13 is taken as representing the fair market value of a share of stock as of the date of the gift

$$[(3 \times 15) + (2 \times 10)] / 5$$

Example (3). Assume that on the date of the gift (Tuesday, April 3, 1973) the closing selling price of certain listed bonds was \$25 per bond and that the highest and lowest selling prices are not available in a generally available listing or publication of general circulation for that date. Assume further, that the closing selling price of such bonds was \$21 per bond on the day before the date of the gift (Monday, April 2, 1973). Thus, under paragraph (b)(2) of this section, the price of \$23 is taken as representing the fair market value per bond as of the date of the gift

$$[(25 + 21)] / 2$$

Example (4). Assume the same facts as in example 3 except that there were no sales on the day before the date of the gift. Assume further, that there were sales on Thursday, March 29, 1973, and that the closing selling price on that day was \$23. The price of \$24.50 is taken as representing the fair market value per bond as of the date of the gift

$$[(1 \times 23) + (3 \times 25)] / 4$$

Example (5). Assume that no bonds were traded on the date of the gift (Friday, April 20). Assume further, that sales of bonds nearest the date of the gift occurred two trading days before (Wednesday, April 18) and three trading days after (Wednesday, April 25) the date of the gift and that on these two days the closing selling prices per bond were \$29 and \$22, respectively. The highest and lowest selling prices are not available for these dates in a generally available listing or publication of general circulation. Thus, under paragraph (b)(2) of this section the price of \$26.20 is taken as representing the fair market value of a bond as of the date of the gift

$$[(3 \times 29) + (2 \times 22)] / 5$$

(c) *Based on bid and asked prices.* If the provisions of paragraph (b) of this section are inapplicable because actual

sales are not available during reasonable period beginning before and ending after the date of the gift, the fair market value may be determined by taking the mean between the bona fide bid and asked prices on the date of the gift, or if none, by taking a weighted average of the means between the bona fide bid and asked prices on the nearest trading date before and the nearest trading date after the date of the gift, if both such nearest dates are within a reasonable period. The average is to be determined in the manner described in paragraph (b) of this section.

(d) *Where selling prices and bid and asked prices are not available for dates both before and after the date of gift.* If the provisions of paragraphs (b) and (c) of this section are inapplicable because no actual sale prices or quoted bona fide bid and asked prices are available on a date within a reasonable period before the date of the gift, but such prices are available on a date within a reasonable period after the date of the gift, or vice versa, then the mean between the highest and lowest available sale prices or bid and asked prices may be taken as the value.

(e) *Where selling prices or bid and asked prices do not represent fair market value.* In cases in which it is established that the value per bond or share of any security determined on the basis of the selling or bid and asked prices as provided under paragraphs (b), (c), and (d) of this section does not represent the fair market value thereof, then some reasonable modification of the value determined on that basis or other relevant facts and elements of value shall be considered in determining fair market value. Where sales at or near the date of the gift are few or of a sporadic nature, such sales alone may not indicate fair market value. In certain exceptional cases, the size of the block of securities made the subject of each separate gift in relation to the number of shares changing hands in sales may be relevant in determining whether selling prices reflect the fair market value of the block of stock to be valued. If the donor can show that the block of stock to be valued, with reference to each separate gift, is so large in relation to the actual sales on the existing market that it could not be

liquidated in a reasonable time without depressing the market, the price at which the block could be sold as such outside the usual market, as through an underwriter, may be a more accurate indication of value than market quotations. Complete data in support of any allowance claimed due to the size of the block of stock being valued should be submitted with the return. On the other hand, if the block of stock to be valued represents a controlling interest, either actual or effective, in a going business, the price at which other lots change hands may have little relation to its true value.

(f) *Where selling prices or bid and asked prices are unavailable.* If the provisions of paragraphs (b), (c), and (d) of this section are inapplicable because actual sale prices and bona fide bid and asked prices are lacking, then the fair market value is to be determined by taking the following factors into consideration:

(1) In the case of corporate or other bonds, the soundness of the security, the interest yield, the date of maturity, and other relevant factors; and

(2) In the case of shares of stock, the company's net worth, prospective earning power and dividend-paying capacity, and other relevant factors.

Some of the "other relevant factors" referred to in subparagraphs (1) and (2) of this paragraph are: The goodwill of the business; the economic outlook in the particular industry; the company's position in the industry and its management; the degree of control of the business represented by the block of stock to be valued; and the values of securities of corporations engaged in the same or similar lines of business which are listed on a stock exchange. However, the weight to be accorded such comparisons or any other evidentiary factors considered in the determination of a value depends upon the facts of each case. Complete financial and other data upon which the valuation is based should be submitted with the return, including copies of reports of any examinations of the company made by accountants, engineers,

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or any technical experts as of or near the date of the gift.

[T.D. 6334, 23 FR 8904, Nov. 15, 1958; 25 FR 14021, Dec. 31, 1960, as amended by T.D. 7327, 39 FR 35355, Oct. 1, 1974; T.D. 7432, 41 FR 38769, Sept. 13, 1976]

§ 25.2512-3 Valuation of interest in businesses.

(a) Care should be taken to arrive at an accurate valuation of any interest in a business which the donor transfers without an adequate and full consideration in money or money's worth. The fair market value of any interest in a business, whether a partnership or a proprietorship, is the net amount which a willing purchaser, whether an individual or a corporation, would pay for the interest to a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of the relevant facts. The net value is determined on the basis of all relevant factors including—

(1) A fair appraisal as of the date of the gift of all the assets of the business, tangible and intangible, including good will;

(2) The demonstrated earning capacity of the business; and

(3) The other factors set forth in paragraph (f) of § 25.2512-2 relating to the valuation of corporate stock, to the extent applicable.

Special attention should be given to determining an adequate value of the good will of the business. Complete financial and other data upon which the valuation is based should be submitted with the return, including copies of reports of examinations of the business made by accountants, engineers, or any technical experts as of or near the date of the gift.

(b) [Reserved]

§ 25.2512-4 Valuation of notes.

The fair market value of notes, secured or unsecured, is presumed to be the amount of unpaid principal, plus accrued interest to the date of the gift, unless the donor establishes a lower value. Unless returned at face value, plus accrued interest, it must be shown by satisfactory evidence that the note is worth less than the unpaid amount (because of the interest rate, or date of maturity, or other cause), or that the

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note is uncollectible in part (by reason of the insolvency of the party or parties liable, or for other cause), and that the property, if any, pledged or mortgaged as security is insufficient to satisfy it.

§ 25.2512-5 Valuation of annuities, unitrust interests, interests for life or term of years, and remainder or reversionary interests.

(a) *In general.* Except as otherwise provided in paragraph (b) of this section and § 25.7520-3(b), the fair market value of annuities, unitrust interests, life estates, terms of years, remainders, and reversions transferred by gift is the present value of the interests determined under paragraph (d) of this section. Section 20.2031-7 of this chapter (Estate Tax Regulations) and related sections provide tables with standard actuarial factors and examples that illustrate how to use the tables to compute the present value of ordinary annuity, life, and remainder interests in property. These sections also refer to standard and special actuarial factors that may be necessary to compute the present value of similar interests in more unusual fact situations. These factors and examples are also generally applicable for gift tax purposes in computing the values of taxable gifts.

(b) *Commercial annuities and insurance contracts.* The value of life insurance contracts and contracts for the payment of annuities issued by companies regularly engaged in their sale is determined under § 25.2512-6.

(c) *Actuarial valuations.* The present value of annuities, unitrust interests, life estates, terms of years, remainders, and reversions transferred by gift on or after May 1, 2009, is determined under paragraph (d) of this section. The present value of annuities, unitrust interests, life estates, terms of years, remainders, and reversions transferred by gift before May 1, 2009, is determined under the following sections:

| Transfers | | Applicable regulations |
|----------------|----------------|------------------------|
| After | Before | |
| — | 01-01-52 | 25.2512-5A(a). |
| 12-31-51 | 01-01-71 | 25.2512-5A(b). |
| 12-31-70 | 12-01-83 | 25.2512-5A(c). |
| 11-30-83 | 05-01-89 | 25.2512-5A(d). |
| 04-30-89 | 05-01-99 | 25.2512-5A(e). |

| Transfers | | Applicable regulations |
|----------------|----------------|------------------------|
| After | Before | |
| 04-30-99 | 05-01-09 | 25.2512-5A(f). |

(d) *Actuarial valuations on or after May 1, 2009*—(1) *In general.* Except as otherwise provided in paragraph (b) of this section and § 25.7520-3(b) (relating to exceptions to the use of prescribed tables under certain circumstances), if the valuation date for the gift is on or after May 1, 2009, the fair market value of annuities, life estates, terms of years, remainders, and reversions transferred on or after May 1, 2009, is the present value of such interests determined under paragraph (d)(2) of this section and by use of standard or special section 7520 actuarial factors. These factors are derived by using the appropriate section 7520 interest rate and, if applicable, the mortality component for the valuation date of the interest that is being valued. See §§ 25.7520-1 through 25.7520-4. The fair market value of a qualified annuity interest described in section 2702(b)(1) and a qualified unitrust interest described in section 2702(b)(2) is the present value of such interests determined under § 25.7520-1(c).

(2) *Specific interests.* When the donor transfers property in trust or otherwise and retains an interest therein, generally, the value of the gift is the value of the property transferred less the value of the donor's retained interest. However, if the donor transfers property after October 8, 1990, to or for the benefit of a member of the donor's family, the value of the gift is the value of the property transferred less the value of the donor's retained interest as determined under section 2702. If the donor assigns or relinquishes an annuity, life estate, remainder, or reversion that the donor holds by virtue of a transfer previously made by the donor or another, the value of the gift is the value of the interest transferred. However, see section 2519 for a special rule in the case of the assignment of an income interest by a person who received the interest from a spouse.

(i) *Charitable remainder trusts.* The fair market value of a remainder interest in a pooled income fund, as defined in § 1.642(c)-5 of this chapter, is its

value determined under § 1.642(c)-6(e) (see § 1.642(c)-6A for certain prior periods). The fair market value of a remainder interest in a charitable remainder annuity trust, as described in § 1.664-2(a), is its present value determined under § 1.664-2(c). The fair market value of a remainder interest in a charitable remainder unitrust, as defined in § 1.664-3, is its present value determined under § 1.664-4(e). The fair market value of a life interest or term for years in a charitable remainder unitrust is the fair market value of the property as of the date of transfer less the fair market value of the remainder interest, determined under § 1.664-4(e)(4) and (e)(5).

(ii) *Ordinary remainder and reversionary interests.* If the interest to be valued is to take effect after a definite number of years or after the death of one individual, the present value of the interest is computed by multiplying the value of the property by the appropriate remainder interest actuarial factor (that corresponds to the applicable section 7520 interest rate and remainder interest period) in Table B (for a term certain) or in Table S (for one measuring life), as the case may be. Table B is contained in § 20.2031-7(d)(6) of this chapter and Table S (for one measuring life when the valuation date is on or after May 1, 2009) is included in § 20.2031-7(d)(7) and Internal Revenue Service Publication 1457. See § 20.2031-7A containing Table S for valuation of interests before May 1, 2009. For information about obtaining actuarial factors for other types of remainder interests, see paragraph (d)(4) of this section.

(iii) *Ordinary term-of-years and life interests.* If the interest to be valued is the right of a person to receive the income of certain property, or to use certain nonincome-producing property, for a term of years or for the life of one individual, the present value of the interest is computed by multiplying the value of the property by the appropriate term-of-years or life interest actuarial factor (that corresponds to the applicable section 7520 interest rate and term-of-years or life interest period). Internal Revenue Service Publication 1457 includes actuarial factors for a remainder interest after a term of

years in Table B and after the life of one individual in Table S (for one measuring life when the valuation date is on or after May 1, 2009). However, term-of-years and life interest actuarial factors are not included in Table B in § 20.2031-7(d)(6) of this chapter or Table S in § 20.2031-7(d)(7) (or in § 20.2031-7A). If Internal Revenue Service Publication 1457 (or any other reliable source of term-of-years and life interest actuarial factors) is not conveniently available, an actuarial factor for the interest may be derived mathematically. This actuarial factor may be derived by subtracting the correlative remainder factor (that corresponds to the applicable section 7520 interest rate) in Table B (for a term of years) in § 20.2031-7(d)(6) or in Table S (for the life of one individual) in § 20.2031-7(d)(7), as the case may be, from 1.000000. For information about obtaining actuarial factors for other types of term-of-years and life interests, see paragraph (d)(4) of this section.

(iv) *Annuities.* (A) If the interest to be valued is the right of a person to receive an annuity that is payable at the end of each year for a term of years or for the life of one individual, the present value of the interest is computed by multiplying the aggregate amount payable annually by the appropriate annuity actuarial factor (that corresponds to the applicable section 7520 interest rate and annuity period). Internal Revenue Service Publication 1457 includes actuarial factors in Table B (for a remainder interest after an annuity payable for a term of years) and in Table S (for a remainder interest after an annuity payable for the life of one individual when the valuation date is on or after May 1, 2009). However, annuity actuarial factors are not included in Table B in § 20.2031-7(d)(6) of this chapter or Table S in § 20.2031-7(d)(7) (or in § 20.2031-7A). If Internal Revenue Service Publication 1457 (or any other reliable source of annuity actuarial factors) is not conveniently available, an annuity factor for a term of years or for one life may be derived mathematically. This annuity factor may be derived by subtracting the applicable remainder factor (that corresponds to the applicable section 7520

interest rate and annuity period) in Table B (in the case of a term-of-years annuity) in § 20.2031-7(d)(6) or in Table S (in the case of a one-life annuity) in § 20.2031-7(d)(7), as the case may be, from 1.000000 and then dividing the result by the applicable section 7520 interest rate expressed as a decimal number. See § 20.2031-7(d)(2)(iv) for an example that illustrates the computation of the present value of an annuity.

(B) If the annuity is payable at the end of semiannual, quarterly, monthly, or weekly periods, the product obtained by multiplying the annuity factor by the aggregate amount payable annually is then multiplied by the applicable adjustment factor set forth in Table K in § 20.2031-7(d)(6) at the appropriate interest rate component for payments made at the end of the specified periods. The provisions of this paragraph (d)(2)(iv)(B) are illustrated by the following example:

Example. In July of a year after 2009 but before 2019, the donor agreed to pay the annuitant the sum of \$10,000 per year, payable in equal semiannual installments at the end of each period. The semiannual installments are to be made on each December 31st and June 30th. The annuity is payable until the annuitant's death. On the date of the agreement, the annuitant is 68 years and 5 months old. The donee annuitant's age is treated as 68 for purposes of computing the present value of the annuity. The section 7520 rate on the date of the agreement is 6.6 percent. Under Table S in § 20.2031-7(d)(7), the factor at 6.6 percent for determining the present value of a remainder interest payable at the death of an individual aged 68 is .42001. Converting the remainder factor to an annuity factor, as described above, the annuity factor for determining the present value of an annuity transferred to an individual age 68 is 8.7877 (1.000000 minus .42001 divided by .066). The adjustment factor from Table K in § 20.2031-7(d)(6) in the column for payments made at the end of each semiannual period at the rate of 6.6 percent is 1.0162. The aggregate annual amount of the annuity, \$10,000, is multiplied by the factor 8.7877 and the product is multiplied by 1.0162. The present value of the donee's annuity is, therefore, \$89,300.61 ($\$10,000 \times 8.7877 \times 1.0162$).

(C) If an annuity is payable at the beginning of annual, semiannual, quarterly, monthly, or weekly periods for a term of years, the value of the annuity is computed by multiplying the aggregate amount payable annually by the annuity factor described in paragraph

(d)(2)(iv)(A) of this section; and the product so obtained is then multiplied by the adjustment factor in Table J in § 20.2031-7(d)(6) of this chapter at the appropriate interest rate component for payments made at the beginning of specified periods. If an annuity is payable at the beginning of annual, semi-annual, quarterly, monthly, or weekly periods for one or more lives, the value of the annuity is the sum of the first payment and the present value of a similar annuity, the first payment of which is not to be made until the end of the payment period, determined as provided in paragraph (d)(2)(iv)(B) of this section.

(v) *Annuity and unitrust interests for a term of years or until the prior death of an individual*—(A) *Annuity interests.* The present value of an annuity interest that is payable until the earlier to occur of the lapse of a specific number of years or the death of an individual may be computed with values from the tables in §§ 20.2031-7(d)(6) and 20.2031-7(d)(7) of this chapter as described in the following example:

Example. The donor transfers \$100,000 into a trust early in 2010, and retains the right to receive an annuity from the trust in the amount of \$6,000 per year, payable in equal semiannual installments at the end of each period. The semiannual installments are to be made on each June 30th and December 31st.

The annuity is payable for 10 years or until the donor's prior death. At the time of the transfer, the donor is 59 years and 6 months old. The donor's age is deemed to be 60 for purposes of computing the present value of the retained annuity. If the section 7520 rate for the month in which the transfer occurs in 5.8 percent, the present value of the donor's retained interest would be \$42,575.65, determined as follows:

| | |
|---------------------------|--------|
| TABLE S value at 5.8 per- | |
| cent, age 60 | 34656 |
| TABLE S value at 5.8 per- | |
| cent, age 70 | .49025 |
| TABLE 2000CM value at age | |
| 70 | 74794 |
| TABLE 2000CM value at age | |
| 60 | 87595 |
| TABLE B value at 5.8 per- | |
| cent, 10 years | 569041 |
| TABLE K value at 5.8 per- | |
| cent | 1.0143 |

$$\frac{(1.00000 - .34656) - (.569041 \times (74794/87595) \times (1.00000 - .49025))}{.058} = 6.9959$$

Factor for donor's retained interest at 5.8 percent:

Present value of donor's retained interest:
 $(\$6,000 \times 6.9959 \times 1.0143) \dots \$42,575.65$

(B) *Unitrust interests.* The present value of a unitrust interest that is payable until the earlier to occur of the lapse of a specific number of years or the death of an individual may be computed with values from the tables in §§ 1.664-4(e)(6) and 1.664-4(e)(7) of this chapter as described in the following example:

Example. The donor who, as of the nearest birthday, is 60 years old, transfers \$100,000 to a unitrust on January 1st of a year after 2009 but before 2019. The trust instrument requires that each year the trust pay to the donor, in equal semiannual installments on June 30th and December 31st, 6 percent of the fair market value of the trust assets, valued as of January 1st each year, for 10 years or until the prior death of the donor. The section 7520 rate for the January in which the

transfer occurs is 6.6 percent. Under Table F(6.6) in § 1.664-4(e)(6), the appropriate adjustment factor is .953317 for semiannual payments payable at the end of the semi-annual period. The adjusted payout rate is 5.720 percent (6% × .953317). The present value of the donor's retained interest is \$41,920.00 determined as follows:

| | |
|---------------------------|---------|
| TABLE U(1) value at 5.6 | |
| percent, age 60 | .33970 |
| TABLE U(1) value at 5.6 | |
| percent, age 70 | .48352 |
| TABLE 2000CM value at age | |
| 70 | 74794 |
| TABLE 2000CM value at age | |
| 60 | 87595 |
| TABLE D value at 5.6 per- | |
| cent, 10 years | .561979 |

Factor for donor's retained interest at 5.6 percent:

$$(1.000000 - .33970) - (.561979 \times (74794/87595) \times (1.000000 - .48352)) = .41247$$

| | |
|-------------------------|--------|
| TABLE U(1) value at 5.8 | |
| percent, age 60 | .32846 |

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| | | | |
|---|--------|--|---------|
| TABLE U(1) value at 5.8 percent, age 70 | .47241 | TABLE 2000CM value at age 60 | 87595 |
| TABLE 2000CM value at age 70 | 74794 | TABLE D value at 5.8 percent, 10 years | .550185 |

$$(1.000000 - .32846) - (.550185 \times (74974/87595) \times (1.000000 - .47241)) = .42369$$

Difference .. .01122

Interpolation adjustment:

$$\frac{5.720\% - 5.6\%}{0.2\%} = \frac{x}{.01122}$$

$$x = .00673$$

| | |
|--------------------------------------|--------|
| Factor at 5.6 percent, age 60 | .41247 |
| Plus: Interpolation adjustment | .00673 |
| Interpolated Factor | .41920 |

Present value of donor's retained interest:

$$(\$100,000 \times .41920) \dots\dots\dots \$41,920.00.$$

Factor for donor's retained interest at 5.8 percent:

(3) *Transitional rule.* If the valuation date of a transfer of property by gift is on or after May 1, 2009, and before July 1, 2009, the fair market value of the interest transferred is determined by use of the section 7520 interest rate for the month in which the valuation date occurs (see §§25.7520-1(b) and 25.7520-2(a)(2)) and the appropriate actuarial tables under either §20.2031-7(d)(7) or §20.2031-7A(f)(4) of this chapter, at the option of the donor. However, with respect to each individual transaction and with respect to all transfers occurring on the valuation date, the donor must use the same actuarial tables (for example, gift and income tax charitable deductions with respect to the same transfer must be determined based on the same tables, and all transfers made on the same date must be valued based on the same tables).

(4) *Publications and actuarial computations by the Internal Revenue Service.* Many standard actuarial factors not included in §20.2031-7(d)(6) or §20.2031-7(d)(7) of this chapter are included in

Internal Revenue Service Publication 1457, "Actuarial Valuations Version 3A" (2009). Internal Revenue Service Publication 1457 also includes examples that illustrate how to compute many special factors for more unusual situations. A copy of this publication is available, at no charge, electronically via the IRS Internet site at <http://www.irs.gov>. If a special factor is required in the case of a completed gift, the Internal Revenue Service may furnish the factor to the donor upon a request for a ruling. The request for a ruling must be accompanied by a recitation of the facts including a statement of the date of birth for each measuring life, the date of the gift, any other applicable dates, and a copy of the will, trust, or other relevant documents. A request for a ruling must comply with the instructions for requesting a ruling published periodically in the Internal Revenue Bulletin (see §§601.201 and 601.601(d)(2)(ii)(b) of this chapter) and include payment of the required user fee.

(e) *Effective/applicability date.* This section applies on and after May 1, 2009.

[T.D. 8540, 59 FR 30174, June 10, 1994, as amended by T.D. 8819, 64 FR 23224, Apr. 30, 1999; T.D. 8886, 65 FR 36940, June 12, 2000; 65 FR 39470, June 26, 2000; 65 FR 58222, Sept. 28, 2000; T.D. 9448, 74 FR 21512, May 7, 2009; T.D. 9540, 76 FR 49639, Aug. 10, 2011]

§ 25.2512-6 Valuation of certain life insurance and annuity contracts; valuation of shares in an open-end investment company.

(a) *Valuation of certain life insurance and annuity contracts.* The value of a life insurance contract or of a contract for the payment of an annuity issued by a company regularly engaged in the selling of contracts of that character is established through the sale of the particular contract by the company, or through the sale by the company of comparable contracts. As valuation of an insurance policy through sale of comparable contracts is not readily ascertainable when the gift is of a contract which has been in force for some time and on which further premium payments are to be made, the value may be approximated by adding to the interpolated terminal reserve at the date of the gift the proportionate part of the gross premium last paid before the date of the gift which covers the period extending beyond that date. If, however, because of the unusual nature of the contract such approximation is not reasonably close to the full value, this method may not be used. The following examples, so far as relating to life insurance contracts, are of gifts of such contracts on which there are no accrued dividends or outstanding indebtedness.

Example (1). A donor purchases from a life insurance company for the benefit of another a life insurance contract or a contract for the payment of an annuity. The value of the gift is the cost of the contract.

Example (2). An annuitant purchased from a life insurance company a single payment annuity contract by the terms of which he was entitled to receive payments of \$1,200 annually for the duration of his life. Five years subsequent to such purchase, and when of the age of 50 years, he gratuitously assigns the contract. The value of the gift is the amount which the company would charge for an annuity contract providing for the pay-

ment of \$1,200 annually for the life of a person 50 years of age.

Example (3). A donor owning a life insurance policy on which no further payments are to be made to the company (e.g., a single premium policy or paid-up policy) makes a gift of the contract. The value of the gift is the amount which the company would charge for a single premium contract of the same specified amount on the life of a person of the age of the insured.

Example (4). A gift is made four months after the last premium due date of an ordinary life insurance policy issued nine years and four months prior to the gift thereof by the insured, who was 35 years of age at date of issue. The gross annual premium is \$2,811. The computation follows:

| | |
|--|-------------|
| Terminal reserve at end of tenth year | \$14,601.00 |
| Terminal reserve at end of ninth year | 12,965.00 |
| Increase | 1,636.00 |
| One-third of such increase (the gift having been made four months following the last preceding premium due date), is | 545.33 |
| Terminal reserve at end of ninth year | 12,965.00 |
| Interpolated terminal reserve at date of gift | 13,510.33 |
| Two-thirds of gross premium (\$2,811) | 1,874.00 |
| Value of the gift | 15,384.33 |

Example (5). A donor purchases from a life insurance company for \$15,198, a joint and survivor annuity contract which provides for the payment of \$60 a month to the donor during his lifetime, and then to his sister for such time as she may survive him. The premium which would have been charged by the company for an annuity of \$60 monthly payable during the life of the donor alone is \$10,690. The value of the gift is \$4,508 (\$15,198 less \$10,690).

(b) *Valuation of shares in an open-end investment company.* (1) The fair market value of a share in an open-end investment company (commonly known as a "mutual fund") is the public redemption price of a share. In the absence of an affirmative showing of the public redemption price in effect at the time of the gift, the last public redemption price quoted by the company for the date of the gift shall be presumed to be the applicable public redemption price. If there is no public redemption price quoted by the company for the date of the gift (e.g., the date of the gift is a Saturday, Sunday, or holiday), the fair market value of the mutual fund share is the last public redemption price quoted by the company for the first day preceding the date of the gift for which there is a quotation. As used in

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this paragraph the term “open-end investment company” includes only a company which on the date of the gift was engaged in offering its shares to the public in the capacity of an open-end investment company.

(2) The provisions of this paragraph shall apply with respect to gifts made after December 31, 1954.

[T.D. 6680, 28 FR 10872, Oct. 10, 1963, as amended by T.D. 7319, 39 FR 26723, July 23, 1974]

§ 25.2512-7 Effect of excise tax.

If jewelry, furs or other property, the purchase of which is subject to an excise tax, is purchased at retail by a taxpayer and made the subject of gifts within a reasonable time after purchase, the purchase price, including the excise tax, is considered to be the fair market value of the property on the date of the gift, in the absence of evidence that the market price of similar articles has increased or decreased in the meantime. Under other circumstances, the excise tax is taken into account in determining the fair market value of property to the extent, and only to the extent, that it affects the price at which the property would change hands between a willing buyer and a willing seller, as provided in § 25.2512-1.

§ 25.2512-8 Transfers for insufficient consideration.

Transfers reached by the gift tax are not confined to those only which, being without a valuable consideration, accord with the common law concept of gifts, but embrace as well sales, exchanges, and other dispositions of property for a consideration to the extent that the value of the property transferred by the donor exceeds the value in money or money's worth of the consideration given therefor. However, a sale, exchange, or other transfer of property made in the ordinary course of business (a transaction which is bona fide, at arm's length, and free from any donative intent), will be considered as made for an adequate and full consideration in money or money's worth. A consideration not reducible to a value in money or money's worth, as love and affection, promise of marriage, etc., is to be wholly disregarded,

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and the entire value of the property transferred constitutes the amount of the gift. Similarly, a relinquishment or promised relinquishment of dower or curtesy, or of a statutory estate created in lieu of dower or curtesy, or of other marital rights in the spouse's property or estate, shall not be considered to any extent a consideration “in money or money's worth.” See, however, section 2516 and the regulations thereunder with respect to certain transfers incident to a divorce. See also sections 2701, 2702, 2703 and 2704 and the regulations at §§ 25.2701-0 through 25.2704-3 for special rules for valuing transfers of business interests, transfers in trust, and transfers pursuant to options and purchase agreements.

[T.D. 6334, 23 FR 8904, Nov. 15, 1958; 25 FR 14021, Dec. 31, 1960; as amended by T.D. 8395, 57 FR 4255, Feb. 4, 1992]

§ 25.2513-1 Gifts by husband or wife to third party considered as made one-half by each.

(a) A gift made by one spouse to a person other than his (or her) spouse may, for the purpose of the gift tax, be considered as made one-half by his spouse, but only if at the time of the gift each spouse was a citizen or resident of the United States. For purposes of this section, an individual is to be considered as the spouse of another individual only if he was married to such individual at the time of the gift and does not remarry during the remainder of the “calendar period” (as defined in § 25.2502-1(c)(1)).

(b) The provisions of this section will apply to gifts made during a particular “calendar period” (as defined in § 25.2502-1(c)(1)) only if both spouses signify their consent to treat all gifts made to third parties during that calendar period by both spouses while married to each other as having been made one-half by each spouse. As to the manner and time for signifying consent, see § 25.2513-2. Such consent, if signified with respect to any calendar period, is effective with respect to all gifts made to third parties during such calendar period except as follows:

(1) If the consenting spouses were not married to each other during a portion of the calendar period, the consent is not effective with respect to any gifts

made during such portion of the calendar period. Where the consent is signified by an executor or administrator of a deceased spouse, the consent is not effective with respect to gifts made by the surviving spouse during the portion of the calendar period that his spouse was deceased.

(2) If either spouse was a nonresident not a citizen of the United States during any portion of the calendar period, the consent is not effective with respect to any gift made during that portion of the calendar period.

(3) The consent is not effective with respect to a gift by one spouse of a property interest over which he created in his spouse a general power of appointment (as defined in section 2514(c)).

(4) If one spouse transferred property in part to his spouse and in part to third parties, the consent is effective with respect to the interest transferred to third parties only insofar as such interest is ascertainable at the time of the gift and hence severable from the interest transferred to his spouse. See § 25.2512-5 for the principles to be applied in the valuation of annuities, life estates, terms for years, remainders and reversions.

(5) The consent applies alike to gifts made by one spouse alone and to gifts made partly by each spouse, provided such gifts were to third parties and do not fall within any of the exceptions set forth in subparagraphs (1) through (4) of this paragraph. The consent may not be applied only to a portion of the property interest constituting such gifts. For example, a wife may not treat gifts made by her spouse from his separate property to third parties as having been made one-half by her if her spouse does not consent to treat gifts made by her to third parties during the same calendar period as having been made one-half by him. If the consent is effectively signified on either the husband's return or the wife's return, all gifts made by the spouses to third parties (except as described in subparagraphs (1) through (4) of this paragraph), during the calendar period will be treated as having been made one-half by each spouse.

(c) If a husband and wife consent to have the gifts made to third party

donees considered as made one-half by each spouse, and only one spouse makes gifts during the "calendar period" (as defined in § 25.2502-1(c)(1)), the other spouse is not required to file a gift tax return provided: (1) The total value of the gifts made to each third party donee since the beginning of the calendar year is not in excess of \$20,000 (\$6,000 for calendar years prior to 1982), and (2) no portion of the property transferred constitutes a gift of a future interest. If a transfer made by either spouse during the calendar period to a third-party represents a gift of a future interest in property and the spouses consent to have the gifts considered as made one-half by each, a gift tax return for such calendar period must be filed by each spouse regardless of the value of the transfer. (See § 25.2503-3 for the definition of a future interest.)

(d) The following examples illustrate the application of this section relating to the requirements for the filing of a return, assuming that a consent was effectively signified:

(1) A husband made gifts valued at \$7,000 during the second quarter of 1971 to a third party and his wife made no gifts during this time. Each spouse is required to file a return for the second calendar quarter of 1971.

(2) A husband made gifts valued at \$5,000 to each of two third parties during the year 1970 and his wife made no gifts. Only the husband is required to file a return. (See § 25.6019-2.)

(3) During the third quarter of 1971, a husband made gifts valued at \$5,000 to a third party, and his wife made gifts valued at \$2,000 to the same third party. Each spouse is required to file a return for the third calendar quarter of 1971.

(4) A husband made gifts valued at \$5,000 to a third party and his wife made gifts valued at \$3,000 to another third party during the year 1970. Only the husband is required to file a return for the calendar year 1970. (See § 25.6019-2.)

(5) A husband made gifts valued at \$2,000 during the first quarter of 1971 to third parties which represented gifts of future interests in property (see § 25.2503-3), and his wife made no gifts during such calendar quarter. Each

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spouse is required to file a return for the first calendar quarter of 1971.

[T.D. 6334, 23 FR 8904, Nov. 15, 1958, as amended by T.D. 7238, 37 FR 28729, Dec. 29, 1972; T.D. 7910, 48 FR 40374, Sept. 7, 1983]

§ 25.2513-2 Manner and time of signifying consent.

(a)(1) Consent to the application of the provisions of section 2513 with respect to a “calendar period” (as defined in § 25.2502-1(c)(1)) shall, in order to be effective, be signified by both spouses. If both spouses file gift tax returns within the time for signifying consent, it is sufficient if—

(i) The consent of the husband is signified on the wife’s return, and the consent of the wife is signified on the husband’s return;

(ii) The consent of each spouse is signified on his own return; or

(iii) The consent of both spouses is signified on one of the returns.

If only one spouse files a gift tax return within the time provided for signifying consent, the consent of both spouses shall be signified on that return. However, wherever possible, the notice of the consent is to be shown on both returns and it is preferred that the notice be executed in the manner described in subdivision (i) of this subparagraph. The consent may be revoked only as provided in § 25.2513-3. If one spouse files more than one gift tax return for a calendar period on or before the due date of the return, the last return so filed shall, for the purpose of determining whether a consent has been signified, be considered as the return. (See §§ 25.6075-1 and 25.6075-2 for the due date of a gift tax return.)

(2) For gifts made after December 31, 1970, and before January 1, 1982 subject to the limitations of paragraph (b) of this section, the consent signified on a return filed for a calendar quarter will be effective for a previous calendar quarter of the same calendar year for which no return was filed because the gifts made during such previous calendar quarter did not exceed the annual exclusion provided by section 2503(b), if the gifts in such previous calendar quarter are listed on that return. Thus, for example, if A gave \$2,000 to his son in the first quarter of 1972 (and filed no return because of section

2503(b)) and gave a further \$4,000 to such son in the last quarter of the year, A and his spouse could signify consent to the application of section 2513 on the return filed for the fourth quarter and have it apply to the first quarter as well, provided that the \$2,000 gift is listed on such return.

(b)(1) With respect to gifts made after December 31, 1981, or before January 1, 1971, the consent may be signified at any time following the close of the calendar year, subject to the following limitations:

(i) The consent may not be signified after the 15th day of April following the close of the calendar year, unless before such 15th day no return has been filed for the year by either spouse, in which case the consent may not be signified after a return for the year is filed by either spouse; and

(ii) The consent may not be signified for a calendar year after a notice of deficiency in gift tax for that year has been sent to either spouse in accordance with the provisions of section 6212(a).

(2) With respect to gifts made after December 31, 1970 and before January 1, 1982, the consent may be signified at any time following the close of the calendar quarter in which the gift was made, subject to the following limitations:

(i) The consent may not be signified after the 15th day of the second month following the close of such calendar quarter, unless before such 15th day, no return has been filed for such calendar quarter by either spouse, in which case the consent may not be signified after a return for such calendar quarter is filed by either spouse; and

(ii) The consent may not be signified after a notice of deficiency with respect to the tax for such calendar quarter has been sent to either spouse in accordance with section 6212(a).

(c) The executor or administrator of a deceased spouse, or the guardian or committee of a legally incompetent spouse, as the case may be, may signify the consent.

(d) If the donor and spouse consent to the application of section 2513, the return or returns for the “calendar period” (as defined in § 25.2502-1(c)(1)) must set forth, to the extent provided

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thereon, information relative to the transfers made by each spouse.

[T.D. 6334, 23 FR 8904, Nov. 15, 1958, as amended by T.D. 7238, 37 FR 28730, Dec. 29, 1972; T.D. 7910, 48 FR 40375, Sept. 7, 1983]

§ 25.2513-3 Revocation of consent.

(a)(1) With respect to gifts made after December 31, 1981, or before January 1, 1971, if the consent to the application of the provisions of section 2513 for a calendar year was effectively signified on or before the 15th day of April following the close of the calendar year, either spouse may revoke the consent by filing in duplicate a signed statement of revocation, but only if the statement is filed on or before such 15th day of April. Therefore, a consent that was not effectively signified until after the 15th day of April following the close of the calendar year to which it applies may not be revoked.

(2) With respect to gifts made after December 31, 1970, and before January 1, 1982, if the consent to the application of the provisions of section 2513 for a calendar quarter was effectively signified on or before the 15th day of the second month following the close of such calendar quarter, either spouse may revoke the consent by filing in duplicate a signed statement of revocation, but only if the statement is filed on or before such 15th day of the second month following the close of such calendar quarter. Therefore, a consent that was not effectively signified until after the 15th day of the second month following the close of the calendar quarter to which it applies may not be revoked.

(b) Except as provided in paragraph (b) of § 301.6091-1 of this chapter (relating to hand-carried documents), the statement referred to in paragraph (a) of this section shall be filed with the internal revenue officer with whom the gift tax return is required to be filed, or with whom the gift tax return would be required to be filed if a return were required.

[T.D. 7238, 37 FR 28730, Dec. 29, 1972, as amended by T.D. 7910, 48 FR 40375, Sept. 7, 1983]

§ 25.2513-4 Joint and several liability for tax.

If consent to the application of the provisions of section 2513 is signified as provided in § 25.2513-2, and not revoked as provided in § 25.2513-3, the liability with respect to the entire gift tax of each spouse for such "calendar period" (as defined in § 25.2502-1(c)(1)) is joint and several. See paragraph (d) of § 25.2511-1.

[T.D. 7238, 37 FR 28730, Dec. 29, 1972, as amended by T.D. 7910, 48 FR 40375, Sept. 7, 1983]

§ 25.2514-1 Transfers under power of appointment.

(a) *Introductory.* (1) Section 2514 treats the exercise of a general power of appointment created on or before October 21, 1942, as a transfer of property for purposes of the gift tax. The section also treats as a transfer of property the exercise or complete release of a general power of appointment created after October 21, 1942, and under certain circumstances the exercise of a power of appointment (not a general power of appointment) created after October 21, 1942, by the creation of another power of appointment. See paragraph (d) of § 25.2514-3. Under certain circumstances, also, the failure to exercise a power of appointment created after October 21, 1942, within a specified time, so that the power lapses, constitutes a transfer of property. Paragraphs (b) through (e) of this section contain definitions of certain terms used in §§ 25.2514-2 and 25.2514-3. See § 25.2514-2 for specific rules applicable to certain powers created on or before October 21, 1942. See § 25.2514-3 for specific rules applicable to powers created after October 21, 1942.

(2) [Reserved]

(b) *Definition of "power of appointment"*—(1) *In general.* The term "power of appointment" includes all powers which are in substance and effect powers of appointment received by the donee of the power from another person, regardless of the nomenclature used in creating the power and regardless of local property law connotations. For example, if a trust instrument provides that the beneficiary may appropriate or consume the principal of the

trust, the power to consume or appropriate is a power of appointment. Similarly, a power given to a donee to affect the beneficial enjoyment of a trust property or its income by altering, amending or revoking the trust instrument or terminating the trust is a power of appointment. A power in a donee to remove or discharge a trustee and appoint himself may be a power of appointment. For example, if under the terms of a trust instrument, the trustee or his successor has the power to appoint the principal of the trust for the benefit of individuals including himself, and A, another person, has the unrestricted power to remove or discharge the trustee at any time and appoint any other person, including himself, A is considered as having a power of appointment. However, he would not be considered to have a power of appointment if he only had the power to appoint a successor, including himself, under limited conditions which did not exist at the time of exercise, release or lapse of the trustee's power, without an accompanying unrestricted power of removal. Similarly, a power to amend only the administrative provisions of a trust instrument, which cannot substantially affect the beneficial enjoyment of the trust property or income, is not a power of appointment. The mere power of management, investment, custody of assets, or the power to allocate receipts and disbursements as between income and principal, exercisable in a fiduciary capacity, whereby the holder has no power to enlarge or shift any of the beneficial interests therein except as an incidental consequence of the discharge of such fiduciary duties is not a power of appointment. Further, the right in a beneficiary of a trust to assent to a periodic accounting, thereby relieving the trustee from further accountability, is not a power of appointment if the right of assent does not consist of any power or right to enlarge or shift the beneficial interest of any beneficiary therein.

(2) *Relation to other sections.* For purposes of §§ 25.2514-1 through 25.2514-3, the term "power of appointment" does not include powers reserved by a donor to himself. No provision of section 2514 or of §§ 25.2514-1 through 25.2514-3 is to

be construed as in any way limiting the application of any other section of the Internal Revenue Code or of these regulations. The power of the owner of a property interest already possessed by him to dispose of his interest, and nothing more, is not a power of appointment, and the interest is includible in the amount of his gifts to the extent it would be includible under section 2511 or other provisions of the Internal Revenue Code. For example, if a trust created by S provides for payment of the income to A for life with power in A to appoint the entire trust property by deed during her lifetime to a class consisting of her children, and a further power to dispose of the entire corpus by will to anyone, including her estate, and A exercises the *inter vivos* power in favor of her children, she has necessarily made a transfer of her income interest which constitutes a taxable gift under section 2511(a), without regard to section 2514. This transfer also results in a relinquishment of her general power to appoint by will which constitutes a transfer under section 2514 if the power was created after October 21, 1942.

(3) *Powers over a portion of property.* If a power of appointment exists as to part of an entire group of assets or only over a limited interest in property, section 2514 applies only to such part or interest.

(c) *Definition of "general power of appointment"*—(1) *In general.* The term "general power of appointment" as defined in section 2514(c) means any power of appointment exercisable in favor of the person possessing the power (referred to as the "possessor"), his estate, his creditors, or the creditors of his estate, except (i) joint powers, to the extent provided in §§ 25.2514-2 and 25.2514-3 and (ii) certain powers limited by an ascertainable standard, to the extent provided in subparagraph (2) of this paragraph. A power of appointment exercisable to meet the estate tax, or any other taxes, debts, or charges which are enforceable against the possessor or his estate, is included within the meaning of a power of appointment exercisable in favor of the possessor, his estate, his creditors, or the creditors of his estate. A power of

appointment exercisable for the purpose of discharging a legal obligation of the possessor or for his pecuniary benefit is considered a power of appointment exercisable in favor of the possessor or his creditors. However, for purposes of §§ 25.2514-1 through 25.2514-3, a power of appointment not otherwise considered to be a general power of appointment is not treated as a general power of appointment merely by reason of the fact that an appointee may, in fact, be a creditor of the possessor or his estate. A power of appointment is not a general power if by its terms it is either—

(a) Exercisable only in favor of one or more designated persons or classes other than the possessor or his creditors, or the possessor's estate, or the creditors of his estate, or

(b) Expressly not exercisable in favor of the possessor or his creditors, the possessor's estate, or the creditors of his estate.

A beneficiary may have two powers under the same instrument, one of which is a general power of appointment and the other of which is not. For example, a beneficiary may have a general power to withdraw a limited portion of trust corpus during his life, and a further power exercisable during his lifetime to appoint the corpus among his children. The later power is not a general power of appointment (but its exercise may result in the exercise of the former power; see paragraph (d) of this section).

(2) *Powers limited by an ascertainable standard.* A power to consume, invade, or appropriate income or corpus, or both, for the benefit of the possessor which is limited by an ascertainable standard relating to the health, education, support, or maintenance of the possessor is, by reason of section 2514(c)(1), not a general power of appointment. A power is limited by such a standard if the extent of the possessor's duty to exercise and not to exercise the power is reasonably measurable in terms of his needs for health, education, or support (or any combination of them). As used in this subparagraph, the words "support" and "maintenance" are synonymous and their meaning is not limited to the bare necessities of life. A power to use

property for the comfort, welfare, or happiness of the holder of the power is not limited by the requisite standard. Examples of powers which are limited by the requisite standard are powers exercisable for the holder's "support," "support in reasonable comfort," "maintenance in health and reasonable comfort," "support in his accustomed manner of living," "education, including college and professional education," "health," and "medical, dental, hospital and nursing expenses and expenses of invalidism." In determining whether a power is limited by an ascertainable standard, it is immaterial whether the beneficiary is required to exhaust his other income before the power can be exercised.

(3) *Certain powers under wills of decedents dying between January 1 and April 2, 1948.* Section 210 of the Technical Changes Act of 1953 provides that if a decedent died after December 31, 1947, but before April 3, 1948, certain property interests described therein may, if the decedent's surviving spouse so elects, be accorded special treatment in the determination of the marital deduction to be allowed the decedent's estate under the provisions of section 812(e) of the Internal Revenue Code of 1939. See paragraph (h) of § 81.47a of Regulations 105 (26 CFR (1939) 81.47a(h)). The section further provides that property affected by the election shall be considered property with respect to which the surviving spouse has a general power of appointment. Therefore, notwithstanding any other provision of law or of §§ 25.2514-1 through 25.2514-3, if the surviving spouse has made an election under section 210 of the Technical Changes Act of 1953, the property which was the subject of the election shall be considered as property with respect to which she has a general power of appointment created after October 21, 1942, exercisable by deed or will, to the extent it was treated as an interest passing to the surviving spouse and not passing to any other person for the purpose of the marital deduction in the prior decedent's estate.

(d) *Definition of "exercise."* Whether a power of appointment is in fact exercised may depend upon local law. However, regardless of local law, a power of

appointment is considered as exercised for purposes of section 2514 even though the exercise is in favor of the taker in default of appointment, and irrespective of whether the appointed interest and the interest in default of appointment are identical or whether the appointee renounces any right to take under the appointment. A power of appointment is also considered as exercised even though the disposition cannot take effect until the occurrence of an event after the exercise takes place, if the exercise is irrevocable and, as of the time of the exercise, the condition was not impossible of occurrence. For example, if property is left in trust to A for life, with a power in A to appoint the remainder by an instrument filed with the trustee during his life, and A exercises his power by appointing the remainder to B in the event that B survives A, A is considered to have exercised his power if the exercise was irrevocable. Furthermore, if a person holds both a presently exercisable general power of appointment and a presently exercisable nongeneral power of appointment over the same property, the exercise of the nongeneral power is considered the exercise of the general power only to the extent that immediately after the exercise of the nongeneral power the amount of money or property subject to being transferred by the exercise of the general power is decreased. For example, assume A has a noncumulative annual power to withdraw the greater of \$5,000 or 5 percent of the value of a trust having a value of \$300,000 and a lifetime nongeneral power to appoint all or a portion of the trust corpus to A's child or grandchildren. If A exercises the nongeneral power by appointing \$150,000 to A's child, the exercise of the nongeneral power is treated as the exercise of the general power to the extent of \$7,500 (maximum exercise of general power before the exercise of the nongeneral power, 5% of \$300,000 or \$15,000, less maximum exercise of the general power after the exercise of the nongeneral power, 5% of \$150,000 or \$7,500).

(e) *Time of creation of power.* A power of appointment created by will is, in general, considered as created on the date of the testator's death. However, section 2514(f) provides that a power of

appointment created by a will executed on or before October 21, 1942, is considered a power created on or before that date if the testator dies before July 1, 1949, without having republished the will, by codicil or otherwise, after October 21, 1942. A power of appointment created by an inter vivos instrument is considered as created on the date the instrument takes effect. Such a power is not considered as created at some future date merely because it is not exercisable on the date the instrument takes effect, or because it is revocable, or because the identity of its holders is not ascertainable until after the date the instrument takes effect. However, if the holder of a power exercises it by creating a second power, the second power is considered as created at the time of the exercise of the first. The application of this paragraph may be illustrated by the following examples:

Example (1). A created a revocable trust before October 22, 1942, providing for payment of income to B for life with remainder as B shall appoint by deed or will. Even though A dies after October 21, 1942, without having exercised his power of revocation, B's power of appointment is considered a power created before October 22, 1942.

Example (2). C created an irrevocable inter vivos trust before October 22, 1942, naming T as trustee and providing for payment of income to D for life with remainder to E. T was given the power to pay corpus to D and the power to appoint a successor trustee. If T resigns after October 21, 1942, and appoints D as successor trustee, D is considered to have a power of appointment created before October 22, 1942.

Example (3). F created an irrevocable inter vivos trust before October 22, 1942, providing for payment of income to G for life with remainder as G shall appoint by deed or will, but in default of appointment income to H for life with remainder as H shall appoint by deed or will. If G died after October 21, 1942, without having exercised his power of appointment, H's power of appointment is considered a power created before October 22, 1942, even though it was only a contingent interest until G's death.

Example (4). If in example (3) above G had exercised by will his power of appointment, by creating a similar power in J, J's power of appointment would be considered a power created after October 21, 1942.

[T.D. 6334, 23 FR 8904, Nov. 15, 1958, as amended by T.D. 6582, 26 FR 11861, Dec. 12, 1961, T.D. 9757, 46 FR 6929, Jan. 22, 1981]

§ 25.2514-2 Powers of appointment created on or before October 21, 1942.

(a) *In general.* The exercise of a general power of appointment created on or before October 21, 1942, is deemed to be a transfer of property by the individual possessing the power.

(b) *Joint powers created on or before October 21, 1942.* Section 2514(c)(2) provides that a power created on or before October 21, 1942, which at the time of the exercise is not exercisable by the possessor except in conjunction with another person, is not deemed a general power of appointment.

(c) *Release or lapse.* A failure to exercise a general power of appointment created on or before October 21, 1942, or a complete release of such a power is not considered to be an exercise of a general power of appointment. The phrase "a complete release" means a release of all powers over all or a portion of the property subject to a power of appointment, as distinguished from the reduction of a power of appointment to a lesser power. Thus, if the possessor completely relinquished all powers over one-half of the property subject to a power of appointment, the power is completely released as to that one-half. If at or before the time a power of appointment is relinquished, the holder of the power exercises the power in such a manner or to such an extent that the relinquishment results in the reduction, enlargement, or shift in a beneficial interest in property, the relinquishment will be considered to be an exercise and not a release of the power. For example, assume that A created a trust in 1940 providing for payment of the income to B for life with the power in B to amend the trust, and for payment of the remainder to such persons as B shall appoint or, upon default of appointment, to C. If B amended the trust in 1948 by providing that upon his death the remainder was to be paid to D, and if he further amended the trust in 1955 by deleting his power to amend the trust, such relinquishment will be considered an exercise and not a release of a general power of appointment. On the other hand, if the 1948 amendment became ineffective before or at the time of the 1955 amendment, or if B in 1948 merely amended the trust by changing the

purely ministerial powers of the trustee, his relinquishment of the power in 1955 will be considered as release of a power of appointment.

(d) *Partial release.* If a general power of appointment created on or before October 21, 1942, is partially released so that it is not thereafter a general power of appointment, a subsequent exercise of the partially released power is not an exercise of a general power of appointment if the partial release occurs before whichever is the later of the following dates:

(1) November 1, 1951; or

(2) If the possessor was under a legal disability to release the power on October 21, 1942, the day after the expiration of 6 months following the termination of such legal disability.

However, if a general power created on or before October 21, 1942, is partially released on or after the later of those dates, a subsequent exercise of the power will constitute an exercise of a general power of appointment. The legal disability referred to in this paragraph is determined under local law and may include the disability of an insane person, a minor, or an unborn child. The fact that the type of general power of appointment possessed by the holder actually was not generally releasable under the local law does not place the holder under a legal disability within the meaning of this paragraph. In general, however, it is assumed that all general powers of appointment are releasable, unless the local law on the subject is to the contrary, and it is presumed that the method employed to release the power is effective, unless it is not in accordance with the local law relating specifically to releases or, in the absence of such local law, is not in accordance with the local law relating to similar transactions.

(e) *Partial exercise.* If a general power of appointment created on or before October 21, 1942, is exercised only as to a portion of the property subject to the power, the exercise is considered to be a transfer only as to the value of that portion.

§ 25.2514-3 Powers of appointment created after October 21, 1942.

(a) *In general.* The exercise, release, or lapse (except as provided in paragraph (c) of this section) of a general power of appointment created after October 21, 1942, is deemed to be a transfer of property by the individual possessing the power. The exercise of a power of appointment that is not a general power is considered to be a transfer if it is exercised to create a further power under certain circumstances (see paragraph (d) of this section). See paragraph (c) of § 25.2514-1 for the definition of various terms used in this section. See paragraph (b) of this section for the rules applicable to determine the extent to which joint powers created after October 21, 1942, are to be treated as general powers of appointment.

(b) *Joint powers created after October 21, 1942.* The treatment of a power of appointment created after October 21, 1942, which is exercisable only in conjunction with another person is governed by section 2514(c)(3), which provides as follows:

(1) Such a power is not considered as a general power of appointment if it is not exercisable by the possessor except with the consent or joinder of the creator of the power.

(2) Such power is not considered as a general power of appointment if it is not exercisable by the possessor except with the consent or joinder of a person having a substantial interest in the property subject to the power which is adverse to the exercise of the power in favor of the possessor, his estate, his creditors, or the creditors of his estate. An interest adverse to the exercise of a power is considered as substantial if its value in relation to the total value of the property subject to the power is not insignificant. For this purpose, the interest is to be valued in accordance with the actuarial principles set forth in § 25.2512-5 or, if it is not susceptible to valuation under those provisions, in accordance with the general principles set forth in § 25.2512-1. A taker in default of appointment under a power has an interest which is adverse to an exercise of the power. A coholder of the power has no adverse interest merely because of his joint possession of the

power nor merely because he is a permissible appointee under a power. However, a coholder of a power is considered as having an adverse interest where he may possess the power after the possessor's death and may exercise it at that time in favor of himself, his estate, his creditors, or the creditors of his estate. Thus, for example, if X, Y, and Z held a power jointly to appoint among a group of persons which includes themselves and if on the death of X the power will pass to Y and Z jointly, then Y and Z are considered to have interests adverse to the exercise of the power in favor of X. Similarly, if on Y's death the power will pass to Z, Z is considered to have an interest adverse to the exercise of the power in favor of Y. The application of this subparagraph may be further illustrated by the following examples in each of which it is assumed that the value of the interest in question is substantial:

Example (1). The taxpayer and R are trustees of a trust under which the income is to be paid to the taxpayer for life and then to M for life, and R is remainderman. The trustees have power to distribute corpus to the taxpayer. Since R's interest is substantially adverse to an exercise of the power in favor of the taxpayer, the latter does not have a general power of appointment. If M and the taxpayer were trustees, M's interest would likewise be adverse.

Example (2). The taxpayer and L are trustees of a trust under which the income is to be paid to L for life and then to M for life, and the taxpayer is remainderman. The trustees have power to distribute corpus to the taxpayer during L's life. Since L's interest is adverse to an exercise of the power in favor of the taxpayer, the taxpayer does not have a general power of appointment. If the taxpayer and M were trustees, M's interest would likewise be adverse.

Example (3). The taxpayer and L are trustees of a trust under which the income is to be paid to L for life. The trustees can designate whether corpus is to be distributed to the taxpayer or to A after L's death. L's interest is not adverse to an exercise of the power in favor of the taxpayer, and the taxpayer therefore has a general power of appointment.

(3) A power which is exercisable only in conjunction with another person, and which after application of the rules set forth in subparagraphs (1) and (2) of this paragraph, constitutes a general power of appointment, will be treated as though the holders of the power who

are permissible appointees of the property were joint owners of property subject to the power. The possessor, under this rule, will be treated as possessed of a general power of appointment over an aliquot share of the property to be determined with reference to the number of joint holders, including the possessor, who (or whose estates or creditors) are permissible appointees. Thus, for example, if X, Y, and Z hold an unlimited power jointly to appoint among a group of persons, including themselves, but on the death of X the power does not pass to Y and Z jointly, then Y and Z are not considered to have interests adverse to the exercise of the power in favor of X. In this case, X is considered to possess a general power of appointment as to one-third of the property subject to the power.

(c) *Partial releases, lapses, and disclaimers of general powers of appointment created after October 21, 1942*—(1) *Partial release of power.* The general principles set forth in § 25.2511-2 for determining whether a donor of property (or of a property right or interest) has divested himself of all or any portion of his interest therein to the extent necessary to effect a completed gift are applicable in determining whether a partial release of a power of appointment constitutes a taxable gift. Thus, if a general power of appointment is partially released so that thereafter the donor may still appoint among a limited class of persons not including himself the partial release does not effect a complete gift, since the possessor of the power has retained the right to designate the ultimate beneficiaries of the property over which he holds the power and since it is only the termination of such control which completes a gift.

(2) *Power partially released before June 1, 1951.* If a general power of appointment created after October 21, 1942, was partially released prior to June 1, 1951, so that it no longer represented a general power of appointment, as defined in paragraph (c) of § 25.2514-1, the subsequent exercise, release, or lapse of the partially released power at any time thereafter will not constitute the exercise or release of a general power of appointment. For example, assume that A created a trust in 1943 under which B possessed a general power of

appointment. By an instrument executed in 1948 such general power of appointment was reduced in scope by B to an excepted power. The inter vivos exercise in 1955, or in any “calendar period” (as defined in § 25.2502-1(c)(1)) thereafter, of such excepted power is not considered an exercise or release of a general power of appointment for purposes of the gift tax.

(3) *Power partially released after May 31, 1951.* If a general power of appointment created after October 21, 1942, was partially released after May 31, 1951, the subsequent exercise, release or a lapse of the power at any time thereafter, will constitute the exercise or release of a general power of appointment for gift tax purposes.

(4) *Release or lapse of power.* A release of a power of appointment need not be formal or express in character. For example, the failure to exercise a general power of appointment created after October 21, 1942, within a specified time so that the power lapses, constitutes a release of the power. In any case where the possessor of a general power of appointment is incapable of validly exercising or releasing a power, by reason of minority, or otherwise, and the power may not be validly exercised or released on his behalf, the failure to exercise or release the power is not a lapse of the power. If a trustee has in his capacity as trustee a power which is considered as a general power of appointment, his resignation or removal as trustee will cause a lapse of his power. However, section 2514(e) provides that a lapse during any calendar year is considered as a release so as to be subject to the gift tax only to the extent that the property which could have been appointed by exercise of the lapsed power of appointment exceeds the greater of (i) \$5,000, or (ii) 5 percent of the aggregate value, at the time of the lapse, of the assets out of which, or the proceeds of which, the exercise of the lapsed power could be satisfied. For example, if an individual has a non-cumulative right to withdraw \$10,000 a year from the principal of a trust fund, the failure to exercise this right of withdrawal in a particular year will not constitute a gift if the fund at the end of the year equals or exceeds \$200,000. If, however, at the end of the

particular year the fund should be worth only \$100,000, the failure to exercise the power will be considered a gift to the extent of \$5,000, the excess of \$10,000 over 5 percent of a fund of \$100,000. Where the failure to exercise a power, such as a right of withdrawal, occurs in more than a single year, the value of the taxable transfer will be determined separately for each year.

(5) *Disclaimer of power created after December 31, 1976.* A disclaimer or renunciation of a general power of appointment created in a transfer made after December 31, 1976, is not considered a release of the power for gift tax purposes if the disclaimer or renunciation is a qualified disclaimer as described in section 2518 and the corresponding regulations. For rules relating to when a transfer creating the power occurs, see § 25.2518-2(c)(3). If the disclaimer or renunciation is not a qualified disclaimer, it is considered a release of the power.

(6) *Disclaimer of power created before January 1, 1977.* A disclaimer or renunciation of a general power of appointment created in a taxable transfer before January 1, 1977, in the person disclaiming is not considered a release of the power. The disclaimer or renunciation must be unequivocal and effective under local law. A disclaimer is a complete and unqualified refusal to accept the rights to which one is entitled. There can be no disclaimer or renunciation of a power after its acceptance. In the absence of facts to the contrary, the failure to renounce or disclaim within a reasonable time after learning of the existence of a power shall be presumed to constitute an acceptance of the power. In any case where a power is purported to be disclaimed or renounced as to only a portion of the property subject to the power, the determination as to whether there has been a complete and unqualified refusal to accept the rights to which one is entitled will depend on all the facts and circumstances of the particular case, taking into account the recognition and effectiveness of such a disclaimer under local law. Such rights refer to the incidents of the power and not to other interests of the possessor of the power in the property. If effective under local law, the power may be

disclaimed or renounced without disclaiming or renouncing such other interests.

(7) The first and second sentences of paragraph (c)(5) of this section are applicable for transfers creating the power to be disclaimed made on or after December 31, 1997.

(d) *Creation of another power in certain cases.* Paragraph (d) of section 2514 provides that there is a transfer for purposes of the gift tax of the value of property (or of property rights or interests) with respect to which a power of appointment, which is not a general power of appointment, created after October 21, 1942, is exercised by creating another power of appointment which, under the terms of the instruments creating and exercising the first power and under applicable local law, can be validly exercised so as to (1) postpone the vesting of any estate or interest in the property for a period ascertainable without regard to the date of the creation of the first power, or (2) (if the applicable rule against perpetuities is stated in terms of suspensions of ownership or of the power of alienation, rather than of vesting) suspend the absolute ownership or the power of alienation of the property for a period ascertainable without regard to the date of the creation of the first power. For the purpose of section 2514(d), the value of the property subject to the second power of appointment is considered to be its value unreduced by any precedent or subsequent interest which is not subject to the second power. Thus, if a donor has a power to appoint \$100,000 among a group consisting of his children or grandchildren and during his lifetime exercises the power by making an outright appointment of \$75,000 and by giving one appointee a power to appoint \$25,000, no more than \$25,000 will be considered a gift under section 2514(d). If, however, the donor appoints the income from the entire fund to a beneficiary for life with power in the beneficiary to appoint the remainder, the entire \$100,000 will be considered a gift under section 2514(d), if the exercise of the second power can validly postpone the vesting of any estate or interest in the property or can suspend the absolute ownership or power of alienation of the property for

a period ascertainable without regard to the date of the creation of the first power.

(e) *Examples.* The application of this section may be further illustrated by the following examples in each of which it is assumed, unless otherwise stated, that S has transferred property in trust after October 21, 1942, with the remainder payable to R at L's death, and that neither L nor R has any interest in or power over the enjoyment of the trust property except as is indicated separately in each example:

Example (1). The income is payable to L for life. L has the power to cause the income to be paid to R. The exercise of the right constitutes the making of a transfer of property under section 2511. L's power does not constitute a power of appointment since it is only a power to dispose of his income interest, a right otherwise possessed by him.

Example (2). The income is to be accumulated during L's life. L has the power to have the income distributed to himself. If L's power is limited by an ascertainable standard (relating to health, etc.) as defined in paragraph (c)(2) of § 25.2514-1, the lapse of such power will not constitute a transfer of property for gift tax purposes. If L's power is not so limited, its lapse or release during L's lifetime may constitute a transfer of property for gift tax purposes. See especially paragraph (c)(4) of § 25.2514-3.

Example (3). The income is to be paid to L for life. L has a power, exercisable at any time, to cause the corpus to be distributed to himself. L has a general power of appointment over the remainder interest, the release of which constitutes a transfer for gift tax purposes of the remainder interest. If in this example L had a power to cause the corpus to be distributed only to X, L would have a power of appointment which is not a general power of appointment, the exercise or release of which would not constitute a transfer of property for purposes of the gift tax. Although the exercise or release of the nongeneral power is not taxable under this section, see § 25.2514-1(b)(2) for the gift tax consequences of the transfer of the life income interest.

Example (4). The income is payable to L for life. R has the right to cause the corpus to be distributed to L at any time. R's power is not a power of appointment, but merely a right to dispose of his remainder interest, a right already possessed by him. In such a case, the exercise of the right constitutes the making of a transfer of property under section 2511 of the value, if any, of his remainder interest. See paragraph (e) of § 25.2511-1.

Example (5). The income is to be paid to L. R has the right to appoint the corpus to him-

self at any time. R's general power of appointment over the corpus includes a general power to dispose of L's income interest therein. The lapse or release of R's general power over the income interest during his life may constitute the making of a transfer of property. See especially paragraph (c)(4) of § 25.2514-3.

[T.D. 6334, 23 FR 8904, Nov. 15, 1958, as amended by T.D. 7238, 37 FR 28730, Dec. 29, 1972; T.D. 7776, 46 FR 27642, May 21, 1981; T.D. 7910, 48 FR 40375, Sept. 7, 1983; T.D. 8095, 51 FR 28370, Aug. 7, 1986; T.D. 8744, 62 FR 68185, Dec. 31, 1997]

§ 25.2515-1 Tenancies by the entirety; in general.

(a) *Scope—(1) In general.* This section and §§ 25.2515-2 through 25.2515-4 do not apply to the creation of a tenancy by the entirety after December 31, 1981, and do not reflect changes made to the Internal Revenue Code by sections 702(k)(1)(A) of the Revenue Act of 1978, or section 2002(c)(2) of the Tax Reform Act of 1976.

(2) *Special rule in the case of tenancies created after July 13, 1988, if the donee spouse is not a United States citizen.* Under section 2523(i)(3), applicable (subject to the special treaty rule contained in Public Law 101-239, section 7815(d)(14)) in the case of tenancies by the entirety and joint tenancies created between spouses after July 13, 1988, if the donee spouse is not a citizen of the United States, the principles contained in section 2515 and §§ 25.2515-1 through 25.2515-4 apply in determining the gift tax consequences with respect to the creation and termination of the tenancy, except that the election provided in section 2515(a) (prior to repeal by the Economic Recovery Tax Act of 1981) and § 25.2515-2 (relating to the donor's election to treat the creation of the tenancy as a transfer for gift tax purposes) does not apply.

(3) *Nature of.* An estate by the entirety in real property is essentially a joint tenancy between husband and wife with the right of survivorship. As used in this section and §§ 25.2515-2 through 25.2515-4, the term "tenancy by the entirety" includes a joint tenancy between husband and wife in real property with right of survivorship, or a tenancy which accords to the spouses rights equivalent thereto regardless of

the term by which such a tenancy is described in local property law.

(b) *Gift upon creation of tenancy by the entirety; in general.* During calendar years prior to 1955 the contribution made by a husband or wife in the creation of a tenancy by the entirety constituted a gift to the extent that the consideration furnished by either spouse exceeded the value of the rights retained by that spouse. The contribution made by either or both spouses in the creation of such a tenancy during the calendar year 1955, any calendar year beginning before January 1, 1971, or any calendar quarter beginning after December 31, 1970, is not deemed a gift by either spouse, regardless of the proportion of the total consideration furnished by either spouse, unless the donor spouse elects (see § 25.2515-2) under section 2515(c) to treat such transaction as a gift in the calendar quarter or calendar year in which the transaction is effected. See § 25.2502-1(c)(1) for the definition of calendar quarter. However, there is a gift upon the termination of such a tenancy, other than by the death of a spouse, if the proceeds received by one spouse on termination of the tenancy are larger than the proceeds allocable to the consideration furnished by that spouse to the tenancy. The creation of a tenancy by the entirety takes place if (1) a husband or his wife purchases property and causes the title thereto to be conveyed to themselves as tenants by the entirety, (2) both join in such a purchase, or (3) either or both cause to be created such a tenancy in property already owned by either or both of them. The rule prescribed herein with respect to the creation of a tenancy by the entirety applies also to contributions made in the making of additions to the value of such a tenancy (in the form of improvements, reductions in the indebtedness, or otherwise), regardless of the proportion of the consideration furnished by each spouse. See § 25.2516-1 for transfers made pursuant to a property settlement agreement incident to divorce.

(c) *Consideration—(1) In general.* (i) The consideration furnished by a person in the creation of a tenancy by the entirety or the making of additions to the value thereof is the amount con-

tributed by him in connection therewith. The contribution may be made by either spouse or by a third party. It may be furnished in the form of money, other property, or an interest in property. If it is furnished in the form of other property or an interest in property, the amount of the contribution is the fair market value of the property or interest at the time it was transferred to the tenancy or was exchanged for the property which became the subject of the tenancy. For example, if a decedent devised real property to the spouses as tenants by the entirety and the fair market value of the property was \$30,000 at the time of the decedent's death, the amount of the decedent's contribution to the creation of the tenancy was \$30,000. As another example, assume that in 1950 the husband purchased real property for \$25,000, taking it in his own name as sole owner, and that in 1956 when the property had a fair market value of \$40,000 he caused it to be transferred to himself and his wife as tenants by the entirety. Here, the amount of the husband's contribution to the creation of the tenancy was \$40,000 (the fair market value of the property at the time it was transferred to the tenancy). Similarly, assume that in 1950 the husband purchased, as sole owner, corporate shares for \$25,000 and in 1956, when the shares had a fair market value of \$35,000, he exchanged them for real property which was transferred to the husband and his wife as tenants by the entirety. The amount of the husband's contribution to the creation of the tenancy was \$35,000 (the fair market value of the shares at the time he exchanged them for the real property which became the subject of the tenancy).

(ii) Whether consideration derived from third-party sources is deemed to have been furnished by a third party or to have been furnished by the spouses will depend upon the terms under which the transfer is made. If a decedent devises real property to the spouses as tenants by the entirety, the decedent, and not the spouses, is the person who furnished the consideration for the creation of the tenancy. Likewise, if a decedent in his will directs his executor to discharge an indebtedness of the tenancy, the decedent, and

not the spouses, is the person who furnished the consideration for the addition to the value of the tenancy. However, if the decedent bequeathed a general legacy to the husband and the wife and they used the legacy to discharge an indebtedness of the tenancy, the spouses, and not the decedent, are the persons who furnished the consideration for the addition to the value of the tenancy. The principles set forth in this subdivision with respect to transfers by decedents apply equally well to inter vivos transfers by third parties.

(iii) Where a tenancy is terminated in part (e.g., where a portion of the property subject to the tenancy is sold to a third party, or where the original property is disposed of and in its place there is substituted other property of lesser value acquired through reinvestment under circumstances which satisfy the requirements of paragraph (d)(2)(ii) of this section), the proportionate contribution of each person to the remaining tenancy is in general the same as his proportionate contribution to the original tenancy, and the character of his contribution remains the same. These proportions are applied to the cost of the remaining or substituted property. Thus, if the total contribution to the cost of the property was \$20,000 and a fourth of the property was sold, the contribution to the remaining portion of the tenancy is normally \$15,000. However, if it is shown that at the time of the contribution more or less than one-fourth thereof was attributable to the portion sold, the contribution is divided between the portion sold and the portion retained in the proper proportion. If the portion sold was acquired as a separate tract, it is treated as a separate tenancy. As another example of the application of this subdivision, assume that in 1950 X (a third party) gave to H and W (H's wife), as tenants by the entirety, real property then having a value of \$15,000. In 1955, H spent \$5,000 thereon in improvements and under section 2515(c) elected to treat his contribution as a gift. In 1956, W spent \$10,000 in improving the property but did not elect to treat her contribution as a gift. Between 1957 and 1960 the property appreciated in value by \$30,000. In 1960, the property was sold

for \$60,000, and \$45,000 of the proceeds of the sale were, under circumstances that satisfy the requirements of paragraph (d)(2)(ii) of this section, reinvested in other real property. Since X contributed one-half of the total consideration for the original property and the additions to its value, he is considered as having furnished \$22,500 (one-half of \$45,000) toward the creation of the remaining portion of the tenancy and the making of additions to the value thereof. Similarly, H is considered as having furnished \$7,500 (one-sixth of \$45,000) which was treated as a gift in the year furnished, and W is considered as having furnished \$15,000 (one-third of \$45,000) which was not treated as a gift in the year furnished.

(2) *Proportion of consideration attributable to appreciation.* Any general appreciation (appreciation due to fluctuations in market value) in the value of the property occurring between two successive contribution dates which can readily be measured and which can be determined with reasonable certainty to be allocable to any particular contribution or contributions previously furnished is to be treated, for the purpose of the computations in §§ 25.2515-3 and 25.2515-4, as though it were additional consideration furnished by the person who furnished the prior consideration. Any general depreciation in value is treated in a comparable manner. For the purpose of the first sentence of this subparagraph, successive contribution dates are the two consecutive dates on which any contributions to the tenancy are made, not necessarily by the same party. Further, appreciation allocable to the prior consideration falls in the same class as the prior consideration to which it relates. The application of this subparagraph may be illustrated by the following examples:

Example (1). In 1940, H purchased real property for \$15,000 which he caused to be transferred to himself and W (his wife) as tenants by the entirety. In 1956 when the fair market value of the property was \$30,000, W made \$5,000 improvements to the property. In 1957 the property was sold for \$35,000. The general appreciation of \$15,000 which occurred between the date of purchase and the date of W's improvements to the property constitutes an additional contribution by H,

having the same characteristics as his original contribution of \$15,000.

Example (2). In 1955 real property was purchased by H and W and conveyed to them as tenants by the entirety. The purchase price of the property was \$15,000 of which H contributed \$10,000 and W, \$5,000. In 1960 when the fair market value of the property is \$21,000, W makes improvements thereto of \$5,000. The property then is sold for \$26,000. The appreciation in value of \$6,000 results in an additional contribution of \$4,000 ($10,000/15,000 \times \$6,000$) by H, and an additional contribution by W of \$2,000 ($5,000/15,000 \times \$6,000$). H's total contribution to the tenancy is \$14,000 ($\$10,000 + \$4,000$) and W's total contribution is \$12,000 ($\$5,000 + \$2,000 + \$5,000$).

Example (3). In 1956 real property was purchased by H and W and conveyed to them as tenants by the entirety. The purchase price of the property was \$15,000, on which a down payment of \$3,000 was made. The remaining \$12,000 was to be paid in monthly installments over a period of 15 years. H furnished \$2,000 of the down payment and W, \$1,000. H paid all the monthly installments. During the period 1956 to 1971 the property gradually appreciates in value to \$24,000. Here, the appreciation is so gradual and the contributions so numerous that the amount allocable to any particular contribution cannot be ascertained with any reasonable certainty. Accordingly, in such a case the appreciation in value may be disregarded in determining the amount of consideration furnished in making the computations provided for in §§ 25.2515-3 and 25.2515-4.

(d) *Gift upon termination of tenancy by the entirety*—(1) *In general.* Upon the termination of the tenancy, whether created before, during, or subsequent to the calendar year 1955, a gift may result, depending upon the disposition made of the proceeds of the termination (whether the proceeds be in the form of cash, property, or interests in property). A gift may result notwithstanding the fact that the contribution of either spouse to the tenancy was treated as a gift. See § 25.2515-3 for the method of determining the amount of any gift that may result from the termination of the tenancy in those cases in which no portion of the consideration contributed was treated as a gift by the spouses in the calendar quarter or calendar year in which it was furnished. See § 25.2515-4 for the method of determining the amount of any gift that may result from the termination of the tenancy in those cases in which all or a portion of the consideration contributed was treated as consti-

tuting a gift by the spouses in the calendar quarter or calendar year in which it was furnished. See § 25.2515-2 for the procedure to be followed by a donor who elects under section 2515(c) to treat the creation of a tenancy by the entirety (or the making of additions to its value) as a transfer subject to the gift tax in the calendar quarter (calendar year with respect to such transfers made before January 1, 1971) in which the transfer is made, and for the method of determining the amount of the gift. See § 25.2502-1(c)(1) for the definition of calendar quarter.

(2) *Termination*—(i) *In general.* Except as indicated in subdivision (ii) of this subparagraph, a termination of a tenancy is effected when all or a portion of the property so held by the spouses is sold, exchanged, or otherwise disposed of, by gift or in any other manner, or when the spouses through any form of conveyance or agreement become tenants in common of the property or otherwise alter the nature of their respective interests in the property formerly held by them as tenants by the entirety. In general, any increase in the indebtedness on a tenancy constitutes a termination of the tenancy to the extent of the increase in the indebtedness. However, such an increase will not constitute a termination of the tenancy to the extent that the increase is offset by additions to the tenancy within a reasonable time after such increase. Such additions (to the extent of the increase in the indebtedness) shall not be treated by the spouses as contributions within the meaning of paragraph (c) of this section.

(ii) *Exchange or reinvestment.* A termination is not considered as effected to the extent that the property subject to the tenancy is exchanged for other real property, the title of which is held by the spouses in an identical tenancy. For this purpose, a tenancy is considered identical if the proportionate values of the spouses' respective rights (other than any change in the proportionate values resulting solely from the passing of time) are identical to those held in the property which was sold. In addition the sale, exchange (other than an exchange described above), or other disposition of property held as tenants by the entirety is not

considered as a termination if all three of the following conditions are satisfied:

(a) There is no division of the proceeds of the sale, exchange or other disposition of the property held as tenants by the entirety;

(b) On or before the due date for the filing of a gift tax return for the calendar quarter or calendar year (see § 25.6075-1 for the time for filing gift tax returns) in which the property held as tenants by the entirety was sold, exchanged, or otherwise disposed of, the spouses enter into a binding contract for the purchase of other real property; and

(c) After the sale, exchange or other disposition of the former property and within a reasonable time after the date of the contract referred to in §(b) of this subdivision, such other real property actually is acquired by the spouses and held by them in an identical tenancy.

To the extent that all three of the conditions set forth in this subdivision are not met (whether by reason of the death of one of the spouses or for any other reason), the provisions of the preceding sentence shall not apply, and the sale, exchange or other disposition of the property will constitute a termination of the tenancy. As used in subdivision (c) the expression "a reasonable time" means the time which, under the particular facts in each case, is needed for those matters which are incident to the acquisition of the other property (i.e., perfecting of title, arranging for financing, construction, etc.). The fact that proceeds of a sale are deposited in the name of one tenant or of both tenants separately or jointly as a convenience does not constitute a division within the meaning of subdivision (a) if the other requirements of this subdivision are met. The proceeds of a sale, exchange, or other disposition of property held as tenants by the entirety will be deemed to have been used for the purchase of other real property if applied to the purchase or construction of improvements which themselves constitute real property and which are additions to other real property held by the spouses in a tenancy identical to that in which they held the

property which was sold, exchanged, or otherwise disposed of.

(3) *Proceeds of termination.* (i) The proceeds of termination may be received by a spouse in the form of money, property, or an interest in property. Where the proceeds are received in the form of property (other than money) or an interest in property, the value of the proceeds received by that spouse is the fair market value, on the date of termination of the tenancy by the entirety, of the property or interest received. Thus, if a tenancy by the entirety is terminated so that thereafter each spouse owns an undivided half interest in the property as tenant in common, the value of the proceeds of termination received by each spouse is one-half the value of the property at the time of the termination of the tenancy by the entirety. If under local law one spouse, without the consent of the other, can bring about a severance of his or her interest in a tenancy by the entirety and does so by making a gift of his or her interest to a third party, that spouse is considered as having received proceeds of termination in the amount of the fair market value, at the time of the termination, of his severable interest determined in accordance with the rules prescribed in § 25.2512-5. He has, in addition, made a gift to the third party of the fair market value of the interest conveyed to the third party. In such a case, the other spouse also is considered as having received as proceeds of termination the fair market value, at the time of termination, of the interest which she thereafter holds in the property as tenant in common with the third party. However, since section 2515(b) contemplates that the spouses may divide the proceeds of termination in some proportion other than that represented by the values of their respective legal interests in the property, if both spouses join together in making a gift to a third party of property held by them as tenants by the entirety, the value of the proceeds of termination which will be treated as received by each is the amount which each reports (on his or her gift tax return filed for the calendar quarter or calendar year in which the termination occurs) as the value of his or her gift to the third party. This amount is the

amount which each reports without regard to whether the spouses elect under section 2513 to treat the gifts as made one-half by each. For example, assume that H and W (his wife) hold real property as tenants by the entirety; that in the first calendar quarter of 1972, when the property has a fair market value of \$60,000, they give it to their son; and that on their gift tax returns for such calendar quarter, H reports himself as having made a gift to the son of \$36,000 and W reports herself as having made a gift to the son of \$24,000. Under these circumstances, H is considered as having received proceeds of termination valued at \$36,000, and W is considered as having received proceeds of termination valued at \$24,000.

(ii) Except as provided otherwise in subparagraph (2)(i) of this paragraph (under which certain tenancies by the entirety are considered not to be terminated), where the proceeds of a sale, exchange, or other disposition of the property are not actually divided between the spouses but are held (whether in a bank account or otherwise) in their joint names or in the name of one spouse as custodian or trustee for their joint interests, each spouse is presumed, in the absence of a showing to the contrary, to have received, as of the date of termination, proceeds of termination equal in value to the value of his or her enforceable property rights in respect of the proceeds.

[T.D. 6334, 23 FR 8904, Nov. 15, 1958, as amended by T.D. 7238, 37 FR 28731, Dec. 29, 1972, as amended by T.D. 8522, 59 FR 9656, Mar. 1, 1994]

§ 25.2515-2 Tenancies by the entirety; transfers treated as gifts; manner of election and valuation.

(a) The election to treat the creation of a tenancy by the entirety in real property, or additions made to its value, as constituting a gift in the calendar quarter or calendar year in which effected, shall be exercised by including the value of such gifts in the gift tax return of the donor for such calendar quarter or calendar year in which the tenancy was created, or the additions in value were made to the property. See section 6019 and the regulations thereunder. The election may be exercised only in a return filed with-

in the time prescribed by law, or before the expiration of any extension of time granted pursuant to law for the filing of the return. See section 6075 for the time for filing the gift tax return and section 6081 for extensions of time for filing the return, together with the regulations thereunder. In order to make the election, a gift tax return must be filed for the calendar quarter or calendar year in which the tenancy was created, or additions in value thereto made, even though the value of the gift involved does not exceed the amount of the exclusion provided by section 2503(b). See § 25.2502-1(c)(1) for the definition of calendar quarter.

(b) If the donor spouse exercises the election as provided in paragraph (a) of this section, the amount of the gift at the creation of the tenancy is the amount of his contribution to the tenancy less the value of his retained interest in it, determined as follows:

(1) If under the law of the jurisdiction governing the rights of the spouses, either spouse, acting alone, can bring about a severance of his or her interest in the property, the value of the donor's retained interest is one-half the value of the property.

(2) If, under the law of the jurisdiction governing the rights of the spouses each is entitled to share in the income or other enjoyment of the property but neither, acting alone, may defeat the right of the survivor of them to the whole of the property, the amount of retained interest of the donor is determined by use of the appropriate actuarial factors for the spouses at their respective attained ages at the time the transaction is effected.

(c) Factors representing the respective interests of the spouses, under a tenancy by the entirety, at their attained ages at the time of the transaction may be readily computed based on the method described in § 25.2512-5. State law may provide that the husband only is entitled to all of the income or other enjoyment of the real property held as tenants by the entirety, and the wife's interest consists only of the right of survivorship with no right of severance. In such a case, a special factor may be needed to determine the value of the interests of the

respective spouses. See § 25.2512-5(d)(4) for the procedure for obtaining special factors from the Internal Revenue Service in appropriate cases.

(d) The application of this paragraph may be illustrated by the following example:

Example. A husband with his own funds acquires real property valued at \$10,000 and has it conveyed to himself and his wife as tenants by the entirety. Under the law of the jurisdiction governing the rights of the parties, each spouse is entitled to share in the income from the property but neither spouse acting alone could bring about a severance of his or her interest. The husband elects to treat the transfer as a gift in the year in which effected. At the time of transfer, the ages of the husband and wife are 45 and 40, respectively, on their birthdays nearest to the date of transfer. The value of the gift to the wife is \$5,502.90, computed as follows:

| | |
|---|-------------|
| Value of property transferred | \$10,000.00 |
| Less \$10,000×0.44971 (factor for value of donor's retained rights) | 4,497.10 |
| Value of gift | 5,502.90 |

[T.D. 6334, 23 FR 8904, Nov. 15, 1958, as amended by T.D. 7150, 36 FR 22900, Dec. 2, 1971; T.D. 7238, 37 FR 28731, Dec. 29, 1972; T.D. 8540, 59 FR 30177, June 10, 1994]

§ 25.2515-3 Termination of tenancy by the entirety; cases in which entire value of gift is determined under section 2515(b).

(a) In any case in which—(1) The creation of a tenancy by the entirety (including additions in value thereto) was not treated as a gift, and

(2) The entire consideration for the creation of the tenancy, and any additions in value thereto, was furnished solely by the spouses (see paragraph (c)(1)(ii) of § 25.2515-1),

the termination of the tenancy (other than by the death of a spouse) always results in the making of a gift by a spouse who receives a smaller share of the proceeds of the termination (whether received in cash, property or interests in property) than the share of the proceeds attributable to the total consideration furnished by him. See paragraph (c) of § 25.2515-1 for a discussion of what constitutes consideration and the value thereof. Thus, a gift is effected at the time of termination of the tenancy by the spouse receiving less than one-half of the proceeds of termination if such spouse (regardless of

age) furnished one-half or more of the total consideration for the purchase and improvements, if any, of the property held in the tenancy. Also, if one spouse furnished the entire consideration, a gift is made by such spouse to the extent that the other spouse receives any portion of the proceeds of termination. See § 25.2515-4 for determination of the amount of the gift, if any, in cases in which the creation of the tenancy was treated as a gift or a portion of the consideration was furnished by a third person. See paragraph (d)(2) of § 25.2515-1 as to the acts which effect a termination of the tenancy.

(b) In computing the value of the gift under the circumstances described in paragraph (a) of this section, it is first necessary to determine the spouse's share of the proceeds attributable to the consideration furnished by him. This share is computed by multiplying the total value of the proceeds of the termination by a fraction, the numerator of which is the total consideration furnished by the donor spouse and the denominator of which is the total consideration furnished by both spouses. From this amount there is subtracted the value of the proceeds of termination received by the donor spouse. The amount remaining is the value of the gift. In arriving at the "total consideration furnished by the donor spouse" and the "total consideration furnished by both spouses", for purposes of the computation provided for in this paragraph, the consideration furnished (see paragraph (c) of § 25.2515-1) is not reduced by any amounts which otherwise would have been excludable under section 2503(b) in determining the amounts of taxable gifts for calendar quarters or calendar years in which the consideration was furnished. (See § 25.2502-1 (c)(1) for the definition of calendar quarter.) As an example assume that in 1955, real property was purchased for \$30,000, the husband and wife each contributing \$12,000 and the remaining \$6,000 being obtained through a mortgage on the property. In each of the years 1956 and 1957, the husband paid \$3,000 on the principal of the indebtedness, but did not disclose the value of these transfers on his gift tax returns for those years. The total consideration furnished by the husband is

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\$18,000, the total consideration furnished by the wife is \$12,000, and the total consideration furnished by both spouses is \$30,000.

(c) The application of this section may be illustrated by the following examples:

Example (1). In 1956 the husband furnished \$30,000 and his wife furnished \$10,000 of the consideration for the purchase and subsequent improvement of real property held by them as tenants by the entirety. The husband did not elect to treat the consideration furnished as a gift. The property later is sold for \$60,000, the husband receiving \$35,000 and his wife receiving \$25,000 of the proceeds of the termination. The termination of the tenancy results in a gift of \$10,000 by the husband to his wife, computed as follows:

$[\$30,000 \text{ (consideration furnished by husband)} + \$40,000 \text{ (total consideration furnished by both spouses)}] \times \$60,000 \text{ (proceeds of termination)} = \$45,000$

$\$45,000 - \$35,000 \text{ (proceeds received by husband)} = \$10,000 \text{ gift by husband to wife}$

Example (2). In 1950 the husband purchased shares of X Company for \$10,000. In 1955 when those shares had a fair market value of \$30,000, he and his wife purchased real property from A and had it conveyed to them as tenants by the entirety. In payment for the real property, the husband transferred his shares of X Company to A and the wife paid A the sum of \$10,000. They later sold the real property for \$60,000, divided \$24,000 (each taking \$12,000) and reinvested the remaining \$36,000 in other real property under circumstances that satisfied the conditions set forth in paragraph (d)(2)(ii) of § 25.2515-1. The tenancy was terminated only with respect to the \$24,000 divided between them. This termination of the tenancy resulted in a gift of \$6,000 by the husband to the wife, computed as follows:

$[\$30,000 \text{ (consideration furnished by husband)} + \$40,000 \text{ (total consideration furnished by both spouses)}] \times \$24,000 \text{ (proceeds of termination)} = \$18,000$

$\$18,000 - \$12,000 \text{ (proceeds received by husband)} = \$6,000 \text{ gift by husband to wife.}$

Since the tenancy was terminated only in part, with respect to the remaining portion of the tenancy each spouse is considered as having furnished that proportion of the total consideration for the remaining portion of the tenancy as the consideration furnished by him before the sale bears to the total consideration furnished by both spouses before the sale. See paragraph (c) of § 25.2515-1. The consideration furnished by the husband for the reduced tenancy is \$27,000, computed as follows:

$[\$30,000 \text{ (consideration furnished by husband before sale)} + \$40,000 \text{ (total consideration$

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furnished by both spouses before sale)] \times \$36,000 (consideration for reduced tenancy) = \$27,000

The consideration furnished by the wife is \$9,000, computed in a similar manner.

[T.D. 6334, 23 FR 8904, Nov. 15, 1958, as amended by T.D. 7238, 37 FR 28732, Dec. 29, 1972]

§ 25.2515-4 Termination of tenancy by entirety; cases in which none, or a portion only, of value of gift is determined under section 2515(b).

(a) *In general.* The rules provided in section 2515(b) (see § 25.2515-3) are not applied in determining whether a gift has been made at the termination of a tenancy to the extent that the consideration furnished for the creation of the tenancy was treated as a gift or if the consideration for the creation of the tenancy was furnished by a third party. Consideration furnished for the creation of the tenancy was treated as a gift if it was furnished either (1) during calendar years prior to 1955, or (2) during the calendar year 1955 and subsequent calendar years and calendar quarters and the donor spouse exercised the election to treat the furnishing of consideration as a gift. (For the definition of calendar quarter see § 25.2502-1(c)(1).) See paragraph (b) of this section for the manner of computing the value of gifts resulting from the termination of the tenancy under these circumstances. See paragraph (c) of this section for the rules to be applied where part of the total consideration for the creation of the tenancy and additions to the value thereof was not treated as a gift and part either was treated as a gift or was furnished by a third party.

(b) *Value of gift when entire consideration is of the type described in paragraph (a) of this section.* If the entire consideration for the creation of a tenancy by the entirety was treated as a gift or contributed by a third party, the determination of the amount, if any, of a gift made at the termination of the tenancy will be made by the application of the general principles set forth in § 25.2511-1. Under those principles, when a spouse surrenders a property interest in a tenancy, the creation of which was treated as a gift, and in return receives an amount (whether in the form of cash, property, or an interest in property) less than

the value of the property interest surrendered, that spouse is deemed to have made a gift in an amount equal to the difference between the value at the time of termination, of the property interest surrendered by such spouse and the amount received in exchange. Thus, if the husband's interest in such a tenancy at the time of termination is worth \$44,971 and the wife's interest therein at the time is worth \$55,029, the property is sold for \$100,000, and each spouse received \$50,000 out of the proceeds of the sale, the wife has made a gift to the husband of \$5,029. The principles applied in paragraph (c) of § 25.2515-2 for the method of determining the value of the respective interests of the spouses at the time of the creation of a tenancy by the entirety are equally applicable in determining the value of each spouse's interest in the tenancy at termination, except that the actuarial factors to be applied are those for the respective spouses at the ages attained at the date of termination.

(c) *Valuation of gift where both types of consideration are involved.* If the consideration furnished consists in part of the type described in paragraph (a) of § 25.2515-3 (consideration furnished by the spouses after 1954, and not treated as a gift in the calendar quarter or calendar year in which it was furnished) and in part of the type described in paragraph (a) of this section (consideration furnished by the spouses and treated as a gift or furnished by a third party), the amount of the gift is determined as follows:

(1) By applying the principles set forth in paragraph (b) of § 25.2515-3 to that portion of the total proceeds of termination which the consideration described in paragraph (a) of § 25.2515-3 bears to the total consideration furnished;

(2) By applying the principles set forth in paragraph (b) of this section to the remaining portion of the total proceeds of termination; and

(3) By subtracting the proceeds of termination received by the donor from the total of the amounts which under the principles referred to in subparagraphs (1) and (2) of this paragraph are to be compared with the proceeds of termination received by a spouse in de-

termining whether a gift was made by that spouse. For example, assume that consideration of \$30,000 was furnished by the husband in 1954. Assume also that on February 1, 1955, the husband contributed \$12,000 and the wife \$8,000, the husband's contribution not being treated as a gift (see paragraph (b) of § 25.2515-1). Assume further that between 1957 and 1965 the property appreciated in value by \$40,000 and was sold in 1965 for \$90,000 (of which the husband received \$40,000 and the wife \$50,000). The principles set forth in paragraph (b) of § 25.2515-3 are applied to \$36,000 ($20,000/50,000 \times \$90,000$) in arriving at the amount which is compared with the proceeds of termination received by a spouse. Applying the principles set forth in paragraph (b) of § 25.2515-3, this amount in the case of the husband is \$21,600 ($12,000/20,000 \times \$36,000$). Similarly, the principles set forth in paragraph (b) of this section are applied to \$54,000 ($\$90,000 - \$36,000$), the remaining portion of the proceeds of termination, in arriving at the amount which is compared with the proceeds of termination received by a spouse. If in this case either spouse, without the consent of the other spouse, can bring about a severance of his interest in the tenancy, the amount determined under paragraph (b) of this section in the case of the husband would be \$27,000 ($\frac{1}{2}$ of \$54,000). The total of the two amounts which are to be compared with the proceeds of termination received by the husband is \$48,600 ($\$21,600 + \$27,000$). This sum of \$48,600 is then compared with the \$40,000 proceeds received by the husband, and the termination of the tenancy has resulted, for gift tax purposes, in a transfer of \$8,600 by the husband to his wife in 1965. See paragraph (d) of this section for an additional example illustrating the application of this paragraph.

(d) The application of paragraph (c) of this section may further be illustrated by the following example:

Example. X died in 1948 and devised real property to Y and Z (Y's wife) as tenant by the entirety. Under the law of the jurisdiction, both spouses are entitled to share equally in the income from, or the enjoyment of, the property, but neither spouse, acting alone, may defeat the right of the survivor of them to the whole of the property. The fair market value of the property at the

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time of X's death was \$100,000 and this amount is the consideration which X furnished toward the creation of the tenancy. In 1955, at which time the fair market value of the property was the same as at the time of X's death, improvements of \$50,000 were made to the property, of which Y furnished \$40,000 out of his own funds and Z furnished \$10,000 out of her own funds. Y did not elect to treat his transfer to the tenancy as resulting in the making of a gift in 1955. In 1956 the property was sold for \$300,000 and Y and Z each received \$150,000 of the proceeds. At the time the property was sold Y and Z were 45 and 40 years of age, respectively, on their birthdays nearest the date of sale. The value of the gift made by Y to Z is \$19,942, computed as follows:

Amount determined under principles set forth in § 25.2515-3:

\$50,000 (consideration not treated as gift in year furnished)+\$150,000 (total consideration furnished)×\$300,000 (proceeds of termination)=\$100,000 (proceeds of termination) to which principles set forth in § 25.2515-3 apply)

\$40,000 (consideration furnished by H and not treated as gift)+\$50,000 (total consideration not treated as gift)×\$100,000=\$80,000

Amount determined under principles set forth in paragraph (b) of this section:

\$300,000 (total proceeds of termination)—\$100,000 (proceeds to which principles set forth in § 25.2515-3 apply)=\$200,000 (proceeds to which principles set forth in paragraph (b) apply) 0.44971 (factor for Y's latest)×\$200,000=\$89,942

| | |
|---|----------|
| Amount of gift: | |
| Amount determined under § 25.2515-3 | \$80,000 |
| Amount determined under paragraph (b) | 89,942 |
| Total | 169,942 |
| Less: Proceeds received by Y | 150,000 |
| Amount of gift made by Y to Z | 19,942 |

[T.D. 6334, 23 FR 8904, Nov. 15, 1958, as amended by T.D. 7238, 37 FR 28732, Dec. 29, 1972]

§ 25.2516-1 Certain property settlements.

(a) Section 2516 provides that transfers of property or interests in property made under the terms of a written agreement between spouses in settlement of their marital or property rights are deemed to be for an adequate and full consideration in money or money's worth and, therefore, exempt from the gift tax (whether or not such agreement is approved by a divorce decree), if the spouses obtain a final decree of divorce from each other within two years after entering into the agreement.

(b) See paragraph (b) of § 25.6019-3 for the circumstances under which information relating to property settlements must be disclosed on the transferor's gift tax return for the "calendar period" (as defined in § 25.2502-1(c)(1)) in which the agreement becomes effective.

[T.D. 6334, 23 FR 8904, Nov. 15, 1958, as amended by T.D. 7238, 37 FR 28732, Dec. 29, 1972; T.D. 7910, 48 FR 40375, Sept. 7, 1983]

§ 25.2516-2 Transfers in settlement of support obligations.

Transfers to provide a reasonable allowance for the support of children (including legally adopted children) of a marriage during minority are not subject to the gift tax if made pursuant to an agreement which satisfies the requirements of section 2516.

§ 25.2518-1 Qualified disclaimers of property; in general.

(a) *Applicability*—(1) *In general.* The rules described in this section, § 25.2518-2, and § 25.2518-3 apply to the qualified disclaimer of an interest in property which is created in the person disclaiming by a transfer made after December 31, 1976. In general, a qualified disclaimer is an irrevocable and unqualified refusal to accept the ownership of an interest in property. For rules relating to the determination of when a transfer creating an interest occurs, see § 25.2518-2(c) (3) and (4).

(2) *Example.* The provisions of paragraph (a)(1) of this section may be illustrated by the following example:

Example. W creates an irrevocable trust on December 10, 1968, and retains the right to receive the income for life. Upon the death of W, which occurs after December 31, 1976, the trust property is distributable to W's surviving issue, *per stirpes*. The transfer creating the remainder interest in the trust occurred in 1968. See § 25.2511-1(c)(2). Therefore, section 2518 does not apply to the disclaimer of the remainder interest because the transfer creating the interest was made prior to January 1, 1977. If, however, W had caused the gift to be incomplete by also retaining the power to designate the person or persons to receive the trust principal at death, and, as a result, no transfer (within the meaning of § 25.2511-1(c)(2)) of the remainder interest was made at the time of the creation of the trust, section 2518 would apply to any disclaimer made after W's death with respect to an interest in the trust property.

(3) Paragraph (a)(1) of this section is applicable for transfers creating the interest to be disclaimed made on or after December 31, 1997.

(b) *Effect of a qualified disclaimer.* If a person makes a qualified disclaimer as described in section 2518(b) and § 25.2518-2, for purposes of the Federal estate, gift, and generation-skipping transfer tax provisions, the disclaimed interest in property is treated as if it had never been transferred to the person making the qualified disclaimer. Instead, it is considered as passing directly from the transferor of the property to the person entitled to receive the property as a result of the disclaimer. Accordingly, a person making a qualified disclaimer is not treated as making a gift. Similarly, the value of a decedent's gross estate for purposes of the Federal estate tax does not include the value of property with respect to which the decedent, or the decedent's executor or administrator on behalf of the decedent, has made a qualified disclaimer. If the disclaimer is not a qualified disclaimer, for the purposes of the Federal estate, gift, and generation-skipping transfer tax provisions, the disclaimer is disregarded and the disclaimant is treated as having received the interest.

(c) *Effect of local law—(1) In general—*

(i) *Interests created before 1982.* A disclaimer of an interest created in a taxable transfer before 1982 which otherwise meets the requirements of a qualified disclaimer under section 2518 and the corresponding regulations but which, by itself, is not effective under applicable local law to divest ownership of the disclaimed property from the disclaimant and vest it in another, is nevertheless treated as a qualified disclaimer under section 2518 if, under applicable local law, the disclaimed interest in property is transferred, as a result of attempting the disclaimer, to another person without any direction on the part of the disclaimant. An interest in property will not be considered to be transferred without any direction on the part of the disclaimant if, under applicable local law, the disclaimant has any discretion (whether or not such discretion is exercised) to determine who will receive such interest. Actions by the disclaimant

which are required under local law merely to divest ownership of the property from the disclaimant and vest ownership in another person will not disqualify the disclaimer for purposes of section 2518(a). See § 25.2518-2(d)(1) for rules relating to the immediate vesting of title in the disclaimant.

(ii) *Interests created after 1981.* [Reserved]

(2) *Creditor's claims.* The fact that a disclaimer is voidable by the disclaimant's creditors has no effect on the determination of whether such disclaimer constitutes a qualified disclaimer. However, a disclaimer that is wholly void or that is voided by the disclaimant's creditors cannot be a qualified disclaimer.

(3) *Examples.* The provisions of paragraphs (c) (1) and (2) of this section may be illustrated by the following examples:

Example (1). F dies testate in State Y on June 17, 1978. G and H are beneficiaries under the will. The will provides that any disclaimed property is to pass to the residuary estate. H has no interest in the residuary estate. Under the applicable laws of State Y, a disclaimer must be made within 6 months of the death of the testator. Seven months after F's death, H disclaimed the real property H received under the will. The disclaimer statute of State Y has a provision stating that an untimely disclaimer will be treated as an assignment of the interest disclaimed to those persons who would have taken had the disclaimer been valid. Pursuant to this provision, the disclaimed property became part of the residuary estate. Assuming the remaining requirements of section 2518 are met, H has made a qualified disclaimer for purposes of section 2518 (a).

Example (2). Assume the same facts as in example (1) except that the law of State Y does not treat an ineffective disclaimer as a transfer to alternative takers. H assigns the disclaimed interest by deed to those who would have taken had the disclaimer been valid. Under these circumstances, H has not made a qualified disclaimer for purposes of section 2518 (a) because the disclaimant directed who would receive the property.

Example (3). Assume the same facts as in example (1) except that the law of State Y requires H to pay a transfer tax in order to effectuate the transfer under the ineffective disclaimer provision. H pays the transfer tax. H has made a qualified disclaimer for purposes of section 2518 (a).

(d) *Cross-reference.* For rules relating to the effect of qualified disclaimers on

the estate tax charitable and marital deductions, see §§ 20.2055-2(c) and 20.2056(d)-1 respectively. For rules relating to the effect of a qualified disclaimer of a general power of appointment, see § 20.2041-3(d).

[T.D. 8095, 51 FR 28370, Aug. 7, 1986, as amended by T.D. 8744, 62 FR 68185, Dec. 31, 1997]

§ 25.2518-2 Requirements for a qualified disclaimer.

(a) *In general.* For the purposes of section 2518(a), a disclaimer shall be a qualified disclaimer only if it satisfies the requirements of this section. In general, to be a qualified disclaimer—

(1) The disclaimer must be irrevocable and unqualified;

(2) The disclaimer must be in writing;

(3) The writing must be delivered to the person specified in paragraph (b) (2) of this section within the time limitations specified in paragraph (c)(1) of this section;

(4) The disclaimant must not have accepted the interest disclaimed or any of its benefits; and

(5) The interest disclaimed must pass either to the spouse of the decedent or to a person other than the disclaimant without any direction on the part of the person making the disclaimer.

(b) *Writing—(1) Requirements.* A disclaimer is a qualified disclaimer only if it is in writing. The writing must identify the interest in property disclaimed and be signed either by the disclaimant or by the disclaimant's legal representative.

(2) *Delivery.* The writing described in paragraph (b)(1) of this section must be delivered to the transferor of the interest, the transferor's legal representative, the holder of the legal title to the property to which the interest relates, or the person in possession of such property.

(c) *Time limit—(1) In general.* A disclaimer is a qualified disclaimer only if the writing described in paragraph (b)(1) of this section is delivered to the persons described in paragraph (b)(2) of this section no later than the date which is 9 months after the later of—

(i) The date on which the transfer creating the interest in the disclaimant is made, or

(ii) The day on which the disclaimant attains age 21.

(2) *A timely mailing of a disclaimer treated as a timely delivery.* Although section 7502 and the regulations under that section apply only to documents to be filed with the Service, a timely mailing of a disclaimer to the person described in paragraph (b)(2) of this section is treated as a timely delivery if the mailing requirements under paragraphs (c)(1), (c)(2) and (d) of § 301.7502-1 are met. Further, if the last day of the period specified in paragraph (c)(1) of this section falls on Saturday, Sunday or a legal holiday (as defined in paragraph (b) of § 301.7503-1), then the delivery of the writing described in paragraph (b)(1) of this section shall be considered timely if delivery is made on the first succeeding day which is not Saturday, Sunday or a legal holiday. See paragraph (d)(3) of this section for rules applicable to the exception for individuals under 21 years of age.

(3) *Transfer.* (i) For purposes of the time limitation described in paragraph (c)(1)(i) of this section, the 9-month period for making a disclaimer generally is to be determined with reference to the transfer creating the interest in the disclaimant. With respect to inter vivos transfers, a transfer creating an interest occurs when there is a completed gift for Federal gift tax purposes regardless of whether a gift tax is imposed on the completed gift. Thus, gifts qualifying for the gift tax annual exclusion under section 2503(b) are regarded as transfers creating an interest for this purpose. With respect to transfers made by a decedent at death or transfers that become irrevocable at death, the transfer creating the interest occurs on the date of the decedent's death, even if an estate tax is not imposed on the transfer. For example, a bequest of foreign-situs property by a nonresident alien decedent is regarded as a transfer creating an interest in property even if the transfer would not be subject to estate tax. If there is a transfer creating an interest in property during the transferor's lifetime and such interest is later included in the transferor's gross estate for estate tax purposes (or would have been included if such interest were subject to estate tax), the 9-month period for making the qualified disclaimer is determined with reference to the earlier

transfer creating the interest. In the case of a general power of appointment, the holder of the power has a 9-month period after the transfer creating the power in which to disclaim. If a person to whom any interest in property passes by reason of the exercise, release, or lapse of a general power desires to make a qualified disclaimer, the disclaimer must be made within a 9-month period after the exercise, release, or lapse regardless of whether the exercise, release, or lapse is subject to estate or gift tax. In the case of a nongeneral power of appointment, the holder of the power, permissible appointees, or takers in default of appointment must disclaim within a 9-month period after the original transfer that created or authorized the creation of the power. If the transfer is for the life of an income beneficiary with succeeding interests to other persons, both the life tenant and the other remaindermen, whether their interests are vested or contingent, must disclaim no later than 9 months after the original transfer creating an interest. In the case of a remainder interest in property which an executor elects to treat as qualified terminable interest property under section 2056(b)(7), the remainderman must disclaim within 9 months of the transfer creating the interest, rather than 9 months from the date such interest is subject to tax under section 2044 or 2519. A person who receives an interest in property as the result of a qualified disclaimer of the interest must disclaim the previously disclaimed interest no later than 9 months after the date of the transfer creating the interest in the preceding disclaimant. Thus, if A were to make a qualified disclaimer of a specific bequest and as a result of the qualified disclaimer the property passed as part of the residue, the beneficiary of the residue could make a qualified disclaimer no later than 9 months after the date of the testator's death. See paragraph (d)(3) of this section for the time limitation rule with reference to recipients who are under 21 years of age.

(ii) Sentences 1 through 10 and 12 of paragraph (c)(3)(i) of this section are applicable for transfers creating the in-

terest to be disclaimed made on or after December 31, 1997.

(4) *Joint property*—(i) *Interests in joint tenancy with right of survivorship or tenancies by the entirety*. Except as provided in paragraph (c)(4)(iii) of this section (with respect to joint bank, brokerage, and other investment accounts), in the case of an interest in a joint tenancy with right of survivorship or a tenancy by the entirety, a qualified disclaimer of the interest to which the disclaimant succeeds upon creation of the tenancy must be made no later than 9 months after the creation of the tenancy regardless of whether such interest can be unilaterally severed under local law. A qualified disclaimer of the survivorship interest to which the survivor succeeds by operation of law upon the death of the first joint tenant to die must be made no later than 9 months after the death of the first joint tenant to die regardless of whether such interest can be unilaterally severed under local law and, except as provided in paragraph (c)(4)(ii) of this section (with respect to certain tenancies created on or after July 14, 1988), such interest is deemed to be a one-half interest in the property. (See, however, section 2518(b)(2)(B) for a special rule in the case of disclaimers by persons under age 21.) This is the case regardless of the portion of the property attributable to consideration furnished by the disclaimant and regardless of the portion of the property that is included in the decedent's gross estate under section 2040 and regardless of whether the interest can be unilaterally severed under local law. See paragraph (c)(5), Examples (7) and (8), of this section.

(ii) *Certain tenancies in real property between spouses created on or after July 14, 1988*. In the case of a joint tenancy between spouses or a tenancy by the entirety in real property created on or after July 14, 1988, to which section 2523(i)(3) applies (relating to the creation of a tenancy where the spouse of the donor is not a United States citizen), the surviving spouse may disclaim any portion of the joint interest that is includible in the decedent's gross estate under section 2040. See paragraph (c)(5), Example (9), of this section.

(iii) *Special rule for joint bank, brokerage, and other investment accounts (e.g., accounts held at mutual funds) established between spouses or between persons other than husband and wife.* In the case of a transfer to a joint bank, brokerage, or other investment account (e.g., an account held at a mutual fund), if a transferor may unilaterally regain the transferor's own contributions to the account without the consent of the other cotenant, such that the transfer is not a completed gift under § 25.2511-1(h)(4), the transfer creating the survivor's interest in the decedent's share of the account occurs on the death of the deceased cotenant. Accordingly, if a surviving joint tenant desires to make a qualified disclaimer with respect to funds contributed by a deceased cotenant, the disclaimer must be made within 9 months of the cotenant's death. The surviving joint tenant may not disclaim any portion of the joint account attributable to consideration furnished by that surviving joint tenant. See paragraph (c)(5), *Examples (12), (13), and (14)*, of this section, regarding the treatment of disclaimed interests under sections 2518, 2033 and 2040.

(iv) *Effective date.* This paragraph (c)(4) is applicable for disclaimers made on or after December 31, 1997.

(5) *Examples.* The provisions of paragraphs (c)(1) through (c)(4) of this section may be illustrated by the following examples. For purposes of the following examples, assume that all beneficiaries are over 21 years of age.

Example (1). On May 13, 1978, in a transfer which constitutes a completed gift for Federal gift tax purposes, A creates a trust in which B is given a lifetime interest in the income from the trust. B is also given a non-general testamentary power of appointment over the corpus of the trust. The power of appointment may be exercised in favor of any of the issue of A and B. If there are no surviving issue at B's death or if the power is not exercised, the corpus is to pass to E. On May 13, 1978, A and B have two surviving children, C and D. If A, B, C or D wishes to make a qualified disclaimer, the disclaimer must be made no later than 9 months after May 13, 1978.

Example (2). Assume the same facts as in example (1) except that B is given a general power of appointment over the corpus of the trust. B exercises the general power of appointment in favor of C upon B's death on

June 17, 1989. C may make a qualified disclaimer no later than 9 months after June 17, 1989. If B had died without exercising the general power of appointment, E could have made a qualified disclaimer no later than 9 months after June 17, 1989.

Example (3). F creates a trust on April 1, 1978, in which F's child G is to receive the income from the trust for life. Upon G's death, the corpus of the trust is to pass to G's child H. If either G or H wishes to make a qualified disclaimer, it must be made no later than 9 months after April 1, 1978.

Example (4). A creates a trust on February 15, 1978, in which B is named the income beneficiary for life. The trust further provides that upon B's death the proceeds of the trust are to pass to C, if then living. If C predeceases D, the proceeds shall pass to D or D's estate. To have timely disclaimers for purposes of section 2518, B, C, and D must disclaim their respective interests no later than 9 months after February 15, 1978.

Example (5). A, a resident of State Q, dies on January 10, 1979, devising certain real property to B. The disclaimer laws of State Q require that a disclaimer be made within a reasonable time after a transfer. B disclaims the entire interest in real property on November 10, 1979. Although B's disclaimer may be effective under State Q law, it is not a qualified disclaimer under section 2518 because the disclaimer was made later than 9 months after the taxable transfer to B.

Example (6). A creates a revocable trust on June 1, 1980, in which B and C are given the income interest for life. Upon the death of the last income beneficiary, the remainder interest is to pass to D. The creation of the trust is not a completed gift for Federal gift tax purposes, but each distribution of trust income to B and C is a completed gift at the date of distribution. B and C must disclaim each income distribution no later than 9 months after the date of the particular distribution. In order to disclaim an income distribution in the form of a check, the recipient must return the check to the trustee uncashed along with a written disclaimer. A dies on September 1, 1982, causing the trust to become irrevocable, and the trust corpus is includible in A's gross estate for Federal estate tax purposes under section 2038. If B or C wishes to make a qualified disclaimer of his income interest, he must do so no later than 9 months after September 1, 1982. If D wishes to make a qualified disclaimer of his remainder interest, he must do so no later than 9 months after September 1, 1982.

Example (7). On February 1, 1990, A purchased real property with A's funds. Title to the property was conveyed to "A and B, as joint tenants with right of survivorship." Under applicable state law, the joint interest is unilaterally severable by either tenant. B dies on May 1, 1998, and is survived by A. On

January 1, 1999, A disclaims the one-half survivorship interest in the property to which A succeeds as a result of B's death. Assuming that the other requirements of section 2518(b) are satisfied, A has made a qualified disclaimer of the one-half survivorship interest (but not the interest retained by A upon the creation of the tenancy, which may not be disclaimed by A). The result is the same whether or not A and B are married and regardless of the proportion of consideration furnished by A and B in purchasing the property.

Example (8). Assume the same facts as in *Example (7)* except that A and B are married and title to the property was conveyed to "A and B, as tenants by the entirety." Under applicable state law, the tenancy cannot be unilaterally severed by either tenant. Assuming that the other requirements of section 2518(b) are satisfied, A has made a qualified disclaimer of the one-half survivorship interest (but not the interest retained by A upon the creation of the tenancy, which may not be disclaimed by A). The result is the same regardless of the proportion of consideration furnished by A and B in purchasing the property.

Example (9). On March 1, 1989, H and W purchase a tract of vacant land which is conveyed to them as tenants by the entirety. The entire consideration is paid by H. W is not a United States citizen. H dies on June 1, 1998. W can disclaim the entire joint interest because this is the interest includible in H's gross estate under section 2040(a). Assuming that W's disclaimer is received by the executor of H's estate no later than 9 months after June 1, 1998, and the other requirements of section 2518(b) are satisfied, W's disclaimer of the property would be a qualified disclaimer. The result would be the same if the property was held in joint tenancy with right of survivorship that was unilaterally severable under local law.

Example (10). In 1986, spouses A and B purchased a personal residence taking title as tenants by the entirety. B dies on July 10, 1998. A wishes to disclaim the one-half undivided interest to which A would succeed by right of survivorship. If A makes the disclaimer, the property interest would pass under B's will to their child C. C, an adult, and A resided in the residence at B's death and will continue to reside there in the future. A continues to own a one-half undivided interest in the property. Assuming that the other requirements of section 2518(b) are satisfied, A may make a qualified disclaimer with respect to the one-half undivided survivorship interest in the residence if A delivers the written disclaimer to the personal representative of B's estate by April 10, 1999, since A is not deemed to have accepted the interest or any of its benefits prior to that time and A's occupancy of the residence after B's death is consistent with

A's retained undivided ownership interest. The result would be the same if the property was held in joint tenancy with right of survivorship that was unilaterally severable under local law.

Example (11). H and W, husband and wife, reside in state X, a community property state. On April 1, 1978, H and W purchase real property with community funds. The property is not held by H and W as jointly owned property with rights of survivorship. H and W hold the property until January 3, 1985, when H dies. H devises his portion of the property to W. On March 15, 1985, W disclaims the portion of the property devised to her by H. Assuming all the other requirements of section 2518 (b) have been met, W has made a qualified disclaimer of the interest devised to her by H. However, W could not disclaim the interest in the property that she acquired on April 1, 1978.

Example (12). On July 1, 1990, A opens a bank account that is held jointly with B, A's spouse, and transfers \$50,000 of A's money to the account. A and B are United States citizens. A can regain the entire account without B's consent, such that the transfer is not a completed gift under § 25.2511-1(h)(4). A dies on August 15, 1998, and B disclaims the entire amount in the bank account on October 15, 1998. Assuming that the remaining requirements of section 2518(b) are satisfied, B made a qualified disclaimer under section 2518(a) because the disclaimer was made within 9 months after A's death at which time B had succeeded to full dominion and control over the account. Under state law, B is treated as predeceasing A with respect to the disclaimed interest. The disclaimed account balance passes through A's probate estate and is no longer joint property includible in A's gross estate under section 2040. The entire account is, instead, includible in A's gross estate under section 2033. The result would be the same if A and B were not married.

Example (13). The facts are the same as *Example (12)*, except that B, rather than A, dies on August 15, 1998. A may not make a qualified disclaimer with respect to any of the funds in the bank account, because A furnished the funds for the entire account and A did not relinquish dominion and control over the funds.

Example (14). The facts are the same as *Example (12)*, except that B disclaims 40 percent of the funds in the account. Since, under state law, B is treated as predeceasing A with respect to the disclaimed interest, the 40 percent portion of the account balance that was disclaimed passes as part of A's probate estate, and is no longer characterized as joint property. This 40 percent portion of the account balance is, therefore, includible in A's gross estate under section 2033. The remaining 60 percent of the account balance that was not disclaimed retains its character

as joint property and, therefore, is includible in A's gross estate as provided in section 2040(b). Therefore, 30 percent ($\frac{1}{2} \times 60$ percent) of the account balance is includible in A's gross estate under section 2040(b), and a total of 70 percent of the aggregate account balance is includible in A's gross estate. If A and B were not married, then the 40 percent portion of the account subject to the disclaimer would be includible in A's gross estate as provided in section 2033 and the 60 percent portion of the account not subject to the disclaimer would be includible in A's gross estate as provided in section 2040(a), because A furnished all of the funds with respect to the account.

(d) *No acceptance of benefits*—(1) *Acceptance*. A qualified disclaimer cannot be made with respect to an interest in property if the disclaimant has accepted the interest or any of its benefits, expressly or impliedly, prior to making the disclaimer. Acceptance is manifested by an affirmative act which is consistent with ownership of the interest in property. Acts indicative of acceptance include using the property or the interest in property; accepting dividends, interest, or rents from the property; and directing others to act with respect to the property or interest in property. However, merely taking delivery of an instrument of title, without more, does not constitute acceptance. Moreover, a disclaimant is not considered to have accepted property merely because under applicable local law title to the property vests immediately in the disclaimant upon the death of a decedent. The acceptance of one interest in property will not, by itself, constitute an acceptance of any other separate interests created by the transferor and held by the disclaimant in the same property. In the case of residential property, held in joint tenancy by some or all of the residents, a joint tenant will not be considered to have accepted the joint interest merely because the tenant resided on the property prior to disclaiming his interest in the property. The exercise of a power of appointment to any extent by the donee of the power is an acceptance of its benefits. In addition, the acceptance of any consideration in return for making the disclaimer is an acceptance of the benefits of the entire interest disclaimed.

(2) *Fiduciaries*. If a beneficiary who disclaims an interest in property is

also a fiduciary, actions taken by such person in the exercise of fiduciary powers to preserve or maintain the disclaimed property shall not be treated as an acceptance of such property or any of its benefits. Under this rule, for example, an executor who is also a beneficiary may direct the harvesting of a crop or the general maintenance of a home. A fiduciary, however, cannot retain a wholly discretionary power to direct the enjoyment of the disclaimed interest. For example, a fiduciary's disclaimer of a beneficial interest does not meet the requirements of a qualified disclaimer if the fiduciary exercised or retains a discretionary power to allocate enjoyment of that interest among members of a designated class. See paragraph (e) of this section for rules relating to the effect of directing the redistribution of disclaimed property.

(3) *Under 21 years of age*. A beneficiary who is under 21 years of age has until 9 months after his twenty-first birthday in which to make a qualified disclaimer of his interest in property. Any actions taken with regard to an interest in property by a beneficiary or a custodian prior to the beneficiary's twenty-first birthday will not be an acceptance by the beneficiary of the interest.

(4) *Examples*. The provisions of paragraphs (d) (1), (2) and (3) of this section may be illustrated by the following examples:

Example (1). On April 9, 1977, A established a trust for the benefit of B, then age 22. Under the terms of the trust, the current income of the trust is to be paid quarterly to B. Additionally, one half the principal is to be distributed to B when B attains the age of 30 years. The balance of the principal is to be distributed to B when B attains the age of 40 years. Pursuant to the terms of the trust, B received a distribution of income on June 30, 1977. On August 1, 1977, B disclaimed B's right to receive both the income from the trust and the principal of the trust, B's disclaimer of the income interest is not a qualified disclaimer for purposes of section 2518(a) because B accepted income prior to making the disclaimer. B's disclaimer of the principal, however, does satisfy section 2518(b)(3). See also § 25.2518-3 for rules relating to the disclaimer of less than an entire interest in property.

Example (2). B is the recipient of certain property devised to B under the will of A.

The will stated that any disclaimed property was to pass to C. B and C entered into negotiations in which it was decided that B would disclaim all interest in the real property that was devised to B. In exchange, C promised to let B live in the family home for life. B's disclaimer is not a qualified disclaimer for purposes of section 2518(a) because B accepted consideration for making the disclaimer.

Example (3). A received a gift of Blackacre on December 25, 1978. A never resided on Blackacre but when property taxes on Blackacre became due on July 1, 1979, A paid them out personal funds. On August 15, 1979, A disclaimed the gift of Blackacre. Assuming all the requirements of section 2518 (b) have been met, A has made a qualified disclaimer of Blackacre. Merely paying the property taxes does not constitute an acceptance of Blackacre even though A's personal funds were used to pay the taxes.

Example (4). A died on February 15, 1978. Pursuant to A's will, B received a farm in State Z. B requested the executor to sell the farm and to give the proceeds to B. The executor then sold the farm pursuant to B's request. B then disclaimed \$50,000 of the proceeds from the sale of the farm. B's disclaimer is not a qualified disclaimer. By requesting the executor to sell the farm B accepted the farm even though the executor may not have been legally obligated to comply with B's request. See also § 25.2518-3 for rules relating to the disclaimer of less than an entire interest in property.

Example (5). Assume the same facts as in example (4) except that instead of requesting the executor to sell the farm, B pledged the farm as security for a short-term loan which was paid off prior to distribution of the estate. B then disclaimed his interest in the farm. B's disclaimer is not a qualified disclaimer. By pledging the farm as security for the loan, B accepted the farm.

Example (6). A delivered 1,000 shares of stock in Corporation X to B as a gift on February 1, 1980. A had the shares registered in B's name on that date. On April 1, 1980, B disclaimed the interest in the 1,000 shares. Prior to making the disclaimer, B did not pledge the shares, accept any dividends or otherwise commit any acts indicative of acceptance. Assuming the remaining requirements of section 2518 are satisfied, B's disclaimer is a qualified disclaimer.

Example (7). On January 1, 1980, A created an irrevocable trust in which B was given a testamentary general power of appointment over the trust's corpus. B executed a will on June 1, 1980, in which B provided for the exercise of the power of appointment. On September 1, 1980, B disclaimed the testamentary power of appointment. Assuming the remaining requirements of section 2518 (b) are satisfied, B's disclaimer of the testa-

mentary power of appointment is a qualified disclaimer.

Example (8). H and W reside in X, a community property state. On January 1, 1981, H and W purchase a residence with community funds. They continue to reside in the house until H dies testate on February 1, 1990. Although H could devise his portion of the residence to any person, H devised his portion of the residence to W. On September 1, 1990, W disclaims the portion of the residence devised to her pursuant to H's will but continues to live in the residence. Assuming the remaining requirements of section 2518(b) are satisfied, W's disclaimer is a qualified disclaimer under section 2518 (a). W's continued occupancy of the house prior to making the disclaimer will not by itself be treated as an acceptance of the benefits of the portion of the residence devised to her by H.

Example (9). In 1979, D established a trust for the benefit of D's minor children E and F. Under the terms of the trust, the trustee is given the power to make discretionary distributions of current income and corpus to both children. The corpus of the trust is to be distributed equally between E and F when E becomes 35 years of age. Prior to attaining the age of 21 years on April 8, 1982, E receives several distributions of income from the trust. E receives no distributions of income between April 8, 1982 and August 15, 1982, which is the date on which E disclaims all interest in the income from the trust. As a result of the disclaimer the income will be distributed to F. If the remaining requirements of section 2518 are met, E's disclaimer is a qualified disclaimer under section 2518(a). To have a qualified disclaimer of the interest in corpus, E must disclaim the interest no later than 9 months after April 8, 1982, E's 21st birthday.

Example (10). Assume the same facts as in example (9) except that E accepted a distribution of income on May 13, 1982. E's disclaimer is not a qualified disclaimer under section 2518 because by accepting an income distribution after attaining the age of 21, E accepted benefits from the income interest.

Example (11). F made a gift of 10 shares of stock to G as custodian for H under the State X Uniform Gifts to Minors Act. At the time of the gift, H was 15 years old. At age 18, the local age of majority, the 10 shares were delivered to and registered in the name of H. Between the receipt of the shares and H's 21st birthday, H received dividends from the shares. Within 9 months of attaining age 21, H disclaimed the 10 shares. Assuming H did not accept any dividends from the shares after attaining age 21, the disclaimer by H is a qualified disclaimer under section 2518.

(e) *Passage without direction by the disclaimant of beneficial enjoyment of disclaimed interest—(1) In general.* A disclaimer is not a qualified disclaimer

unless the disclaimed interest passes without any direction on the part of the disclaimant to a person other than the disclaimant (except as provided in paragraph (e)(2) of this section). If there is an express or implied agreement that the disclaimed interest in property is to be given or bequeathed to a person specified by the disclaimant, the disclaimant shall be treated as directing the transfer of the property interest. The requirements of a qualified disclaimer under section 2518 are not satisfied if—

(i) The disclaimant, either alone or in conjunction with another, directs the redistribution or transfer of the property or interest in property to another person (or has the power to direct the redistribution or transfer of the property or interest in property to another person unless such power is limited by an ascertainable standard); or

(ii) The disclaimed property or interest in property passes to or for the benefit of the disclaimant as a result of the disclaimer (except as provided in paragraph (e)(2) of this section).

If a power of appointment is disclaimed, the requirements of this paragraph (e)(1) are satisfied so long as there is no direction on the part of the disclaimant with respect to the transfer of the interest subject to the power or with respect to the transfer of the power to another person. A person may make a qualified disclaimer of a beneficial interest in property even if after such disclaimer the disclaimant has a fiduciary power to distribute to designated beneficiaries, but only if the power is subject to an ascertainable standard. See examples (11) and (12) of paragraph (e)(5) of this section.

(2) *Disclaimer by surviving spouse.* In the case of a disclaimer made by a decedent's surviving spouse with respect to property transferred by the decedent, the disclaimant satisfies the requirements of this paragraph (e) if the interest passes as a result of the disclaimer without direction on the part of the surviving spouse either to the surviving spouse or to another person. If the surviving spouse, however, retains the right to direct the beneficial enjoyment of the disclaimed property in a transfer that is not subject to Fed-

eral estate and gift tax (whether as trustee or otherwise), such spouse will be treated as directing the beneficial enjoyment of the disclaimed property, unless such power is limited by an ascertainable standard. See examples (4), (5), and (6) in paragraph (e)(5) of this section.

(3) *Partial failure of disclaimer.* If a disclaimer made by a person other than the surviving spouse is not effective to pass completely an interest in property to a person other than the disclaimant because—

(i) The disclaimant also has a right to receive such property as an heir at law, residuary beneficiary, or by any other means; and

(ii) The disclaimant does not effectively disclaim these rights, the disclaimer is not a qualified disclaimer with respect to the portion of the disclaimed property which the disclaimant has a right to receive. If the portion of the disclaimed interest in property which the disclaimant has a right to receive is not severable property or an undivided portion of the property, then the disclaimer is not a qualified disclaimer with respect to any portion of the property. Thus, for example, if a disclaimant who is not a surviving spouse receives a specific bequest of a fee simple interest in property and as a result of the disclaimer of the entire interest, the property passes to a trust in which the disclaimant has a remainder interest, then the disclaimer will not be a qualified disclaimer unless the remainder interest in the property is also disclaimed. See § 25.2518-3 (a)(1)(ii) for the definition of severable property.

(4) *Effect of precatory language.* Precatory language in a disclaimer naming takers of disclaimed property will not be considered as directing the redistribution or transfer of the property or interest in property to such persons if the applicable State law gives the language no legal effect.

(5) *Examples.* The provisions of this paragraph (e) may be illustrated by the following examples:

Example (1). A, a resident of State X, died on July 30, 1978. Pursuant to A's will, B, A's son and heir at law, received the family home. In addition, B and C each received 50 percent of A's residuary estate. B disclaimed

the home. A's will made no provision for the distribution of property in the case of a beneficiary's disclaimer. Therefore, pursuant to the disclaimer laws of State X, the disclaimed property became part of the residuary estate. Because B's 50 percent share of the residuary estate will be increased by 50 percent of the value of the family home, the disclaimed property will not pass solely to another person. Consequently, B's disclaimer of the family home is a qualified disclaimer only with respect to the 50 percent portion that passes solely to C. Had B also disclaimed B's 50 percent interest in the residuary estate, the disclaimer would have been a qualified disclaimer under section 2518 of the entire interest in the home (assuming the remaining requirements of a qualified disclaimer were satisfied). Similarly, if under the laws of State X, the disclaimer has the effect of divesting B of all interest in the home, both as devisee and as a beneficiary of the residuary estate, including any property resulting from its sale, the disclaimer would be a qualified disclaimer of B's entire interest in the home.

Example (2). D, a resident of State Y, died testate on June 30, 1978. E, an heir at law of D, received specific bequests of certain severable personal property from D. E disclaimed the property transferred by D under the will. The will made no provision for the distribution of property in the case of a beneficiary's disclaimer. The disclaimer laws of State Y provide that such property shall pass to the decedent's heirs at law in the same manner as if the disclaiming beneficiary had died immediately before the testator's death. Because State Y's law treats E as predeceasing D, the property disclaimed by E does not pass to E as an heir at law or otherwise. Consequently, if the remaining requirements of section 2518(b) are satisfied, E's disclaimer is a qualified disclaimer under section 2518(a).

Example (3). Assume the same facts as in example (2) except that State Y has no provision treating the disclaimant as predeceasing the testator. E's disclaimer satisfies section 2518 (b)(4) only to the extent that E does not have a right to receive the property as an heir at law. Had E disclaimed both the share E received under D's will and E's intestate share, the requirement of section 2518 (b)(4) would have been satisfied.

Example (4). B died testate on February 13, 1980. B's will established both a marital trust and a nonmarital trust. The decedent's surviving spouse, A, is an income beneficiary of the marital trust and has a testamentary general power of appointment over its assets. A is also an income beneficiary of the nonmarital trust, but has no power to appoint or invade the corpus. The provisions of the will specify that any portion of the marital trust disclaimed is to be added to the nonmarital trust. A disclaimed 30 percent of the marital trust. (See § 25.2518-3 (b) for rules relating to

the disclaimer of an undivided portion of an interest in property.) Pursuant to the will, this portion of the marital trust property was transferred to the nonmarital trust without any direction on the part of A. This disclaimer by A satisfies section 2518 (b)(4).

Example (5). Assume the same facts as in example (4) except that A, the surviving spouse, has both an income interest in the nonmarital trust and a testamentary nongeneral power to appoint among designated beneficiaries. This power is not limited by an ascertainable standard. The requirements of section 2518 (b)(4) are not satisfied unless A also disclaims the nongeneral power to appoint the portion of the trust corpus that is attributable to the property that passed to the nonmarital trust as a result of A's disclaimer. Assuming that the fair market value of the disclaimed property on the date of the disclaimer is \$250,000 and that the fair market value of the nonmarital trust (including the disclaimed property) immediately after the disclaimer is \$750,000, A must disclaim the power to appoint one-third of the nonmarital trust's corpus. The result is the same regardless of whether the nongeneral power is testamentary or *inter vivos*.

Example (6). Assume the same facts as in example (4) except that A has both an income interest in the nonmarital trust and a power to invade corpus if needed for A's health or maintenance. In addition, an independent trustee has power to distribute to A any portion of the corpus which the trustee determines to be desirable for A's happiness. Assuming the other requirements of section 2518 are satisfied, A may make a qualified disclaimer of interests in the marital trust without disclaiming any of A's interests in the nonmarital trust.

Example (7). B died testate on June 1, 1980. B's will created both a marital trust and a nonmarital trust. The decedent's surviving spouse, C, is an income beneficiary of the marital trust and has a testamentary general power of appointment over its assets. C is an income beneficiary of the nonmarital trust, and additionally has the noncumulative right to withdraw yearly the greater of \$5,000 or 5 percent of the aggregate value of the principal. The provisions of the will specify that any portion of the marital trust disclaimed is to be added to the nonmarital trust. C disclaims 50 percent of the marital trust corpus. Pursuant to the will, this amount is transferred to the nonmarital trust. Assuming the remaining requirements of section 2518(b) are satisfied, C's disclaimer is a qualified disclaimer.

Example (8). A, a resident of State X, died on July 19, 1979. A was survived by a spouse B, and three children, C, D, and E. Pursuant to A's will, B received one-half of A's estate and the children received equal shares of the

remaining one-half of the estate. B disclaimed the entire interest B had received. The will made no provisions for the distribution of property in the case of a beneficiary's disclaimer. The disclaimer laws of State X provide that under these circumstances disclaimed property passes to the decedent's heirs at law in the same manner as if the disclaiming beneficiary had died immediately before the testator's death. As a result, C, D, and E are A's only remaining heirs at law, and will divide the disclaimed property equally among themselves. B's disclaimer includes language stating that "it is my intention that C, D, and E will share equally in the division of this property as a result of my disclaimer." State X considers these to be precatory words and gives them no legal effect. B's disclaimer meets all other requirements imposed by State X on disclaimers, and is considered an effective disclaimer under which the property will vest solely in C, D, and E in equal shares without any further action required by B. Therefore, B is not treated as directing the redistribution or transfer of the property. If the remaining requirements of section 2518 are met, B's disclaimer is a qualified disclaimer.

Example (9). C died testate on January 1, 1979. According to C's will, D was to receive $\frac{1}{3}$ of the residuary estate with any disclaimed property going to E. D was also to receive a second $\frac{1}{3}$ of the residuary estate with any disclaimed property going to F. Finally, D was to receive a final $\frac{1}{3}$ of the residuary estate with any disclaimed property going to G. D specifically states that he is disclaiming the interest in which the disclaimed property is designated to pass to E. D has effectively directed that the disclaimed property will pass to E and therefore D's disclaimer is not a qualified disclaimer under section 2518(a).

Example (10). Assume the same facts as in example (9) except that C's will also states that D was to receive Blackacre and Whiteacre. C's will further provides that if D disclaimed Blackacre then such property was to pass to E and that if D disclaimed Whiteacre then Whiteacre was to pass to F. D specifically disclaims Blackacre with the intention that it pass to E. Assuming the other requirements of section 2518 are met, D has made a qualified disclaimer of Blackacre. Alternatively, D could disclaim an undivided portion of both Blackacre and Whiteacre. Assuming the other requirements of section 2518 are met, this would also be a qualified disclaimer.

Example (11). G creates an irrevocable trust on February 16, 1983, naming H, I and J as the income beneficiaries for life and F as the remainderman. F is also named the trustee and as trustee has the discretionary power to invade the corpus and make discretionary distributions to H, I or J during their lives. F disclaims the remainder interest on Au-

gust 8, 1983, but retains his discretionary power to invade the corpus. F has not made a qualified disclaimer because F retains the power to direct enjoyment of the corpus and the retained fiduciary power is not limited by an ascertainable standard.

Example (12). Assume the same facts as in example (11) except that F may only invade the corpus to make distributions for the health, maintenance or support of H, I or J during their lives. If the other requirements of section 2518(b) are met, F has made a qualified disclaimer of the remainder interest because the retained fiduciary power is limited by an ascertainable standard.

[T.D. 8095, 51 FR 28371, Aug. 7, 1986; 51 FR 31939, Sept. 8, 1986, as amended by T.D. 8744, 62 FR 68185, Dec. 31, 1997]

§ 25.2518-3 Disclaimer of less than an entire interest.

(a) *Disclaimer of a partial interest—(1) In general—(i) Interest.* If the requirements of this section are met, the disclaimer of all or an undivided portion of any separate interest in property may be a qualified disclaimer even if the disclaimant has another interest in the same property. In general, each interest in property that is separately created by the transferor is treated as a separate interest. For example, if an income interest in securities is bequeathed to A for life, then to B for life, with the remainder interest in such securities bequeathed to A's estate, and if the remaining requirements of section 2518(b) are met, A could make a qualified disclaimer of either the income interest or the remainder, or an undivided portion of either interest. A could not, however, make a qualified disclaimer of the income interest for a certain number of years. Further, where local law merges interests separately created by the transferor, a qualified disclaimer will be allowed only if there is a disclaimer of the entire merged interest or an undivided portion of such merged interest. See example (12) in paragraph (d) of this section. See § 25.2518-3(b) for rules relating to the disclaimer of an undivided portion. Where the merger of separate interests would occur but for the creation by the transferor of a nominal interest (as defined in paragraph (a)(1)(iv) of this section), a qualified disclaimer will be allowed only if there is a disclaimer of all the separate interests, or an undivided portion of all

such interests, which would have merged but for the nominal interest.

(ii) *Severable property.* A disclaimant shall be treated as making a qualified disclaimer of a separate interest in property if the disclaimer relates to severable property and the disclaimant makes a disclaimer which would be a qualified disclaimer if such property were the only property in which the disclaimant had an interest. If applicable local law does not recognize a purported disclaimer of severable property, the disclaimant must comply with the requirements of paragraph (c)(1) of § 25.2518-1 in order to make a qualified disclaimer of the severable property. Severable property is property which can be divided into separate parts each of which, after severance, maintains a complete and independent existence. For example, a legatee of shares of corporate stock may accept some shares of the stock and make a qualified disclaimer of the remaining shares.

(iii) *Powers of appointment.* A power of appointment with respect to property is treated as a separate interest in such property and such power of appointment with respect to all or an undivided portion of such property may be disclaimed independently from any other interests separately created by the transferor in the property if the requirements of section 2518(b) are met. See example (21) of paragraph (d) of this section. Further, a disclaimer of a power of appointment with respect to property is a qualified disclaimer only if any right to direct the beneficial enjoyment of the property which is retained by the disclaimant is limited by an ascertainable standard. See example (9) of paragraph (d) of this section.

(iv) *Nominal interest.* A nominal interest is an interest in property created by the transferor that—

(A) Has an actuarial value (as determined under § 20.2031-7) of less than 5 percent of the total value of the property at the time of the taxable transfer creating the interest,

(B) Prevents the merger under local law or two or more other interests created by the transferor, and

(C) Can be clearly shown from all the facts and circumstances to have been created primarily for the purpose of

preventing the merger of such other interests.

Factors to be considered in determining whether an interest is created primarily for the purpose of preventing merger include (but are not limited to) the following: the relationship between the transferor and the interest holder; the age difference between the interest holder and the beneficiary whose interests would have merged; the interest holder's state of health at the time of the taxable transfer; and, in the case of a contingent remainder, any other factors which indicate that the possibility of the interest vesting as a fee simple is so remote as to be negligible.

(2) *In trust.* A disclaimer is not a qualified disclaimer under section 2518 if the beneficiary disclaims income derived from specific property transferred in trust while continuing to accept income derived from the remaining properties in the same trust unless the disclaimer results in such property being removed from the trust and passing, without any direction on the part of the disclaimant, to persons other than the disclaimant or to the spouse of the decedent. Moreover, a disclaimer of both an income interest and a remainder interest in specific trust assets is not a qualified disclaimer if the beneficiary retains interests in other trust property unless, as a result of the disclaimer, such assets are removed from the trust and pass, without any direction on the part of the disclaimant, to persons other than the disclaimant or to the spouse of the decedent. The disclaimer of an undivided portion of an interest in a trust may be a qualified disclaimer. See also paragraph (b) of this section for rules relating to the disclaimer of an undivided portion of an interest in property.

(b) *Disclaimer of undivided portion.* A disclaimer of an undivided portion of a separate interest in property which meets the other requirements of a qualified disclaimer under section 2518(b) and the corresponding regulations is a qualified disclaimer. An undivided portion of a disclaimant's separate interest in property must consist of a fraction or percentage of each and every substantial interest or right owned by the disclaimant in such property and must extend over the entire

term of the disclaimant's interest in such property and in other property into which such property is converted. A disclaimer of some specific rights while retaining other rights with respect to an interest in the property is not a qualified disclaimer of an undivided portion of the disclaimant's interest in property. Thus, for example, a disclaimer made by the devisee of a fee simple interest in Blackacre is not a qualified disclaimer if the disclaimant disclaims a remainder interest in Blackacre but retains a life estate.

(c) *Disclaimer of a pecuniary amount.* A disclaimer of a specific pecuniary amount out of a pecuniary or nonpecuniary bequest or gift which satisfies the other requirements of a qualified disclaimer under section 2518 (b) and the corresponding regulations is a qualified disclaimer provided that no income or other benefit of the disclaimed amount inures to the benefit of the disclaimant either prior to or subsequent to the disclaimer. Thus, following the disclaimer of a specific pecuniary amount from a bequest or gift,

the amount disclaimed and any income attributable to such amount must be segregated from the portion of the gift or bequest that was not disclaimed. Such a segregation of assets making up the disclaimer of a pecuniary amount must be made on the basis of the fair market value of the assets on the date of the disclaimer or on a basis that is fairly representative of value changes that may have occurred between the date of transfer and the date of the disclaimer. A pecuniary amount distributed to the disclaimant from the bequest or gift prior to the disclaimer shall be treated as a distribution of corpus from the bequest or gift. However, the acceptance of a distribution from the gift or bequest shall also be considered to be an acceptance of a proportionate amount of income earned by the bequest or gift. The proportionate share of income considered to be accepted by the disclaimant shall be determined at the time of the disclaimer according to the following formula:

$$\frac{\text{Total amount of distributions received by the disclaimant out of the gift or bequest}}{\text{Total value of the gift or bequest on the date of transfer}} \times \frac{\text{Total amount of income earned by the gift or bequest between date of transfer and date of disclaimer}}{\text{Total amount of income earned by the gift or bequest between date of transfer and date of disclaimer}}$$

See examples (17), (18), and (19) in § 25.2518-3(d) for illustrations of the rules set forth in this paragraph (c).

(d) *Examples.* The provisions of this section may be illustrated by the following examples:

Example (1). A, a resident of State Q, died on August 1, 1978. A's will included specific bequests of 100 shares of stock in X corporation; 200 shares of stock in Y corporation; 500 shares of stock in Z corporation; personal effects consisting of paintings, home furnishings, jewelry, and silver, and a 500 acre farm consisting of a residence, various outbuildings, and 500 head of cattle. The laws of State Q provide that a disclaimed interest passes in the same manner as if the disclaiming beneficiary had died immediately before the testator's death. Pursuant to A's will, B was to receive both the personal effects and the farm. C was to receive all the shares of stock in Corporation X and Y and D was to receive all the shares of stock in

Corporation Z. B disclaimed 2 of the paintings and all the jewelry, C disclaimed 50 shares of Y corporation stock, and D disclaimed 100 shares of Z corporation stock. If the remaining requirements of section 2518(b) and the corresponding regulations are met, each of these disclaimers is a qualified disclaimer for purposes of section 2518(a).

Example (2). Assume the same facts as in example (1) except that D disclaimed the income interest in the shares of Z corporation stock while retaining the remainder interest in such shares. D's disclaimer is not a qualified disclaimer.

Example (3). Assume the same facts as in example (1) except that B disclaimed 300 identified acres of the 500 acres. Assuming that B's disclaimer meets the remaining requirements of section 2518(b), it is a qualified disclaimer.

Example (4). Assume the same facts as in example (1) except that A devised the income from the farm to B for life and the remainder interest to C. B disclaimed 40 percent of the

income from the farm. Assuming that it meets the remaining requirements of section 2518(b), B's disclaimer of an undivided portion of the income is a qualified disclaimer.

Example (5). E died on September 13, 1978. Under the provisions of E's will, E's shares of stock in X, Y, and Z corporations were to be transferred to a trust. The trust provides that all income is to be distributed currently to F and G in equal parts until F attains the age of 45 years. At that time the corpus of the trust is to be divided equally between F and G. F disclaimed the income arising from the shares of X stock. G disclaimed 20 percent of G's interest in the trust. F's disclaimer is not a qualified disclaimer because the X stock remains in the trust. If the remaining requirements of section 2518(b) are met, G's disclaimer is a qualified disclaimer.

Example (6). Assume the same facts as in example (5) except that F disclaimed both the income interest and the remainder interest in the shares of X stock. F's disclaimer results in the X stock being transferred out of the trust to G without any direction on F's part. F's disclaimer is a qualified disclaimer under section 2518(b).

Example (7). Assume the same facts as in example (5) except that F is only an income beneficiary of the trust. The X stock remains in the trust after F's disclaimer of the income arising from the shares of X stock. F's disclaimer is not a qualified disclaimer under section 2518.

Example (8). Assume the same facts as in example (5) except that F disclaimed the entire income interest in the trust while retaining the interest F has in corpus. Alternatively, assume that G disclaimed G's entire corpus interest while retaining G's interest in the income from the trust. If the remaining requirements of section 2518(b) are met, either disclaimer will be a qualified disclaimer.

Example (9). G creates an irrevocable trust on May 13, 1980, with H, I, and J as the income beneficiaries. In addition, H, who is the trustee, holds the power to invade corpus for H's health, maintenance, support and happiness and a testamentary power of appointment over the corpus. In the absence of the exercise of the power of appointment, the property passes to I and J in equal shares. H disclaimed the power to invade corpus for H's health, maintenance, support and happiness. Because H retained the testamentary power to appoint the property in the corpus, H's disclaimer is not a qualified disclaimer. If H also disclaimed the testamentary power of appointment, H's disclaimer would have been a qualified disclaimer.

Example (10). E creates an irrevocable trust on May 1, 1980, in which D is the income beneficiary for life. Subject to the trustee's discretion, E's children, A, B, and C, have the right to receive corpus during D's lifetime. The remainder passes to D if D survives A, B,

C, and all their issue. D also holds an inter vivos power to appoint the trust corpus to A, B, and C. On September 1, 1980, D disclaimed the remainder interest. D's disclaimer is not a qualified disclaimer because D retained the power to direct the use and enjoyment of corpus during D's life.

Example (11). Under H's will, a trust is created from which W is to receive all of the income for life. The trustee has the power to invade the trust corpus for the support or maintenance of D during the life of W. The trust is to terminate at W's death, at which time the trust property is to be distributed to D. D makes a timely disclaimer of the right to corpus during W's lifetime, but does not disclaim the remainder interest. D's disclaimer is a qualified disclaimer assuming the remaining requirements of section 2518 are met.

Example (12). Under the provisions of G's will A received a life estate in a farm, and was the sole beneficiary of property in the residuary estate. The will also provided that the remainder interest in the farm pass to the residuary estate. Under local law A's interests merged to give A a fee simple in the farm. A made a timely disclaimer of the life estate. A's disclaimer of a partial interest is not a qualified disclaimer under section 2518(a). If A makes a disclaimer of the entire merged interest in the farm or an undivided portion of such merged interest then A would be making a qualified disclaimer assuming all the other requirements of section 2518(b) are met.

Example (13). A, a resident of State Z, dies on September 3, 1980. Under A's will, Blackacre is devised to C for life, then to D for 1 month, remainder to C. Had A not created D's interest, State Z law would have merged C's life estate and the remainder to C to create a fee simple interest in C. Assume that the actuarial value of D's interest is less than 5 percent of the total value of Blackacre on the date of A's death. Further assume that facts and circumstances (particularly the duration of D's interest) clearly indicate that D's interest was created primarily for the purpose of preventing the merger of C's two interests in Blackacre. D's interest in Blackacre is a nominal interest and C's two interests will, for purposes of making a qualified disclaimer, be considered to have merged. Thus, C cannot make a qualified disclaimer of his remainder while retaining the life estate. C can, however, make a qualified disclaimer of both of these interests entirely or an undivided portion of both.

Example (14). A, a resident of State X, dies on October 12, 1978. Under A's will, Blackacre was devised to B for life, then to C for life if C survives B, remainder to B's estate. On the date of A's death, B and C are both 8 year old grandchildren of A. In addition, C is in good health. The actual value of C's interest is

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less than 5 percent of the total value of Blackacre on the date of A's death. No facts are present which would indicate that the possibility of C's contingent interest vesting is so remote as to be negligible. Had C's contingent life estate not been created, B's life estate and remainder interests would have merged under local law to give B a fee simple interest in Blackacre. Although C's interest prevents the merger of B's two interests and has an actual value of less than 5 percent, C's interest is not a nominal interest within the meaning of § 25.2518-3(a)(1)(iv) because the facts and circumstances do not clearly indicate that the interest was created primarily for the purpose of preventing the merger of other interests in the property. Assuming all the other requirements of section 2518(b) are met, B can make a qualified disclaimer of the remainder while retaining his life estate.

Example (15). In 1981, A transfers \$60,000 to a trust created for the benefit of B who was given the income interest for life and who also has a testamentary nongeneral power of appointment over the corpus. A transfers an additional \$25,000 to the trust on June 1, 1984. At that time the trust corpus (exclusive of the \$25,000 transfer) has a fair market value of \$75,000. On January 1, 1985, B disclaims the right to receive income attributable to 25 percent of the corpus

$$\left(\frac{\$25,000 \text{ (1984 transfer)}}{\$100,000 \text{ (Fair market value of corpus immediately after the 1984 transfer)}} = 25\% \right)$$

Assuming that no distributions were made to B attributable to the \$25,000, B's disclaimer is a qualified disclaimer for purposes of section 2518(a) if all the remaining requirements of section 2518(b) are met.

Example (16). Under the provisions of B's will, A is left an outright cash legacy of \$50,000 and has no other interest in B's estate. A timely disclaimer by A of any stated dollar amount is a qualified disclaimer under section 2518(a).

Example (17). D bequeaths his brokerage account to E. The account consists of stocks

and bonds and a cash amount earning interest. The total value of the cash and assets in the account on the date of D's death is \$100,000. Four months after D's death, E makes a withdrawal of cash from the account for personal use amounting to \$40,000. Eight months after D's death, E disclaims \$60,000 of the account without specifying any particular assets or cash. The cumulative fair market value of the stocks and bonds in the account on the date of the disclaimer is equal to the value of such stocks and bonds on the date of D's death. The income earned by the account between the date of D's death and the date of E's disclaimer was \$20,000. The amount of income earned by the account that E accepted by withdrawing \$40,000 from the account prior to the disclaimer is determined by applying the formula set forth in § 25.2518-3(c) as follows:

$$\frac{\$40,000}{\$100,000} \times \$20,000 = \$8,000$$

E is considered to have accepted \$8,000 of the income earned by the account. If (i) the \$60,000 disclaimed by E and the \$12,000 of income earned prior to the disclaimer which is attributable to that amount are segregated from the \$8,000 of income E is considered to have accepted, (ii) E does not accept any benefits of the \$72,000 so segregated, and (iii) the other requirements of section 2518 (b) are met, then E's disclaimer of \$60,000 from the account is a qualified disclaimer.

Example (18). A bequeathed his residuary estate to B. The residuary estate had a value of \$1 million on the date of A's death. Six months later, B disclaimed \$200,000 out of this bequest. B received distributions of all the income from the entire estate during the period of administration. When the estate was distributed, B received the entire residuary estate except for \$200,000 in cash. B did not make a qualified disclaimer since he accepted the benefits of the \$200,000 during the period of estate administration.

Example (19). Assume the same facts as in example (18) except that no income was paid to B and the value of the residuary estate on the date of the disclaimer (including interest earned from date of death) was \$1.5 million. In addition, as soon as B's disclaimer was made, the executor of A's estate set aside assets worth \$300,000

$$\left(\frac{\$200,000}{\$1,000,000} \times \$1,500,000 \right)$$

and the interest earned after the disclaimer on that amount in a separate fund so that none of the income was paid to B. B's disclaimer is a qualified disclaimer under section 2518(a).

Example (20). A bequeathed his residuary estate to B. B disclaims a fractional share of the residuary estate. Any disclaimed property will pass to A's surviving spouse, W. The numerator of the fraction disclaimed is the smallest amount which will allow A's estate to pass free of Federal estate tax and the denominator is the value of the residuary estate. B's disclaimer is a qualified disclaimer.

Example (21). A created a trust on July 1, 1979. The trust provides that all current income is to be distributed equally between B and C for the life of B. B also is given a testamentary general power of appointment over the corpus. If the power is not exercised, the corpus passes to C or C's heirs. B disclaimed the testamentary power to appoint an undivided one-half of the trust corpus. Assuming the remaining requirements of section 2518(b) are satisfied, B's disclaimer is a qualified disclaimer under section 2518(a).

[T.D. 8095, 51 FR 28375, Aug. 7, 1986; 51 FR 31939, Sept. 8, 1986, as amended by T.D. 8540, 59 FR 30103, June 10, 1994]

ACTUARIAL TABLES APPLICABLE BEFORE
MAY 1, 2009

§ 25.2512-5A Valuation of annuities, unitrust interests, interests for life or term of years, and remainder or reversionary interests transferred before May 1, 2009.

(a) *Valuation of annuities, interests for life or term of years, and remainder or reversionary interests transferred before January 1, 1952.* Except as otherwise provided in § 25.2512-5(b), if the transfer was made before January 1, 1952, the present value of annuities, life estates, terms of years, remainders, and reversions is their present value determined under this section. If the valuation of the interest involved is dependent upon the continuation or termination of one or more lives or upon a term certain concurrent with one or more lives, the factor for the present value is computed on the basis of interest at the rate of 4 percent a year, compounded annually, and life contingencies for each life involved from values that are based upon the "Actuaries' or Combined Experience Table of Mortality, as extended." This table and many additional factors are described in former § 86.19 (as contained in the 26 CFR part

81 edition revised as of April 1, 1958). The present value of an interest measured by a term of years is computed on the basis of interest at the rate of 4 percent a year.

(b) *Valuation of annuities, interests for life or term of years, and remainder or reversionary interests transferred after December 31, 1951, and before January 1, 1971.* Except as otherwise provided in § 25.2512-5(b), the present value of annuities, life estates, terms of years, remainders, and reversions transferred after December 31, 1951, and before January 1, 1971, is the present value of such interests determined under this section. If the value of the interest involved is dependent upon the continuation or termination of one or more lives, the factor for the present value is computed on the basis of interest at the rate of 3½ percent a year, compounded annually, and life contingencies for each life involved from U.S. Life Table 38. This table and many accompanying factors are set forth in former § 25.2512-5 (as contained in the 26 CFR part 25 edition revised as of April 1, 1984). Special factors involving one and two lives may be found in or computed with the use of tables contained in Internal Revenue Service Publication Number 11, "Actuarial Values for Estate and Gift Tax," (Rev. 5-59). This publication is no longer available for purchase from the Superintendent of Documents. However, it may be obtained by requesting a copy from: CC:DOM:CORP:T:R (IRS Publication 11), room 5228, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. The present value of an interest measured by a term of years is computed on the basis of interest at the rate of 3½ percent a year.

(c) *Valuation of annuities, interests for life or term of years, and remainder or reversionary interests transferred after December 31, 1970, and before December 1, 1983.* Except as otherwise provided in § 25.2512-5(b), the present value of annuities, life estates, terms of years, remainders, and reversions transferred after December 31, 1970, and before December 1, 1983, is the present value of such interests determined under this section. If the interest to be valued is dependent upon the continuation or

termination of one or more lives or upon a term certain concurrent with one or more lives, the factor for the present value is computed on the basis of interest at the rate of 6 percent a year, compounded annually, and life contingencies determined for each male and female life involved, from the values that are set forth in Table LN. Table LN contains values that are taken from the life table for total males and the life table for total females appearing as Tables 2 and 3, respectively, in United States Life Tables: 1959-61, published by the Department of Health and Human Services, Public Health Service. Table LN and accompanying factors are set forth in former § 25.2512-9 (as contained in the 26 CFR part 25 edition revised as of April 1, 1994). Special factors involving one and two lives may be found in or computed with the use of tables contained in Internal Revenue Service Publication 723, entitled "Actuarial Values I: Valuation of Last Survivor Charitable Remainders" (12-70), and Internal Revenue Service Publication 723A, entitled "Actuarial Values II: Factors at 6 Percent Involving One and Two Lives" (12-70). These publications are no longer available for purchase from the Superintendent of Documents. However, a copy of each may be obtained from: CC:DOM:CORP:T:R (IRS Publication 723/723A), room 5228, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. The present value of an interest measured by a term of years is computed on the basis of interest at the rate of 6 percent a year.

(d) *Valuation of annuities, interests for life or term of years, and remainder or reversionary interests transferred after November 30, 1983, and before May 1, 1989—*

(1) *In general.* (i)(A) Except as otherwise provided in § 25.2512-5(b) and in this paragraph (d)(1)(i)(A), the fair market value of annuities, life estates, terms of years, remainders, and reversions transferred after November 30, 1983, and before May 1, 1989, is the present value of such interests determined under this section. The value of annuities issued by companies regularly engaged in their sale and of insurance policies issued by companies regularly engaged in their sale is deter-

mined under § 25.2512-6. The fair market value of a remainder interest in a charitable remainder unitrust, as defined in § 1.664-3, is its present value determined under § 1.664-4. The fair market value of a life interest or term for years in a charitable remainder unitrust is the fair market value of the property as of the date of transfer less the fair market value of the remainder interest on such date determined under § 1.664-4. The fair market value of interests in a pooled income fund, as defined in § 1.642(c)-5, is their value determined under § 1.642(c)-6. Where the donor transfers property in trust or otherwise and retains an interest therein, the value of the gift is the value of the property transferred less the value of the donor's retained interest. See section 2702 and the regulations at § 25.2702 for special rules for valuing transfers of interests in trust after October 8, 1990. See § 25.2512-9 with respect to the valuation of annuities, life estates, terms for years, remainders, and reversions transferred after December 31, 1970, and before December 1, 1983.

(B) If the donor transfers in December of 1983, either—

(1) A remainder or a reversion subject to a life interest or a term for years where the life interest or term for years was transferred by the donor after December 31, 1982, and before December 1, 1983, or

(2) A life interest or term for years, the remainder interest of which was transferred by the donor after December 31, 1982, and before December 1, 1983,

the donor shall make an election. The donor may elect to value both interests transferred in 1983 under § 25.2512-5A(c) as if such section applied to all transfers made before January 1, 1984, or the donor may elect to have both interests transferred valued under this section. The donor shall indicate the election being made in a statement attached to the donor's gift tax return for 1983.

(C) If the donor transfers in calendar year 1984, either—

(1) A remainder on a reversion subject to a life interest or a term for years where the life interest or term for years was transferred by the donor in the first eleven months of 1983, or

(2) A life interest or term for years, the remainder interest of which was transferred by the donor in the first eleven months of 1983,

the donor shall make an election. The donor may elect to value the interest transferred in 1984 under § 25.2512-5A(c) as if such section applied to all transfers made before January 1, 1985, or the donor may elect to have the transfer valued under this section. If the donor elects to value the interest transferred in 1984 under § 25.2512-5A(c), the donor shall indicate that the election is being made by attaching a statement to the donor's gift tax return for 1984. If the donor elects to value the interest transferred in 1984 under this section the election shall not be effective unless the donor declares, in a statement attached to the donor's gift tax return for 1984, that the donor has filed an amended gift tax return for 1983, in which the donor has revalued the transfers made in the first eleven months of 1983 under this section as if this section applied to transfers made after December 31, 1982.

(ii) The present value of an annuity, life estate, remainder, or reversion determined under this section which is dependent on the continuation or termination of the life of one person is computed by the use of Table A in paragraph (d)(6) of this section. The present value of an annuity, term for years, remainder, or reversion dependent on a term certain is computed by the use of Table B in paragraph (d)(6) of this section. If the interest to be valued is dependent upon more than one life or there is a term certain concurrent with one or more lives, see paragraph (d)(5) of this section. For purposes of the computations described in this section, the age of the person is to be taken at his or her nearest birthday.

(iii) In all examples set forth in this section, the interest is assumed to have been transferred after November 30, 1983, and before May 1, 1989.

(2) *Annuities.* (i) If an annuity is payable annually at the end of each year during the life of an individual (as for example if the first payment is due one year after the date of the gift), the amount payable annually is multiplied by the figure in column 2 of Table A opposite the number of years in column

1 nearest the age of the individual whose life measures the duration of the annuity. If the annuity is payable annually at the end of each year for a definite number of years, the amount payable annually is multiplied by the figure in column 2 of Table B opposite the number of years in column 1 representing the duration of the annuity. The application of this paragraph (d)(2)(i) may be illustrated by the following examples:

Example (1). The donor assigns an annuity of \$10,000 a year payable annually during the donor's life immediately after an annual payment has been made. The age of the donor on the date of assignment is 40 years and eight months. By reference to Table A, it is found that the figure in column 2 opposite 41 years is 9.1030. The value of the gift is, therefore, \$91,030 (\$10,000 multiplied by 9.1030).

Example (2). The donor was entitled to receive an annuity of \$10,000 a year payable annually at the end of annual periods throughout a term of 20 years. The donor, when 15 years have elapsed, makes a gift thereof to the donor's son. By reference to Table B, it is found that the figure in column 2 opposite five years, the unexpired portion of the 20-year period, is 3.7908. The present value of the annuity is, therefore, \$37,908 (10,000 multiplied by 3.7908).

(ii) If an annuity is payable at the end of semiannual, quarterly, monthly, or weekly periods during the life of an individual (as for example if the first payment is due one month after the date of the gift), the aggregate amount to be paid within a year is first multiplied by the figure in column 2 of Table A opposite the number of years in column 1 nearest the age of the individual whose life measures the duration of the annuity. The product so obtained is then multiplied by whichever of the following factors is appropriate:

1.0244 for semiannual payments,
1.0368 for quarterly payments,
1.0450 for monthly payments,
1.0482 for weekly payments.

If the annuity is payable at the end of semiannual, quarterly, monthly, or weekly periods for a definite number of years the aggregate amount to be paid within a year is first multiplied by the figure in column 2 of Table B opposite the number of years in column 1 representing the duration of the annuity.

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The product so obtained is then multiplied by whichever of the above factors is appropriate. The application of this paragraph (d)(2)(ii) may be illustrated by the following example:

Example. The facts are the same as those contained in example (1) set forth in paragraph (d)(2)(i) above, except that the annuity is payable semiannually. The aggregate annual amount, \$10,000 is multiplied by the factor 9.1030, and the product multiplied by 1.0244. The value of the gift is, therefore, \$93,251.13 (\$10,000×9.1030×1.0244).

(iii)(A) If the first payment of an annuity for the life of an individual is due at the beginning of the annual or other payment period rather than at the end (as for example if the first payment is to be made immediately after the date of the gift), the value of the annuity is the sum of (A) the first payment plus (B) the present value of a similar annuity, the first payment of which is not to be made until the end of the payment period, determined as provided in paragraph (d)(2)(i) or (ii) of this section. The application of this paragraph (d)(2)(iii)(A) may be illustrated by the following example:

Example. The donee is made the beneficiary for life of an annuity of \$50 a month from the income of a trust, subject to the right reserved by the donor to cause the annuity to be paid for the donor's own benefit or for the benefit of another. On the day a payment is due, the donor relinquishes the reserved power. The donee is then 50 years of age. The value of the gift is \$50 plus the product of \$50×12×8.4743 (see Table A)×1.0450. That is, \$50 plus \$5,313.39, or \$5,363.39.

(B) If the first payment of an annuity for a definite number of years is due at the beginning of the annual or other payment period, the applicable factor is the product of the factor shown in Table B multiplied by whichever of the following factors is appropriate:

- 1.1000 for annual payments,
- 1.0744 for semiannual payments,
- 1.0618 for quarterly payments,
- 1.0534 for monthly payments, or
- 1.0502 for weekly payments.

The application of this paragraph (d)(2)(iii)(B) may be illustrated by the following example:

Example. The donee is the beneficiary of an annuity of \$50 a month, subject to a reserved right in the donor to cause the annuity or the cash value thereof to be paid for the do-

nor's own benefit or the benefit of another. On the day a payment is due, the donor relinquishes the power. There are 300 payments to be made covering a period of 25 years, including the payment due. The value of the gift is the product of \$50×12×9.0770 (factor for 25 years Table B)×1.0534, or \$5,737.03.

(3) *Life estates and terms for years.* If the interest to be valued is the right of a person for his or her life, or for the life of another person, to receive the income of certain property or to use non-income-producing property, the value of the interest is the value of the property multiplied by the figure in column 3 of Table A opposite the number of years nearest to the actual age of the measuring life. If the interest to be valued is the right to receive income of property or to use nonincome-producing property for a term of years, column 3 of Table B is used. The application of this paragraph (d)(3) may be illustrated by the following example:

Example. The donor who during the donor's life is entitled to receive the income from property worth \$50,000, makes a gift of such interest. The donor is 31 years old on the date of the gift. The value of the gift is \$47,627 (\$50,000×.95254).

(4) *Remainders or reversionary interests.* If the interest to be valued is a remainder or reversionary interest subject to a life estate, the value of the interest should be obtained by multiplying the value of the property at the date of the gift by the figure in column 4 of Table A opposite the number of years nearest the age of the life tenant. If the remainder or reversion is to take effect at the end of a term for years, column 4 of Table B should be used. The application of this paragraph (d)(4) may be illustrated by the following example:

Example. The donor transfers by gift a remainder interest in property worth \$50,000, subject to the donor's sister's right to receive the income therefrom for her life. The sister at the date of the gift is 31 years of age. By reference to Table A it is found that the figure in column 4 opposite age 31 is .04746. The value of the gift is, therefore, \$2,373 (\$50,000×.04746).

(5) *Actuarial computations by the Internal Revenue Service.* If the interest to be valued is dependent upon the continuation or termination of more than one life, or there is a term certain concurrent with one or more lives, or if the

retained interest of the donor is conditioned upon survivorship, a special factor is necessary. The factor is to be computed on the basis of interest at the rate of 10 percent a year, compounded annually, and life contingencies are determined for each person involved from the values of lx that are set forth in column 2 of Table LN in §20.2031-7A(d)(6) of this chapter. Table LN contains values of lx taken from the life table for the total population appearing as Table 1 in United States Life Tables: 1969-71, published by the Department of Health and Human Services, Public Health Service. A copy of the publication containing many such special factors, may be purchased from the Superintendent of Documents, United States Government Printing Office, Washington, DC 20402. However, if a special factor is required in the case of an actual gift, the Commissioner will furnish the factor to the donor upon request. The request must be accompanied by a statement of the date of birth of each person the duration of whose life may affect the value of the interest, and by copies of the relevant instruments. Special factors are not furnished for prospective transfers.

(6) *Tables.* (i) For actuarial factors showing the present worth at 10 percent of a single life annuity, a life interest, and a remainder interest postponed for a single life, see §20.2031-7A(d)(6) of this chapter, Table A, of the Estate Tax Regulations.

(ii) For actuarial factors showing the present worth at 10 percent of an annuity for a term certain, an income interest for a term certain, and a remainder interest postponed for a term certain, see §20.2031-7A(d)(6) of this chapter, Table B, of the Estate Tax Regulations.

(e) *Valuation of annuities, unitrust interests, interests for life or term of years, and remainder or reversionary interests transferred after April 30, 1989, and before May 1, 1999—(1) In general.* Except as otherwise provided in §§25.2512-5(b) and 25.7520-3(b) (pertaining to certain limitations on the use of prescribed tables), if the valuation date of the transferred interest is after April 30, 1989, and before May 1, 1999, the fair market value of annuities, unitrust interests, life estates, terms of years, remainders, and reversions transferred by gift is the

present value of the interests determined by use of standard or special section 7520 actuarial factors and the valuation methodology described in §25.2512-5(d). Sections 20.2031-7(d)(6) and 20.2031-7A(e)(4) of this chapter and related sections provide tables with standard actuarial factors and examples that illustrate how to use the tables to compute the present value of ordinary annuity, life, and remainder interests in property. These sections also refer to standard and special actuarial factors that may be necessary to compute the present value of similar interests in more unusual fact situations. These factors and examples are also generally applicable for gift tax purposes in computing the values of taxable gifts.

(2) *Transitional rule.* (i) If the valuation date of a transfer of an interest in property by gift is after April 30, 1989, and before June 10, 1994, a donor can rely on Notice 89-24 (1989-1 C.B. 660), or Notice 89-60 (1989-1 C.B. 700), in valuing the transferred interest. (See §601.601(d)(2)(ii)(b) of this chapter.)

(ii) If a donor transferred an interest in property by gift after December 31, 1988, and before May 1, 1989, retaining an interest in the same property, and after April 30, 1989, and before January 1, 1990, transferred the retained interest in property, the donor may, at the option of the donor, value the transfer of the retained interest under this paragraph (e) or paragraph (d) of this section.

(3) *Publications and actuarial computations by the Internal Revenue Service.* Many standard actuarial factors not included in §§20.2031-7(d)(6) and 20.2031-7A(e)(4) of this chapter are included in Internal Revenue Service Publication 1457, "Actuarial Values, Alpha Volume," (8-89). Internal Revenue Service Publication 1457 also includes examples that illustrate how to compute many special factors for more unusual situations. Publication 1457 is no longer available for purchase from the Superintendent of Documents, United States Government Printing Office, Washington, DC 20402. However, pertinent factors in this publication may be obtained from: CC:DOM:CORP:R (IRS Publication 1457), room 5226, Internal

Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. If a special factor is required in the case of a completed gift, the Internal Revenue Service may furnish the factor to the donor upon a request for a ruling. The request for a ruling must be accompanied by a recitation of the facts including a statement of the date of birth for each measuring life, the date of the gift, any other applicable dates, and a copy of the will, trust, or other relevant documents. A request for a ruling must comply with the instructions for requesting a ruling published periodically in the Internal Revenue Bulletin (see §§ 601.201 and 601.601(d)(2)(ii)(b) of this chapter) and include payment of the required user fee.

(f) *Valuation of annuities, unitrust interests, interests for life or term of years, and remainder or reversionary interests transferred after April 30, 1999, and before May 1, 2009—(1) In general.* Except as otherwise provided in §§ 25.2512-5(b) and 25.7520-3(b) (pertaining to certain limitations on the use of prescribed tables), if the valuation date of the transferred interest is after April 30, 1999, and before May 1, 2009, the fair market value of annuities, unitrust interests, life estates, terms of years, remainders, and reversions transferred by gift is the present value of the interests determined by use of standard or special section 7520 actuarial factors and the valuation methodology described in § 25.2512-5(d). Sections 20.2031-7(d)(6) and 20.2031-7A(f)(4) and related sections provide tables with standard actuarial factors and examples that illustrate how to use the tables to compute the present value of ordinary annuity, life, and remainder interests in property. These sections also refer to standard and special actuarial factors that may be necessary to compute the present value of similar interests in more unusual fact situations. These factors and examples are also generally applicable for gift tax purposes in computing the values of taxable gifts.

(2) *Transitional rule.* If the valuation date of a transfer of property by gift is after April 30, 1999, and before July 1, 1999, the fair market value of the interest transferred is determined by use of the section 7520 interest rate for the

month in which the valuation date occurs (see §§ 25.7520-1(b) and 25.7520-2(a)(2)) and the appropriate actuarial tables under either § 20.2031-7A(e)(4) or § 20.2031-7A(f)(4), at the option of the donor. However, with respect to each individual transaction and with respect to all transfers occurring on the valuation date, the donor must use the same actuarial tables (for example, gift and income tax charitable deductions with respect to the same transfer must be determined based on the same tables, and all transfers made on the same date must be valued based on the same tables).

(3) *Publications and actuarial computations by the Internal Revenue Service.* Many standard actuarial factors not included in §§ 20.2031-7(d)(6) and 20.2031-7A(f)(4) are included in Internal Revenue Service Publication 1457, “Actuarial Values, Book Aleph,” (7-99). Internal Revenue Service Publication 1457 also includes examples that illustrate how to compute many special factors for more unusual situations. Publication 1457 is no longer available for purchase from the Superintendent of Documents, United States Government Printing Office. However, pertinent factors in this publication may be obtained from: CC:PA:LPD:PR (IRS Publication 1457), Room 5205, Internal Revenue Service, P.O.Box 7604, Ben Franklin Station, Washington, DC 20044. If a special factor is required in the case of a completed gift, the Internal Revenue Service may furnish the factor to the donor upon a request for a ruling. The request for a ruling must be accompanied by a recitation of the facts including a statement of the date of birth for each measuring life, the date of the gift, any other applicable dates, and a copy of the will, trust, or other relevant documents. A request for a ruling must comply with the instructions for requesting a ruling published periodically in the Internal Revenue Bulletin (see §§ 601.201 and 601.601(d)(2)(ii)(b)) and include payment of the required user fee.

(4) *Effective/applicability dates.* Paragraphs (f)(1) through (f)(3) apply after April 30, 1999, and before May 1, 2009.

[T.D. 8540, 59 FR 30173, June 10, 1994, as amended at 59 FR 30173, 30174, June 10, 1994; T.D. 8819, 64 FR 23226, Apr. 30, 1999; T.D. 8886, 65 FR 36943, June 12, 2000; T.D. 9448, 74 FR 21515, May 7, 2009; T.D. 9540, 76 FR 49641, Aug. 10, 2011]

DEDUCTIONS

§ 25.2519-1 Dispositions of certain life estates.

(a) *In general.* If a donee spouse makes a disposition of all or part of a qualifying income interest for life in any property for which a deduction was allowed under section 2056(b)(7) or section 2523(f) for the transfer creating the qualifying income interest, the donee spouse is treated for purposes of chapters 11 and 12 of subtitle B of the Internal Revenue Code as transferring all interests in property other than the qualifying income interest. For example, if the donee spouse makes a disposition of part of a qualifying income interest for life in trust corpus, the spouse is treated under section 2519 as making a transfer subject to chapters 11 and 12 of the entire trust other than the qualifying income interest for life. Therefore, the donee spouse is treated as making a gift under section 2519 of the entire trust less the qualifying income interest, and is treated for purposes of section 2036 as having transferred the entire trust corpus, including that portion of the trust corpus from which the retained income interest is payable. A transfer of all or a portion of the income interest of the spouse is a transfer by the spouse under section 2511. See also section 2702 for special rules applicable in valuing the gift made by the spouse under section 2519.

(b) *Presumption.* Unless the donee spouse establishes to the contrary, section 2519 applies to the entire trust at the time of the disposition. If a deduction is taken on either the estate or gift tax return with respect to the transfer which created the qualifying income interest, it is presumed that the deduction was allowed for purposes of section 2519. To avoid the application of section 2519 upon a transfer of all or part of the donee spouse's income

interest, the donee spouse must establish that a deduction was not taken for the transfer of property which created the qualifying income interest. For example, to establish that a deduction was not taken, the donee spouse may produce a copy of the estate or gift tax return filed with respect to the transfer creating the qualifying income interest for life establishing that no deduction was taken under section 2056(b)(7) or section 2523(f). In addition, the donee spouse may establish that no return was filed on the original transfer by the donor spouse because the value of the first spouse's gross estate was below the threshold requirement for filing under section 6018. Similarly, the donee spouse could establish that the transfer creating the qualifying income interest for life was made before the effective date of section 2056(b)(7) or section 2523(f), whichever is applicable.

(c) *Amount treated as a transfer—(1) In general.* The amount treated as a transfer under this section upon a disposition of all or part of a qualifying income interest for life in qualified terminable interest property is equal to the fair market value of the entire property subject to the qualifying income interest, determined on the date of the disposition (including any accumulated income and not reduced by any amount excluded from total gifts under section 2503(b) with respect to the transfer creating the interest), less the value of the qualifying income interest in the property on the date of the disposition. The gift tax consequences of the disposition of the qualifying income interest are determined separately under § 25.2511-2. See paragraph (c)(4) of this section for the effect of gift tax that the donee spouse is entitled to recover under section 2207A.

(2) *Disposition of interest in property with respect to which a partial election was made.* If, in connection with the transfer of property that created the spouse's qualifying income interest for life, a deduction was allowed under section 2056(b)(7) or section 2523(f) for less than the entire interest in the property (i.e., for a fractional or percentage share of the entire interest in the transferred property) the amount

treated as a transfer by the donee spouse under this section is equal to the fair market value of the entire property subject to the qualifying income interest on the date of the disposition, less the value of the qualifying income interest for life, multiplied by the fractional or percentage share of the interest for which the deduction was taken.

(3) *Reduction for distributions charged to nonelective portion of trust.* The amount determined under paragraph (c)(2) of this section (if applicable) is appropriately reduced if—

(i) The donee spouse's interest is in a trust and distributions of principal have been made to the donee spouse;

(ii) The trust provides that distributions of principal are made first from the qualified terminable interest share of the trust; and

(iii) The donee spouse establishes the reduction in that share based on the fair market value of the trust assets at the time of each distribution.

(4) *Effect of gift tax entitled to be recovered under section 2207A on the amount of the transfer.* The amount treated as a transfer under paragraph (c)(1) of this section is further reduced by the amount the donee spouse is entitled to recover under section 2207A(b) (relating to the right to recover gift tax attributable to the remainder interest). If the donee spouse is entitled to recover gift tax under section 2207A(b), the amount of gift tax recoverable and the value of the remainder interest treated as transferred under section 2519 are determined by using the same interrelated computation applicable for other transfers in which the transferee assumes the gift tax liability. The gift tax consequences of failing to exercise the right of recovery are determined separately under § 25.2207A-1(b).

(5) *Interest in previously severed trust.* If the donee spouse's interest is in a trust consisting of only qualified terminable interest property, and the trust was previously severed (in compliance with § 20.2056(b)-7(b)(2)(ii) of this chapter or § 25.2523(f)-1(b)(3)(ii) from a trust that, after the severance, held only property that was not qualified terminable interest property, only the value of the property in the severed portion of the trust at the time of the

disposition is treated as transferred under this section.

(d) *Identification of property transferred.* If only part of the property in which a donee spouse has a qualifying income interest for life is qualified terminable interest property, the donee spouse is, in the case of a disposition of all or part of the income interest within the meaning of section 2519, deemed to have transferred a pro rata portion of the entire qualified terminable interest property for purposes of this section.

(e) *Exercise of power of appointment.* The exercise by any person of a power to appoint qualified terminable interest property to the donee spouse is not treated as a disposition under section 2519, even though the donee spouse subsequently disposes of the appointed property.

(f) *Conversion of qualified terminable interest property.* The conversion of qualified terminable interest property into other property in which the donee spouse has a qualifying income interest for life is not, for purposes of this section, treated as a disposition of the qualifying income interest. Thus, the sale and reinvestment of assets of a trust holding qualified terminable interest property is not a disposition of the qualifying income interest, provided that the donee spouse continues to have a qualifying income interest for life in the trust after the sale and reinvestment. Similarly, the sale of real property in which the spouse possesses a legal life estate and thus meets the requirements of qualified terminable interest property, followed by the transfer of the proceeds into a trust which also meets the requirements of qualified terminable interest property, or by the reinvestment of the proceeds in income producing property in which the donee spouse has a qualifying income interest for life, is not considered a disposition of the qualifying income interest. On the other hand, the sale of qualified terminable interest property, followed by the payment to the donee spouse of a portion of the proceeds equal to the value of the donee spouse's income interest, is considered a disposition of the qualifying income interest.

(g) *Examples.* The following examples illustrate the application of paragraphs (a) through (f) of this section. Except as provided otherwise in the examples, assume that the decedent, D, was survived by spouse, S, that in each example the section 2503(b) exclusion has already been fully utilized for each year with respect to the donee in question, that section 2503(e) is not applicable to the amount deemed transferred, and that the gift taxes on the amount treated as transferred under paragraph (c) are offset by S's unified credit. The examples are as follows:

Example 1. Transfer of the spouse's life estate in residence. Under D's will, a personal residence valued for estate tax purposes at \$250,000 passes to S for life, and after S's death to D's children. D's executor made a valid election to treat the property as qualified terminable interest property. During 1995, when the fair market value of the property is \$300,000 and the value of S's life interest in the property is \$100,000, S makes a gift of S's entire interest in the property to D's children. Pursuant to section 2519, S makes a gift in the amount of \$200,000 (i.e., the fair market value of the qualified terminable interest property of \$300,000 less the fair market value of S's qualifying income interest in the property of \$100,000). In addition, under section 2511, S makes a gift of \$100,000 (i.e., the fair market value of S's income interest in the property). See § 25.2511-2.

Example 2. Sale of spouse's life estate. The facts are the same as in *Example 1* except that during 1995, S sells S's interest in the property to D's children for \$100,000. Pursuant to section 2519, S makes a gift of \$200,000 (\$300,000 less \$100,000 value of the qualifying income interest in the property). S does not make a gift of the income interest under section 2511, because the consideration received for S's income interest is equal to the value of the income interest.

Example 3. Transfer of income interest in trust subject to partial election. D's will established a trust valued for estate tax purposes at \$500,000, all of the income of which is payable annually to S for life. After S's death, the principal of the trust is to be distributed to D's children. Assume that only 50 percent of the trust was treated as qualified terminable interest property. During 1995, S makes a gift of all of S's interest in the trust to D's children at which time the fair market value of the trust is \$400,000 and the fair market value of S's life income interest in the trust is \$100,000. Pursuant to section 2519, S makes a gift of \$150,000 (the fair market value of the qualified terminable interest property, 50 percent of \$400,000, less the \$50,000 income interest in the qualified terminable interest

property). S also makes a gift pursuant to section 2511 of \$100,000 (i.e., the fair market value of S's life income interest).

Example 4. Transfer of a portion of income interest in trust subject to a partial election. The facts are the same as in *Example 3* except that S makes a gift of only 40 percent of S's interest in the trust. Pursuant to section 2519, S makes a gift of \$150,000 (i.e., the fair market value of the qualified terminable interest property, 50 percent of \$400,000, less the \$50,000 value of S's qualified income interest in the qualified terminable interest property). S also makes a gift pursuant to section 2511 of \$40,000 (i.e., the fair market value of 40 percent of S's life income interest). See also section 2702 for additional rules that may affect the value of the total amount of S's gift under section 2519 to take into account the fact that S's 30 percent retained income interest attributable to the qualifying income interest is valued at zero under that section, thereby increasing the value of S's section 2519 gift to \$180,000. In addition, under § 25.2519-1(d), S's disposition of 40 percent of the income interest is deemed to be a transfer of a pro rata portion of the qualified terminable interest property. Thus, assuming no further lifetime dispositions by S, 30 percent (60 percent of 50 percent) of the trust property is included in S's gross estate under section 2036 and an adjustment is made to S's adjusted taxable gifts under section 2001(b)(1)(B). If S later disposes of all or a portion of the retained income interest, see § 25.2702-6.

Example 5. Transfer of a portion of spouse's interest in a trust from which corpus was previously distributed to the spouse. D's will established a trust valued for estate tax purposes at \$500,000, all of the income of which is payable annually to S for life. The trustee is granted the discretion to distribute trust principal to S. All appointments of principal must be made from the portion of the trust subject to the section 2056(b)(7) election. After S's death, the principal of the trust is to be distributed to D's children. The executor makes the section 2056(b)(7) election with respect to 50 percent of the trust. In 1994, pursuant to the terms of D's will, the trustee distributed \$50,000 of principal to S and charged the entire distribution to the qualified terminable interest portion of the trust.

Immediately prior to the distribution, the value of the entire trust was \$550,000 and the value of the qualified terminable interest portion was \$275,000 (50 percent of \$550,000). Provided S can establish the above facts, the qualified terminable interest portion of the trust immediately after the distribution is \$225,000 or 45 percent of the value of the trust (\$225,000/\$500,000). In 1996, when the value of the trust is \$400,000 and the value of S's income interest is \$100,000, S makes a transfer of 40 percent of S's income interest. S's gift under section 2519 is \$135,000; i.e., the fair

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market value of the qualified terminable interest property, 45 percent of \$400,000 (\$180,000), less the value of the income interest in the qualified terminable interest property, \$45,000 (45 percent of \$100,000). S also makes a gift under section 2511 of \$40,000; i.e., the fair market value of 40 percent of S's income interest. S's disposition of 40 percent of the income interest is deemed to be a transfer under section 2519 of the entire 45 percent portion of the remainder subject to the section 2056(b)(7) election. Since S retained 60 percent of the income interest, 27 percent (60 percent of 45 percent) of the trust property is includible in S's gross estate under section 2036. See also section 2702 and *Example 4* as to the principles applicable in valuing S's gift under section 2702 and adjusted taxable gifts upon S's subsequent death.

Example 6. Transfer of Spousal Annuity Payable From Trust. D died prior to October 24, 1992. D's will established a trust valued for estate tax purposes at \$500,000. The trust instrument required the trustee to pay an annuity to S of \$20,000 a year for life. All the trust income other than the amounts paid to S as an annuity are to be accumulated in the trust and may not be distributed during S's lifetime to any person other than S. After S's death, the principal of the trust is to be distributed to D's children. Because D died prior to the effective date of section 1941 of the Energy Policy Act of 1992, S's annuity interest qualifies as a qualifying income interest for life. Under § 20.2056(b)-7(e) of this chapter, based on an applicable 10 percent interest rate, 40 percent of the property, or \$200,000, is the value of the deductible interest. During 1996, S makes a gift of the annuity interest to D's children at which time the fair market value of the trust is \$800,000 and the fair market value of S's annuity interest in the trust is \$100,000. Pursuant to section 2519, S is treated as making a gift of \$220,000 (the fair market value of the qualified terminable interest property, 40 percent of \$800,000 (\$320,000), less the \$100,000 annuity interest in the qualified terminable interest property). S is also treated pursuant to section 2511 as making a gift of \$100,000 (the fair market value of S's annuity interest).

[T.D. 8522, 59 FR 9656, Mar. 1, 1994, as amended by T.D. 9077, 68 FR 42595, July 18, 2003]

§ 25.2519-2 Effective date.

Except as specifically provided in § 25.2519-1(g), *Example 6*, the provisions of § 25.2519-1 are effective with respect to gifts made after March 1, 1994. With respect to gifts made on or before such date, the donee spouse of a section 2056(b)(7) or section 2523(f) transfer may rely on any reasonable interpretation of the statutory provisions. For these

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purposes, the provisions of § 25.2519-1 (as well as project LR-211-76, 1984-1 C.B., page 598, see § 601.601(d)(2)(ii)(b) of this chapter), are considered a reasonable interpretation of the statutory provisions.

[T.D. 8522, 59 FR 9658, Mar. 1, 1994]

§ 25.2521-1 Specific exemption.

(a) In determining the amount of taxable gifts for the calendar quarter (calendar year with respect to gifts made before January 1, 1971) there may be deducted, if the donor was a resident or citizen of the United States at the time the gifts were made, a specific exemption of \$30,000, less the sum of the amounts claimed and allowed as an exemption in prior calendar quarters or calendar years. The exemption, at the option of the donor, may be taken in the full amount of \$30,000 in a single calendar quarter or calendar year, or be spread over a period of time in such amounts as the donor sees fit, but after the limit has been reached no further exemption is allowable. Except as otherwise provided in a tax convention between the United States and another country, a donor who was a non-resident not a citizen of the United States at the time the gift or gifts were made is not entitled to this exemption. For the definition of calendar quarter see § 25.2502-1(c)(1).

(b) No part of a donor's lifetime specific exemption of \$30,000 may be deducted from the value of a gift attributable to his spouse where a husband and wife consent, under the provisions of section 2513, to have the gifts made during a calendar quarter or calendar year considered as made one-half by each of them. The "gift-splitting" provisions of section 2513 do not authorize the filing of a joint gift tax return nor permit a donor to claim any of his spouse's specific exemption. For example, if a husband has no specific exemption remaining available, but his wife does, and the husband makes a gift to which his wife consents under the provisions of section 2513, the specific exemption remaining available may be claimed only on the return of the wife with respect to one-half of the gift. The husband may not claim any specific exemption since he has none available.

(c)(1) With respect to gifts made after December 31, 1970, the amount by which the specific exemption claimed and allowed in gift tax returns for prior calendar quarters and calendar years exceeds \$30,000 is includible in determining the aggregate sum of the taxable gifts for preceding calendar years and calendar quarters. See paragraph (b) of § 25.2504-1.

(2) With respect to gifts made before January 1, 1971, the amount by which the specific exemption claimed and allowed in gift tax returns for prior calendar years exceeds \$30,000 is includible in determining the aggregate sum of the taxable gifts for preceding calendar years. See paragraph (b) of § 25.2504-1.

[T.D. 7238, 37 FR 28732, Dec. 29, 1972]

§ 25.2522(a)-1 Charitable and similar gifts; citizens or residents.

(a) In determining the amount of taxable gifts for the "calendar period" (as defined in § 25.2502-1(c)(1)) there may be deducted, in the case of a donor who was a citizen or resident of the United States at the time the gifts were made, all gifts included in the "total amount of gifts" made by the donor during the calendar period (see section 2503 and the regulations thereunder) and made to or for the use of:

(1) The United States, any State, Territory, or any political subdivision thereof, or the District of Columbia, for exclusively public purposes.

(2) Any corporation, trust, community chest, fund, or foundation organized and operated exclusively for religious charitable, scientific, literary, or educational purposes, including the encouragement of art and the prevention of cruelty to children or animals, if no part of the net earnings of the organization inures to the benefit of any private shareholder or individual, if it is not disqualified for tax exemption under section 501(c)(3) by reason of attempting to influence legislation, and if, in the case of gifts made after December 31, 1969, it does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of or in opposition to any candidate for public office.

(3) A fraternal society, order, or association, operating under the lodge sys-

tem, provided the gifts are to be used by the society, order or association exclusively for one or more of the purposes set forth in subparagraph (2) of this paragraph.

(4) Any post or organization of war veterans or auxiliary unit or society thereof, if organized in the United States or any of its possessions, and if no part of its net earnings inures to the benefit of any private shareholder or individual.

The deduction is not limited to gifts for use within the United States, or to gifts to or for the use of domestic corporations, trusts, community chests, funds, or foundations, or fraternal societies, orders, or associations operating under the lodge system. An organization will not be considered to meet the requirements of subparagraph (2) of this paragraph, or of paragraph (b) (2) or (3) of this section, if such organization engages in any activity which would cause it to be classified as an "action" organization under paragraph (c)(3) of § 1.501(c)(3)-1 of this chapter (Income Tax Regulations). For the deductions for charitable and similar gifts made by a nonresident who was not a citizen of the United States at the time the gifts were made, see § 25.2522(b)-1. See §§ 25.2522(c)-1 and 25.2522(c)-2 for rules relating to the disallowance of deductions to trusts and organizations which engage in certain prohibited transactions or whose governing instruments do not contain certain specified requirements.

(b) The deduction under section 2522 is not allowed for a transfer to a corporation, trust, community chest, fund, or foundation unless the organization or trust meets the following four tests:

(1) It must be organized and operated exclusively for one or more of the specified purposes.

(2) It must not be disqualified for tax exemption under section 501(c)(3) by reason of attempting to influence legislation.

(3) In the case of gifts made after December 31, 1969, it must not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

(4) Its net earnings must not inure in whole or in part to the benefit of private shareholders or individuals other than as legitimate objects of the exempt purposes.

For further limitations see § 25.2522(c)-1, relating to gifts to trusts and organizations which have engaged in a prohibited transaction described in section 681(b)(2) or section 503(c).

(c) In order to prove the right to the charitable, etc., deduction provided by section 2522 the donor must submit such data as may be requested by the Internal Revenue Service. As to the extent the deductions provided by this section are allowable, see section 2524.

[T.D. 6334, 23 FR 8904, Nov. 15, 1958, as amended by T.D. 7012, 34 FR 7691, May 15, 1969; T.D. 7238, 37 FR 28733, Dec. 29, 1972; T.D. 7318, 39 FR 25457, July 11, 1974; T.D. 7910, 48 FR 40375, Sept. 7, 1983; T.D. 8308, 55 FR 35594, Aug. 31, 1990]

§ 25.2522(a)-2 Transfers not exclusively for charitable, etc., purposes in the case of gifts made before August 1, 1969.

(a) *Remainders and similar interests.* If a trust is created or property is transferred for both a charitable and a private purpose, deduction may be taken of the value of the charitable beneficial interest only insofar as that interest is presently ascertainable, and hence severable from the noncharitable interest. The present value of a remainder or other deferred payment to be made for a charitable purpose is to be determined in accordance with the rules stated in § 25.2512-5. Thus, if money or property is placed in trust to pay the income to an individual during his life, or for a term of years, and then to pay the principal to a charitable organization, the present value of the remainder is deductible. If the interest involved is such that its value is to be determined by a special computation, see § 25.2512-5(d)(4). If the Commissioner does not furnish the factor, the claim for deduction must be supported by a full statement of the computation of the present value made in accordance with the principles set forth in the applicable paragraph of § 25.2512-5.

(b) *Transfers subject to a condition or a power.* If, as of the date of the gift, a transfer for charitable purposes is de-

pendent upon the performance of some act or the happening of a precedent event in order that it might become effective, no deduction is allowable unless the possibility that the charitable transfer will not become effective is so remote as to be negligible. If an estate or interest passes to or is vested in charity on the date of the gift and the estate or interest would be defeated by the performance of some act or the happening of some event, the occurrence of which appeared to have been highly improbable on the date of the gift, the deduction is allowable. If the donee or trustee is empowered to divert the property or fund, in whole or in part, to a use or purpose which would have rendered it, to the extent that it is subject to such power, not deductible had it been directly so given by the donor, the deduction will be limited to that portion of the property or fund which is exempt from the exercise of the power. The deduction is not allowed in the case of a transfer in trust conveying to charity a present interest in income if by reason of all the conditions and circumstances surrounding the transfer it appears that the charity may not receive the beneficial enjoyment of the interest. For example, assume that assets placed in trust by the donor consists of stock in a corporation, the fiscal policies of which are controlled by the donor and his family, that the trustees and remaindermen are likewise members of the donor's family, and that the governing instrument contains no adequate guarantee of the requisite income to the charitable organization. Under such circumstances, no deduction will be allowed. Similarly, if the trustees are not members of the donor's family but have no power to sell or otherwise dispose of closely held stock, or otherwise insure the requisite enjoyment of income to the charitable organization, no deduction will be allowed.

(c) *Effective date.* This section applies only to gifts made before August 1, 1969. In the case of gifts made after July 31, 1969, see § 25.2522(c)-2.

[T.D. 6334, 23 FR 8904, Nov. 15, 1958; 25 FR 14021 Dec. 31, 1960, as amended by T.D. 7318, 39 FR 25457, July 11, 1974; T.D. 8540, 59 FR 30177, June 10, 1994]

§ 25.2522(b)-1 Charitable and similar gifts; nonresidents not citizens.

(a) The deduction for charitable and similar gifts, in the case of a nonresident who was not a citizen of the United States at the time he made the gifts, is governed by the same rules as those applying to gifts by citizens or residents, subject, however, to the following exceptions:

(1) If the gifts are made to or for the use of a corporation, the corporation must be one created or organized under the laws of the United States or of any State or Territory thereof.

(2) If the gifts are made to or for the use of a trust, community chest, fund or foundation, or a fraternal society, order or association operating under the lodge system, the gifts must be for use within the United States exclusively for religious, charitable, scientific, literary or educational purposes, including the encouragement of art and the prevention of cruelty to children or animals.

(b) [Reserved]

§ 25.2522(c)-1 Disallowance of charitable, etc., deductions because of "prohibited transactions" in the case of gifts made before January 1, 1970.

(a) Sections 503(e) and 681(b)(5) provide that no deduction which would otherwise be allowable under section 2522 for a gift for religious, charitable, scientific, literary or educational purposes, including the encouragement of art and the prevention of cruelty to children or animals, is allowed if—

(1) The gift is made in trust and, for income tax purposes for the taxable year of the trust in which the gift is made, the deduction otherwise allowable to the trust under section 642(c) is limited by section 681(b)(1) by reason of the trust having engaged in a prohibited transaction described in section 681(b)(2); or

(2) The gift is made to any corporation, community chest, fund or foundation which, for its taxable year in which the gift is made is not exempt from income tax under section 501(a) by reason of having engaged in a prohibited transaction described in section 503(c).

(b) For purposes of section 503(e) and section 681(b)(5) the term "gift" includes any gift, contribution, or transfer without adequate consideration.

(c) Regulations relating to the income tax contain the rules for the determination of the taxable year of the trust for which the deduction under section 642(c) is limited by section 681(b), and for the determination of the taxable year of the organization for which an exemption is denied under section 503(a). Generally, such taxable year is a taxable year subsequent to the taxable year during which the trust or organization has been notified by the Internal Revenue Service that it has engaged in a prohibited transaction. However, if the trust or organization during or prior to the taxable year entered into the prohibited transaction for the purpose of diverting its corpus or income from the charitable or other purposes by reason of which it is entitled to a deduction or exemption, and the transaction involves a substantial part of such income or corpus, then the deduction of the trust under section 642(c) for such taxable year is limited by section 681(b), or the exemption of the organization for such taxable year is denied under section 503(a), whether or not the organization has previously received notification by the Internal Revenue Service that it has engaged in a prohibited transaction. In certain cases, the limitation of section 503 or 681 may be removed or the exemption may be reinstated for certain subsequent taxable years under the rules set forth in the income tax regulations under sections 503 and 681.

(d) In cases in which prior notification by the Internal Revenue Service is not required in order to limit the deduction of the trust under section 681(b), or to deny exemption of the organization under section 503, the deduction otherwise allowable under § 25.2522(a)-1 is not disallowed with respect to gifts made during the same taxable year of the trust or organization in which a prohibited transaction occurred, or in a prior taxable year, unless the donor or a member of his family was a party to the prohibited transaction. For purposes of the preceding sentence, the members of the donor's family include only his brothers and

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sisters (whether by whole or half blood), spouse, ancestors, and lineal descendants.

(e) This section applies only to gifts made before January 1, 1970. In the case of gifts made after December 31, 1969, see § 25.2522(c)-2.

[T.D. 6334, 23 FR 8904, Nov. 15, 1958; 25 FR 14021, Dec. 31, 1960, as amended by T.D. 7318, 39 FR 25458, July 11, 1974]

§ 25.2522(c)-2 Disallowance of charitable, etc., deductions in the case of gifts made after December 31, 1969.

(a) *Organizations subject to section 507(c) tax.* Section 508(d)(1) provides that, in the case of gifts made after December 31, 1969, a deduction which would otherwise be allowable under section 2522 for a gift to or for the use of an organization upon which the tax provided by section 507(c) has been imposed shall not be allowed if the gift is made by the donor after notification is made under section 507(a) or if the donor is a substantial contributor (as defined in section 507(d)(2)) who makes such gift in his taxable year (as defined in section 441) which includes the first day on which action is taken by such organization that culminates in the imposition of the tax under section 507(c) and any subsequent taxable year. This paragraph does not apply if the entire amount of the unpaid portion of the tax imposed by section 507(c) is abated under section 507(g) by the Commissioner or his delegate.

(b) *Taxable private foundations, section 4947 trusts, etc.* Section 508(d)(2) provides that, in the case of gifts made after December 31, 1969, a deduction which would otherwise be allowable under section 2522 shall not be allowed if the gift is made to or for the use of—

(1) A private foundation or a trust described in section 4947(a)(2) in a taxable year of such organization for which such organization fails to meet the governing instrument requirements of section 508(e) (determined without regard to section 508(e)(2) (B) and (C)), or

(2) Any organization in a period for which it is not treated as an organization described in section 501(c)(3) by reason of its failure to give notification under section 508(a) of its status to the Commissioner.

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For additional rules, see § 1.508-2(b)(1) of this chapter (Income Tax Regulations).

(c) *Foreign organizations with substantial support from foreign sources.* Section 4948(c)(4) provides that, in the case of gifts made after December 31, 1969, a deduction which would otherwise be allowable under section 2522 for a gift to or for the use of a foreign organization which has received substantially all of its support (other than gross investment income) from sources without the United States shall not be allowed if the gift is made (1) after the date on which the Commissioner has published notice that he has notified such organization that it has engaged in a prohibited transaction, or (2) in a taxable year of such organization for which it is not exempt from taxation under section 501(a) because it has engaged in a prohibited transaction after December 31, 1969.

[T.D. 7318, 39 FR 25458, July 11, 1974]

§ 25.2522(c)-3 Transfers not exclusively for charitable, etc., purposes in the case of gifts made after July 31, 1969.

(a) *Remainders and similar interests.* If a trust is created or property is transferred for both a charitable and a private purpose, deduction may be taken of the value of the charitable beneficial interest only insofar as that interest is presently ascertainable, and hence severable from the noncharitable interest.

(b) *Transfers subject to a condition or a power.* (1) If, as of the date of the gift, a transfer for charitable purposes is dependent upon the performance of some act or of the happening of a precedent event in order that it might become effective, no deduction is allowable unless the possibility that the charitable transfer will not become effective is so remote as to be negligible. If an estate or interest has passed to, or is vested in, charity on the date of the gift and the estate or interest would be defeated by the performance of some act or the happening of some event, the possibility of occurrence of which appeared on such date to be so remote as to be negligible, the deduction is allowable. If the donee or trustee is empowered to divert the property or fund, in whole or in part, to a use or purpose which

would have rendered it, to the extent that it is subject to such power, not deductible had it been directly so given by the donor, the deduction will be limited to that portion, if any, of the property or fund which is exempt from an exercise of the power.

(2) The application of this paragraph may be illustrated by the following examples:

Example (1). In 1965, A transfers certain property in trust in which charity is to receive the income for his life. The assets placed in trust by the donor consist of stock in a corporation the fiscal policies of which are controlled by the donor and his family. The trustees of the trust and the remainderman are members of the donor's family and the governing instrument contains no adequate guarantee of the requisite income to the charitable organization. Under such circumstances, no deduction will be allowed. Similarly, if the trustees are not members of the donor's family but have no power to sell or otherwise dispose of the closely held stock, or otherwise insure the requisite enjoyment of income to the charitable organization, no deduction will be allowed.

Example (2). C transfers a tract of land to a city government for as long as the land is used by the city for a public park. If on the date of gift the city does plan to use the land for a public park and the possibility that the city will not use the land for a public park is so remote as to be negligible, a deduction will be allowed.

(c) *Transfers of partial interest in property—(1) Disallowance of deduction—(i) In general.* If a donor transfers an interest in property after July 31, 1969, for charitable purposes and an interest in the same property is retained by the donor, or is transferred or has been transferred for private purposes after such date (for less than an adequate and full consideration in money or money's worth), no deduction is allowed under section 2522 for the value of the interest which is transferred or has been transferred for charitable purposes unless the interest in property is a deductible interest described in subparagraph (2) of this paragraph. The principles that are used in applying section 2523 and the regulations thereunder shall apply for purposes of determining under this paragraph (c)(1)(i) whether an interest in property is retained by the donor, or is transferred or has been transferred by the donor. If, however, as of the date of the gift, a

retention of any interest by a donor, or a transfer for a private purpose, is dependent upon the performance of some act or the happening of a precedent event in order that it may become effective, an interest in property will be considered retained by the donor, or transferred for a private purpose, unless the possibility of occurrence of such act or event is so remote as to be negligible. The application of this paragraph (c)(1)(i) may be illustrated by the following examples, in each of which it is assumed that the property interest which is transferred for private purposes is not transferred for an adequate and full consideration in money or money's worth:

Example (1). In 1973, H creates a trust which is to pay the income of the trust to W for her life, the reversionary interest in the trust being retained by H. In 1975, H gives the reversionary interest to charity, while W is still living. For purposes of this paragraph (c)(1)(i), interests in the same property have been transferred by H for charitable purposes and for private purposes.

Example (2). In 1973, H creates a trust which is to pay the income of the trust to W for her life and upon termination of the life estate to transfer the remainder to S. In 1975, S gives his remainder interest to charity, while W is still living. For purposes of this paragraph (c)(1)(i), interests in the same property have not been transferred by H or S for charitable purposes and for private purposes.

Example (3). H transfers Blackacre to A by gift, reserving the right to the rentals of Blackacre for a term of 20 years. After 4 years H transfers the right to the remaining rentals to charity. For purposes of this paragraph (c)(1)(i) the term "property" refers to Blackacre, and the right to rentals from Blackacre consist of an interest in Blackacre. An interest in Blackacre has been transferred by H for charitable purposes and for private purposes.

Example (4). H transfers property in trust for the benefit of A and a charity. An annuity of \$5,000 a year is to be paid to charity for 20 years. Upon termination of the 20-year term the corpus is to be distributed to A if living. However, if A should die during the 20-year term, the corpus is to be distributed to charity upon termination of the term. An interest in property has been transferred by H for charitable purposes. In addition, an interest in the same property has been transferred by H for private purposes unless the possibility that A will survive the 20-year term is so remote as to be negligible.

Example (5). H transfers property in trust, under the terms of which an annuity of \$5,000

a year is to be paid to charity for 20 years. Upon termination of the term, the corpus is to pass to such of A's children and their issue as A may appoint. However, if A should die during the 20-year term without exercising the power of appointment, the corpus is to be distributed to charity upon termination of the term. Since the possible appointees include private persons, an interest in the corpus of the trust is considered to have been transferred by H for private purposes.

(ii) *Works of art and copyright treated as separate properties.* For purposes of paragraphs (c)(1)(i) and (c)(2) of this section, rules similar to the rules in § 20.2055-2(e)(1)(ii) shall apply in the case of transfers made after December 31, 1981.

(2) *Deductible interests.* A deductible interest for purposes of subparagraph (1) of this paragraph is a charitable interest in property where—

(i) *Undivided portion of donor's entire interest.* The charitable interest is an undivided portion, not in trust, of the donor's entire interest in property. An undivided portion of a donor's entire interest in property must consist of a fraction or percentage of each and every substantial interest or right owned by the donor in such property and must extend over the entire term of the donor's interest in such property and in other property into which such property is converted. For example, if the donor gave a life estate in an office building to his wife for her life and retained a reversionary interest in the office building, the gift by the donor of one-half of that reversionary interest to charity while his wife is still alive will not be considered the transfer of a deductible interest; because an interest in the same property has already passed from the donor for private purposes, the reversionary interest will not be considered the donor's entire interest in the property. If, on the other hand, the donor had been given a life estate in Blackacre for the life of his wife and the donor had no other interest in Blackacre on or before the time of gift, the gift by the donor of one-half of that life estate to charity would be considered the transfer of a deductible interest; because the life estate would be considered the donor's entire interest in the property, the gift would be of an undivided portion of such entire interest. An undivided portion of a do-

nor's entire interest in property includes an interest in property whereby the charity is given the right, as a tenant in common with the donor, to possession, dominion, and control of the property for a portion of each year appropriate to its interest in such property. However, except as provided in paragraphs (c)(2)(ii), (iii), and (iv) of this section, for purposes of this subdivision a charitable contribution of an interest in property not in trust where the decedent transfers some specific rights to one party and transfers other substantial rights to another party will not be considered a contribution of a undivided portion of the decedent's entire interest in property. A gift of an open space easement in gross in perpetuity shall be considered a gift of a undivided portion of the donor's entire interest in property. A gift to charity made on or before December 17, 1980, of an open space easement in gross in perpetuity shall be considered the transfer to charity of an undivided portion of the donor's entire interest in property."

(ii) *Remainder interest in a personal residence.* The charitable interest is an irrevocable remainder interest, not in trust, in a personal residence. Thus, for example, if the donor gives to charity a remainder interest in a personal residence and retains an estate in such property for life or a term of years the value of such remainder interest is deductible under section 2522. For purposes of this subdivision, the term "personal residence" means any property which is used by the donor as his personal residence even though it is not used as his principal residence. For example, a donor's vacation home may be a personal residence for purposes of this subdivision. The term "personal residence" also includes stock owned by the donor on the date of gift as a tenant-stockholder in a cooperative housing corporation (as those terms are defined in section 216(b) (1) and (2)) if the dwelling which the donor is entitled to occupy as such stockholder is used by him as his personal residence.

(iii) *Remainder interest in a farm.* The charitable interest is an irrevocable remainder interest, not in trust, in a farm. Thus, for example, if the donor gives to charity a remainder interest in

a farm and retains an estate in such property for life or a term of years, the value of such remainder interest is deductible under section 2522. For purposes of this subdivision, the term "farm" means any land used by the donor or his tenant for the production of crops, fruits, or other agricultural products or for the sustenance of livestock. The term "livestock" includes cattle, hogs, horses, mules, donkeys, sheep, goats, captive fur-bearing animals, chickens, turkeys, pigeons, and other poultry. A farm includes the improvements thereon.

(iv) *Qualified conservation contribution.* The charitable interest is a qualified conservation contribution. For the definition of a qualified conservation contribution, see § 1.170A-14.

(v) *Charitable remainder trust and pooled income funds.* The charitable interest is a remainder interest in a trust which is a charitable remainder annuity trust, as defined in section 664(d)(1) and § 1.664-2 of this chapter; a charitable remainder unitrust, as defined in section 664(d)(2) and (3) and § 1.664-3 of this chapter; or a pooled income fund, as defined in section 642(c)(5) and § 1.642(c)-5 of this chapter. The charitable organization to or for the use of which the remainder interest is transferred must meet the requirements of both section 2522 (a) or (b) and section 642(c)(5)(A), section 664(d)(1)(C), or section 664(d)(2)(C), whichever applies. For example, the charitable organization to which the remainder interest in a charitable remainder annuity trust is transferred may not be a foreign corporation.

(vi) *Guaranteed annuity interest.* (a) The charitable interest is a guaranteed annuity interest, whether or not such interest is in trust. For purposes of this paragraph (c)(2)(vi), the term "guaranteed annuity interest" means an irrevocable right pursuant to the instrument of transfer to receive a guaranteed annuity. A guaranteed annuity is an arrangement under which a determinable amount is paid periodically, but not less often than annually, for a specified term of years or for the life or lives of certain individuals, each of whom must be living at the date of the gift and can be ascertained at such date. Only one or more of the following

individuals may be used as measuring lives: the donor, the donor's spouse, and an individual who, with respect to all remainder beneficiaries (other than charitable organizations described in section 170, 2055, or 2522), is either a lineal ancestor or the spouse of a lineal ancestor of those beneficiaries. A trust will satisfy the requirement that all noncharitable remainder beneficiaries are lineal descendants of the individual who is the measuring life, or that individual's spouse, if there is less than a 15% probability that individuals who are not lineal descendants will receive any trust corpus. This probability must be computed, based on the current applicable Life Table contained in § 20.2031-7, at the time property is transferred to the trust taking into account the interests of all primary and contingent remainder beneficiaries who are living at that time. An interest payable for a specified term of years can qualify as a guaranteed annuity interest even if the governing instrument contains a savings clause intended to ensure compliance with a rule against perpetuities. The savings clause must utilize a period for vesting of 21 years after the deaths of measuring lives who are selected to maximize, rather than limit, the term of the trust. The rule in this paragraph that a charitable interest may be payable for the life or lives of only certain specified individuals does not apply in the case of a charitable guaranteed annuity interest payable under a charitable remainder trust described in section 664. An amount is determinable if the exact amount which must be paid under the conditions specified in the instrument of transfer can be ascertained as of the date of gift. For example, the amount to be paid may be a stated sum for a term of years, or for the life of the donor, at the expiration of which it may be changed by a specified amount, but it may not be redetermined by reference to a fluctuating index such as the cost of living index. In further illustration, the amount to be paid may be expressed as a fraction or percentage of the cost of living index on the date of gift.

(b) A charitable interest is a guaranteed annuity interest only if it is a guaranteed annuity interest in every

respect. For example, if the charitable interest is the right to receive from a trust each year a payment equal to the lesser of a sum certain or a fixed percentage of the net fair market value of the trust assets, determined annually, such interest is not a guaranteed annuity interest.

(c) Where a charitable interest in the form of a guaranteed annuity interest is not in trust, the interest will be considered a guaranteed annuity interest only if it is to be paid by an insurance company or by an organization regularly engaged in issuing annuity contracts.

(d) Where a charitable interest in the form of a guaranteed annuity interest is in trust, the governing instrument of the trust may provide that income of the trust which is in excess of the amount required to pay the guaranteed annuity interest shall be paid to or for the use of a charity. Nevertheless, the amount of the deduction under section 2522 shall be limited to the fair market value of the guaranteed annuity interest as determined under paragraph (d)(2)(iv) of this section.

(e) Where a charitable interest in the form of a guaranteed annuity interest is in trust and the present value on the date of gift of all income interests for a charitable purpose exceeds 60 percent of the aggregate fair market value of all amounts in such trust (after the payment of liabilities), the charitable interest will not be considered a guaranteed annuity interest unless the governing instrument of the trust prohibits both the acquisition and the retention of assets which would give rise to a tax under section 4944 if the trustee had acquired such assets. The requirement in this (e) for a prohibition in the governing instrument against the retention of assets which would give rise to a tax under section 4944 if the trustee had acquired the assets shall not apply to a gift made on or before May 21, 1972.

(f) Where a charitable interest in the form of a guaranteed annuity interest is in trust, and the gift of such interest is made after May 21, 1972, the charitable interest generally is not a guaranteed annuity interest if any amount may be paid by the trust for a private purpose before the expiration of all the

charitable annuity interests. There are two exceptions to this general rule. First, the charitable interest is a guaranteed annuity interest if the amount payable for a private purpose is in the form of a guaranteed annuity interest and the trust's governing instrument does not provide for any preference or priority in the payment of the private annuity as opposed to the charitable annuity. Second, the charitable interest is a guaranteed annuity interest if under the trust's governing instrument the amount that may be paid for a private purpose is payable only from a group of assets that are devoted exclusively to private purposes and to which section 4947(a)(2) is inapplicable by reason of section 4947(a)(2)(B). For purposes of this paragraph (c)(2)(vi)(f), an amount is not paid for a private purpose if it is paid for an adequate and full consideration in money or money's worth. See § 53.4947-1(c) of this chapter for rules relating to the inapplicability of section 4947(a)(2) to segregated amounts in a split-interest trust.

(g) For rules relating to certain governing instrument requirements and to the imposition of certain excise taxes where the guaranteed annuity interest is in trust and for rules governing payment of private income interests by a split-interest trust, see section 4947(a)(2) and (b)(3)(A), and the regulations thereunder.

(vii) *Unitrust interest.* (a) The charitable interest is a unitrust interest, whether or not such interest is in trust. For purposes of this paragraph (c)(2)(vii), the term "unitrust interest" means an irrevocable right pursuant to the instrument of transfer to receive payment, not less often than annually, of a fixed percentage of the net fair market value, determined annually, of the property which funds the unitrust interest. In computing the net fair market value of the property which funds the unitrust interest, all assets and liabilities shall be taken into account without regard to whether particular items are taken into account in determining the income from the property. The net fair market value of the property which funds the unitrust interest may be determined on any one date during the year or by taking the average of valuations made on more

than one date during the year, provided that the same valuation date or dates and valuation methods are used each year. Where the charitable interest is a unitrust interest to be paid by a trust and the governing instrument of the trust does not specify the valuation date or dates, the trustee shall select such date or dates and shall indicate his selection on the first return on Form 1041 which the trust is required to file. Payments under a unitrust interest may be paid for a specified term of years or for the life or lives of certain individuals, each of whom must be living at the date of the gift and can be ascertained at such date. Only one or more of the following individuals may be used as measuring lives: the donor, the donor's spouse, and an individual who, with respect to all remainder beneficiaries (other than charitable organizations described in section 170, 2055, or 2522), is either a lineal ancestor or the spouse of a lineal ancestor of those beneficiaries. A trust will satisfy the requirement that all noncharitable remainder beneficiaries are lineal descendants of the individual who is the measuring life, or that individual's spouse, if there is less than a 15% probability that individuals who are not lineal descendants will receive any trust corpus. This probability must be computed, based on the current applicable Life Table contained in § 20.2031-7, at the time property is transferred to the trust taking into account the interests of all primary and contingent remainder beneficiaries who are living at that time. An interest payable for a specified term of years can qualify as a unitrust interest even if the governing instrument contains a savings clause intended to ensure compliance with a rule against perpetuities. The savings clause must utilize a period for vesting of 21 years after the deaths of measuring lives who are selected to maximize, rather than limit, the term of the trust. The rule in this paragraph that a charitable interest may be payable for the life or lives of only certain specified individuals does not apply in the case of a charitable unitrust interest payable under a charitable remainder trust described in section 664.

(b) A charitable interest is a unitrust interest only if it is a unitrust interest

in every respect. For example, if the charitable interest is the right to receive from a trust each year a payment equal to the lesser of a sum certain or a fixed percentage of the net fair market value of the trust assets, determined annually, such interest is not a unitrust interest.

(c) Where a charitable interest in the form of a unitrust interest is not in trust, the interest will be considered a unitrust interest only if it is to be paid by an insurance company or by an organization regularly engaged in issuing interests otherwise meeting the requirements of a unitrust interest.

(d) Where a charitable interest in the form of a unitrust interest is in trust, the governing instrument of the trust may provide that income of the trust which is in excess of the amount required to pay the unitrust interest shall be paid to or for the use of a charity. Nevertheless, the amount of the deduction under section 2522 shall be limited to the fair market value of the unitrust interest as determined under paragraph (d)(2)(v) of this section.

(e) Where a charitable interest in the form of a unitrust interest is in trust, the charitable interest generally is not a unitrust interest if any amount may be paid by the trust for a private purpose before the expiration of all the charitable unitrust interests. There are two exceptions to this general rule. First, the charitable interest is a unitrust interest if the amount payable for a private purpose is in the form of a unitrust interest and the trust's governing instrument does not provide for any preference or priority in the payment of the private unitrust interest as opposed to the charitable unitrust interest. Second, the charitable interest is a unitrust interest if under the trust's governing instrument the amount that may be paid for a private purpose is payable only from a group of assets that are devoted exclusively to private purposes and to which section 4947(a)(2) is inapplicable by reason of section 4947(a)(2)(B). For purposes of this paragraph (c)(2)(vii)(e), an amount is not paid for a private purpose if it is paid for an adequate and full consideration in money or money's worth. See § 53.4947-1(c) of this chapter for rules relating to the inapplicability of section

4947(a)(2) to segregated amounts in a split-interest trust.

(f) For rules relating to certain governing instrument requirements and to the imposition of certain excise taxes where the unitrust interest is in trust and for rules governing payment of private income interests by a split-interest trust, see sections 4947(a)(2) and (b)(3)(A), and the regulations thereunder.

(d) *Valuation of charitable interest*—(1) *In general.* The amount of the deduction in the case of a contribution of a partial interest in property to which this section applies is the fair market value of the partial interest on the date of gift. The fair market value of an annuity, life estate, term for years, remainder, reversion or unitrust interest is its present value.

(2) *Certain transfers after July 31, 1969.* In the case of a transfer after July 31, 1969, of an interest described in paragraph (c)(2) (v), (vi), or (vii) of this section, the present value of such interest is to be determined under the following rules:

(i) The present value of a remainder interest in a charitable remainder annuity trust is to be determined under § 1.664-2(c) of this chapter (Income Tax Regulations).

(ii) The present value of a remainder interest in a charitable remainder unitrust is to be determined under § 1.664-4 of this chapter.

(iii) The present value of a remainder interest in a pooled income fund is to be determined under § 1.642(c)-6 of this chapter.

(iv) The present value of a guaranteed annuity interest described in paragraph (c)(2)(vi) of this section is to be determined under § 25.2512-5, except that, if the annuity is issued by a company regularly engaged in the sale of annuities, the present value is to be determined under § 25.2512-6. If by reason of all the conditions and circumstances surrounding a transfer of an income interest in property in trust it appears that the charity may not receive the beneficial enjoyment of the interest, a deduction will be allowed under section 2522 only for the minimum amount it is evident the charity will receive.

Example (1). In 1975, B transfers \$20,000 in trust with the requirement that a designated

charity be paid a guaranteed annuity interest (as defined in paragraph (c)(2)(vi) of this section) of \$4,100 a year, payable annually at the end of each year for a period of 6 years and that the remainder be paid to his children. The fair market value of an annuity of \$4,100 a year for a period of 6 years is \$20,160.93 ($\$4,100 \times 4.9173$), as determined under § 25.2512-5A(c). The deduction with respect to the guaranteed annuity interest will be limited to \$20,000, which is the minimum amount it is evident the charity will receive.

Example (2). In 1975, C transfers \$40,000 in trust with the requirement that D, an individual, and X Charity be paid simultaneously guaranteed annuity interests (as defined in paragraph (c)(2)(vi) of this section) of \$5,000 a year each, payable annually at the end of each year, for a period of 5 years and that the remainder be paid to C's children. The fair market value of two annuities of \$5,000 each a year for a period of 5 years is \$42,124 ($[\$5,000 \times 4.2124] \times 2$), as determined under § 25.2512-5A(c). The trust instrument provides that in the event the trust fund is insufficient to pay both annuities in a given year, the trust fund will be evenly divided between the charitable and private annuitants. The deduction with respect to the charitable annuity will be limited to \$20,000, which is the minimum amount it is evident the charity will receive.

Example (3). In 1975, D transfers \$65,000 in trust with the requirement that a guaranteed annuity interest (as defined in paragraph (c)(2)(vi) of this section) of \$5,000 a year, payable annually at the end of each year, be paid to Y Charity for a period of 10 years and that a guaranteed annuity interest (as defined in paragraph (c)(2)(vi) of this section) of \$5,000 a year, payable annually at the end of each year, be paid to W, his wife, aged 62, for 10 years or until her prior death. The annuities are to be paid simultaneously, and the remainder is to be paid to D's children. The fair market value of the private annuity is \$33,877 ($\$5,000 \times 6.7754$), as determined pursuant to § 25.2512-5A(c) and by the use of factors involving one life and a term of years as published in Publication 723A (12-70). The fair market value of the charitable annuity is \$36,800.50 ($\$5,000 \times 7.3601$), as determined under § 25.2512-5A(c). It is not evident from the governing instrument of the trust or from local law that the trustee would be required to apportion the trust fund between the wife and charity in the event the fund were insufficient to pay both annuities in a given year. Accordingly, the deduction with respect to the charitable annuity will be limited to \$31,123 ($\$65,000$ less $\$33,877$ [the value of the private annuity]), which is the minimum amount it is evident the charity will receive.

(v) The present value of a unitrust interest described in paragraph (c)(2)(vii)

of this section is to be determined by subtracting the present value of all interests in the transferred property other than the unitrust interest from the fair market value of the transferred property.

(3) *Other transfers.* The present value of an interest not described in paragraph (d)(2) of this section is to be determined under § 25.2512-5.

(4) *Special computations.* If the interest transferred is such that its present value is to be determined by a special computation, a request for a special factor, accompanied by a statement of the date of birth and sex of each individual the duration of whose life may affect the value of the interest, and by copies of the relevant instruments, may be submitted by the donor to the Commissioner who may, if conditions permit, supply the factor requested. If the Commissioner furnishes the factor, a copy of the letter supplying the factor must be attached to the tax return in which the deduction is claimed. If the Commissioner does not furnish the factor, the claim for deduction must be supported by a full statement of the computation of the present value made in accordance with the principles set forth in this paragraph.

(e)

(e) *Effective/applicability date.* This section applies only to gifts made after July 31, 1969. In addition, the rule in paragraphs (c)(2)(vi)(a) and (c)(2)(vii)(a) of this section that guaranteed annuity interests or unitrust interests, respectively, may be payable for a specified term of years or for the life or lives of only certain individuals applies to transfers made on or after April 4, 2000. If a transfer is made on or after April 4, 2000, that uses an individual other than one permitted in paragraphs (c)(2)(vi)(a) and (c)(2)(vii)(a) of this section, the interest may be reformed into a lead interest payable for a specified term of years. The term of years is determined by taking the factor for valuing the annuity or unitrust interest for the named individual measuring life and identifying the term of years (rounded up to the next whole year) that corresponds to the equivalent term of years factor for an annuity or unitrust interest. For example, in the case of an annuity interest payable for

the life of an individual age 40 at the time of the transfer on or after May 1, 2009 (the effective date of Table S), assuming an interest rate of 7.4 percent under section 7520, the annuity factor from column 1 of Table S(7.4), contained in IRS Publication 1457, Actuarial Valuations Version 3A, for the life of an individual age 40 is 12.1519 (1-.10076/.074). Based on Table B(7.4), contained in Publication 1457, "Actuarial Valuations Version 3A", the factor 12.1519 corresponds to a term of years between 32 and 33 years. Accordingly, the annuity interest must be reformed into an interest payable for a term of 33 years. A judicial reformation must be commenced prior to October 15th of the year following the year in which the transfer is made and must be completed within a reasonable time after it is commenced. A non-judicial reformation is permitted if effective under state law, provided it is completed by the date on which a judicial reformation must be commenced. In the alternative, if a court, in a proceeding that is commenced on or before July 5, 2001, declares any transfer, made on or after April 4, 2000, and on or before March 6, 2001, null and void ab initio, the Internal Revenue Service will treat such transfers in a manner similar to that described in section 2055(e)(3)(J).

[T.D. 7318, 39 FR 25458, July 11, 1974; 39 FR 26154, July 17, 1974, as amended by T.D. 7340, 40 FR 1240, Jan. 7, 1975; T.D. 7955, 49 FR 19998, May 11, 1984; T.D. 7957, 49 FR 20812, May 17, 1984; T.D. 8069, 51 FR 1507, Jan. 14, 1986; 51 FR 5323, Feb. 13, 1986; 51 FR 6319, Feb. 21, 1986; T.D. 8540, 59 FR 30103, 30177, June 10, 1994; T.D. 8630, 60 FR 63919, Dec. 13, 1995; T.D. 8923, 66 FR 1043, Jan. 5, 2001; T.D. 9068, 68 FR 40132, July 7, 2003; T.D. 9448, 74 FR 21515, May 7, 2009; T.D. 9540, 76 FR 49641, Aug. 10, 2011]

§ 25.2522(c)-4 Disallowance of double deduction in the case of qualified terminable interest property.

No deduction is allowed under section 2522 for the transfer of an interest in property if a deduction is taken from the *total amount of gifts* with respect to that property by reason of section 2523(f). See § 25.2523(h)-1.

[T.D. 8522, 59 FR 9658, Mar. 1, 1994]

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§ 25.2522(d)-1 Additional cross references.

(a) See section 14 of the Wild and Scenic Rivers Act (Pub. L. 90-542, 82 Stat. 918) for provisions relating to the claim and allowance of the value of certain easements as a gift under section 2522.

(b) For treatment of gifts accepted by the Secretary of State or the Secretary of Commerce, for the purpose of organizing and holding an international conference to negotiate a Patent Corporation Treaty, as gifts to or for the use of the United States, see section 3 of Joint Resolution of December 24, 1969 (Pub. L. 91-160, 83 Stat. 443).

(c) For treatment of gifts accepted by the Secretary of the Department of Housing and Urban Development, for the purpose of aiding or facilitating the work of the Department, as gifts to or for the use of the United States, see section 7(k) of the Department of Housing and Urban Development Act (42 U.S.C. 3535), as added by section 905 of Pub. L. 91-609 (84 Stat. 1809).

(d) For treatment of certain property accepted by the Chairman of the Administrative Conference of the United States, for the purpose of aiding and facilitating the work of the Conference, as gifts to the United States, see 5 U.S.C. 575(c)(12), as added by section 1(b) of the Act of October 21, 1972 (Pub. L. 92-526, 86 Stat. 1048).

(e) For treatment of the Board for International Broadcasting as a corporation described in section 2522(a)(2), see section 7 of the Board for International Broadcasting Act of 1973 (Pub. L. 93-129, 87 Stat. 459).

[T.D. 7318, 39 FR 25461, July 11, 1974]

§ 25.2523(a)-1 Gift to spouse; in general.

(a) *In general.* In determining the amount of taxable gifts for the calendar quarter (with respect to gifts made after December 31, 1970, and before January 1, 1982), or calendar year (with respect to gifts made before January 1, 1971, or after December 31, 1981), a donor may deduct the value of any property interest transferred by gift to a donee who at the time of the gift is the donor's spouse, except as limited by paragraphs (b) and (c) of this sec-

tion. See § 25.2502-1(c)(1) for the definition of calendar quarter. This deduction is referred to as the *marital deduction*. In the case of gifts made prior to July 14, 1988, no marital deduction is allowed with respect to a gift if, at the time of the gift, the donor is a non-resident not a citizen of the United States. Further, in the case of gifts made on or after July 14, 1988, no marital deduction is allowed (regardless of the donor's citizenship or residence) for transfers to a spouse who is not a citizen of the United States at the time of the transfer. However, for certain special rules applicable in the case of estate and gift tax treaties, see section 7815(d)(14) of Public Law 101-239. The donor must submit any evidence necessary to establish the donor's right to the marital deduction.

(b) *"Deductible interests" and "non-deductible interests"*—(1) *In general.* The property interests transferred by a donor to his spouse consist of either transfers with respect to which the marital deduction is authorized (as described in subparagraph (2) of this paragraph) or transfers with respect to which the marital deduction is not authorized (as described in subparagraph (3) of this paragraph). These transfers are referred to in this section and in §§ 25.2523(b)-1 through 25.2523(f)-1 as "deductible interests" and "non-deductible interests", respectively.

(2) *"Deductible interest"*. A property interest transferred by a donor to his spouse is a "deductible interest" if it does not fall within either class of "nondeductible interests" described in subparagraph (3) of this paragraph.

(3) *"Nondeductible interests"*. (i) A property interest transferred by a donor to his spouse which is a "terminable interest", as defined in § 25.2523(b)-1, is a "nondeductible interest" to the extent specified in that section.

(ii) Any property interest transferred by a donor to the donor's spouse is a *nondeductible interest* to the extent it is not required to be included in a gift tax return for a calendar quarter (for gifts made after December 31, 1970, and before January 1, 1982) or calendar year (for gifts made before January 1, 1971, or after December 31, 1981).

(c) *Computation*—(1) *In general.* The amount of the marital deduction depends upon when the interspousal gifts are made, whether the gifts are terminable interests, whether the limitations of § 25.2523(f)-1A (relating to gifts of community property before January 1, 1982) are applicable, and whether § 25.2523(f)-1 (relating to the election with respect to life estates) is applicable, and (with respect to gifts made on or after July 14, 1988) whether the donee spouse is a citizen of the United States (see section 2523(i)).

(2) *Gifts prior to January 1, 1977.* Generally, with respect to gifts made during a calendar quarter prior to January 1, 1977, the marital deduction allowable under section 2523 is 50 percent of the aggregate value of the deductible interests. See section 2524 for an additional limitation on the amount of the allowable deduction.

(3) *Gifts after December 31, 1976, and before January 1, 1982.* Generally, with respect to gifts made during a calendar quarter beginning after December 31, 1976, and ending prior to January 1, 1982, the marital deduction allowable under section 2523 is computed as a percentage of the deductible interests in those gifts. If the aggregate amount of deductions for such gifts is \$100,000 or less, a deduction is allowed for 100 percent of the deductible interests. No deduction is allowed for otherwise deductible interests in an aggregate amount that exceeds \$100,000 and is equal to or less than \$200,000. For deductible interests in excess of \$200,000, the deduction is limited to 50 percent of such deductible interests. If a donor remarries, the computations in this paragraph (c)(3) are made on the basis of aggregate gifts to all persons who at the time of the gifts are the donor's spouse. See section 2524 for an additional limitation on the amount of the allowable deduction.

(4) *Gifts after December 31, 1981.* Generally, with respect to gifts made during a calendar year beginning after December 31, 1981 (other than gifts made on or after July 14, 1988, to a spouse who is not a United States citizen on the date of the transfer), the marital deduction allowable under section 2523 is 100 percent of the aggregate value of the deductible interests. See section

2524 for an additional limitation on the amount of the allowable deduction, and section 2523(i) regarding disallowance of the marital deduction for gifts to a spouse who is not a United States citizen.

(d) *Examples.* The following examples (in which it is assumed that the donors have previously utilized any specific exemptions provided by section 2521 for gifts prior to January 1, 1977) illustrate the application of paragraph (c) of this section and the interrelationship of sections 2523 and 2503.

Example 1. A donor made a transfer by gift of \$6,000 cash to his spouse on December 25, 1971. The donor made no other transfers during 1971. The amount of the marital deduction for the fourth calendar quarter of 1971 is \$3,000 (one-half of \$6,000); the amount of the annual exclusion under section 2503(b) is \$3,000; and the amount of taxable gifts is zero (\$6,000 - \$3,000 (annual exclusion) - \$3,000 (marital deduction)).

Example 2. A donor made transfers by gift to his spouse of \$3,000 cash on January 1, 1971, and \$3,000 cash on May 1, 1971. The donor made no other transfers during 1971. For the first calendar quarter of 1971 the marital deduction is zero because the amount excluded under section 2503(b) is \$3,000, and the amount of taxable gifts is also zero. For the second calendar quarter of 1971 the marital deduction is \$1,500 (one-half of \$3,000), and the amount of taxable gifts is \$1,500 (\$3,000 - \$1,500 (marital deduction)). Under section 2503(b) no amount of the second \$3,000 gift may be excluded because the entire \$3,000 annual exclusion was applied against the gift made in the first calendar quarter of 1971.

Example 3. A donor made a transfer by gift to his spouse of \$10,000 cash on April 1, 1972. The donor made no other transfers during 1972. For the second calendar quarter of 1972 the amount of the marital deduction is \$5,000 (one-half of \$10,000); the amount excluded under section 2503(b) is \$3,000; the amount of taxable gifts is \$2,000 (\$10,000 - \$3,000 (annual exclusion) - \$5,000 (marital deduction)).

Example 4. A donor made transfers by gift to his spouse of \$2,000 cash on January 1, 1971, \$2,000 cash on April 5, 1971, and \$10,000 cash on December 1, 1971. The donor made no other transfers during 1971. For the first calendar quarter of 1971 the marital deduction is zero because the amount excluded under section 2503(b) is \$2,000, and the amount of taxable gifts is also zero. For the second calendar quarter of 1971 the marital deduction is \$1,000 (one-half of \$2,000) (see section 2524); the amount excluded under section 2503(b) is \$1,000 because \$2,000 of the \$3,000 annual exclusion was applied against the gift made in

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the first calendar quarter of 1971; and the amount of taxable gifts is zero (\$2,000-\$1,000 (annual exclusion) -\$1,000 (marital deduction)). For the fourth calendar quarter of 1971, the marital deduction is \$5,000 (one-half of \$10,000); the amount excluded under section 2503(b) is zero because the entire \$3,000 annual exclusion was applied against the gifts made in the first and second calendar quarters of 1971; and the amount of taxable gifts is \$5,000 (\$10,000-\$5,000 (marital deduction)).

Example 5. A donor made transfers by gift to his spouse of \$2,000 cash on January 10, 1972, \$2,000 cash on May 1, 1972, and a remainder interest valued at \$16,000 on June 1, 1972. The donor made no other transfers during 1972. For the first calendar quarter of 1972, the marital deduction is zero because \$2,000 is excluded under section 2503(b), and the amount of taxable gifts is also zero. For the second calendar quarter of 1972 the marital deduction is \$9,000 (one-half of \$16,000 plus one-half of \$2,000); the amount excluded under section 2503(b) is \$1,000 because \$2,000 of the \$3,000 annual exclusion was applied against the gift made in the first calendar quarter of 1971; and the amount of taxable gifts is \$8,000 (\$18,000-\$1,000 (annual exclusion) -\$9,000 (marital deduction)).

Example 6. A donor made transfers by gift to his spouse of \$2,000 cash on January 1, 1972, a remainder interest valued at \$16,000 on January 5, 1972, and \$2,000 cash on April 30, 1972. The donor made no other transfers during 1972. For the first calendar quarter of 1972, the marital deduction is \$9,000 (one-half of \$16,000 plus one-half of \$2,000); the amount excluded under section 2503(b) is \$2,000; and the amount of taxable gifts is \$7,000 (\$18,000-\$2,000 (annual exclusion) -\$9,000 marital deduction)). For the second calendar quarter of 1972 the marital deduction is \$1,000 (one-half of \$2,000); the amount excluded under section 2503(b) is \$1,000 because \$2,000 of the \$3,000 annual exclusion was applied against the gift of the present interest in the first calendar quarter of 1971; and the amount of taxable gifts is zero (\$2,000-\$1,000 (annual exclusion) -\$1,000 (marital deduction)).

Example 7. A donor made a transfer by gift to his spouse of \$12,000 cash on July 1, 1955. The donor made no other transfers during 1955. For the calendar year 1955 the amount of the marital deduction is \$6,000 (one-half of \$12,000); the amount excluded under section 2503(b) is \$3,000; and the amount of taxable gifts is \$3,000 (\$12,000-\$3,000 (annual exclusion) -\$6,000 (marital deduction)).

Example 8. A donor made a transfer by gift to the donor's spouse, a United States citizen, of \$200,000 cash on January 1, 1995. The donor made no other transfers during 1995. For calendar year 1995, the amount excluded under section 2503(b) is \$10,000; the marital deduction is \$190,000; and the amount of tax-

able gifts is zero (\$200,000-\$10,000 (annual exclusion)-\$190,000 (marital deduction)).

(e) *Valuation.* If the income from property is made payable to the donor or another individual for life or for a term of years, with remainder to the donor's spouse or to the estate of the donor's spouse, the marital deduction is computed (pursuant to § 25.2523(a)-1(c)) with respect to the present value of the remainder, determined under section 7520. The present value of the remainder (that is, its value as of the date of gift) is to be determined in accordance with the rules stated in § 25.2512-5 or, for certain prior periods, § 25.2512-5A. See the example in paragraph (d) of § 25.2512-5. If the remainder is such that its value is to be determined by a special computation, a request for a specific factor, accompanied by a statement of the dates of birth of each person, the duration of whose life may affect the value of the remainder, and by copies of the relevant instruments may be submitted by the donor to the Commissioner who, if conditions permit, may supply the factor requested. If the Commissioner does not furnish the factor, the claim for deduction must be supported by a full statement of the computation of the present value, made in accordance with the principles set forth in § 25.2512-5(d) or, for certain prior periods, § 25.2512-5A.

[T.D. 7238, 37 FR 28733, Dec. 29, 1972, as amended by T.D. 7955, 49 FR 19998, May 11, 1984, T.D. 8522, 59 FR 9658, Mar. 1, 1994; T.D. 8540, 59 FR 30103, June 10, 1994; 60 FR 16382, Mar. 30, 1995]

§ 25.2523(b)-1 Life estate or other terminable interest.

(a) *In general.* (1) The provisions of section 2523(b) generally disallow a marital deduction with respect to certain property interests (referred to generally as *terminable interests* and defined in paragraph (a)(3) of this section) transferred to the donee spouse under the circumstances described in paragraph (a)(2) of this section, unless the transfer comes within the purview of one of the exceptions set forth in § 25.2523(d)-1 (relating to certain joint interests); § 25.2523(e)-1 (relating to certain life estates with powers of appointment); § 25.2523(f)-1 (relating to certain qualified terminable interest

property); or § 25.2523(g)-1 (relating to certain qualified charitable remainder trusts).

(2) If a donor transfers a terminable interest in property to the donee spouse, the marital deduction is disallowed with respect to the transfer if the donor spouse also—

(i) Transferred an interest in the same property to another donee (see paragraph (b) of this section), or

(ii) Retained an interest in the same property in himself (see paragraph (c) of this section), or

(iii) Retained a power to appoint an interest in the same property (see paragraph (d) of this section).

Notwithstanding the preceding sentence, the marital deduction is disallowed under these circumstances only if the other donee, the donor, or the possible appointee, may, by reason of the transfer or retention, possess or enjoy any part of the property after the termination or failure of the interest therein transferred to the donee spouse.

(3) For purposes of this section, a distinction is to be drawn between “property,” as such term is used in section 2523, and an “interest in property.” The “property” referred to is the underlying property in which various interests exist; each such interest is not, for this purpose, to be considered as “property.” A “terminable interest” in property is an interest which will terminate or fail on the lapse of time or on the occurrence or failure to occur of some contingency. Life estates, terms for years, annuities, patents, and copyrights are therefore terminable interests. However, a bond, note, or similar contractual obligation, the discharge of which would not have the effect of an annuity or term for years, is not a terminable interest.

(b) *Interest in property which another donee may possess or enjoy.* (1) Section 2523(b) provides that no marital deduction shall be allowed with respect to the transfer to the donee spouse of a “terminable interest” in property, in case—

(i) The donor transferred (for less than an adequate and full consideration in money or money’s worth) an interest in the same property to any

person other than the donee spouse (or the estate of such spouse), and

(ii) By reason of such transfer, such person (or his heirs or assigns) may possess or enjoy any part of such property after the termination or failure of the interest therein transferred to the donee spouse.

(2) In determining whether the donor transferred an interest in property to any person other than the donee spouse, it is immaterial whether the transfer to the person other than the donee spouse was made at the same time as the transfer to such spouse, or at any earlier time.

(3) Except as provided in § 25.2523(e)-1 or 25.2523(f)-1, if at the time of the transfer it is impossible to ascertain the particular person or persons who may receive a property interest transferred by the donor, such interest is considered as transferred to a person other than the donee spouse for the purpose of section 2523(b). This rule is particularly applicable in the case of the transfer of a property interest by the donor subject to a reserved power. See § 25.2511-2. Under this rule, any property interest over which the donor reserved a power to revest the beneficial title in himself, or over which the donor reserved the power to name new beneficiaries or to change the interests of the beneficiaries as between themselves, is for the purpose of section 2523(b), considered as transferred to a “person other than the donee spouse.” The following examples, in which it is assumed that the donor did not make an election under sections 2523(f)(2)(C) and (f)(4), illustrate the application of the provisions of this paragraph (b)(3):

Example 1. If a donor transferred property in trust naming his wife as the irrevocable income beneficiary for 10 years, and providing that, upon the expiration of that term, the corpus should be distributed among his wife and children in such proportions as the trustee should determine, the right to the corpus, for the purpose of the marital deduction, is considered as transferred to a “person other than the donee spouse.”

Example 2. If, in the above example, the donor had provided that, upon the expiration of the 10-year term, the corpus was to be paid to his wife, but also reserved the power to revest such corpus in himself, the right to

corpus, for the purpose of the marital deduction, is considered as transferred to a "person other than the donee spouse."

(4) The term "person other than the donee spouse" includes the possible unascertained takers of a property interest, as, for example, the members of a class to be ascertained in the future. As another example, assume that the donor created a power of appointment over a property interest, which does not come within the purview of § 25.2523(e)-1. In such a case, the term "person other than the donee spouse" refers to the possible appointees and takers in default (other than the spouse) of such property interest.

(5) An exercise or release at any time by the donor (either alone or in conjunction with any person) of a power to appoint an interest in property, even though not otherwise a transfer by him is considered as a transfer by him in determining, for the purpose of section 2523(b), whether he transferred an interest in such property to a person other than the donee spouse.

(6) The following examples illustrate the application of this paragraph. In each example, it is assumed that the donor made no election under sections 2523(f)(2)(C) and (f)(4) and that the property interest that the donor transferred to a person other than the donee spouse is not transferred for adequate and full consideration in money or money's worth:

Example 1. H (the donor) transferred real property to W (his wife) for life, with remainder to A and his heirs. No marital deduction may be taken with respect to the interest transferred to W, since it will terminate upon her death and A (or his heirs or assigns) will thereafter possess or enjoy the property.

Example 2. H transferred property for the benefit of W and A. The income was payable to W for life and upon her death the principal was to be distributed to A or his issue. However, if A should die without issue, leaving W surviving, the principal was then to be distributed to W. No marital deduction may be taken with respect to the interest transferred to W, since it will terminate in the event of his issue will thereafter possess or enjoy the property.

Example 3. H purchased for \$100,000 a life annuity for W. If the annuity payments made during the life of W should be less than \$100,000, further payments were to be made to A. No marital deduction may be taken with respect to the interest transferred to W;

since A may possess or enjoy a part of the property following the termination of W's interest. If, however, the contract provided for no continuation of payments, and provided for no refund upon the death of W, or provided that any refund was to go to the estate of W, then a marital deduction may be taken with respect to the gift.

Example 4. H transferred property to A for life with remainder to W provided W survives A, but if W predeceases A, the property is to pass to B and his heirs. No marital deduction may be taken with respect to the interest transferred to W.

Example 5. H transferred real property to A, reserving the right to the rentals of the property for a term of 20 years. H later transferred the right to the remaining rentals to W. No marital deduction may be taken with respect to the interest since it will terminate upon the expiration of the balance of the 20-year term and A will thereafter possess or enjoy the property.

Example 6. H transferred a patent to W and A as tenants in common. In this case, the interest of W will terminate upon the expiration of the term of the patent, but possession and enjoyment of the property by A must necessarily cease at the same time. Therefore, since A's possession or enjoyment cannot outlast the termination of W's interest, the provisions of section 2523(b) do not disallow the marital deduction with respect to the interest.

(c) *Interest in property which the donor may possess or enjoy.* (1) Section 2523(b) provides that no marital deduction is allowed with respect to the transfer to the donee spouse of a "terminable interest" in property, if—

(i) The donor retained in himself an interest in the same property, and

(ii) By reason of such retention, the donor (or his heirs or assigns) may possess or enjoy any part of the property after the termination or failure of the interest transferred to the donee spouse. However, as to a transfer to the donee spouse as sole joint tenant with the donor or as tenant by the entirety, see § 25.2523(d)-1.

(2) In general, the principles illustrated by the examples under paragraph (b) of this section are applicable in determining whether the marital deduction may be taken with respect to a property interest transferred to the donee spouse subject to the retention by the donor of an interest in the same property. The application of this paragraph may be further illustrated by the

following example, in which it is assumed that the donor made no election under sections 2523(f)(2)(C) and (f)(4).

Example. The donor purchased three annuity contracts for the benefit of his wife and himself. The first contract provided for payments to the wife for life, with refund to the donor in case the aggregate payments made to the wife were less than the cost of the contract. The second contract provided for payments to the donor for life, and then to the wife for life if she survived the donor. The third contract provided for payments to the donor and his wife for their joint lives and then to the survivor of them for life. No marital deduction may be taken with respect to the gifts resulting from the purchases of the contracts since, in the case of each contract, the donor may possess or enjoy a part of the property after the termination or failure of the interest transferred to the wife.

(d) *Interest in property over which the donor retained a power to appoint.* (1) Section 2523(b) provides that no marital deduction is allowed with respect to the transfer to the donee spouse of a terminable interest" in property if—

(i) The donor had, immediately after the transfer, a power to appoint an interest in the same property, and

(ii) The donor's power was exercisable (either alone or in conjunction with any person) in such manner that the appointee may possess or enjoy any part of the property after the termination or failure of the interest transferred to the donee spouse.

(2) For the purposes of section 2523(b), the donor is to be considered as having, immediately after the transfer to the donee spouse, such a power to appoint even though the power cannot be exercised until after the lapse of time, upon the occurrence of an event or contingency, or upon the failure of an event or contingency to occur. It is immaterial whether the power retained by the donor was a taxable power of appointment under section 2514.

(3) The principles illustrated by the examples under paragraph (b) of this section are generally applicable in determining whether the marital deduction may be taken with respect to a property interest transferred to the donee spouse subject to retention by the donor of a power to appoint an interest in the same property. The application of this paragraph may be fur-

ther illustrated by the following example:

Example. The donor, having a power of appointment over certain property, appointed a life estate to his spouse. No marital deduction may be taken with respect to such transfer, since, if the retained power to appoint the remainder interest is exercised, the appointee thereunder may possess or enjoy the property after the termination or failure of the interest taken by the donee spouse.

[T.D. 6334, 23 FR 8904, Nov. 15, 1958; 25 FR 14021, Dec. 31, 1960, as amended by T.D. 8522, 59 FR 9659, Mar. 1, 1994]

§ 25.2523(c)-1 Interest in unidentified assets.

(a) Section 2523(c) provides that if an interest passing to a donee spouse may be satisfied out of a group of assets (or their proceeds) which include a particular asset that would be a non-deductible interest if it passed from the donor to his spouse, the value of the interest passing to the spouse is reduced, for the purpose of the marital deduction, by the value of the particular asset.

(b) In order for this section to apply, two circumstances must coexist, as follows:

(1) The property interest transferred to the donee spouse must be payable out of a group of assets. An example of a property interest payable out of a group of assets is a right to a share of the corpus of a trust upon its termination.

(2) The group of assets out of which the property interest is payable must include one or more particular assets which, if transferred by the donor to the donee spouse, would not qualify for the marital deduction. Therefore, section 2523 (c) is not applicable merely because a group of assets includes a terminable interest, but would only be applicable if the terminable interest were nondeductible under the provisions of § 25.2523(b)-1.

(c) If both of the circumstances set forth in paragraph (b) of this section exist, only a portion of the property interest passing to the spouse is a deductible interest. The portion qualifying as a deductible interest is an amount equal to the excess, if any, of the value of the property interest passing to the spouse over the aggregate value of the asset (or assets) that if

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transferred to the spouse would not qualify for the marital deduction. See paragraph (c) of § 25.2523(a)-1 to determine the percentage of the deductible interest allowable as a marital deduction. The application of this section may be illustrated by the following example:

Example. H was absolute owner of a rental property and on July 1, 1950, transferred it to A by gift, reserving the income for a period of 20 years. On July 1, 1955, he created a trust to last for a period of 10 years. H was to receive the income from the trust and at the termination of the trust the trustee is to turn over to H's wife, W, property having a value of \$100,000. The trustee has absolute discretion in deciding which properties in the corpus he shall turn over to W in satisfaction of the gift to her. The trustee received two items of property from H. Item (1) consisted of shares of corporate stock. Item (2) consisted of the right to receive the income from the rental property during the unexpired portion of the 20-year term. Assume that at the termination of the trust on July 1, 1965, the value of the right to the rental income for the then unexpired term of 5 years (item (2)) will be \$30,000. Since item (2) is a nondeductible interest and the trustee can turn it over to W in partial satisfaction of her gift, only \$70,000 of the \$100,000 receivable by her on July 1, 1965, will be considered as property with respect to which a marital deduction is allowable. The present value on July 1, 1955, of the right to receive \$70,000 at the end of 10 years is \$49,624.33 as determined under § 25.2512-5A(c). The value of the property qualifying for the marital deduction, therefore, is \$49,624.33 and a marital deduction is allowed for one-half of that amount, or \$24,812.17.

[T.D. 6334, 23 FR 8904, Nov. 15, 1958; 25 FR 14021, Dec. 31, 1960, as amended by T.D. 8522, 59 FR 9659, Mar. 1, 1994; T.D. 8540, 59 FR 30103, June 10, 1994]

§ 25.2523(d)-1 Joint interests.

Section 2523(d) provides that if a property interest is transferred to the donee spouse as sole joint tenant with the donor or as a tenant by the entirety, the interest of the donor in the property which exists solely by reason of the possibility that the donor may survive the donee spouse, or that there may occur a severance of the tenancy, is not for the purposes of section 2523(b), to be considered as an interest retained by the donor in himself. Under this provision, the fact that the donor may, as surviving tenant, possess or

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enjoy the property after the termination of the interest transferred to the donee spouse does not preclude the allowance of the marital deduction with respect to the latter interest. Thus, if the donor purchased real property in the name of the donor and the donor's spouse as tenants by the entirety or as joint tenants with rights of survivorship, a marital deduction is allowable with respect to the value of the interest of the donee spouse in the property (subject to the limitations set forth in § 25.2523(a)-1). See paragraph (c) of § 25.2523(b)-1, and section 2524.

[T.D. 7238, 37 FR 28734, Dec. 29, 1972, as amended by T.D. 8522, 59 FR 9659, Mar. 1, 1994]

§ 25.2523(e)-1 Marital deduction; life estate with power of appointment in donee spouse.

(a) *In general.* Section 2523(e) provides that if an interest in property is transferred by a donor to his spouse (whether or not in trust) and the spouse is entitled for life to all the income from a specific portion of the entire interest, with a power in her to appoint the entire interest of all the income from interest or the specific portion, the interest transferred to her is a deductible interest, to the extent that it satisfies all five of the conditions set forth below (see paragraph (b) of this section if one or more of the conditions is satisfied as to only a portion of the interest):

(1) The donee spouse must be entitled for life to all of the income from the entire interest or a specific portion of the entire interest, or to a specific portion of all the income from the entire interest.

(2) The income payable to the donee spouse must be payable annually or at more frequent intervals.

(3) The donee spouse must have the power to appoint the entire interest of the specific portion to either herself or her estate.

(4) The power in the donee spouse must be exercisable by her alone and (whether exercisable by will or during life) must be exercisable in all events.

(5) The entire interest or the specific portion must not be subject to a power in any other person to appoint any part

to any person other than the donee spouse.

(b) *Specific portion; deductible amount.* If either the right to income or the power of appointment given to the donee spouse pertains only to a specific portion of a property interest, the portion of the interest which qualifies as a deductible interest is limited to the extent that the rights in the donee spouse meet all of the five conditions described in paragraph (a) of this section. While the rights over the income and the power must coexist as to the same interest in property, it is not necessary that the rights over the income or the power as to such interest be in the same proportion. However, if the rights over income meeting the required conditions set forth in paragraph (a) (1) and (2) of this section extend over a smaller share of the property interest than the share with respect to which the power of appointment requirements set forth in paragraph (a) (3) through (5) of this section are satisfied, the deductible interest is limited to the smaller share. Conversely, if a power of appointment meeting all the requirements extends to a smaller portion of the property interest than the portion over which the income rights pertain, the deductible interest cannot exceed the value of the portion to which such power of appointment applies. Thus, if the donor gives to the donee spouse the right to receive annually all of the income from a particular property interest and a power of appointment meeting the specifications prescribed in paragraph (a) (3) through (5) of this section as to only one-half of the property interest, then only one-half of the property interest is treated as a deductible interest. Correspondingly, if the income interest of the spouse satisfying the requirements extends to only one-fourth of the property interest and a testamentary power of appointment satisfying the requirements extends to all of the property interest, then only one-fourth of the interest in the spouse qualifies as a deductible interest. Further, if the donee spouse has no right to income from a specific portion of a property interest but a testamentary power of appointment which meets the necessary conditions over the entire in-

terest, then none of the interest qualifies for the deduction. In addition, if, from the time of the transfer, the donee spouse has a power of appointment meeting all of the required conditions over three-fourths of the entire property interest and the prescribed income rights over the entire interest, but with a power in another person to appoint one-half of the entire interest, the value of the interest in the donee spouse over only one-half of the property interest will qualify as a deductible interest.

(c) *Meaning of specific portion*—(1) *In general.* Except as provided in paragraphs (c)(2) and (c)(3) of this section, a partial interest in property is not treated as a *specific portion* of the entire interest. In addition, any specific portion of an entire interest in property is nondeductible to the extent the specific portion is subject to invasion for the benefit of any person other than the donee spouse, except in the case of a deduction allowable under section 2523(e), relating to the exercise of a general power of appointment by the donee spouse.

(2) *Fraction or percentage share.* Under section 2523(e), a partial interest in property is treated as a specific portion of the entire interest if the rights of the donee spouse in income, and the required rights as to the power described in § 25.2523(e)-1(a), constitute a fractional or percentage share of the entire property interest, so that the donee spouse's interest reflects its proportionate share of the increase or decrease in the value of the entire property interest to which the income rights and the power relate. Thus, if the spouse's right to income and the spouse's power extend to a specified fraction or percentage of the property, or its equivalent, the interest is in a specific portion of the property. In accordance with paragraph (b) of this section, if the spouse has the right to receive the income from a specific portion of the trust property (after applying paragraph (c)(3) of this section) but has a power of appointment over a different specific portion of the property (after applying paragraph (c)(3) of this section), the marital deduction is limited to the lesser specific portion.

(3) *Special rule in the case of gifts made on or before October 24, 1992.* In the case of gifts within the purview of the effective date rule contained in paragraph (c)(3)(iii) of this section:

(i) A specific sum payable annually, or at more frequent intervals, out of the property and its income that is not limited by the income of the property is treated as the right to receive the income from a specific portion of the property. The specific portion, for purposes of paragraph (c)(2) of this section, is the portion of the property that, assuming the interest rate generally applicable for the valuation of annuities at the time of the donor's gift, would produce income equal to such payments. However, a pecuniary amount payable annually to a donee spouse is not treated as a right to the income from a specific portion of trust property for purposes of this paragraph (c)(3)(i) if any person other than the donee spouse may receive, during the donee spouse's lifetime, any distribution of the property. To determine the applicable interest rate for valuing annuities, see sections 2512 and 7520 and the regulations under those sections.

(ii) The right to appoint a pecuniary amount out of a larger fund (or trust corpus) is considered the right to appoint a specific portion of such fund or trust in an amount equal to such pecuniary amount.

(iii) The rules contained in paragraphs (c)(3) (i) and (ii) of this section apply with respect to gifts made on or before October 24, 1992.

(4) *Local law.* A partial interest in property is treated as a specific portion of the entire interest if it is shown that the donee spouse has rights under local law that are identical to those the donee spouse would have acquired had the partial interest been expressed in terms satisfying the requirements of paragraph (c)(2) of this section (or paragraph (c)(3) of this section if applicable).

(5) *Examples.* The following examples illustrate the application of paragraphs (b) and (c) of this section, where D, the donor, transfers property to D's spouse, S:

Example 1. Spouse entitled to the lesser of an annuity or a fraction of trust income. Prior to October 24, 1992, D transferred in trust 500

identical shares of X Company stock, valued for gift tax purposes at \$500,000. The trust provided that during the lifetime of D's spouse, S, the trustee is to pay annually to S the lesser of one-half of the trust income or \$20,000. Any trust income not paid to S is to be accumulated in the trust and may not be distributed during S's lifetime. S has a testamentary general power of appointment over the entire trust principal. The applicable interest rate for valuing annuities as of the date of D's gift under section 7520 is 10 percent. For purposes of paragraphs (a) through (c) of this section, S is treated as receiving all of the income from the lesser of one-half of the stock (\$250,000), or \$200,000, the specific portion of the stock which, as determined in accordance with § 25.2523(e)-1(c)(3)(i) of this chapter, would produce annual income of \$20,000 (20,000/10). Accordingly, the marital deduction is limited to \$200,000 (200,000/500,000 or 2/5 of the value of the trust.)

Example 2. Spouse possesses power and income interest over different specific portions of trust. The facts are the same as in *Example 1* except that S's testamentary general power of appointment is exercisable over only 1/4 of the trust principal. Consequently, under section 2523(e), the marital deduction is allowable only for the value of 1/4 of the trust (\$125,000); i.e., the lesser of the value of the portion with respect to which S is deemed to be entitled to all of the income (2/5 of the trust or \$200,000), or the value of the portion with respect to which S possesses the requisite power of appointment (1/4 of the trust or \$125,000).

Example 3. Power of appointment over shares of stock constitutes a power over a specific portion. D transferred 250 identical shares of Y company stock to a trust under the terms of which trust income is to be paid annually to S, during S's lifetime. S was given a testamentary general power of appointment over 100 shares of stock. The trust provides that if the trustee sells the Y company stock, S's general power of appointment is exercisable with respect to the sale proceeds or the property in which the proceeds are reinvested. Because the amount of property represented by a single share of stock would be altered if the corporation split its stock, issued stock dividends, made a distribution of capital, etc., a power to appoint 100 shares at the time of S's death is not necessarily a power to appoint the entire interest that the 100 shares represented on the date of D's gift. If it is shown that, under local law, S has a general power to appoint not only the 100 shares designated by D but also 100/250 of any distributions by the corporation that are included in trust principal, the requirements of paragraph (c)(2) of this section are satisfied and S is treated as having a general power to appoint 100/250 of the entire interest in the

250 shares. In that case, the marital deduction is limited to 40 percent of the trust principal. If local law does not give S that power, the 100 shares would not constitute a specific portion under § 25.2523(e)-1(c) (including § 25.2523(e)-1(c)(3)(ii)). The nature of the asset is such that a change in the capitalization of the corporation could cause an alteration in the original value represented by the shares at the time of the transfer and is thus not a specific portion of the trust.

(d) *Definition of "entire interest"*. Since a marital deduction is allowed for each qualifying separate interest in property transferred by the donor to the donee spouse, for purposes of paragraphs (a) and (b) of this section, each property interest with respect to which the donee spouse received some rights is considered separately in determining whether her rights extend to the entire interest or to a specific portion of the entire interest. A property interest which consists of several identical units of property (such as a block of 250 shares of stock, whether the ownership is evidenced by one or several certificates) is considered one property interest, unless certain of the units are to be segregated and accorded different treatment, in which case each segregated group of items is considered a separate property interest. The bequest of a specified sum of money constitutes the bequest of a separate property interest if immediately following the transfer and thenceforth it, and the investments made with it, must be so segregated or accounted for as to permit its identification as a separate item of property. The application of this paragraph may be illustrated by the following examples:

Example (1). The donor transferred to a trustee three adjoining farms, Blackacre, Whiteacre, and Greenacre. The trust instrument provided that during the lifetime of the donee spouse the trustee should pay her all of the income from the trust. Upon her death, all of Blackacre, a one-half interest in Whiteacre, and a one-third interest in Greenacre were to be distributed to the person or persons appointed by her in her will. The donee spouse is considered as being entitled to all of the income from the entire interest in Blackacre, all of the income from the entire interest in Whiteacre, and all of the income from the entire interest in Greenacre. She also is considered as having a power of appointment over the entire interest in Blackacre, over one-half of the entire

interest in Whiteacre, and over one-third of the entire interest in Greenacre.

Example (2). The donor transferred \$250,000 to C, as trustee. C is to invest the money and pay all of the income from the investments to W, the donor's spouse, annually. W was given a general power, exercisable by will, to appoint one-half of the corpus of the trust. Here, immediately following establishment of the trust, the \$250,000 will be sufficiently segregated to permit its identification as a separate item, and the \$250,000 will constitute an entire property interest. Therefore, W has a right to income and a power of appointment such that one-half of the entire interest is a deductible interest.

Example (3). The donor transferred 100 shares of Z Corporation stock to D, as trustee. W, the donor's spouse, is to receive all of the income of the trust annually and is given a general power, exercisable by will, to appoint out of the trust corpus the sum of \$25,000. In this case the \$25,000 is not, immediately following establishment of the trust, sufficiently segregated to permit its identification as a separate item of property in which the donee spouse has the entire interest. Therefore, the \$25,000 does not constitute the entire interest in a property for the purpose of paragraphs (a) and (b) of this section.

(e) *Application of local law*. In determining whether or not the conditions set forth in paragraphs (a) (1) through (5) of this section are satisfied by the instrument of transfer, regard is to be had to the applicable provisions of the law of the jurisdiction under which the interest passes and, if the transfer is in trust, the applicable provisions of the law governing the administration of the trust. For example, silence of a trust instrument as to the frequency of payment will not be regarded as a failure to satisfy the condition set forth in paragraph (a)(2) of this section that income must be payable to the donee spouse annually or more frequently unless the applicable law permits payment to be made less frequently than annually. The principles outlined in this paragraph and paragraphs (f) and (g) of this section which are applied in determining whether transfers in trust meet such conditions are equally applicable in ascertaining whether, in the case of interests not in trust, the donee spouse has the equivalent in rights over income and over the property.

(f) *Right to income*. (1) If an interest is transferred in trust, the donee spouse is "entitled for life to all of the income from the entire interest or a specific

portion of the entire interest," for the purpose of the condition set forth in paragraph (a)(1) of this section, if the effect of the trust is to give her substantially that degree of beneficial enjoyment of the trust property during her life which the principles of the law of trust accord to a person who is unqualifiedly designated as the life beneficiary of a trust. Such degree of enjoyment is given only if it was the donor's intention, as manifested by the terms of the trust instrument and the surrounding circumstances, that the trust should produce for the donee spouse during her life such an income, or that the spouse should have such use of the trust property as is consistent with the value of the trust corpus and with its preservation. The designation of the spouse as sole income beneficiary for life of the entire interest or a specific portion of the entire interest will be sufficient to qualify the trust unless the terms of the trust and the surrounding circumstances considered as a whole evidence an intention to deprive the spouse of the requisite degree of enjoyment. In determining whether a trust evidences that intention, the treatment required or permitted with respect to individual items must be considered in relation to the entire system provided for the administration of the trust. In addition, the spouse's interest shall meet the condition set forth in paragraph (a)(1) of this section if the spouse is entitled to income as defined or determined by applicable local law that provides for a reasonable apportionment between the income and remainder beneficiaries of the total return of the trust and that meets the requirements of § 1.643(b)-1 of this chapter.

(2) If the over-all effect of a trust is to give to the donee spouse such enforceable rights as will preserve to her the requisite degree of enjoyment, it is immaterial whether that result is effected by rules specifically stated in the trust instrument, or, in their absence, by the rules for the management of the trust property and the allocation of receipts and expenditures supplied by the State law. For example, a provision in the trust instrument for amortization of bond premium by appropriate periodic charges to interest will

not disqualify the interest transferred in trust even though there is no State law specifically authorizing amortization or there is a State law denying amortization which is applicable only in the absence of such a provision in the trust instrument.

(3) In the case of a trust, the rules to be applied by the trustee in allocation of receipts and expenses between income and corpus must be considered in relation to the nature and expected productivity of the assets transferred in trust, the nature and frequency of occurrence of the expected receipts, and any provisions as to change in the form of investments. If it is evident from the nature of the trust assets and the rules provided for management of the trust that the allocation to income of such receipts as rents, ordinary cash dividends and interest will give to the spouse the substantial enjoyment during life required by the statute, provisions that such receipts as stock dividends and proceeds from the conversion of trust assets shall be treated as corpus will not disqualify the interest transferred in trust. Similarly, provision for a depletion charge against income in the case of trust assets which are subject to depletion will not disqualify the interest transferred in trust, unless the effect is to deprive the spouse of the requisite beneficial enjoyment. The same principle is applicable in the case of depreciation, trustees' commissions, and other charges.

(4) Provisions granting administrative powers to the trustees will not have the effect of disqualifying an interest transferred in trust unless the grant of powers evidences the intention to deprive the donee spouse of the beneficial enjoyment required by the statute. Such an intention will not be considered to exist if the entire terms of the instrument are such that the local courts will impose reasonable limitations upon the exercise of the powers. Among the powers which if subject to reasonable limitations will not disqualify the interest transferred in trust are the power to determine the allocation or apportionment of receipts and disbursements between income and corpus, the power to apply the income or corpus for the benefit of the spouse, and the power to retain the assets

transferred to the trust. For example, a power to retain trust assets which consist substantially of unproductive property will not disqualify the interest if the applicable rules for the administration of the trust require, or permit the spouse to require, that the trustee either make the property productive or convert it within a reasonable time. Nor will such a power disqualify the interest if the applicable rules for administration of the trust require the trustee to use the degree of judgment and care in the exercise of the power which a prudent man would use if he were owner of the trust assets. Further, a power to retain a residence for the spouse or other property for the personal use of the spouse will not disqualify the interest transferred in trust.

(5) An interest transferred in trust will not satisfy the condition set forth in paragraph (a)(1) of this section that the donee spouse be entitled to all the income if the primary purpose of the trust is to safeguard property without providing the spouse with the required beneficial enjoyment. Such trusts include not only trusts which expressly provide for the accumulation of the income but also trusts which indirectly accomplish a similar purpose. For example, assume that the corpus of a trust consists substantially of property which is not likely to be income producing during the life of the donee spouse and that the spouse cannot compel the trustee to convert or otherwise deal with the property as described in subparagraph (4) of this paragraph. An interest transferred to such a trust will not qualify unless the applicable rules for the administration require, or permit the spouse to require, that the trustee provide the required beneficial enjoyment, such as by payments to the spouse out of other assets of the trust.

(6) If a trust may be terminated during the life of the donee spouse, under her exercise of a power of appointment or by distribution of the corpus to her, the interest transferred in trust satisfies the condition set forth in paragraph (a)(1) of this section (that the spouse be entitled to all the income) if she (i) is entitled to the income until the trust terminates, or (ii) has the

right, exercisable in all events, to have the corpus distributed to her at any time during her life.

(7) An interest transferred in trust fails to satisfy the condition set forth in paragraph (a)(1) of this section, that the spouse be entitled to all the income, to the extent that the income is required to be accumulated in whole or in part or may be accumulated in the discretion of any person other than the donee spouse; to the extent that the consent of any person other than the donee spouse is required as a condition precedent to distribution of the income; or to the extent that any person other than the donee spouse has the power to alter the terms of the trust so as to deprive her of her right to the income. An interest transferred in trust will not fail to satisfy the condition that the spouse be entitled to all the income merely because its terms provide that the right of the donee spouse to the income shall not be subject to assignment, alienation, pledge, attachment or claims of creditors.

(8) In the case of an interest transferred in trust, the terms "entitled for life" and "payable annually or at more frequent intervals", as used in the conditions set forth in paragraph (a) (1) and (2) of this section, require that under the terms of the trust the income referred to must be currently (at least annually; see paragraph (e) of this section) distributable to the spouse or that she must have such command over the income that it is virtually hers. Thus, the conditions in paragraph (a) (1) and (2) of this section are satisfied in this respect if, under the terms of the trust instrument, the donee spouse has the right exercisable annually (or more frequently) to require distribution to herself of the trust income, and otherwise the trust income is to be accumulated and added to corpus. Similarly, as respects the income for the period between the last distribution date and the date of the spouse's death, it is sufficient if that income is subject to the spouse's power to appoint. Thus, if the trust instrument provides that income accrued or undistributed on the date of the spouse's death is to be disposed of as if it had been received after her death, and if the spouse has a power of appointment over the trust

corpus, the power necessarily extends to the undistributed income.

(g) *Power of appointment in donee spouse.* (1) The conditions set forth in paragraphs (a) (3) and (4) of this section, that is, that the donee spouse must have a power of appointment exercisable in favor of herself or her estate and exercisable alone and in all events, are not met unless the power of the donee spouse to appoint the entire interest or a specific portion of it falls within one of the following categories:

(i) A power so to appoint fully exercisable in her own favor at any time during her life (as, for example, an unlimited power to invade); or

(ii) A power so to appoint exercisable in favor of her estate. Such a power, if exercisable during life, must be fully exercisable at any time during life, or if exercisable by will, must be fully exercisable irrespective of the time of her death; or

(iii) A combination of the powers described under subdivisions (i) and (ii) of this subparagraph. For example, the donee spouse may, until she attains the age of 50 years, have a power to appoint to herself and thereafter have a power to appoint to her estate. However, the condition that the spouse's power must be exercisable in all events is not satisfied unless irrespective of when the donee spouse may die the entire interest or a specific portion of it will at the time of her death be subject to one power or the other.

(2) The power of the donee spouse must be a power to appoint the entire interest or a specific portion of it as unqualified owner (and free of the trust if a trust is involved, or free of the joint tenancy if a joint tenancy is involved) or to appoint the entire interest or a specific portion of it as a part of her estate (and free of the trust if a trust is involved), that is, in effect, to dispose of it to whomsoever she pleases. Thus, if the donor transferred property to a son and the donee spouse as joint tenants with right of survivorship and under local law the donee spouse has a power of severance exercisable without consent of the other joint tenant, and by exercising this power could acquire a one-half interest in the property as a tenant in common, her power of severance will satisfy the condition

set forth in paragraph (a)(3) of this section that she have a power of appointment in favor of herself or her estate. However, if the donee spouse entered into a binding agreement with the donor to exercise the power only in favor of their issue, that condition is not met. An interest transferred in trust will not be regarded as failing to satisfy the condition merely because takers in default of the donee spouse's exercise of the power are designated by the donor. The donor may provide that, in default of exercise of the power, the trust shall continue for an additional period.

(3) A power is not considered to be a power exercisable by a donee spouse alone and in all events as required by paragraph (a)(4) of this section if the exercise of the power in the donee spouse to appoint the entire interest or a specific portion of it to herself or to her estate requires the joinder or consent of any other person. The power is not "exercisable in all events", if it can be terminated during the life of the donee spouse by any event other than her complete exercise or release of it. Further, a power is not "exercisable in all events" if it may be exercised for a limited purpose only. For example, a power which is not exercisable in the event of the spouse's remarriage is not exercisable in all events. Likewise, if there are any restrictions, either by the terms of the instrument or under applicable local law, on the exercise of a power to consume property (whether or not held in trust) for the benefit of the spouse, the power is not exercisable in all events. Thus, if a power of invasion is exercisable only for the spouse's support, or only for her limited use, the power is not exercisable in all events. In order for a power of invasion to be exercisable in all events, the donee spouse must have the unrestricted power exercisable at any time during her life to use all or any part of the property subject to the power, and to dispose of it in any manner, including the power to dispose of it by gift (whether or not she has power to dispose of it by will).

(4) If the power is in existence at all times following the transfer of the interest, limitations of a formal nature

will not disqualify the interest. Examples of formal limitations on a power exercisable during life are requirements that an exercise must be in a particular form, that it must be filed with a trustee during the spouse's life, that reasonable notice must be given, or that reasonable intervals must elapse between successive partial exercises. Examples of formal limitations on a power exercisable by will are that it must be exercised by a will executed by the donee spouse after the making of the gift or that exercise must be by specific reference to the power.

(5) If the donee spouse has the requisite power to appoint to herself or her estate, it is immaterial that she also has one or more lesser powers. Thus, if she has a testamentary power to appoint to her estate, she may also have a limited power of withdrawal or of appointment during her life. Similarly, if she has an unlimited power of withdrawal, she may have a limited testamentary power.

(h) *Existence of a power in another.* Paragraph (a)(5) of this section provides that a transfer described in paragraph (a) is nondeductible to the extent that the donor created a power in the trustee or in any other person to appoint a part of the interest to any person other than the donee spouse. However, only powers in other persons which are in opposition to that of the donee spouse will cause a portion of the interest to fail to satisfy the condition set forth in paragraph (a)(5) of this section. Thus, a power in a trustee to distribute corpus to or for the benefit of the donee spouse will not disqualify the trust. Similarly, a power to distribute corpus to the spouse for the support of minor children will not disqualify the trust if she is legally obligated to support such children. The application of this paragraph may be illustrated by the following examples:

Example (1). Assume that a donor created a trust, designating his spouse as income beneficiary for life with an unrestricted power in the spouse to appoint the corpus during her life. The donor further provided that in the event the donee spouse should die without having exercised the power, the trust should continue for the life of his son with a power in the son to appoint the corpus. Since the power in the son could become exercisable only after the death of the donee spouse, the

interest is not regarded as failing to satisfy the condition set forth in paragraph (a)(5) of this section.

Example (2). Assume that the donor created a trust, designating his spouse as income beneficiary for life and as donee of a power to appoint by will the entire corpus. The donor further provided that the trustee could distribute 30 percent of the corpus to the donor's son when he reached the age of 35 years. Since the trustee has a power to appoint 30 percent of the entire interest for the benefit of a person other than the donee spouse, only 70 percent of the interest placed in trust satisfied the condition set forth in paragraph (a)(5) of this section. If, in this case, the donee spouse had a power, exercisable by her will, to appoint only one-half of the corpus as it was constituted at the time of her death, it should be noted that only 35 percent of the interest placed in the trust would satisfy the condition set forth in paragraph (a)(3) of this section.

[T.D. 6334, 23 FR 8904, Nov. 15, 1958, as amended by T.D. 6542, 26 FR 552, Jan. 20, 1961, as amended by T.D. 8522, 59 FR 9659, Mar. 1, 1994; T.D. 9102, 69 FR 21, Jan. 2, 2004]

§ 25.2523(f)-1 Election with respect to life estate transferred to donee spouse.

(a) *In general.* (1) With respect to gifts made after December 31, 1981, subject to section 2523(i), a marital deduction is allowed under section 2523(a) for transfers of *qualified terminable interest property*. Qualified terminable interest property is terminable interest property described in section 2523(b)(1) that satisfies the requirements of section 2523(f)(2) and this section. Terminable interests that are described in section 2523(b)(2) cannot qualify as qualified terminable interest property. Thus, if the donor retains a power described in section 2523(b)(2) to appoint an interest in qualified terminable interest property, no deduction is allowable under section 2523(a) for the property.

(2) All of the property for which a deduction is allowed under this paragraph (a) is treated as passing to the donee spouse (for purposes of § 25.2523(a)-1), and no part of the property is treated as retained by the donor or as passing to any person other than the donee spouse (for purposes of § 25.2523(b)-1(b)).

(b) *Qualified terminable interest property—(1) Definition.* Section 2523(f)(2) provides the definition of *qualified terminable interest property*.

(2) *Meaning of property.* For purposes of section 2523(f)(2), the term *property* generally means an *entire interest in property* (within the meaning of § 25.2523(e)-1(d)) or a *specific portion of the entire interest* (within the meaning of § 25.2523(e)-1(c)).

(3) *Property for which the election may be made*—(i) *In general.* The election may relate to all or any part of property that meets the requirements of section 2523(f)(2) (A) and (B), provided that any partial election must be made with respect to a fractional or percentage share of the property so that the elective portion reflects its proportionate share of the increase or decrease in the entire property for purposes of applying sections 2044 or 2519. Thus, if the interest of the donee spouse in a trust (or other property in which the spouse has a qualifying income interest) meets the requirements of this section, the election may be made under section 2523(f)(2)(C) with respect to a part of the trust (or other property) only if the election relates to a defined fraction or percentage of the entire trust (or other property) or specific portion thereof within the meaning of § 25.2523(e)-1(c). The fraction or percentage may be defined by formula.

(ii) *Division of trusts.* If the interest of the donee spouse in a trust meets the requirements of this section, the trust may be divided into separate trusts to reflect a partial election that has been made, if authorized under the terms of the governing instrument or otherwise permissible under local law. A trust may be divided only if the fiduciary is required, either by applicable local law or by the express or implied provisions of the governing instrument, to divide the trust according to the fair market value of the assets of the trust at the time of the division. The division of the trusts must be done on a fractional or percentage basis to reflect the partial election. However, the separate trusts do not have to be funded with a pro rata portion of each asset held by the undivided trust.

(4) *Manner and time of making election.*

(i) An election under section 2523(f)(2)(C) (other than a deemed election with respect to a joint and survivor annuity as described in section 2523(f)(6)), is made on a gift tax return

for the calendar year in which the interest is transferred. The return must be filed within the time prescribed by section 6075(b) (determined without regard to section 6019(a)(2)), including any extensions authorized under section 6075(b)(2) (relating to an automatic extension of time for filing a gift tax return where the donor is granted an extension of time to file the income tax return).

(ii) If the election is made on a return for the calendar year that includes the date of death of the donor, the return (as prescribed by section 6075(b)(3)) must be filed no later than the time (including extensions) for filing the estate tax return. The election, once made, is irrevocable.

(c) *Qualifying income interest for life*—

(1) *In general.* For purposes of this section, the term *qualifying income interest for life* is defined as provided in section 2056(b)(7)(B)(ii) and § 20.2056(b)-7(d)(1).

(i) *Entitled for life to all the income.* The principles outlined in § 25.2523(e)-1(f) (relating to whether the spouse is entitled for life to all of the income from the entire interest or a specific portion of the entire interest) apply in determining whether the donee spouse is entitled for life to all the income from the property, regardless of whether the interest passing to the donee spouse is in trust. An income interest granted for a term of years, or a life estate subject to termination upon the occurrence of a specified event (e.g., divorce) is not a qualifying income interest for life.

(ii) *Income between last distribution date and date of spouse's death.* An income interest does not fail to constitute a qualifying income interest for life solely because income for the period between the last distribution date and the date of the donee spouse's death is not required to be distributed to the estate of the donee spouse. See § 20.2044-1 of this chapter relating to the inclusion of such undistributed income in the gross estate of the donee spouse.

(iii) *Pooled income funds.* An income interest in a pooled income fund described in section 642(c)(5) constitutes a qualifying income interest for life for purposes of this section.

(iv) *Distribution of principal for the benefit of the donee spouse.* An income interest does not fail to constitute a qualifying income interest for life solely because the trustee has a power to distribute principal to or for the benefit of the donee spouse. The fact that property distributed to a donee spouse may be transferred by the spouse to another person does not result in a failure to satisfy the requirement of section 2056(b)(7)(B)(ii)(II). However, if the governing instrument requires the donee spouse to transfer the distributed property to another person without full and adequate consideration in money or money's worth, the requirement of section 2056(b)(7)(B)(ii)(II) is not satisfied.

(2) *Immediate right to income.* In order to constitute a qualifying income interest for life, the donee spouse must be granted the immediate right to receive the income from the property. Thus, an income interest does not constitute a qualifying income interest for life if the donee spouse receives the right to trust income commencing at some time in the future, e.g., on the termination of a preceding life income interest of the donor spouse.

(3) *Annuities payable from trusts in the case of gifts made on or before October 24, 1992.* (i) In the case of gifts made on or before October 24, 1992, a donee spouse's lifetime annuity interest payable from a trust or other group of assets passing from the donor is treated as a qualifying income interest for life for purposes of section 2523(f)(2)(B). The deductible interest, for purposes of § 25.2523(a)-1(b), is the specific portion of the property that, assuming the applicable interest rate for valuing annuities at the time the annuity interest is transferred, would produce income equal to the minimum amount payable annually to the donee spouse. If, based on the applicable interest rate, the entire property from which the annuity may be satisfied is insufficient to produce income equal to the minimum annual payment, the value of the deductible interest is the entire value of the property. The value of the deductible interest may not exceed the value of the property from which the annuity is payable. If the annual payment may increase, the increased amount is not

taken into account in valuing the deductible interest.

(ii) An annuity interest is not treated as a qualifying income interest for life for purposes of section 2523(f)(2)(B) if any person other than the donee spouse may receive during the donee spouse's lifetime, any distribution of the property or its income from which the annuity is payable.

(iii) To determine the applicable interest rate for valuing annuities, see sections 2512 and 7520 and the regulations under those sections.

(4) *Joint and survivor annuities.* [Reserved]

(d) *Treatment of interest retained by the donor spouse—(1) In general.* Under section 2523(f)(5)(A), if a donor spouse retains an interest in qualified terminable interest property, any subsequent transfer by the donor spouse of the retained interest in the property is not treated as a transfer for gift tax purposes. Further, the retention of the interest until the donor spouse's death does not cause the property subject to the retained interest to be includable in the gross estate of the donor spouse.

(2) *Exception.* Under section 2523(f)(5)(B), the rule contained in paragraph (d)(1) of this section does not apply to any property after the donee spouse is treated as having transferred the property under section 2519, or after the property is includable in the gross estate of the donee spouse under section 2044.

(e) *Application of local law.* The provisions of local law are taken into account in determining whether or not the conditions of section 2523(f)(2) (A) and (B), and the conditions of paragraph (c) of this section, are satisfied. For example, silence of a trust instrument on the frequency of payment is not regarded as a failure to satisfy the requirement that the income must be payable to the donee spouse annually or more frequently unless applicable local law permits payments less frequently to the donee spouse.

(f) *Examples.* The following examples illustrate the application of this section, where D, the donor, transfers property to D's spouse, S. Unless stated otherwise, it is assumed that S is not the trustee of any trust established for S's benefit:

Example 1. Life estate in residence. D transfers by gift a personal residence valued at \$250,000 on the date of the gift to S and D's children, giving S the exclusive and unrestricted right to use the property (including the right to continue to occupy the property as a personal residence or rent the property and receive the income for her lifetime). After S's death, the property is to pass to D's children. Under applicable local law, S's consent is required for any sale of the property. If D elects to treat all of the transferred property as qualified terminable interest property, the deductible interest is \$250,000, the value of the property for gift tax purposes.

Example 2. Power to make property productive. D transfers assets having a fair market value of \$500,000 to a trust pursuant to which S is given the right exercisable annually to require distribution of all the trust income to S. No trust property may be distributed during S's lifetime to any person other than S. The assets used to fund the trust include both income producing assets and non-productive assets. Applicable local law permits S to require that the trustee either make the trust property productive or sell the property and reinvest the proceeds in productive property within a reasonable time after the transfer. If D elects to treat the entire trust as qualified terminable interest property, the deductible interest is \$500,000. If D elects to treat only 20 percent of the trust as qualified terminable interest property, the deductible interest is \$100,000; i.e., 20 percent of \$500,000.

Example 3. Power of distribution over fraction of trust income. The facts are the same as in *Example 2* except that S is given the power exercisable annually to require distribution to S of only 50 percent of the trust income for life. The remaining trust income may be accumulated or distributed among D's children and S in the trustee's discretion. The maximum amount that D may elect to treat as qualified terminable interest property is \$250,000; i.e., the value of the trust for gift tax purposes (\$500,000) multiplied by the percentage of the trust in which S has a qualifying income interest for life (50 percent). If D elects to treat only 20 percent of the portion of the trust in which S has a qualifying income interest as qualified terminable interest property, the deductible interest is \$50,000; i.e., 20 percent of \$250,000.

Example 4. Power to distribute trust corpus to other beneficiaries. D transfers \$500,000 to a trust providing that all the trust income is to be paid to D's spouse, S, during S's lifetime. The trustee is given the power to use annually \$5,000 from the trust for the maintenance and support of S's minor child, C. Any such distribution does not necessarily relieve S of S's obligation to support and maintain C. S does not have a qualifying income interest for life in any portion of the

trust because the gift fails to satisfy the condition in sections 2523(f)(3) and 2056(b)(7)(B)(ii)(II) that no person have a power, other than a power the exercise of which takes effect only at or after S's death, to appoint any part of the property to any person other than S. The trust would also be nondeductible under section 2523(f) if S, rather than the trustee, were given the power to appoint a portion of the principal to C. However, in the latter case, if S made a qualified disclaimer (within the meaning of section 2518) of the power to appoint to C, the trust could qualify for the marital deduction pursuant to section 2523(f), assuming that the power was personal to S and S's disclaimer terminates the power. Similarly, if C made a qualified disclaimer of the right to receive distributions from the trust, the trust would qualify under section 2523(f) assuming that C's disclaimer effectively negates the trustee's power under local law.

Example 5. Spouse's interest terminable on divorce. The facts are the same as in *Example 3* except that if S and D divorce, S's interest in the trust will pass to C. S's income interest is not a qualifying income interest for life because it is terminable upon S's divorce. Therefore, no portion of the trust is deductible under section 2523(f).

Example 6. Spouse's interest in trust in the form of an annuity. Prior to October 24, 1992, D established a trust funded with income producing property valued for gift tax purposes at \$800,000. The trustee is required by the trust instrument to pay \$40,000 a year to S for life. Any income in excess of the annuity amount is to be accumulated in the trust and may not be distributed during S's lifetime. S's lifetime annuity interest is treated as a qualifying income interest for life. If D elects to treat the entire portion of the trust in which S has a qualifying income interest as qualified terminable interest property, the value of the deductible interest is \$400,000, because that amount would yield an income to S of \$40,000 a year (assuming a 10 percent interest rate applies in valuing annuities at the time of the transfer).

Example 7. Value of spouse's annuity exceeds value of trust corpus. The facts are the same as in *Example 6*, except that the trustee is required to pay S \$100,000 a year for S's life. If D elects to treat the entire portion of the trust in which S has a qualifying income interest for life as qualified terminable interest property, the value of the deductible interest is \$800,000, which is the lesser of the entire value of the property (\$800,000) or the amount of property that (assuming a 10 percent interest rate) would yield an income to S of \$100,000 a year (\$1,000,000).

Example 8. Transfer to pooled income fund. D transfers \$200,000 on June 1, 1994, to a pooled income fund (described in section 642(c)(5)) designating S as the only life income beneficiary. If D elects to treat the entire \$200,000

as qualified terminable interest property, the deductible interest is \$200,000.

Example 9. Retention by donor spouse of income interest in property. On October 1, 1994, D transfers property to an irrevocable trust under the terms of which trust income is to be paid to D for life, then to S for life and, on S's death, the trust corpus is to be paid to D's children. Because S does not possess an immediate right to receive trust income, S's interest does not qualify as a qualifying income interest for life under section 2523(f)(2). Further, under section 2702(a)(2) and § 25.2702-2(b), D is treated for gift tax purposes as making a gift with a value equal to the entire value of the property. If D dies in 1996 survived by S, the trust corpus will be includible in D's gross estate under section 2036. However, in computing D's estate tax liability, D's adjusted taxable gifts under section 2001(b)(1)(B) are adjusted to reflect the inclusion of the gifted property in D's gross estate. In addition, if S survives D, the trust property is eligible for treatment as qualified terminable interest property under section 2056(b)(7) in D's estate.

Example 10. Retention by donor spouse of income interest in property. On October 1, 1994, D transfers property to an irrevocable trust under the terms of which trust income is to be paid to S for life, then to D for life and, on D's death, the trust corpus is to be paid to D's children. D elects under section 2523(f) to treat the property as qualified terminable interest property. D dies in 1996, survived by S. S subsequently dies in 1998. Under § 2523(f)-1(d)(1), because D elected to treat the transfer as qualified terminable interest property, no part of the trust corpus is includible in D's gross estate because of D's retained interest in the trust corpus. On S's subsequent death in 1998, the trust corpus is includible in S's gross estate under section 2044.

Example 11. Retention by donor spouse of income interest in property. The facts are the same as in *Example 10*, except that S dies in 1996 survived by D, who subsequently dies in 1998. Because D made an election under section 2523(f) with respect to the trust, on S's death the trust corpus is includible in S's gross estate under section 2044. Accordingly, under section 2044(c), S is treated as the transferor of the property for estate and gift tax purposes. Upon D's subsequent death in 1998, because the property was subject to inclusion in S's gross estate under section 2044, the exclusion rule in § 25.2523(f)-1(d)(1) does not apply under § 25.2523(f)-1(d)(2). However, because S is treated as the transferor of the property, the property is not subject to inclusion in D's gross estate under section 2036 or section 2038. If the executor of S's estate made a section 2056(b)(7) election with respect to the trust, the trust is includible in

D's gross estate under section 2044 upon D's later death.

[T.D. 8522, 59 FR 9660, Mar. 1, 1994]

§ 25.2523(g)-1 Special rule for charitable remainder trusts.

(a) *In general.* (1) With respect to gifts made after December 31, 1981, subject to section 2523(i), if the donor's spouse is the only noncharitable beneficiary (other than the donor) of a charitable remainder annuity trust or charitable remainder unitrust described in section 664 (qualified charitable remainder trust), section 2523(b) does not apply to the interest in the trust transferred to the donee spouse. Thus, the value of the annuity or unitrust interest passing to the spouse qualifies for a marital deduction under section 2523(g) and the value of the remainder interest qualifies for a charitable deduction under section 2522.

(2) A marital deduction for the value of the donee spouse's annuity or unitrust interest in a qualified charitable remainder trust to which section 2523(g) applies is allowable only under section 2523(g). Therefore, if an interest in property qualifies for a marital deduction under section 2523(g), no election may be made with respect to the property under section 2523(f).

(3) The donee spouse's interest need not be an interest for life to qualify for a marital deduction under section 2523(g). However, for purposes of section 664, an annuity or unitrust interest payable to the spouse for a term of years cannot be payable for a term that exceeds 20 years or the trust does not qualify under section 2523(g).

(4) A deduction is allowed under section 2523(g) even if the transfer to the donee spouse is conditioned on the donee spouse's payment of state death taxes, if any, attributable to the qualified charitable remainder trust.

(5) For purposes of this section, the term *noncharitable beneficiary* means any beneficiary of the qualified charitable remainder trust other than an organization described in section 170(c).

(b) *Charitable remainder trusts where the donee spouse and the donor are not the only noncharitable beneficiaries.* In the case of a charitable remainder trust where the donor and the donor's spouse are not the only noncharitable

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beneficiaries (for example, where the noncharitable interest is payable to the donor's spouse for life and then to another individual (other than the donor) for life), the qualification of the interest as qualified terminable interest property is determined solely under section 2523(f) and not under section 2523(g). Accordingly, if the transfer to the trust is made prior to October 24, 1992, the spousal annuity or unitrust interest may qualify under § 25.2523(f)-1(c)(3) as a qualifying income interest for life.

[T.D. 8522, 59 FR 9663, Mar. 1, 1994]

§ 25.2523(h)-1 Denial of double deduction.

The value of an interest in property may not be deducted for Federal gift tax purposes more than once with respect to the same donor. For example, assume that D, a donor, transferred a life estate in a farm to D's spouse, S, with a remainder to charity and that D elects to treat the property as qualified terminable interest property. The entire value of the property is deductible under section 2523(f). No part of the value of the property qualifies for a charitable deduction under section 2522 for gift tax purposes.

[T.D. 8522, 59 FR 9663, Mar. 1, 1994]

§ 25.2523(h)-2 Effective dates.

Except as specifically provided, in §§ 25.2523(e)-1(c)(3), 25.2523(f)-1(c)(3), and 25.2523(g)-1(b), the provisions of §§ 25.2523(e)-1(c), 25.2523(f)-1, 25.2523(g)-1, and 25.2523(h)-1 are effective with respect to gifts made after March 1, 1994. With respect to gifts made on or before such date, donors may rely on any reasonable interpretation of the statutory provisions. For these purposes, the provisions of §§ 25.2523(e)-1(c), 25.2523(f)-1, 25.2523(g)-1, and 25.2523(h)-1, (as well as project LR-211-76, 1984-1 C.B., page 598, see § 601.601(d)(2)(ii)(b) of this chapter), are considered a reasonable interpretation of the statutory provisions. In addition, the rule in the last sentence of § 25.2523(e)-1(f)(1) regarding the determination of income under applicable local law applies to trusts for taxable years ending after January 2, 2004.

[T.D. 8522, 59 FR 9663, Mar. 1, 1994, as amended by T.D. 9102, 69 FR 21, Jan. 2, 2004]

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§ 25.2523(i)-1 Disallowance of marital deduction when spouse is not a United States citizen.

(a) *In general.* Subject to § 20.2056A-1(c) of this chapter, section 2523(i)(1) disallows the marital deduction if the spouse of the donor is not a citizen of the United States at the time of the gift. If the spouse of the donor is a citizen of the United States at the time of the gift, the gift tax marital deduction under section 2523(a) is allowed regardless of whether the donor is a citizen or resident of the United States at the time of the gift, subject to the otherwise applicable rules of section 2523.

(b) *Exception for certain joint and survivor annuities.* Paragraph (a) does not apply to disallow the marital deduction with respect to any transfer resulting in the acquisition of rights by a noncitizen spouse under a joint and survivor annuity described in section 2523(f)(6).

(c) *Increased annual exclusion—(1) In general.* In the case of gifts made from a donor to the donor's spouse for which a marital deduction is not allowable under this section, if the gift otherwise qualifies for the gift tax annual exclusion under section 2503(b), the amount of the annual exclusion under section 2503(b) is \$100,000 in lieu of \$10,000. However, in the case of gifts made after June 29, 1989, in order for the increased annual exclusion to apply, the gift in excess of the otherwise applicable annual exclusion under section 2503(b) must be in a form that qualifies for the marital deduction but for the disallowance provision of section 2523(i)(1). See paragraph (d), *Example 4*, of this section.

(2) *Status of donor.* The \$100,000 annual exclusion for gifts to a noncitizen spouse is available regardless of the status of the donor. Accordingly, it is immaterial whether the donor is a citizen, resident or a nonresident not a citizen of the United States, as long as the spouse of the donor is not a citizen of the United States at the time of the gift and the conditions for allowance of the increased annual exclusion have been satisfied. See § 25.2503-2(f).

(d) *Examples.* The principles outlined in this section are illustrated in the following examples. Assume in each of the examples that the donee, S, is D's

spouse and is not a United States citizen at the time of the gift.

Example 1. Outright transfer of present interest. In 1995, *D*, a United States citizen, transfers to *S*, outright, 100 shares of *X* corporation stock valued for federal gift tax purposes at \$130,000. The transfer is a gift of a present interest in property under section 2503(b). Additionally, the gift qualifies for the gift tax marital deduction except for the disallowance provision of section 2523(i)(1). Accordingly, \$100,000 of the \$130,000 gift is excluded from the total amount of gifts made during the calendar year by *D* for gift tax purposes.

Example 2. Transfer of survivor benefits. In 1995, *D*, a United States citizen, retires from employment in the United States and elects to receive a reduced retirement annuity in order to provide *S* with a survivor annuity upon *D*'s death. The transfer of rights to *S* in the joint and survivor annuity is a gift by *D* for gift tax purposes. However, under paragraph (b) of this section, the gift qualifies for the gift tax marital deduction even though *S* is not a United States citizen.

Example 3. Transfer of present interest in trust property. In 1995, *D*, a resident alien, transfers property valued at \$500,000 in trust to *S*, who is also a resident alien. The trust instrument provides that the trust income is payable to *S* at least quarterly and *S* has a testamentary general power to appoint the trust corpus. The transfer to *S* qualifies for the marital deduction under section 2523 but for the provisions of section 2523(i)(1). Because *S* has a life income interest in the trust, *S* has a present interest in a portion of the trust. Accordingly, *D* may exclude the present value of *S*'s income interest (up to \$100,000) from *D*'s total 1995 calendar year gifts.

Example 4. Transfer of present interest in trust property. The facts are the same as in *Example 3*, except that *S* does not have a testamentary general power to appoint the trust corpus. Instead, *D*'s child, *C*, has a remainder interest in the trust. If *S* were a United States citizen, the transfer would qualify for the gift tax marital deduction if a qualified terminable interest property election was made under section 2523(f)(4). However, because *S* is not a U.S. citizen, *D* may not make a qualified terminable interest property election. Accordingly, the gift does not qualify for the gift tax marital deduction but for the disallowance provision of section 2523(i)(1). The \$100,000 annual exclusion under section 2523(i)(2) is not available with respect to *D*'s transfer in trust and *D* may not exclude the present value of *S*'s income interest in excess of \$10,000 from *D*'s total 1995 calendar year gifts.

Example 5. Spouse becomes citizen after transfer. *D*, a United States citizen, transfers a residence valued at \$350,000 on December 20,

1995, to *D*'s spouse, *S*, a resident alien. On January 31, 1996, *S* becomes a naturalized United States citizen. On *D*'s federal gift tax return for 1995, *D* must include \$250,000 as a gift (\$350,000 transfer less \$100,000 exclusion). Although *S* becomes a citizen in January, 1996, *S* is not a citizen of the United States at the time the transfer is made. Therefore, no gift tax marital deduction is allowable. However, the transfer does qualify for the \$100,000 annual exclusion.

[T.D. 8612, 60 FR 43552, Aug. 22, 1995]

§ 25.2523(i)-2 Treatment of spousal joint tenancy property where one spouse is not a United States citizen.

(a) *In general.* In the case of a joint tenancy with right of survivorship between spouses, or a tenancy by the entirety, where the donee spouse is not a United States citizen, the gift tax treatment of the creation and termination of the tenancy (regardless of whether the donor is a citizen, resident or nonresident not a citizen of the United States at such time), is governed by the principles of sections 2515 and 2515A (as such sections were in effect before their repeal by the Economic Recovery Tax Act of 1981). However, in applying these principles, the donor spouse may not elect to treat the creation of a tenancy in real property as a gift, as provided in section 2515(c) (prior to its repeal by the Economic Recovery Tax Act of 1981, Pub. L. 97-34, 95 Stat. 172).

(b) *Tenancies by the entirety and joint tenancies in real property—(1) Creation of the tenancy on or after July 14, 1988.* Under the principles of section 2515 (without regard to section 2515(c)), the creation of a tenancy by the entirety (or joint tenancy) in real property (either by one spouse alone or by both spouses), and any additions to the value of the tenancy in the form of improvements, reductions in indebtedness thereon, or otherwise, is not deemed to be a transfer of property for purposes of the gift tax, regardless of the proportion of the consideration furnished by each spouse, but only if the creation of the tenancy would otherwise be a gift to the donee spouse who is not a citizen of the United States at the time of the gift.

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(2) *Termination*—(i) *Tenancies created after December 31, 1954 and before January 1, 1982 not subject to an election under section 2515(c), and tenancies created on or after July 14, 1988.* When a tenancy to which this paragraph (b) applies is terminated on or after July 14, 1988, other than by reason of the death of a spouse, then, under the principles of section 2515, a spouse is deemed to have made a gift to the extent that the proportion of the total consideration furnished by the spouse, multiplied by the proceeds of the termination (whether in the form of cash, property, or interests in property), exceeds the value of the proceeds of termination received by the spouse. See section 2523(i), and § 25.2523(i)-1 and § 25.2503-2(f) as to certain of the tax consequences that may result upon termination of the tenancy. This paragraph (b)(2)(i) applies to tenancies created after December 31, 1954, and before January 1, 1982, not subject to an election under section 2515(c), and to tenancies created on or after July 14, 1988.

(ii) *Tenancies created after December 31, 1954 and before January 1, 1982 subject to an election under section 2515(c) and tenancies created after December 31, 1981 and before July 14, 1988.* When a tenancy to which this paragraph (b) applies is terminated on or after July 14, 1988, other than by reason of the death of a spouse, then, under the principles of section 2515, a spouse is deemed to have made a gift to the extent that the proportion of the total consideration furnished by the spouse, multiplied by the proceeds of the termination (whether in the form of cash, property, or interests in property), exceeds the value of the proceeds of termination received by the spouse. See section 2523(i), and §§ 25.2523(i)-1 and 25.2503-2(f) as to certain of the tax consequences that may result upon termination of the tenancy. In the case of tenancies to which this paragraph applies, if the creation

of the tenancy was treated as a gift to the noncitizen donee spouse under section 2515(c) (in the case of tenancies created prior to 1982) or section 2511 (in the case of tenancies created after December 31, 1981 and before July 14, 1988), then, upon termination of the tenancy, for purposes of applying the principles of section 2515 and the regulations thereunder, the amount treated as a gift on creation of the tenancy is treated as consideration originally belonging to the noncitizen spouse and never acquired by the noncitizen spouse from the donor spouse. This paragraph (b)(2)(ii) applies to tenancies created after December 31, 1954, and before January 1, 1982, subject to an election under section 2515(c), and to tenancies created after December 31, 1981, and before July 14, 1988.

(3) *Miscellaneous provisions*—(i) *Tenancy by the entirety.* For purposes of this section, *tenancy by the entirety* includes a joint tenancy between husband and wife with right of survivorship.

(ii) *No election to treat as gift.* The regulations under section 2515 that relate to the election to treat the creation of a tenancy by the entirety as constituting a gift and the consequences of such an election upon termination of the tenancy (§§ 25.2515-2 and 25.2515-4) do not apply for purposes of section 2523(i)(3).

(4) *Examples.* The application of this section may be illustrated by the following examples:

Example 1. In 1992, A, a United States citizen, furnished \$200,000 and A's spouse B, a resident alien, furnished \$50,000 for the purchase and subsequent improvement of real property held by them as tenants by the entirety. The property is sold in 1998 for \$300,000. A receives \$225,000 and B receives \$75,000 of the sales proceeds. The termination results in a gift of \$15,000 by A to B, computed as follows:

$$\frac{\$200,000}{\$250,000} \times \$300,000 \text{ (proceeds of termination)} = \$240,000$$

(total consideration furnished by both spouses) (Proceeds of termination attributable to A.)

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\$240,000 – \$225,000 (proceeds received by A) = \$15,000 gift by A to B.

Example 2. In 1986, A purchased real property for \$300,000 and took title in the names of A and B, A’s spouse, as joint tenants. Under section 2511 and § 25.2511-1(h)(1) of the regulations, A was treated as making a gift of one-half of the value of the property (\$150,000) to B. In 1995, the real property is sold for \$400,000 and B receives the entire

proceeds of sale. For purposes of determining the amount of the gift on termination of the tenancy under the principles of section 2515 and the regulations thereunder, the amount treated as a gift to B on creation of the tenancy under section 2511 is treated as B’s contribution towards the purchase of the property. Accordingly, the termination of the tenancy results in a gift of \$200,000 from A to B determined as follows:

$$\frac{\$150,000 \text{ (consideration furnished by A)}}{\$300,000 \text{ (total consideration deemed furnished by both spouses)}} \times \$400,000 \text{ (proceeds of termination)} = \$200,000 \text{ (Proceeds of termination attributable to A.)}$$

\$200,000 – 0 (proceeds received by A) = \$200,000 gift by A to B.

(c) *Tenancies by the entirety in personal property where one spouse is not a United States citizen—(1) In general.* In the case of the creation (either by one spouse alone or by both spouses where at least one of the spouses is not a United States citizen) of a joint interest in personal property with right of survivorship, or additions to the value thereof in the form of improvements, reductions in the indebtedness thereof, or otherwise, the retained interest of each spouse, solely for purposes of determining whether there has been a gift by the donor to the spouse who is not a citizen of the United States at the time of the gift, is treated as one-half of the value of the joint interest. See section 2523(i) and §§ 25.2523(i)-1 and 25.2503-2(f) as to certain of the tax consequences that may result upon creation and termination of the tenancy.

(2) *Exception.* The rule provided in paragraph (c)(1) of this section does not apply with respect to any joint interest in property if the fair market value of the interest in property (determined as if each spouse had a right to sever) cannot reasonably be ascertained except by reference to the life expectancy of one or both spouses. In these cases, actuarial principles may need to be resorted to in determining the gift tax consequences of the transaction.

[T.D. 8612, 60 FR 43553, Aug. 22, 1995]

§ 25.2523(i)-3 Effective date.

The provisions of §§ 25.2523(i)-1 and 25.2523(i)-2 are effective in the case of gifts made after August 22, 1995.

[T.D. 8612, 60 FR 43554, Aug. 22, 1995]

§ 25.2524-1 Extent of deductions.

Under the provisions of section 2524, the charitable deduction provided for in section 2522 and the marital deduction provided for in section 2523 are allowable only to the extent that the gifts, with respect to which those deductions are authorized, are included in the “total amount of gifts” made during the “calendar period” (as defined in § 25.2502-1(c)(1)), computed as provided in section 2503 and § 25.2503-1 (i.e., the total gifts less exclusions). The following examples (in both of which it is assumed that the donor has previously utilized his entire \$30,000 specific exemption provided by section 2521, which was in effect at the time) illustrate the application of the provisions of this section:

Example (1). A donor made transfers by gift to his spouse of \$5,000 cash on January 1, 1971, and \$1,000 cash on April 5, 1971. The donor made no other transfers during 1971. The first \$3,000 of such gifts for the calendar year is excluded under the provisions of section 2503(b) in determining the “total amount of gifts” made during the first calendar quarter of 1971. The marital deduction for the first calendar quarter of \$2,500 (one-half of \$5,000) otherwise allowable is limited by section 2524 to \$2,000. The amount of taxable gifts is zero (\$5,000 – \$3,000 (annual exclusion) – \$2,000 (marital deduction)). For the second calendar quarter of 1971, the marital

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deduction is \$500 (one-half of \$1,000); the amount excluded under section 2503(b) is zero because the entire \$3,000 annual exclusion was applied against the gift in the first calendar quarter of 1971; and the amount of taxable gifts is \$500 (\$1,000 - \$500 (marital deduction)).

Example (2). The only gifts made by a donor to his spouse during calendar year 1969 were a gift of \$2,400 in May and a gift of \$3,000 in August. The first \$3,000 of such gifts is excluded under the provisions of section 2503(b) in determining the "total amount of gifts" made during the calendar year. The marital deduction for 1969 of \$2,700 (one-half of \$2,400 plus one-half \$3,000) otherwise allowable is limited by section 2524 to \$2,400. The amount of taxable gifts is zero (\$5,400 - \$3,000 (annual exclusion) - \$2,400 (marital deduction)).

[T.D. 7238, 37 FR 28734, Dec. 29, 1972, as amended by T.D. 7910, 48 FR 40375, Sept. 7, 1983]

DEDUCTIONS PRIOR TO 1982

§ 25.2523(f)-1A Special rule applicable to community property transferred prior to January 1, 1982.

(a) *In general.* With respect to gifts made prior to January 1, 1982, the marital deduction is allowable with respect to any transfer by a donor to the donor's spouse only to the extent that the transfer is shown to represent a gift of property that was not, at the time of the gift, held as *community property*, as defined in paragraph (b) of this section. The burden of establishing the extent to which a transfer represents a gift of property not so held rests upon the donor.

(b) *Definition of "community property."*
(1) For the purpose of paragraph (a) of this section, the term "community property" is considered to include—

(i) Any property held by the donor and his spouse as community property under the law of any State, Territory, or possession of the United States, or of any foreign country, except property in which the donee spouse had at the time of the gift merely an expectant interest. The donee spouse is regarded as having, at any particular time, merely an expectant interest in property held at that time by the donor and herself as community property under the law of any State, Territory, or possession of the United States, or of any foreign country, if, in case such property were transferred by gift into the separate property of the donee spouse,

the entire value of such property (and not merely one-half of it), would be treated as the amount of the gift.

(ii) Separate property acquired by the donor as a result of a "conversion", after December 31, 1941, of property held by him and the donee spouse as community property under the law of any State, Territory, or possession of the United States, or of any foreign country (except such property in which the donee spouse had at the time of the "conversion" merely an expectant interest), into their separate property, subject to the limitation with respect to value contained in subparagraph (5) of this paragraph.

(iii) Property acquired by the donor in exchange (by one exchange or a series of exchanges) for separate property resulting from such "conversion."

(2) The characteristics of property which acquired a noncommunity instead of a community status by reason of an agreement (whether antenuptial or post-nuptial) are such that section 2523(f) classifies the property as community property of the donor and his spouse in the computation of the marital deduction. In distinguishing property which thus acquired a noncommunity status from property which acquired such a status solely by operation of the community property law, section 2523(f) refers to the former category of property as "separate property" acquired as a result of a "conversion" of "property held as such community property." As used in section 2523(f) the phrase "property held as such community property" is used to denote the body of property comprehended within the community property system; the expression "separate property" includes any noncommunity property, whether held in joint tenancy, tenancy by the entirety, tenancy in common, or otherwise; and the term "conversion" includes any transaction or agreement which transforms property from a community status into a noncommunity status.

(3) The separate property which section 2523(f) classifies as community property is not limited to that which was in existence at the time of the conversion. The following are illustrative of the scope of section 2523(f):

(i) A partition of community property between husband and wife, whereby a portion of the property became the separate property of each, is a conversion of community property.

(ii) A transfer of community property into some other form of coownership, such as a joint tenancy, is a conversion of the property.

(iii) An agreement (whether made before or after marriage) that future earnings and gains which would otherwise be community property shall be shared by the spouses as separate property effects a conversion of such earnings and gains.

(iv) A change in the form of ownership of property which causes future rentals, which would otherwise have been acquired as community property, to be acquired as separate property effects a conversion of the rentals.

(4) The rules of section 2523(f) are applicable, however, only if the conversion took place after December 31, 1941, and only to the extent stated in this section.

(5) If the value of the separate property acquired by the donor as a result of a conversion did not exceed the value of the separate property thus acquired by the donee spouse, the entire separate property thus acquired by the donor is to be considered, for the purposes of this section, as held by him and the donee spouse as community property. If the value (at the time of conversion) of the separate property so acquired by the donor exceeded the value (at that time) of the separate property so acquired by the donee spouse, only a part of the separate property so acquired by the donor (and only the same fractional part of property acquired by him in exchange for such separate property) is to be considered, for purposes of this section, as held by him and the donee spouse as community property. The part of such separate property (or property acquired in exchange for it) which is considered as so held is the same proportion of it which the value (at the time of the conversion) of the separate property so acquired by the donee spouse is of the value (at that time) of the separate property so acquired by the donor. The following example illustrates the appli-

cation of the provisions of this paragraph:

Example. During 1942 the donor and his spouse partitioned certain real property held by them under community property laws. The real property then had a value of \$224,000. A portion of the property, then having a value of \$160,000, was converted into the donor's separate property, and the remaining portion, then having a value of \$64,000, was converted into his spouse's separate property. In 1955 the donor made a gift to his spouse of the property acquired by him as a result of the partition, which property then had a value of \$200,000. The portion of the property transferred by gift which is considered as community property is

\$64,000 (value of property acquired by donee spouse) ÷ \$160,000 (value of property acquired by donor spouse) × \$200,000 = \$80,000.

The marital deduction with respect to the gift is, therefore, limited to one-half of \$120,000 (the difference between \$200,000, the value of the gift, and \$80,000, the portion of the gift considered to have been of "community property"). The marital deduction with respect to the gift is, therefore, \$60,000.

[T.D. 6334, 23 FR 8904, Nov. 15, 1958; 25 FR 14021, Dec. 31, 1960. Redesignated and amended by T.D. 8522, 59 FR 9660, Mar. 1, 1994]

SPECIAL VALUATION RULES

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[T.D. 8395, 57 FR 4255, Feb. 4, 1992, as amended by T.D. 8536, 59 FR 23154, May 5, 1994]

§ 25.2701-1 Special valuation rules in the case of transfers of certain interests in corporations and partnerships.

(a) *In general*—(1) *Scope of section 2701.* Section 2701 provides special valuation rules to determine the amount of the gift when an individual transfers an equity interest in a corporation or partnership to a member of the individual's family. For section 2701 to apply, the transferor or an applicable family member (as defined in paragraph (d)(2) of this section) must, immediately after the transfer, hold an applicable retained interest (a type of equity interest defined in § 25.2701-2(b)(1)). If certain subsequent payments with respect to the applicable retained interest do not conform to the assumptions used in valuing the interest at the time of the initial transfer, § 25.2701-4 provides a special rule to increase the individual's later taxable gifts or taxable estate. Section 25.2701-5 provides an adjustment to mitigate the effects of double taxation when an applicable retained interest is subsequently transferred.

(2) *Effect of section 2701.* If section 2701 applies to a transfer, the amount of the

transferor's gift, if any, is determined using a subtraction method of valuation (described in § 25.2701-3). Under this method, the amount of the gift is determined by subtracting the value of any family-held applicable retained interests and other non-transferred equity interests from the aggregate value of family-held interests in the corporation or partnership (the "entity"). Generally, in determining the value of any applicable retained interest held by the transferor or an applicable family member—

(i) Any put, call, or conversion right, any right to compel liquidation, or any similar right is valued at zero if the right is an "extraordinary payment right" (as defined in § 25.2701-2(b)(2));

(ii) Any distribution right in a controlled entity (*e.g.*, a right to receive dividends) is valued at zero unless the right is a "qualified payment right" (as defined in § 25.2701-2(b)(6)); and

(iii) Any other right (including a qualified payment right) is valued as if any right valued at zero did not exist but otherwise without regard to section 2701.

(3) *Example.* The following example illustrates rules of this paragraph (a).

Example. A, an individual, holds all the outstanding stock of S Corporation. A exchanges A's shares in S for 100 shares of 10-percent cumulative preferred stock and 100 shares of voting common stock. A transfers the common stock to A's child. Section 2701 applies to the transfer because A has transferred an equity interest (the common stock) to a member of A's family, and immediately thereafter holds an applicable retained interest (the preferred stock). A's preferred stock is valued under the rules of section 2701. A's gift is determined under the subtraction method by subtracting the value of A's preferred stock from the value of A's interest in S immediately prior to the transfer.

(b) *Transfers and other triggering events—(1) Completed transfers.* Section 2701 applies to determine the existence and amount of any gift, whether or not the transfer would otherwise be a taxable gift under chapter 12 of the Internal Revenue Code. For example, section 2701 applies to a transfer that would not otherwise be a gift under chapter 12 because it was a transfer for full and adequate consideration.

(2) *Transactions treated as transfers—(i) In general.* Except as provided in

paragraph (b)(3) of this section, for purposes of section 2701, transfer includes the following transactions:

(A) A contribution to the capital of a new or existing entity;

(B) A redemption, recapitalization, or other change in the capital structure of an entity (a "capital structure transaction"), if—

(1) The transferor or an applicable family member receives an applicable retained interest in the capital structure transaction;

(2) The transferor or an applicable family member holding an applicable retained interest before the capital structure transaction surrenders an equity interest that is junior to the applicable retained interest (a "subordinate interest") and receives property other than an applicable retained interest; or

(3) The transferor or an applicable family member holding an applicable retained interest before the capital structure transaction surrenders an equity interest in the entity (other than a subordinate interest) and the fair market value of the applicable retained interest is increased; or

(C) The termination of an indirect holding in an entity (as defined in § 25.2701-6) (or a contribution to capital by an entity to the extent an individual indirectly holds an interest in the entity), if—

(1) The property is held in a trust as to which the indirect holder is treated as the owner under subchapter J of chapter 1 of the Internal Revenue Code; or

(2) If the termination (or contribution) is not treated as a transfer under paragraph (b)(2)(i)(C)(1) of this section, to the extent the value of the indirectly-held interest would have been included in the value of the indirect holder's gross estate for Federal estate tax purposes if the indirect holder died immediately prior to the termination.

(ii) *Multiple attribution.* For purposes of paragraph (b)(2)(i)(C) of this section, if the transfer of an indirect holding in property is treated as a transfer with respect to more than one indirect holder, the transfer is attributed in the following order:

(A) First, to the indirect holder(s) who transferred the interest to the entity (without regard to section 2513);

(B) Second, to the indirect holder(s) possessing a presently exercisable power to designate the person who shall possess or enjoy the property;

(C) Third, to the indirect holder(s) presently entitled to receive the income from the interest;

(D) Fourth, to the indirect holder(s) specifically entitled to receive the interest at a future date; and

(E) Last, to any other indirect holder(s) proportionally.

(3) *Excluded transactions.* For purposes of section 2701, a transfer does not include the following transactions:

(i) A capital structure transaction, if the transferor, each applicable family member, and each member of the transferor's family holds substantially the same interest after the transaction as that individual held before the transaction. For this purpose, common stock with non-lapsing voting rights and nonvoting common stock are interests that are substantially the same;

(ii) A shift of rights occurring upon the execution of a qualified disclaimer described in section 2518; and

(iii) A shift of rights occurring upon the release, exercise, or lapse of a power of appointment other than a general power of appointment described in section 2514, except to the extent the release, exercise, or lapse would otherwise be a transfer under chapter 12.

(c) *Circumstances in which section 2701 does not apply.* To the extent provided, section 2701 does not apply in the following cases:

(1) *Marketable transferred interests.* Section 2701 does not apply if there are readily available market quotations on an established securities market for the value of the transferred interests.

(2) *Marketable retained interests.* Section 25.2701-2 does not apply to any applicable retained interest if there are readily available market quotations on an established securities market for the value of the applicable retained interests.

(3) *Interests of the same class.* Section 2701 does not apply if the retained interest is of the same class of equity as the transferred interest or if the re-

tained interest is of a class that is proportional to the class of the transferred interest. A class is the same class as (or is proportional to the class of) the transferred interest if the rights are identical (or proportional) to the rights of the transferred interest, except for non-lapsing differences in voting rights (or, for a partnership, non-lapsing differences with respect to management and limitations on liability). For purposes of this section, non-lapsing provisions necessary to comply with partnership allocation requirements of the Internal Revenue Code (e.g., section 704(b)) are non-lapsing differences with respect to limitations on liability. A right that lapses by reason of Federal or State law is treated as a non-lapsing right unless the Secretary determines, by regulation or by published revenue ruling, that it is necessary to treat such a right as a lapsing right to accomplish the purposes of section 2701. An interest in a partnership is not an interest in the same class as the transferred interest if the transferor or applicable family members have the right to alter the liability of the transferee.

(4) *Proportionate transfers.* Section 2701 does not apply to a transfer by an individual to a member of the individual's family of equity interests to the extent the transfer by that individual results in a proportionate reduction of each class of equity interest held by the individual and all applicable family members in the aggregate immediately before the transfer. Thus, for example, section 2701 does not apply if P owns 50 percent of each class of equity interest in a corporation and transfers a portion of each class to P's child in a manner that reduces each interest held by P and any applicable family members, in the aggregate, by 10 percent even if the transfer does not proportionately reduce P's interest in each class. See § 25.2701-6 regarding indirect holding of interests.

(d) *Family definitions*—(1) *Member of the family.* A member of the family is, with respect to any transferor—

(i) The transferor's spouse;

(ii) Any lineal descendant of the transferor or the transferor's spouse; and

(iii) The spouse of any such lineal descendant.

(2) *Applicable family member.* An applicable family member is, with respect to any transferor—

- (i) The transferor's spouse;
- (ii) Any ancestor of the transferor or the transferor's spouse; and
- (iii) The spouse of any such ancestor.

(3) *Relationship by adoption.* For purposes of section 2701, any relationship by legal adoption is the same as a relationship by blood.

(e) *Examples.* The following examples illustrate provisions of this section:

Example 1. P, an individual, holds all the outstanding stock of X Corporation. Assume the fair market value of P's interest in X immediately prior to the transfer is \$1.5 million. X is recapitalized so that P holds 1,000 shares of \$1,000 par value preferred stock bearing an annual cumulative dividend of \$100 per share (the aggregate fair market value of which is assumed to be \$1 million) and 1,000 shares of voting common stock. P transfers the common stock to P's child. Section 2701 applies to the transfer because P has transferred an equity interest (the common stock) to a member of P's family and immediately thereafter holds an applicable retained interest (the preferred stock). P's right to receive annual cumulative dividends is a qualified payment right and is valued for purposes of section 2701 at its fair market value of \$1,000,000. The amount of P's gift, determined using the subtraction method of § 25.2701-3, is \$500,000 (\$1,500,000 minus \$1,000,000).

Example 2. The facts are the same as in *Example 1*, except that the preferred dividend right is noncumulative. Under § 25.2701-2, P's preferred dividend right is valued at zero because it is a distribution right in a controlled entity, but is not a qualified payment right. All of P's other rights in the preferred stock are valued as if P's dividend right does not exist but otherwise without regard to section 2701. The amount of P's gift, determined using the subtraction method, is \$1,500,000 (\$1,500,000 minus \$0). P may elect, however, to treat the dividend right as a qualified payment right as provided in § 25.2701-2(c)(2).

[T.D. 8395, 57 FR 4255, Feb. 4, 1992; 57 FR 11264, Apr. 2, 1992, as amended by T.D. 8536, 59 FR 23154, May 5, 1994]

§ 25.2701-2 Special valuation rules for applicable retained interests.

(a) *In general.* In determining the amount of a gift under § 25.2701-3, the value of any applicable retained interest (as defined in paragraph (b)(1) of this section) held by the transferor or by an applicable family member is de-

termined using the rules of chapter 12, with the modifications prescribed by this section. See § 25.2701-6 regarding the indirect holding of interests.

(1) *Valuing an extraordinary payment right.* Any extraordinary payment right (as defined in paragraph (b)(2) of this section) is valued at zero.

(2) *Valuing a distribution right.* Any distribution right (as defined in paragraph (b)(3) of this section) in a controlled entity is valued at zero, unless it is a qualified payment right (as defined in paragraph (b)(6) of this section). Controlled entity is defined in paragraph (b)(5) of this section.

(3) *Special rule for valuing a qualified payment right held in conjunction with an extraordinary payment right.* If an applicable retained interest confers a qualified payment right and one or more extraordinary payment rights, the value of all these rights is determined by assuming that each extraordinary payment right is exercised in a manner that results in the lowest total value being determined for all the rights, using a consistent set of assumptions and giving due regard to the entity's net worth, prospective earning power, and other relevant factors (the "lower of" valuation rule). See §§ 20.2031-2(f) and 20.2031-3 for rules relating to the valuation of business interests generally.

(4) *Valuing other rights.* Any other right (including a qualified payment right not subject to the prior paragraph) is valued as if any right valued at zero does not exist and as if any right valued under the lower of rule is exercised in a manner consistent with the assumptions of that rule but otherwise without regard to section 2701. Thus, if an applicable retained interest carries no rights that are valued at zero or under the lower of rule, the value of the interest for purposes of section 2701 is its fair market value.

(5) *Example.* The following example illustrates rules of this paragraph (a).

Example. P, an individual, holds all 1,000 shares of X Corporation's \$1,000 par value preferred stock bearing an annual cumulative dividend of \$100 per share and holds all 1,000 shares of X's voting common stock. P has the right to put all the preferred stock to X at any time for \$900,000. P transfers the common stock to P's child and immediately thereafter holds the preferred stock. Assume

that at the time of the transfer, the fair market value of X is \$1,500,000, and the fair market value of P's annual cumulative dividend right is \$1,000,000. Because the preferred stock confers both an extraordinary payment right (the put right) and a qualified payment right (*i.e.*, the right to receive cumulative dividends), the lower of rule applies and the value of these rights is determined as if the put right will be exercised in a manner that results in the lowest total value being determined for the rights (in this case, by assuming that the put will be exercised immediately). The value of P's preferred stock is \$900,000 (the lower of \$1,000,000 or \$900,000). The amount of the gift is \$600,000 (\$1,500,000 minus \$900,000).

(b) *Definitions*—(1) *Applicable retained interest*. An applicable retained interest is any equity interest in a corporation or partnership with respect to which there is either—

(i) An extraordinary payment right (as defined in paragraph (b)(2) of this section), or

(ii) In the case of a controlled entity (as defined in paragraph (b)(5) of this section), a distribution right (as defined in paragraph (b)(3) of this section).

(2) *Extraordinary payment right*. Except as provided in paragraph (b)(4) of this section, an extraordinary payment right is any put, call, or conversion right, any right to compel liquidation, or any similar right, the exercise or nonexercise of which affects the value of the transferred interest. A call right includes any warrant, option, or other right to acquire one or more equity interests.

(3) *Distribution right*. A distribution right is the right to receive distributions with respect to an equity interest. A distribution right does not include—

(i) Any right to receive distributions with respect to an interest that is of the same class as, or a class that is subordinate to, the transferred interest;

(ii) Any extraordinary payment right; or

(iii) Any right described in paragraph (b)(4) of this section.

(4) *Rights that are not extraordinary payment rights or distribution rights*. Mandatory payment rights, liquidation participation rights, rights to guaranteed payments of a fixed amount under section 707(c), and non-lapsing conver-

sion rights are neither extraordinary payment rights nor distribution rights.

(i) *Mandatory payment right*. A mandatory payment right is a right to receive a payment required to be made at a specific time for a specific amount. For example, a mandatory redemption right in preferred stock requiring that the stock be redeemed at its fixed par value on a date certain is a mandatory payment right and therefore not an extraordinary payment right or a distribution right. A right to receive a specific amount on the death of the holder is a mandatory payment right.

(ii) *Liquidation participation rights*. A liquidation participation right is a right to participate in a liquidating distribution. If the transferor, members of the transferor's family, or applicable family members have the ability to compel liquidation, the liquidation participation right is valued as if the ability to compel liquidation—

(A) Did not exist, or

(B) If the lower of rule applies, is exercised in a manner that is consistent with that rule.

(iii) *Right to a guaranteed payment of a fixed amount under section 707(c)*. The right to a guaranteed payment of a fixed amount under section 707(c) is the right to a guaranteed payment (within the meaning of section 707(c)) the amount of which is determined at a fixed rate (including a rate that bears a fixed relationship to a specified market interest rate). A payment that is contingent as to time or amount is not a guaranteed payment of a fixed amount.

(iv) *Non-lapsing conversion right*—(A) *Corporations*. A non-lapsing conversion right, in the case of a corporation, is a non-lapsing right to convert an equity interest in a corporation into a fixed number or a fixed percentage of shares of the same class as the transferred interest (or into an interest that would be of the same class but for non-lapsing differences in voting rights), that is subject to proportionate adjustments for changes in the equity ownership of the corporation and to adjustments similar to those provided in section 2701(d) for unpaid payments.

(B) *Partnerships*. A non-lapsing conversion right, in the case of a partnership, is a non-lapsing right to convert an equity interest in a partnership into

a specified interest (other than an interest represented by a fixed dollar amount) of the same class as the transferred interest (or into an interest that would be of the same class but for non-lapsing differences in management rights or limitations on liability) that is subject to proportionate adjustments for changes in the equity ownership of the partnership and to adjustments similar to those provided in section 2701(d) for unpaid payments.

(C) *Proportionate adjustments in equity ownership.* For purposes of this paragraph (b)(4), an equity interest is subject to proportionate adjustments for changes in equity ownership if, in the case of a corporation, proportionate adjustments are required to be made for splits, combinations, reclassifications, and similar changes in capital stock, or, in the case of a partnership, the equity interest is protected from dilution resulting from changes in the partnership structure.

(D) *Adjustments for unpaid payments.* For purposes of this paragraph (b)(4), an equity interest is subject to adjustments similar to those provided in section 2701(d) if it provides for—

(1) Cumulative payments;

(2) Compounding of any unpaid payments at the rate specified in § 25.2701-4(c)(2); and

(3) Adjustment of the number or percentage of shares or the size of the interest into which it is convertible to take account of accumulated but unpaid payments.

(5) *Controlled entity*—(i) *In general.* For purposes of section 2701, a controlled entity is a corporation or partnership controlled, immediately before a transfer, by the transferor, applicable family members, and any lineal descendants of the parents of the transferor or the transferor's spouse. See § 25.2701-6 regarding indirect holding of interests.

(ii) *Corporations*—(A) *In general.* In the case of a corporation, control means the holding of at least 50 percent of the total voting power or total fair market value of the equity interests in the corporation.

(B) *Voting rights.* Equity interests that carry no right to vote other than on liquidation, merger, or a similar event are not considered to have voting

rights for purposes of this paragraph (b)(5)(ii). Generally, a voting right is considered held by an individual to the extent that the individual, either alone or in conjunction with any other person, is entitled to exercise (or direct the exercise of) the right. However, if an equity interest carrying voting rights is held in a fiduciary capacity, the voting rights are not considered held by the fiduciary, but instead are considered held by each beneficial owner of the interest and by each individual who is a permissible recipient of the income from the interest. A voting right does not include a right to vote that is subject to a contingency that has not occurred, other than a contingency that is within the control of the individual holding the right.

(iii) *Partnerships.* In the case of any partnership, control means the holding of at least 50 percent of either the capital interest or the profits interest in the partnership. Any right to a guaranteed payment under section 707(c) of a fixed amount is disregarded in making this determination. In addition, in the case of a limited partnership, control means the holding of any equity interest as a general partner. See § 25.2701-2(b)(4)(iii) for the definition of a right to a guaranteed payment of a fixed amount under section 707(c).

(6) *Qualified payment right*—(i) *In general.* A qualified payment right is a right to receive qualified payments. A qualified payment is a distribution that is—

(A) A dividend payable on a periodic basis (at least annually) under any cumulative preferred stock, to the extent such dividend is determined at a fixed rate;

(B) Any other cumulative distribution payable on a periodic basis (at least annually) with respect to an equity interest, to the extent determined at a fixed rate or as a fixed amount; or

(C) Any distribution right for which an election has been made pursuant to paragraph (c)(2) of this section.

(ii) *Fixed rate.* For purposes of this section, a payment rate that bears a fixed relationship to a specified market interest rate is a payment determined at a fixed rate.

(c) *Qualified payment elections*—(1) *Election to treat a qualified payment right*

as other than a qualified payment right. Any transferor holding a qualified payment right may elect to treat all rights held by the transferor of the same class as rights that are not qualified payment rights. An election may be a partial election, in which case the election must be exercised with respect to a consistent portion of each payment right in the class as to which the election has been made.

(2) *Election to treat other distribution rights as qualified payment rights.* Any individual may elect to treat a distribution right held by that individual in a controlled entity as a qualified payment right. An election may be a partial election, in which case the election must be exercised with respect to a consistent portion of each payment right in the class as to which the election has been made. An election under this paragraph (c)(2) will not cause the value of the applicable retained interest conferring the distribution right to exceed the fair market value of the applicable retained interest (determined without regard to section 2701). The election is effective only to the extent—

- (i) Specified in the election, and
- (ii) That the payments elected are permissible under the legal instrument giving rise to the right and are consistent with the legal right of the entity to make the payment.

(3) *Elections irrevocable.* Any election under paragraph (c)(1) or (c)(2) of this section is revocable only with the consent of the Commissioner.

(4) *Treatment of certain payments to applicable family members.* Any payment right described in paragraph (b)(6) of this section held by an applicable family member is treated as a payment right that is not a qualified payment right unless the applicable family member elects (pursuant to paragraph (c)(2) of this section) to treat the payment right as a qualified payment right. An election may be a partial election, in which case the election must be exercised with respect to a consistent portion of each payment right in the class as to which the election has been made.

(5) *Time and manner of elections.* Any election under paragraph (c)(1) or (c)(2) of this section is made by attaching a

statement to the Form 709, Federal Gift Tax Return, filed by the transferor on which the transfer is reported. An election filed after the time of the filing of the Form 709 reporting the transfer is not a valid election. An election filed as of April 6, 1992, for transfers made prior to its publication is effective. The statement must—

(i) Set forth the name, address, and taxpayer identification number of the electing individual and of the transferor, if different;

(ii) If the electing individual is not the transferor filing the return, state the relationship between the individual and the transferor;

(iii) Specifically identify the transfer disclosed on the return to which the election applies;

(iv) Describe in detail the distribution right to which the election applies;

(v) State the provision of the regulation under which the election is being made; and

(vi) If the election is being made under paragraph (c)(2) of this section—

(A) State the amounts that the election assumes will be paid, and the times that the election assumes the payments will be made;

(B) Contain a statement, signed by the electing individual, in which the electing individual agrees that—

(1) If payments are not made as provided in the election, the individual's subsequent taxable gifts or taxable estate will, upon the occurrence of a taxable event (as defined in § 25.2701-4(b)), be increased by an amount determined under § 25.2701-4(c), and

(2) The individual will be personally liable for any increase in tax attributable thereto.

(d) *Examples.* The following examples illustrate provisions of this section:

Example 1. On March 30, 1991, P transfers non-voting common stock of X Corporation to P's child, while retaining \$100 par value voting preferred stock bearing a cumulative annual dividend of \$10. Immediately before the transfer, P held 100 percent of the stock. Because X is a controlled entity (within the meaning of paragraph (b)(5) of this section), P's dividend right is a distribution right that is subject to section 2701. See § 25.2701-2(b)(3). Because the distribution right is an annual cumulative dividend, it is a qualified payment right. See § 25.2701-2(b)(6).

Example 2. The facts are the same as in *Example 1*, except that the dividend right is non-cumulative. P's dividend right is a distribution right in a controlled entity, but is not a qualified payment right because the dividend is non-cumulative. Therefore, the non-cumulative dividend right is valued at zero under § 25.2701-2(a)(2). If the corporation were not a controlled entity, P's dividend right would be valued without regard to section 2701.

Example 3. The facts are the same as in *Example 1*. Because P holds sufficient voting power to compel liquidation of X, P's right to participate in liquidation is an extraordinary payment right under paragraph (b)(2) of this section. Because P holds an extraordinary payment right in conjunction with a qualified payment right (the right to receive cumulative dividends), the lower of rule applies.

Example 4. The facts are the same as in *Example 1*, except that immediately before the transfer, P, applicable family members of P, and members of P's family, hold 60 percent of the voting rights in X. Assume that 80 percent of the vote is required to compel liquidation of any interest in X. P's right to participate in liquidation is not an extraordinary payment right under paragraph (b)(2) of this section, because P and P's family cannot compel liquidation of X. P's preferred stock is an applicable retained interest that carries no rights that are valued under the special valuation rules of section 2701. Thus, in applying the valuation method of § 25.2701-3, the value of P's preferred stock is its fair market value determined without regard to section 2701.

Example 5. L holds 10-percent non-cumulative preferred stock and common stock in a corporation that is a controlled entity. L transfers the common stock to L's child. L holds no extraordinary payment rights with respect to the preferred stock. L elects under paragraph (c)(2) of this section to treat the noncumulative dividend right as a qualified payment right consisting of the right to receive a cumulative annual dividend of 5 percent. Under § 25.2701-2(c)(2), the value of the distribution right pursuant to the election is the lesser of—

(A) The fair market value of the right to receive a cumulative 5-percent dividend from the corporation, giving due regard to the corporation's net worth, prospective earning power, and dividend-paying capacity; or

(B) The value of the distribution right determined without regard to section 2701 and without regard to the terms of the qualified payment election.

[T.D. 8395, 57 FR 4257, Feb. 4, 1992]

§ 25.2701-3 Determination of amount of gift.

(a) *Overview*—(1) *In general.* The amount of the gift resulting from any transfer to which section 2701 applies is determined by a subtraction method of valuation. Under this method, the amount of the transfer is determined by subtracting the values of all family-held senior equity interests from the fair market value of all family-held interests in the entity determined immediately before the transfer. The values of the senior equity interests held by the transferor and applicable family members generally are determined under section 2701. Other family-held senior equity interests are valued at their fair market value. The balance is then appropriately allocated among the transferred interests and other family-held subordinate equity interests. Finally, certain discounts and other appropriate reductions are provided, but only to the extent permitted by this section.

(2) *Definitions.* The following definitions apply for purposes of this section.

(i) *Family-held.* Family-held means held (directly or indirectly) by an individual described in § 25.2701-2(b)(5)(i).

(ii) *Senior equity interest.* Senior equity interest means an equity interest in the entity that carries a right to distributions of income or capital that is preferred as to the rights of the transferred interest.

(iii) *Subordinate equity interest.* Subordinate equity interest means an equity interest in the entity as to which an applicable retained interest is a senior equity interest.

(b) *Valuation methodology.* The following methodology is used to determine the amount of the gift when section 2701 applies.

(1) *Step 1—Valuation of family-held interest*—(i) *In general.* Except as provided in paragraph (b)(1)(ii) of this section determine the fair market value of all family-held equity interests in the entity immediately after the transfer. The fair market value is determined by assuming that the interests are held by one individual, using a consistent set of assumptions.

(ii) *Special rule for contributions to capital.* In the case of a contribution to

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capital, determine the fair market value of the contribution.

(2) *Step 2—Subtract the value of senior equity interests*—(i) *In general.* If the amount determined in *Step 1* of paragraph (b)(1) of this section is not determined under the special rule for contributions to capital, from that value subtract the following amounts:

(A) An amount equal to the sum of the fair market value of all family-held senior equity interests, (other than applicable retained interests held by the transferor or applicable family members) and the fair market value of any family-held equity interests of the same class or a subordinate class to the transferred interests held by persons other than the transferor, members of the transferor's family, and applicable family members of the transferor. The fair market value of an interest is its pro rata share of the fair market value of all family-held senior equity interests of the same class (determined, immediately after the transfer, as is all family-held senior equity interests were held by one individual); and

(B) The value of all applicable retained interests held by the transferor or applicable family members (other than an interest received as consideration for the transfer) determined under § 25.2701-2, taking into account the adjustment described in paragraph (b)(5) of this section.

(ii) *Special rule for contributions to capital.* If the value determined in *Step 1* of paragraph (b)(1) of this section is determined under the special rule for contributions to capital, subtract the value of any applicable retained interest received in exchange for the contribution to capital determined under § 25.2701-2.

(2) *Step 2—Subtract the value of senior equity interests.* From the value determined in *Step 1*, subtract the following amounts:

(i) An amount equal to the fair market value of all family-held senior equity interests, other than applicable retained interests held by the transferor or applicable family members. The fair market value of an interest is its pro rata share of the fair market value of all family-held senior equity interests of the same class (determined as if all family-held senior equity in-

terests were held by one individual); and

(ii) The value of all applicable retained interests held by the transferor or applicable family members determined under § 25.2701-2, taking into account the adjustment described in paragraph (b)(5) of this section.

(3) *Step 3—Allocate the remaining value among the transferred interests and other family-held subordinate equity interests.* The value remaining after *Step 2* is allocated among the transferred interests and other subordinate equity interests held by the transferor, applicable family members, and members of the transferor's family. If more than one class of family-held subordinate equity interest exists, the value remaining after *Step 2* is allocated, beginning with the most senior class of subordinate equity interest, in the manner that would most fairly approximate their value if all rights valued under section 2701 at zero did not exist (or would be exercised in a manner consistent with the assumptions of the rule of § 25.2702-2(a)(4), if applicable). If there is no clearly appropriate method of allocating the remaining value pursuant to the preceding sentence, the remaining value (or the portion remaining after any partial allocation pursuant to the preceding sentence) is allocated to the interests in proportion to their fair market values determined without regard to section 2701.

(4) *Step 4—Determine the amount of the gift*—(i) *In general.* The amount allocated to the transferred interests in *Step 3* is reduced by the amounts determined under this paragraph (b)(4).

(ii) *Reduction for minority or similar discounts.* Except as provided in § 25.2701-3(c), if the value of the transferred interest (determined without regard to section 2701) would be determined after application of a minority or similar discount with respect to the transferred interest, the amount of the gift determined under section 2701 is reduced by the excess, if any, of—

(A) A pro rata portion of the fair market value of the family-held interests of the same class (determined as if all voting rights conferred by family-held equity interests were held by one person who had no interest in the entity other than the family-held interests

of the same class, but otherwise without regard to section 2701), over

(B) The value of the transferred interest (without regard to section 2701).

(iii) *Adjustment for transfers with a retained interest.* If the value of the transferor's gift (determined without regard to section 2701) would be reduced under section 2702 to reflect the value of a retained interest, the value determined under section 2701 is reduced by the same amount.

(iv) *Reduction for consideration.* The amount of the transfer (determined under section 2701) is reduced by the amount of consideration in money or money's worth received by the transferor, but not in excess of the amount of the gift (determined without regard to section 2701). The value of consideration received by the transferor in the form of an applicable retained interest in the entity is determined under section 2701 except that, in the case of a contribution to capital, the *Step 4* value of such an interest is zero.

(5) *Adjustment in Step 2—(i) In general.* For purposes of paragraph (b)(2) of this section, if the percentage of any class of applicable retained interest held by the transferor and by applicable family members (including any interest received as consideration for the transfer) exceeds the family interest percentage, the excess is treated as a family-held interest that is not held by the transferor or an applicable family member.

(ii) *Family interest percentage.* The family interest percentage is the highest ownership percentage (determined on the basis of relative fair market values) of family-held interests in—

(A) Any class of subordinate equity interest; or

(B) All subordinate equity interests, valued in the aggregate.

(c) *Minimum value rule—(1) In general.* If section 2701 applies to the transfer of an interest in an entity, the value of a junior equity interest is not less than its pro-rata portion of 10 percent of the sum of—

(i) The total value of all equity interests in the entity, and

(ii) The total amount of any indebtedness of the entity owed to the transferor and applicable family members.

(2) *Junior equity interest.* For purposes of paragraph (c)(1) of this section, junior equity interest means common stock or, in the case of a partnership, any partnership interest under which the rights to income and capital are junior to the rights of all other classes of partnership interests. Common stock means the class or classes of stock that, under the facts and circumstances, are entitled to share in the reasonably anticipated residual growth in the entity.

(3) *Indebtedness—(i) In general.* For purposes of paragraph (c)(1) of this section, indebtedness owed to the transferor (or an applicable family member) does not include—

(A) Short-term indebtedness incurred with respect to the current conduct of the entity's trade or business (such as amounts payable for current services);

(B) Indebtedness owed to a third party solely because it is guaranteed by the transferor or an applicable family member; or

(C) Amounts permanently set aside in a qualified deferred compensation arrangement, to the extent the amounts are unavailable for use by the entity.

(ii) *Leases.* A lease of property is not indebtedness, without regard to the length of the lease term, if the lease payments represent full and adequate consideration for use of the property. Lease payments are considered full and adequate consideration if a good faith effort is made to determine the fair rental value under the lease and the terms of the lease conform to the value so determined. Arrearages with respect to a lease are indebtedness.

(d) *Examples.* The application of the subtraction method described in this section is illustrated by the following Examples:

Example 1. Corporation X has outstanding 1,000 shares of \$1,000 par value voting preferred stock, each share of which carries a cumulative annual dividend of 8 percent and a right to put the stock to X for its par value at any time. In addition, there are outstanding 1,000 shares of non-voting common stock. A holds 600 shares of the preferred stock and 750 shares of the common stock. The balance of the preferred and common stock is held by B, a person unrelated to A. Because the preferred stock confers both a

qualified payment right and an extraordinary payment right, A's rights are valued under the "lower of" rule of § 25.2701-2(a)(3). Assume that A's rights in the preferred stock are valued at \$800 per share under the "lower of" rule (taking account of A's voting rights). A transfers all of A's common stock to A's child. The method for determining the amount of A's gift is as follows—

Step 1: Assume the fair market value of all the family-held interests in X, taking account of A's control of the corporation, is determined to be \$1 million.

Step 2: From the amount determined under Step 1, subtract \$480,000 (600 shares \times \$800 (the section 2701 value of A's preferred stock, computed under the "lower of" rule of § 25.2701-2(a)(3))).

Step 3: The result of Step 2 is a balance of \$520,000. This amount is fully allocated to the 750 shares of family-held common stock.

Step 4: Because no consideration was furnished for the transfer, the adjustment under Step 4 is limited to the amount of any appropriate minority or similar discount. Before the application of Step 4 the amount of A's gift is \$520,000.

Example 2. The facts are the same as in *Example 1*, except that prior to the transfer A holds only 50 percent of the common stock and B holds the remaining 50 percent. Assume that the fair market value of A's 600 shares of preferred stock is \$600,000.

Step 1: Assume that the result of this step (determining the value of the family-held interest) is \$980,000.

Step 2: From the amount determined under Step 1, subtract \$500,000 (\$400,000, the value of 500 shares of A's preferred stock determined without regard to section 2701 pursuant to the valuation adjustment determined under paragraph (b)(5) of this section). The adjustment in step 2 applies in this example because A's percentage ownership of the preferred stock (60 percent) exceeds the family interest percentage of the common stock (50 percent). Therefore, 100 shares of A's preferred stock are valued at fair market value, or \$100,000 (100 \times \$1,000). The balance of A's preferred stock is valued under section 2701 at \$400,000 (500 shares \times \$800). The value of A's preferred stock for purposes of section 2701 equals \$500,000 (\$100,000 plus \$400,000).

Step 3: The result of Step 2 is \$480,000 (\$980,000 minus \$500,000) which is allocated to the family-held common stock. Because A transferred all of the family-held subordinate equity interests, all of the value determined under Step 2 is allocated to the transferred shares. Step 4: The adjustment under Step 4 is the same as in *Example 1*. Thus, the amount of the gift is \$480,000.

Example 3. Corporation X has outstanding 1,000 shares of \$1,000 par value non-voting preferred stock, each share of which carries a cumulative annual dividend of 8 percent and a right to put the stock to X for its par

value at any time. In addition, there are outstanding 1,000 shares of voting common stock. A holds 600 shares of the preferred stock and 750 shares of the common stock. The balance of the preferred and common stock is held by B, a person unrelated to A. Assume further that steps one through three, as in *Example 1*, result in \$520,000 being allocated to the family-held common stock and that A transfers only 75 shares of A's common stock. The transfer fragments A's voting interest. Under Step 4, an adjustment is appropriate to reflect the fragmentation of A's voting rights. The amount of the adjustment is the difference between 10 percent (75/750) of the fair market value of A's common shares and the fair market value of the transferred shares, each determined as if the holder thereof had no other interest in the corporation.

Example 4. On December 31, 1990, the capital structure of Y corporation consists of 1,000 shares of voting common stock held three-fourths by A and one-fourth by A's child, B. On January 15, 1991, A transfers 250 shares of common stock to Y in exchange for 300 shares of nonvoting, noncumulative 8% preferred stock with a section 2701 value of zero. Assume that the fair market value of Y is \$1,000,000 at the time of the exchange and that the exchange by A is for full and adequate consideration in moneys' worth. However, for purposes of section 2701, if a subordinate equity interest is transferred in exchange for an applicable retained interest, consideration in the exchange is determined with reference to the section 2701 value of the senior interest. Thus, A is treated as transferring the common stock to the corporation for no consideration. Immediately after the transfer, B is treated as holding one-third (250/750) of the common stock and A is treated as holding two-thirds (500/750). The amount of the gift is determined as follows:

Step 1. Because Y is held exclusively by A and B, the Step 1 value is \$1,000,000.

Step 2. The result of Step 2 is \$1,000,000 (\$1,000,000 - 0).

Step 3. The amount allocated to the transferred common stock is \$250,000 (250/1,000 \times \$1,000,000). That amount is further allocated in proportion to the respective holdings of A and B in the common stock (\$166,667 and \$83,333, respectively).

Step 4. There is no Step 4 adjustment because the section 2701 value of the consideration received by A was zero and no minority discount would have been involved in the exchange. Thus, the amount of the gift is \$83,333. If the section 2701 value of the applicable retained interest were \$100,000, the Step 4 adjustment would have been a \$33,333 reduction for consideration received ((250/750) \times \$100,000).

Example 5. The facts are the same as in *Example 4*, except that on January 6, 1992, when

the fair market value of Y is still \$1,000,000, A transfers A's remaining 500 shares of common stock to Y in exchange for 2500 shares of preferred stock. The second transfer is also for full and adequate consideration in money or money's worth. The result of Step 2 is the same—\$1,000,000.

Step 3. The amount allocated to the transferred common stock is \$666,667 ($500/750 \times \$1,000,000$). Since A holds no common stock immediately after the transfer, A is treated as transferring the entire interest to the other shareholder (B). Thus, \$666,667 is fully allocated to the shares held by B.

Step 4. There is no Step 4 adjustment because the section 2701 value of the consideration received by A was zero and no minority discount would have been involved in the exchange. Thus, the amount of the gift is \$666,667.

[T.D. 8395, 57 FR 4259, Feb. 4, 1992; T.D. 8395, 57 FR 11264, Apr. 2, 1992]

§ 25.2701-4 Accumulated qualified payments.

(a) *In general.* If a taxable event occurs with respect to any applicable retained interest conferring a distribution right that was previously valued as a qualified payment right (a "qualified payment interest"), the taxable estate or taxable gifts of the individual holding the interest are increased by the amount determined under paragraph (c) of this section.

(b) *Taxable event*—(1) *In general.* Except as otherwise provided in this section, taxable event means the transfer of a qualified payment interest, either during life or at death, by the individual in whose hands the interest was originally valued under section 2701 (the "interest holder") or by any individual treated pursuant to paragraph (b)(3) of this section in the same manner as the interest holder. Except as provided in paragraph (a)(2) of this section, any termination of an individual's rights with respect to a qualified payment interest is a taxable event. Thus, for example, if an individual is treated as indirectly holding a qualified payment interest held by a trust, a taxable event occurs on the earlier of—

(i) The termination of the individual's interest in the trust (whether by death or otherwise), or

(ii) The termination of the trust's interest in the qualified payment interest (whether by disposition or otherwise).

(2) *Exception.* If, at the time of a termination of an individual's rights with respect to a qualified payment interest, the value of the property would be includible in the individual's gross estate for Federal estate tax purposes if the individual died immediately after the termination, a taxable transfer does not occur until the earlier of—

(i) The time the property would no longer be includible in the individual's gross estate (other than by reason of section 2035), or

(ii) The death of the individual.

(3) *Individual treated as interest holder*—(i) *In general.* If a taxable event involves the transfer of a qualified payment interest by the interest holder (or an individual treated as the interest holder) to an applicable family member of the individual who made the transfer to which section 2701 applied (other than the spouse of the individual transferring the qualified payment interest), the transferee applicable family member is treated in the same manner as the interest holder with respect to late or unpaid qualified payments first due after the taxable event. Thus, for example, if an interest holder transfers during life a qualified payment interest to an applicable family member, that transfer is a taxable event with respect to the interest holder whose taxable gifts are increased for the year of the transfer as provided in paragraph (c) of this section. The transferee is treated thereafter in the same manner as the interest holder with respect to late or unpaid qualified payments first due after the taxable event.

(ii) *Transfers to spouse*—(A) *In general.* If an interest holder (or an individual treated as the interest holder) transfers a qualified payment interest, the transfer is not a taxable event to the extent a marital deduction is allowed with respect to the transfer under sections 2056, 2106(a)(3), or 2523 or, in the case of a transfer during the individual's lifetime, to the extent the spouse furnishes consideration for the transfer. If this exception applies, the transferee spouse is treated as if he or she were the holder of the interest from the date the transferor spouse acquired the interest. If the deduction for a transfer to a spouse is allowable under section 2056(b)(8) or 2523(g) (relating to

charitable remainder trusts), the transferee spouse is treated as the holder of the entire interest passing to the trust.

(B) *Marital bequests.* If the selection of property with which a marital bequest is funded is discretionary, a transfer of a qualified payment interest will not be considered a transfer to the surviving spouse unless—

(1) The marital bequest is funded with the qualified payment interest before the due date for filing the decedent's Federal estate tax return (including extensions actually granted) (the "due date"), or

(2) The executor—

(i) Files a statement with the return indicating the extent to which the marital bequest will be funded with the qualified payment interest, and

(ii) Before the date that is one year prior to the expiration of the period of limitations on assessment of the Federal estate tax, notifies the District Director having jurisdiction over the return of the extent to which the bequest was funded with the qualified payment interest (or the extent to which the qualified payment interest has been permanently set aside for that purpose).

(C) *Purchase by the surviving spouse.* For purposes of this section, the purchase (before the date prescribed for filing the decedent's estate tax return, including extensions actually granted) by the surviving spouse (or a trust described in section 2056(b)(7)) of a qualified payment interest held (directly or indirectly) by the decedent immediately before death is considered a transfer with respect to which a deduction is allowable under section 2056 or section 2106(a)(3), but only to the extent that the deduction is allowed to the estate. For example, assume that A bequeaths \$50,000 to A's surviving spouse, B, in a manner that qualifies for deduction under section 2056, and that subsequent to A's death B purchases a qualified payment interest from A's estate for \$200,000, its fair market value. The economic effect of the transaction is the equivalent of a bequest by A to B of the qualified payment interest, one-fourth of which qualifies for the marital deduction. Therefore, for purposes of this section, one-fourth of the qualified payment in-

terest purchased by B (\$50,000 ÷ \$200,000) is considered a transfer of an interest with respect to which a deduction is allowed under 2056. If the purchase by the surviving spouse is not made before the due date of the decedent's return, the purchase of the qualified payment interest will not be considered a bequest for which a marital deduction is allowed unless the executor—

(1) Files a statement with the return indicating the qualified payment interests to be purchased by the surviving spouse (or a trust described in section 2056(b)(7)), and

(2) Before the date that is one year prior to the expiration of the period of limitations on assessment of the Federal estate tax, notifies the District Director having jurisdiction over the return that the purchase of the qualified payment interest has been made (or that the funds necessary to purchase the qualified payment interest have been permanently set aside for that purpose).

(c) *Amount of increase—(1) In general.* Except as limited by paragraph (c)(6) of this section, the amount of the increase to an individual's taxable estate or taxable gifts is the excess, if any, of—

(i) The sum of—

(A) The amount of qualified payments payable during the period beginning on the date of the transfer to which section 2701 applied (or, in the case of an individual treated as the interest holder, on the date the interest of the prior interest holder terminated) and ending on the date of the taxable event; and

(B) The earnings on those payments, determined hypothetically as if each payment were paid on its due date and reinvested as of that date at a yield equal to the appropriate discount rate (as defined below); over

(ii) The sum of—

(A) The amount of the qualified payments actually paid during the same period;

(B) The earnings on those payments, determined hypothetically as if each payment were reinvested as of the date actually paid at a yield equal to the appropriate discount rate; and

(C) To the extent required to prevent double inclusion, by an amount equal to the sum of—

(1) The portion of the fair market value of the qualified payment interest solely attributable to any right to receive unpaid qualified payments determined as of the date of the taxable event;

(2) The fair market value of any equity interest in the entity received by the individual in lieu of qualified payments and held by the individual at the taxable event, and

(3) The amount by which the individual's aggregate taxable gifts were increased by reason of the failure of the individual to enforce the right to receive qualified payments.

(2) *Due date of qualified payments.* With respect to any qualified payment, the "due date" is that date specified in the governing instrument as the date on which payment is to be made. If no date is specified in the governing instrument, the due date is the last day of each calendar year.

(3) *Appropriate discount rate.* The appropriate discount rate is the discount rate that was applied in determining the value of the qualified payment right at the time of the transfer to which section 2701 applied.

(4) *Application of payments.* For purposes of this section, any payment of an unpaid qualified payment is applied in satisfaction of unpaid qualified payments beginning with the earliest unpaid qualified payment. Any payment in excess of the total of all unpaid qualified payments is treated as a prepayment of future qualified payments.

(5) *Payment.* For purposes of this paragraph (c), the transfer of a debt obligation bearing compound interest from the due date of the payment at a rate not less than the appropriate discount rate is a qualified payment if the term of the obligation (including extensions) does not exceed four years from the date issued. A payment in the form of an equity interest in the entity is not a qualified payment. Any payment of a qualified payment made (or treated as made) either before or during the four-year period beginning on the due date of the payment but before the date of the taxable event is treated as having been made on the due date.

(6) *Limitation—(i) In general.* The amount of the increase to an individual's taxable estate or taxable gifts is limited to the applicable percentage of the excess, if any, of—

(A) The sum of—

(1) The fair market value of all outstanding equity interests in the entity that are subordinate to the applicable retained interest, determined as of the date of the taxable event without regard to any accrued liability attributable to unpaid qualified payments; and

(2) Any amounts expended by the entity to redeem or otherwise acquire any such subordinate interest during the period beginning on the date of the transfer to which section 2701 applied (or, in the case of an individual treated as an interest holder, on the date the interest of the prior interest holder terminated) and ending on the date of the taxable event (reduced by any amounts received on the resale or issuance of any such subordinate interest during the same period); over

(B) The fair market value of all outstanding equity interests in the entity that are subordinate to the applicable retained interest, determined as of the date of the transfer to which section 2701 applied (or, in the case of an individual treated as an interest holder, on the date the interest of the prior interest holder terminated).

(ii) *Computation of limitation.* For purposes of computing the limitation applicable under this paragraph (c)(6), the aggregate fair market value of the subordinate interests in the entity are determined without regard to § 25.2701-3(c).

(iii) *Applicable percentage.* The applicable percentage is determined by dividing the number of shares or units of the applicable retained interest held by the interest holder (or an individual treated as the interest holder) on the date of the taxable event by the total number of such shares or units outstanding on the same date. If an individual holds applicable retained interests in two or more classes of interests, the applicable percentage is equal to the largest applicable percentage determined with respect to any class. For example, if T retains 40 percent of the class A preferred and 60 percent of the

class B preferred in a corporation, the applicable percentage with respect to T's holdings is 60 percent.

(d) *Taxpayer election*—(1) *In general.* An interest holder (or individual treated as an interest holder) may elect to treat as a taxable event the payment of an unpaid qualified payment occurring more than four years after its due date. Under this election, the increase under paragraph (c) of this section is determined only with respect to that payment and all previous payments for which an election was available but not made. Payments for which an election applies are treated as having been paid on their due dates for purposes of subsequent taxable events. The election is revocable only with the consent of the Commissioner.

(2) *Limitation not applicable.* If a taxable event occurs by reason of an election described in paragraph (d)(1) of this section, the limitation described in paragraph (c)(6) of this section does not apply.

(3) *Time and manner of election*—(i) *Timely-filed returns.* The election may be made by attaching a statement to a Form 709, Federal Gift Tax Return, filed by the recipient of the qualified payment on a timely basis for the year in which the qualified payment is received. In that case, the taxable event is deemed to occur on the date the qualified payment is received.

(ii) *Election on late returns.* The election may be made by attaching a statement to a Form 709, Federal Gift Tax Return, filed by the recipient of the qualified payment other than on a timely basis for the year in which the qualified payment is received. In that case, the taxable event is deemed to occur on the first day of the month immediately preceding the month in which the return is filed. If an election, other than an election on a timely return, is made after the death of the interest holder, the taxable event with respect to the decedent is deemed to occur on the later of—

(A) The date of the recipient's death, or

(B) The first day of the month immediately preceding the month in which the return is filed.

(iii) *Requirements of statement.* The statement must—

(A) Provide the name, address, and taxpayer identification number of the electing individual and the interest holder, if different;

(B) Indicate that a taxable event election is being made under paragraph (d) of this section;

(C) Disclose the nature of the qualified payment right to which the election applies, including the due dates of the payments, the dates the payments were made, and the amounts of the payments;

(D) State the name of the transferor, the date of the transfer to which section 2701 applied, and the discount rate used in valuing the qualified payment right; and

(E) State the resulting amount of increase in taxable gifts.

(4) *Example.* The following example illustrates the rules of this paragraph (d).

Example. A holds cumulative preferred stock that A retained in a transfer to which section 2701 applied. No dividends were paid in years 1 through 5 following the transfer. In year 6, A received a qualified payment that, pursuant to paragraph (c)(3) of this section, is considered to be in satisfaction of the unpaid qualified payment for year 1. No election was made to treat that payment as a taxable event. In year 7, A receives a qualified payment that, pursuant to paragraph (c)(4) of this section, is considered to be in satisfaction of the unpaid qualified payment for year 2. A elects to treat the payment in year 7 as a taxable event. The election increases A's taxable gifts in year 7 by the amount computed under paragraph (c) of this section with respect to the payments due in both year 1 and year 2. For purposes of any future taxable events, the payments with respect to years 1 and 2 are treated as having been made on their due dates.

[T.D. 8395, 57 FR 4261, Feb. 4, 1992]

§ 25.2701-5 Adjustments to mitigate double taxation.

(a) *Reduction of transfer tax base*—(1) *In general.* This section provides rules under which an individual (the initial transferor) making a transfer subject to section 2701 (the initial transfer) is entitled to reduce his or her taxable gifts or adjusted taxable gifts (the reduction). The amount of the reduction is determined under paragraph (b) of this section. See paragraph (e) of this section if section 2513 (split gifts) applied to the initial transfer.

(2) *Federal gift tax modification.* If, during the lifetime of the initial transferor, the holder of a section 2701 interest (as defined in paragraph (a)(4) of this section) transfers the interest to or for the benefit of an individual other than the initial transferor or an applicable family member of the initial transferor in a transfer subject to Federal estate or gift tax, the initial transferor may reduce the amount on which the initial transferor's tentative tax is computed under section 2502(a). The reduction is first applied on any gift tax return required to be filed for the calendar year in which the section 2701 interest is transferred; any excess reduction is carried forward and applied in each succeeding calendar year until the reduction is exhausted. The amount of the reduction that is used in a calendar year is the amount of the initial transferor's taxable gifts for that year. Any excess reduction remaining at the death of the initial transferor may be applied by the executor of the initial transferor's estate as provided under paragraph (a)(3) of this section. See paragraph (a)(4) of this section for the definition of a section 2701 interest. See § 25.2701-6 for rules relating to indirect ownership of equity interests transferred to trusts and other entities.

(3) *Federal estate tax modification.* Except as otherwise provided in this paragraph (a)(3), in determining the Federal estate tax with respect to an initial transferor, the executor of the initial transferor's estate may reduce the amount on which the decedent's tentative tax is computed under section 2001(b) (or section 2101(b)) by the amount of the reduction (including any excess reduction carried forward under paragraph (a)(2) of this section). The amount of the reduction under this paragraph (a)(3) is limited to the amount that results in zero Federal estate tax with respect to the estate of the initial transferor.

(4) *Section 2701 interest.* A section 2701 interest is an applicable retained interest that was valued using the special valuation rules of section 2701 at the time of the initial transfer. However, an interest is a section 2701 interest only to the extent the transfer of that interest effectively reduces the aggregate ownership of such class of interest

by the initial transferor and applicable family members of the initial transferor below that held by such persons at the time of the initial transfer (or the remaining portion thereof).

(b) *Amount of reduction.* Except as otherwise provided in paragraphs (c)(3)(iv) (pertaining to transfers of partial interests) and (e) (pertaining to initial split gifts) of this section, the amount of the reduction is the lesser of—

(1) The amount by which the initial transferor's taxable gifts were increased as a result of the application of section 2701 to the initial transfer; or

(2) The amount (determined under paragraph (c) of this section) duplicated in the transfer tax base at the time of the transfer of the section 2701 interest (the duplicated amount).

(c) *Duplicated amount—*(1) *In general.* The duplicated amount is the amount by which the transfer tax value of the section 2701 interest at the time of the subsequent transfer exceeds the value of that interest determined under section 2701 at the time of the initial transfer. If, at the time of the initial transfer, the amount allocated to the transferred interest under § 25.2701-3(b)(3) (*Step 3* of the valuation methodology) is less than the entire amount available for allocation at that time, the duplicated amount is a fraction of the amount described in the preceding sentence. The numerator of the fraction is the amount allocated to the transferred interest at the time of the initial transfer (pursuant to § 25.2701-3(b)(3)) and the denominator of the fraction is the amount available for allocation at the time of the initial transfer (determined after application of § 25.2701-3(b)(2)).

(2) *Transfer tax value—in general.* Except as provided in paragraph (c)(3) of this section, for purposes of paragraph (c)(1) of this section the transfer tax value of a section 2701 interest is the value of that interest as finally determined for Federal transfer tax purposes under chapter 11 or chapter 12, as the case may be (including the right to receive any distributions thereon (other than qualified payments)), reduced by the amount of any deduction allowed with respect to the section 2701 interest to the extent that the deduction

would not have been allowed if the section 2701 interest were not included in the transferor's total amount of gifts for the calendar year or the transferor's gross estate, as the case may be. Rules similar to the rules of section 691(c)(2)(C) are applicable to determine the extent that a deduction would not be allowed if the section 2701 interest were not so included.

(3) *Special transfer tax value rules—(i) Transfers for consideration.* Except as provided in paragraph (c)(3)(iii) of this section, if, during the life of the initial transferor, a section 2701 interest is transferred to or for the benefit of an individual other than the initial transferor or an applicable family member of the initial transferor for consideration in money or money's worth, or in a transfer that is treated as a transfer for consideration in money or money's worth, the transfer of the section 2701 interest is deemed to occur at the death of the initial transferor. In this case, the estate of the initial transferor is entitled to a reduction in the same manner as if the initial transferor's gross estate included a section 2701 interest having a chapter 11 value equal to the amount of consideration in money or money's worth received in the exchange (determined as of the time of the exchange).

(ii) *Interests held by applicable family members at date of initial transferor's death.* If a section 2701 interest in existence on the date of the initial transferor's death is held by an applicable family member and, therefore, is not included in the gross estate of the initial transferor, the section 2701 interest is deemed to be transferred at the death of the initial transferor to or for the benefit of an individual other than the initial transferor or an applicable family member of the initial transferor. In this case, the transfer tax value of that interest is the value that the executor of the initial transferor's estate can demonstrate would be determined under chapter 12 if the interest were transferred immediately prior to the death of the initial transferor.

(iii) *Nonrecognition transactions.* If an individual exchanges a section 2701 interest in a nonrecognition transaction (within the meaning of section 7701(a)(45)), the exchange is not treated

as a transfer of a section 2701 interest and the transfer tax value of that interest is determined as if the interest received in exchange is the section 2701 interest.

(iv) *Transfer of less than the entire section 2701 interest.* If a transfer is a transfer of less than the entire section 2701 interest, the amount of the reduction under paragraph (a)(2) or (a)(3) of this section is reduced proportionately.

(v) *Multiple classes of section 2701 interest.* For purposes of paragraph (b) of this section, if more than one class of section 2701 interest exists, the amount of the reduction is determined separately with respect to each such class.

(vi) *Multiple initial transfers.* If an initial transferor has made more than one initial transfer, the amount of the reduction with respect to any section 2701 interest is the sum of the reductions computed under paragraph (b) of this section with respect to each such initial transfer.

(d) *Examples.* The following examples illustrate the provisions of paragraphs (a) through (c) of this section.

Facts—(1) In general. (i) P, an individual, holds 1,500 shares of \$1,000 par value preferred stock of X corporation (bearing an annual noncumulative dividend of \$100 per share that may be put to X at any time for par value) and 1,000 shares of voting common stock of X. There is no other outstanding common stock of X.

(ii) On January 15, 1991, when the aggregate fair market value of the preferred stock is \$1,500,000 and the aggregate fair market value of the common stock is \$500,000, P transfers common stock to P's child. The fair market value of P's interest in X (common and preferred) immediately prior to the transfer is \$2,000,000, and the section 2701 value of the preferred stock (the section 2701 interest) is zero. Neither P nor P's spouse, S, made gifts prior to 1991.

(2) *Additional facts applicable to Examples 1 through 3.* P's transfer consists of all 1,000 shares of P's common stock. With respect to the initial transfer, the amount remaining after Step 2 of the subtraction method of § 25.2701-3 is \$2,000,000 (\$2,000,000 minus zero), all of which is allocated to the transferred stock. P's aggregate taxable gifts for 1991 (including the section 2701 transfer) equal \$2,500,000.

(3) *Additional facts applicable to Examples 4 and 5.* P's initial transfer consists of one-half of P's common stock. With respect to the initial transfer in this case, only \$1,000,000 (one-half of the amount remaining after Step 2 of the subtraction method of § 25.2701-3) is

allocated to the transferred stock. P's aggregate taxable gifts for 1991 (the section 2701 transfer and P's other transfers) equal \$2,500,000.

Example 1. Inter vivos transfer of entire section 2701 interest. (i) On October 1, 1994, at a time when the value of P's preferred stock is \$1,400,000, P transfers all of the preferred stock to P's child. In computing P's 1994 gift tax, P, as the initial transferor, is entitled to reduce the amount on which P's tentative tax is computed under section 2502(a) by \$1,400,000.

(ii) The amount of the reduction computed under paragraph (b) of this section is the lesser of \$1,500,000 (the amount by which the initial transferor's taxable gifts were increased as a result of the application of section 2701 to the initial transfer) or \$1,400,000 (the duplicated amount). The duplicated amount is 100 percent (the portion of the section 2701 interest subsequently transferred) times \$1,400,000 (the amount by which the gift tax value of the preferred stock (\$1,400,000 at the time of the subsequent transfer) exceeds zero (the section 2701 value of the preferred stock at the time of the initial transfer)).

(iii) The result would be the same if the preferred stock had been held by P's parent, GM, and GM had, on October 1, 1994, transferred the preferred stock to or for the benefit of an individual other than P or an applicable family member of P. In that case, in computing the tax on P's 1994 and subsequent transfers, P would be entitled to reduce the amount on which P's tentative tax is computed under section 2502(a) by \$1,400,000. If the value of P's 1994 gifts is less than \$1,400,000, P is entitled to claim the excess adjustment in computing the tax with respect to P's subsequent transfers.

Example 2. Transfer of section 2701 interest at death of initial transferor. (i) P continues to hold the preferred stock until P's death. The chapter 11 value of the preferred stock at the date of P's death is the same as the fair market value of the preferred stock at the time of the initial transfer. In computing the Federal estate tax with respect to P's estate, P's executor is entitled to a reduction of \$1,500,000 under paragraph (a)(3) of this section.

(ii) The result would be the same if P had sold the preferred stock to any individual other than an applicable family member at a time when the value of the preferred stock was \$1,500,000. In that case, the amount of the reduction is computed as if the preferred stock were included in P's gross estate at a fair market value equal to the sales price. If the value of P's taxable estate is less than \$1,500,000, the amount of the adjustment available to P's executor is limited to the actual value of P's taxable estate.

(iii) The result would also be the same if the preferred stock had been held by P's par-

ent, GM, and at the time of P's death, GM had not transferred the preferred stock.

Example 3. Transfer of after-acquired preferred stock. On September 1, 1992, P purchases 100 shares of X preferred stock from an unrelated party. On October 1, 1994, P transfers 100 shares of X preferred stock to P's child. In computing P's 1994 gift tax, P is not entitled to reduce the amount on which P's tentative tax is computed under section 2502(a) because the 1994 transfer does not reduce P's preferred stock holding below that held at the time of the initial transfer. See paragraph (a)(4) of this section.

Example 4. Inter vivos transfer of entire section 2701 interest. (i) On October 1, 1994, at a time when the value of P's preferred stock is \$1,400,000, P transfers all of the preferred stock to P's child. In computing P's 1994 gift tax, P, as the initial transferor, is entitled to reduce the amount on which P's tentative tax is computed under section 2502(a) by \$700,000.

(ii) The amount of the reduction computed under paragraph (b) of this section is the lesser of \$750,000 ($(\$1,500,000 \times .5)$ (\$1,000,000 over \$2,000,000)) the amount by which the initial transferor's taxable gifts were increased as a result of the application of section 2701 to the initial transfer) or \$700,000 ($(\$1,400,000 \times .5)$ the duplicated amount). The duplicated amount is 100 percent (the portion of the section 2701 interest subsequently transferred) times \$700,000; e.g., one-half (the fraction representing the portion of the common stock transferred in the initial transfer (\$1,000,000/\$2,000,000)) of the amount by which the gift tax value of the preferred stock at the time of the subsequent transfer (\$1,400,000) exceeds zero (the section 2701 value of the preferred stock at the time of the initial transfer).

Example 5. Subsequent transfer of less than the entire section 2701 interest. On October 1, 1994, at a time when the value of P's preferred stock is \$1,400,000, P transfers only 250 of P's 1,000 shares of preferred stock to P's child. In this case, the amount of the reduction computed under paragraph (b) is \$175,000 (one-fourth (250/1,000) of the amount of the reduction available if P had transferred all 1,000 shares of preferred stock).

(e) *Computation of reduction if initial transfer is split under section 2513—(1) In general.* If section 2513 applies to the initial transfer (a split initial transfer), the special rules of this paragraph (e) apply.

(2) *Transfers during joint lives.* If there is a split initial transfer and the corresponding section 2701 interest is transferred during the joint lives of the donor and the consenting spouse, for purposes of determining the reduction under paragraph (a)(2) of this section

each spouse is treated as if the spouse was the initial transferor of one-half of the split initial transfer.

(3) *Transfers at or after death of either spouse*—(i) *In general.* If there is a split initial transfer and the corresponding section 2701 interest is transferred at or after the death of the first spouse to die, the reduction under paragraph (a)(2) or (a)(3) of this section is determined as if the donor spouse was the initial transferor of the entire initial transfer.

(ii) *Death of donor spouse.* Except as provided in paragraph (e)(3)(iv) of this section, the executor of the estate of the donor spouse in a split initial transfer is entitled to compute the reduction as if the donor spouse was the initial transferor of the section 2701 interest otherwise attributable to the consenting spouse. In this case, if the consenting spouse survives the donor spouse—

(A) The consenting spouse's aggregate sum of taxable gifts used in computing each tentative tax under section 2502(a) (and, therefore, adjusted taxable gifts under section 2001(b)(1)(B) (or section 2101(b)(1)(B)) and the tax payable on the consenting spouse's prior taxable gifts under section 2001(b)(2) (or section 2101(b)(2))) is reduced to eliminate the remaining effect of the section 2701 interest; and

(B) Except with respect to any excess reduction carried forward under paragraph (a)(2) of this section, the consenting spouse ceases to be treated as the initial transferor of the section 2701 interest.

(iii) *Death of consenting spouse.* If the consenting spouse predeceases the donor spouse, except for any excess reduction carried forward under paragraph (a)(2) of this section, the reduction with respect to any section 2701 interest in the split initial transfer is not available to the estate of the consenting spouse (regardless of whether the interest is included in the consenting spouse's gross estate). Similarly, if the consenting spouse predeceases the donor spouse, no reduction is available to the consenting spouse's adjusted taxable gifts under section 2001(b)(1)(B) (or section 2101(b)(1)(B)) or to the consenting spouse's gift tax payable under section

2001(b)(2) (or section 2101(b)(2)). See paragraph (a)(2) of this section for rules involving transfers by an applicable family member during the life of the initial transferor.

(iv) *Additional limitation on reduction.* If the donor spouse (or the estate of the donor spouse) is treated under this paragraph (e) as the initial transferor of the section 2701 interest otherwise attributable to the consenting spouse, the amount of additional reduction determined under paragraph (b) of this section is the amount determined under that paragraph with respect to the consenting spouse. If a reduction was previously available to the consenting spouse under this paragraph (e), the amount determined under this paragraph (e)(3)(iv) with respect to the consenting spouse is determined as if the consenting spouse's taxable gifts in the split initial transfer had been increased only by that portion of the increase that corresponds to the remaining portion of the section 2701 interest. The amount of the additional reduction (i.e., the amount determined with respect to the consenting spouse) is limited to the amount that results in a reduction in the donor spouse's Federal transfer tax no greater than the amount of the increase in the consenting spouse's gift tax incurred by reason of the section 2701 interest (or the remaining portion thereof).

(f) *Examples.* The following examples illustrate the provisions of paragraph (e) of this section. The examples assume the facts set out in this paragraph (f).

Facts. (1) In each example assume that P, an individual, holds 1,500 shares of \$1,000 par value preferred stock of X corporation (bearing an annual noncumulative dividend of \$100 per share that may be put to X at any time for par value) and 1,000 shares of voting common stock of X. There is no other outstanding stock of X. The annual exclusion under section 2503 is not allowable with respect to any gift.

(2) On January 15, 1991, when the aggregate fair market value of the preferred stock is \$1,500,000 and the aggregate fair market value of the common stock is \$500,000, P transfers all 1,000 shares of the common stock to P's child. Section 2701 applies to the initial transfer because P transferred an equity interest (the common stock) to a member of P's family and immediately thereafter

held an applicable retained interest (the preferred stock). The fair market value of P's interest in X immediately prior to the transfer is \$2,000,000 and the section 2701 value of the preferred stock (the section 2701 interest) is zero. With respect to the initial transfer, the amount remaining after Step 2 of the subtraction method of § 25.2701-3 was \$2,000,000 (\$2,000,000 minus zero), all of which is allocated to the transferred stock. P had made no gifts prior to 1991. The sum of P's aggregate taxable gifts for the calendar year 1991 (including the section 2701 transfer) is \$2,500,000. P's spouse, S, made no gifts prior to 1991.

(3) P and S elected pursuant to section 2513 to treat one-half of their 1991 gifts as having been made by each spouse. Without the application of section 2701, P and S's aggregate gifts would have been \$500,000 and each spouse would have paid no gift tax because of the application of the unified credit under section 2505. However, because of the application of section 2701, both P and S are each treated as the initial transferor of aggregate taxable gifts in the amount of \$1,250,000 and, after the application of the unified credit under section 2505, each paid \$255,500 in gift tax with respect to their 1991 transfers. On October 1, 1994, at a time when the value of the preferred stock is the same as at the time of the initial transfer, P transfers the preferred stock (the section 2701 interest) to P's child.

Example 1. Inter vivos transfer of entire section 2701 interest. P transfers all of the preferred stock to P's child. P and S are each entitled to a reduction of \$750,000 in computing their 1994 gift tax. P is entitled to the reduction because P subsequently transferred the one-half share of the section 2701 interest as to which P was the initial transferor to an individual who was not an applicable family member of P. S is entitled to the reduction because P, an applicable family member with respect to S, transferred the one-half share of the section 2701 interest as to which S was the initial transferor to an individual other than S or an applicable family member of S. S may claim the reduction against S's 1994 gifts. If S's 1994 taxable gifts are less than \$750,000, S may claim the remaining amount of the reduction against S's next succeeding lifetime transfers.

Example 2. Inter vivos transfer of portion of section 2701 interest. P transfers one-fourth of the preferred stock to P's child. In this case, P and S are each entitled to a reduction of \$187,500, the corresponding portion of the reduction otherwise available to each spouse (one-fourth of \$750,000).

Example 3. Transfer at death of donor spouse. P, the donor spouse in the section 2513 election, dies on October 1, 1994, while holding all of the preferred stock. The executor of P's estate is entitled to a reduction in the computation of the tentative tax under sec-

tion 2001(b). Since no reduction had been previously available with respect to the section 2701 interest, P's estate is entitled to a full reduction of \$750,000 with respect to the one-half share of the preferred stock as to which P was the initial transferor. In addition, P's estate is entitled to an additional reduction of up to \$750,000 for the remaining section 2701 interest as to which S was the initial transferor. The reduction for the consenting spouse's remaining section 2701 interest is limited to that amount that will produce a tax saving in P's Federal estate tax of \$255,500, the amount of gift tax incurred by S by reason of the application of section 2701 to the split initial transfer.

Example 4. Transfer after death of donor spouse. The facts are the same as in *Example 3*, except that S acquires the preferred stock from P's estate and subsequently transfers the preferred stock to S's child. S is not entitled to a reduction because S ceased to be an initial transferor upon P's death (and S's prior taxable gifts were automatically adjusted at that time to the level that would have existed had the split initial transfer not been subject to section 2701).

Example 5. Death of donor spouse after inter vivos transfer. (i) P transfers one-fourth of the preferred stock to P's child. In this case, P and S are each entitled to a reduction of \$187,500, the corresponding portion of the reduction otherwise available to each spouse (one-fourth of \$750,000). S may claim the reduction against S's 1994 or subsequent transfers. P dies on November 1, 1994.

(ii) P's executor is entitled to include, in computing the reduction available to P's estate, the remaining reduction to which P is entitled and an additional amount of up to \$562,500 (\$750,000 minus \$187,500, the amount of the remaining reduction attributable to the consenting spouse determined immediately prior to P's death). The amount of additional reduction available to P's estate cannot exceed the amount that will reduce P's estate tax by \$178,625, the amount that S's 1991 gift tax would have been increased if the application of section 2701 had increased S's taxable gifts by only \$562,500 (\$750,000 - \$187,500).

(g) *Double taxation otherwise avoided.* No reduction is available under this section if—

(1) Double taxation is otherwise avoided in the computation of the estate tax under section 2001 (or section 2101); or

(2) A reduction was previously taken under the provisions of section 2701(e)(6) with respect to the same section 2701 interest and the same initial transfer.

(h) *Effective date.* This section is effective for transfers of section 2701 interests after May 4, 1994. If the transfer of a section 2701 interest occurred on or before May 4, 1994, the initial transferor may rely on either this section, project PS-30-91 (1991-2 C.B. 1118, and 1992-1 C.B. 1239 (see § 601.601(d)(2)(ii)(b) of this chapter)) or any other reasonable interpretation of the statute.

[T.D. 8536, 59 FR 23154, May 5, 1994]

§ 25.2701-6 Indirect holding of interests.

(a) *In general*—(1) *Attribution to individuals.* For purposes of section 2701, an individual is treated as holding an equity interest to the extent the interest is held indirectly through a corporation, partnership, estate, trust, or other entity. If an equity interest is treated as held by a particular individual in more than one capacity, the interest is treated as held by the individual in the manner that attributes the largest total ownership of the equity interest. An equity interest held by a lower-tier entity is attributed to higher-tier entities in accordance with the rules of this section. For example, if an individual is a 50-percent beneficiary of a trust that holds 50 percent of the preferred stock of a corporation, 25 percent of the preferred stock is considered held by the individual under these rules.

(2) *Corporations.* A person is considered to hold an equity interest held by or for a corporation in the proportion that the fair market value of the stock the person holds bears to the fair market value of all the stock in the corporation (determined as if each class of stock were held separately by one individual). This paragraph applies to any entity classified as a corporation or as an association taxable as a corporation for federal income tax purposes.

(3) *Partnerships.* A person is considered to hold an equity interest held by or for a partnership in the proportion that the fair market value of the larger of the person's profits interest or capital interest in the partnership bears to the total fair market value of the corresponding profits interests or capital interests in the partnership, as the case may be (determined as if each class were held by one individual). This

paragraph applies to any entity classified as a partnership for federal income tax purposes.

(4) *Estates, trusts and other entities*—(i) *In general.* A person is considered to hold an equity interest held by or for an estate or trust to the extent the person's beneficial interest therein may be satisfied by the equity interest held by the estate or trust, or the income or proceeds thereof, assuming the maximum exercise of discretion in favor of the person. A beneficiary of an estate or trust who cannot receive any distribution with respect to an equity interest held by the estate or trust, including the income therefrom or the proceeds from the disposition thereof, is not considered the holder of the equity interest. Thus, if stock held by a decedent's estate has been specifically bequeathed to one beneficiary and the residue of the estate has been bequeathed to other beneficiaries, the stock is considered held only by the beneficiary to whom it was specifically bequeathed. However, any person who may receive distributions from a trust is considered to hold an equity interest held by the trust if the distributions may be made from current or accumulated income from or the proceeds from the disposition of the equity interest, even though under the terms of the trust the interest can never be distributed to that person. This paragraph applies to any entity that is not classified as a corporation, an association taxable as a corporation, or a partnership for federal income tax purposes.

(ii) *Special rules*—(A) Property is held by a decedent's estate if the property is subject to claims against the estate and expenses of administration.

(B) A person holds a beneficial interest in a trust or an estate so long as the person may receive distributions from the trust or the estate other than payments for full and adequate consideration.

(C) An individual holds an equity interest held by or for a trust if the individual is considered an owner of the trust (a "grantor trust") under subpart E, part 1, subchapter J of the Internal Revenue Code (relating to grantors and others treated as substantial owners). However, if an individual is treated as the owner of only a fractional share of

a grantor trust because there are multiple grantors, the individual holds each equity interest held by the trust, except to the extent that the fair market value of the interest exceeds the fair market value of the fractional share.

(5) *Multiple attribution*—(i) *Applicable retained interests*. If this section attributes an applicable retained interest to more than one individual in a class consisting of the transferor and one or more applicable family members, the interest is attributed within that class in the following order—

(A) If the interest is held in a grantor trust, to the individual treated as the holder thereof;

(B) To the transferor;

(C) To the transferor's spouse; or

(D) To each applicable family member on a pro rata basis.

(ii) *Subordinate equity interests*. If this section attributes a subordinate equity interest to more than one individual in a class consisting of the transferor, applicable family members, and members of the transferor's family, the interest is attributed within that class in the following order—

(A) To the transferee;

(B) To each member of the transferor's family on a pro rata basis;

(C) If the interest is held in a grantor trust, to the individual treated as the holder thereof;

(D) To the transferor;

(E) To the transferor's spouse; or

(F) To each applicable family member on a pro rata basis.

(b) *Examples*. The following examples illustrate the provisions of this section:

Example 1. A, an individual, holds 25 percent by value of each class of stock of Y Corporation. Persons unrelated to A hold the remaining stock. Y holds 50 percent of the stock of Corporation X. Under paragraph (a)(2) of this section, Y's interests in X are attributed proportionately to the shareholders of Y. Accordingly, A is considered to hold a 12.5 percent (25 percent \times 50 percent) interest in X.

Example 2. Z Bank's authorized capital consists of 100 shares of common stock and 100 shares of preferred stock. A holds 60 shares of each (common and preferred) and A's child, B, holds 40 shares of common stock. Z holds the balance of its own preferred stock, 30 shares as part of a common trust fund it maintains and 10 shares permanently set

aside to satisfy a deferred obligation. For purposes of section 2701, A holds 60 shares of common stock and 66 shares of preferred stock in Z, 60 shares of each class directly and 6 shares of preferred stock indirectly (60 percent of the 10 shares set aside to fund the deferred obligation).

Example 3. An irrevocable trust holds a 10-percent general partnership interest in Partnership Q. One-half of the trust income is required to be distributed to O Charity. The other one-half of the income is to be distributed to D during D's life and thereafter to E for such time as E survives D. D holds one-half of the trust's interest in Q by reason of D's present right to receive one-half of the trust's income, and E holds one-half of the trust's interest in Q by reason of E's future right to receive one-half of the trust's income. Nevertheless, no family member is treated as holding more than one-half of the trust's interest in Q because at no time will either D or E actually hold, in the aggregate, any right with respect to income or corpus greater than one-half.

Example 4. An irrevocable trust holds a 10-percent general partnership interest in partnership M. One-half of the trust income is to be paid to D for D's life. The remaining income may, in the trustee's discretion, be accumulated or paid to or for the benefit of a class that includes D's child F, in such amounts as the trustee determines. On the death of the survivor of D and F, the trust corpus is required to be distributed to O Charity. The trust's interest in M is held by the trust's beneficiaries to the extent that present and future income or corpus may be distributed to them. Accordingly, D holds one-half of the trust's interest in M because D is entitled to receive one-half of the trust income currently. F holds the entire value of the interest because F is a member of the class eligible to receive the entire trust income for such time as F survives D. See paragraph (a)(5) of this section for rules applicable in the case of multiple attribution.

Example 5. The facts are the same as in *Example 4*, except that all the income is required to be paid to O Charity for the trust's initial year. The result is the same as in *Example 4*.

[T.D. 8395, 57 FR 4263, Feb. 4, 1992]

§ 25.2701-7 Separate interests.

The Secretary may, by regulation, revenue ruling, notice, or other document of general application, prescribe rules under which an applicable retained interest is treated as two or more separate interests for purposes of section 2701. In addition, the Commissioner may, by ruling issued to a taxpayer upon request, treat any applicable retained interest as two or more

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separate interests as may be necessary and appropriate to carry out the purposes of section 2701.

[T.D. 8395, 57 FR 4264, Feb. 4, 1992]

§ 25.2701-8 Effective dates.

Sections 25.2701-1 through 25.2701-4 and §§ 25.2701-6 and 25.2701-7 are effective as of January 28, 1992. For transfers made prior to January 28, 1992, taxpayers may rely on any reasonable interpretation of the statutory provisions. For these purposes, the provisions of the proposed regulations and the final regulations are considered a reasonable interpretation of the statutory provisions.

[T.D. 8395, 57 FR 4264, Feb. 4, 1992]

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§ 25.2702-7 *Effective dates.*

[T.D. 6334, 23 FR 8904, Nov. 15, 1958; 25 FR 14021, Dec. 31, 1960, as amended by T.D. 9181, 70 FR 9223, Feb. 25, 2005]

§ 25.2702-1 Special valuation rules in the case of transfers of interests in trust.

(a) *Scope of section 2702.* Section 2702 provides special rules to determine the amount of the gift when an individual makes a transfer in trust to (or for the benefit of) a member of the individual's family and the individual or an applicable family member retains an interest in the trust. Section 25.2702-4 treats certain transfers of property as transfers in trust. Certain transfers, including transfers to a personal residence trust, are not subject to section 2702. See paragraph (c) of this section. Member of the family is defined in § 25.2702-2(a)(1). Applicable family member is defined in § 25.2701-1(d)(2).

(b) *Effect of section 2702.* If section 2702 applies to a transfer, the value of any interest in the trust retained by the transferor or any applicable family member is determined under § 25.2702-2(b). The amount of the gift, if any, is then determined by subtracting the value of the interests retained by the transferor or any applicable family member from the value of the transferred property. If the retained interest is not a qualified interest (as defined in § 25.2702-3), the retained interest is generally valued at zero, and the amount of the gift is the entire value of the property.

(c) *Exceptions to section 2702.* Section 2702 does not apply to the following transfers.

(1) *Incomplete gift.* A transfer no portion of which would be treated as a completed gift without regard to any consideration received by the transferor. If a transfer is wholly incomplete as to an undivided fractional share of the property transferred (without regard to any consideration received by the transferor), for purposes of this paragraph the transfer is treated as incomplete as to that share.

(2) *Personal residence trust.* A transfer in trust that meets the requirements of § 25.2702-5.

(3) *Charitable remainder trust.* (i) For transfers made on or after May 19, 1997, a transfer to a pooled income fund described in section 642(c)(5); a transfer to a charitable remainder annuity trust described in section 664(d)(1); a transfer to a charitable remainder

unitrust described in section 664(d)(2) if under the terms of the governing instrument the unitrust amount can be computed only under section 664(d)(2)(A); and a transfer to a charitable remainder unitrust if under the terms of the governing instrument the unitrust amount can be computed under section 664(d)(2) and (3) and either there are only two consecutive noncharitable beneficial interests and the transferor holds the second of the two interests, or the only permissible recipients of the unitrust amount are the transferor, the transferor's U.S. citizen spouse, or both the transferor and the transferor's U.S. citizen spouse.

(ii) For transfers made before May 19, 1997, a transfer in trust if the remainder interest in the trust qualifies for a deduction under section 2522.

(4) *Pooled income fund.* A transfer of property to a pooled income fund (as defined in section 642(c)(5)).

(5) *Charitable lead trust.* A transfer in trust if the only interest in the trust, other than the remainder interest or a qualified annuity or unitrust interest, is an interest that qualifies for deduction under section 2522.

(6) *Certain assignments of remainder interests.* The assignment of a remainder interest if the only retained interest of the transferor or an applicable family member is as the permissible recipient of distributions of income in the sole discretion of an independent trustee (as defined in section 674(c)).

(7) *Certain property settlements.* A transfer in trust if the transfer of an interest to a spouse is deemed to be for full and adequate consideration by reason of section 2516 (relating to certain property settlements) and the remaining interests in the trust are retained by the other spouse.

(8) *Transfer or assignment to a Qualified Domestic Trust.* A transfer or assignment (as described in section 2056(d)(2)(B)) by a noncitizen surviving spouse of property to a Qualified Domestic Trust under the circumstances described in § 20.2056A-4(b) of this chapter, where the surviving spouse retains an interest in the transferred property that is not a qualified interest and the

transfer is not described in sections 2702(a)(3)(A)(ii) or 2702(c)(4).

[T.D. 8395, 57 FR 4265, Feb. 4, 1992, as amended by T.D. 8612, 60 FR 43554, Aug. 22, 1995; T.D. 8791, 63 FR 68194, Dec. 10, 1998]

§ 25.2702-2 Definitions and valuation rules.

(a) *Definitions.* The following definitions apply for purposes of section 2702 and the regulations thereunder.

(1) *Member of the family.* With respect to any individual, member of the family means the individual's spouse, any ancestor or lineal descendant of the individual or the individual's spouse, any brother or sister of the individual, and any spouse of the foregoing.

(2) *Transfer in trust.* A transfer in trust includes a transfer to a new or existing trust and an assignment of an interest in an existing trust. Transfer in trust does not include—

(i) The exercise, release or lapse of a power of appointment over trust property that is not a transfer under chapter 12; or

(ii) The execution of a qualified disclaimer (as defined in section 2518).

(3) *Retained.* Retained means held by the same individual both before and after the transfer in trust. In the case of the creation of a term interest, any interest in the property held by the transferor immediately after the transfer is treated as held both before and after the transfer.

(4) *Interest.* An interest in trust includes a power with respect to a trust if the existence of the power would cause any portion of a transfer to be treated as an incomplete gift under chapter 12.

(5) *Holder.* The holder is the person to whom the annuity or unitrust interest is payable during the fixed term of that interest. References to holder shall also include the estate of that person.

(6) *Qualified interest.* Qualified interest means a qualified annuity interest, a qualified unitrust interest, or a qualified remainder interest. If a transferor retains a power to revoke a qualified annuity interest or qualified unitrust interest of the transferor's spouse, then the revocable qualified annuity or unitrust interest of the transferor's spouse is treated as a retained qualified interest of the transferor. In order for

the transferor to be treated as having retained a qualified interest under the preceding sentence, the interest of the transferor's spouse (the successor holder) must be an interest that meets the requirements of a qualified annuity interest in accordance with § 25.2702-3(b) and (d), or a qualified unitrust interest in accordance with § 25.2702-3(c) and (d), but for the transferor's retained power to revoke the interest.

(7) *Qualified annuity interest.* Qualified annuity interest means an interest that meets all the requirements of § 25.2702-3(b) and (d).

(8) *Qualified unitrust interest.* Qualified unitrust interest means an interest that meets all the requirements of § 25.2702-3(c) and (d).

(9) *Qualified remainder interest.* Qualified remainder interest means an interest that meets all the requirements of § 25.2702-3(f).

(10) *Governing instrument.* Governing instrument means the instrument or instruments creating and governing the operation of the trust arrangement.

(b) *Valuation of retained interests—(1) In general.* Except as provided in paragraphs (b)(2) and (c) of this section, the value of any interest retained by the transferor or an applicable family member is zero.

(2) *Qualified interest.* The value of a qualified annuity interest and a qualified remainder interest following a qualified annuity interest are determined under section 7520. The value of a qualified unitrust interest and a qualified remainder interest following a qualified unitrust interest are determined as if they were interests described in section 664.

(c) *Valuation of a term interest in certain tangible property—(1) In general.* If section 2702 applies to a transfer in trust of tangible property described in paragraph (c)(2) of this section ("tangible property"), the value of a retained term interest (other than a qualified interest) is not determined under section 7520 but is the amount the transferor establishes as the amount a willing buyer would pay a willing seller for the interest, each having reasonable knowledge of the relevant facts and neither being under any compulsion to buy or sell. If the

transferor cannot reasonably establish the value of the term interest pursuant to this paragraph (c)(1), the interest is valued at zero.

(2) *Tangible property subject to rule*—(i) *In general.* Except as provided in paragraph (c)(2)(ii) of this section, paragraph (c)(1) of this section applies only to tangible property—

(A) For which no deduction for depreciation or depletion would be allowable if the property were used in a trade or business or held for the production of income; and

(B) As to which the failure to exercise any rights under the term interest would not increase the value of the property passing at the end of the term interest.

(ii) *Exception for de minimis amounts of depreciable property.* In determining whether property meets the requirements of this paragraph (c)(2) at the time of the transfer in trust, improvements that would otherwise cause the property not to qualify are ignored if the fair market value of the improvements, in the aggregate, do not exceed 5 percent of the fair market value of the entire property.

(3) *Evidence of value of property.* The best evidence of the value of any term interest to which this paragraph (c) applies is actual sales or rentals that are comparable both as to the nature and character of the property and the duration of the term interest. Little weight is accorded appraisals in the absence of such evidence. Amounts determined under section 7520 are not evidence of what a willing buyer would pay a willing seller for the interest.

(4) *Conversion of property*—(i) *In general.* Except as provided in paragraph (c)(4)(iii) of this section, if a term interest in property is valued under paragraph (c)(1) of this section, and during the term the property is converted into property a term interest in which would not qualify for valuation under paragraph (c)(1) of this section, the conversion is treated as a transfer for no consideration for purposes of chapter 12 of the value of the unexpired portion of the term interest.

(ii) *Value of unexpired portion of term interest.* For purposes of paragraph (c)(4)(i) of this section, the value of the unexpired portion of a term interest is

the amount that bears the same relation to the value of the term interest as of the date of conversion (determined under section 7520 using the rate in effect under section 7520 on the date of the original transfer and the fair market value of the property as of the date of the original transfer) as the value of the term interest as of the date of the original transfer (determined under paragraph (c)(1) of this section) bears to the value of the term interest as of the date of the original transfer (determined under section 7520).

(iii) *Conversion to qualified annuity interest.* The conversion of tangible property previously valued under paragraph (c)(1) of this section into property a term interest in which would not qualify for valuation under paragraph (c)(1) of this section is not a transfer of the value of the unexpired portion of the term interest if the interest thereafter meets the requirements of a qualified annuity interest. The rules of § 25.2702-5(d)(8) (including governing instrument requirements) apply for purposes of determining the amount of the annuity payment required to be made and the determination of whether the interest meets the requirements of a qualified annuity interest.

(5) *Additions or improvements to property*—(i) *Additions or improvements substantially affecting nature of property.* If an addition or improvement is made to property a term interest in which was valued under paragraph (c)(1) of this section, and the addition or improvement affects the nature of the property to such an extent that the property would not be treated as property meeting the requirements of paragraph (c)(2) of this section if the property had included the addition or improvement at the time it was transferred, the entire property is deemed, for purposes of paragraph (c)(4) of this section, to convert (effective as of the date the addition or improvement is commenced) into property a term interest in which would not qualify for valuation under paragraph (c)(1) of this section.

(ii) *Other additions or improvements.* If an addition or improvement is made to property, a term interest in which was valued under paragraph (c)(1) of this

section, and the addition or improvement does not affect the nature of the property to such an extent that the property would not be treated as property meeting the requirements of paragraph (c)(2) of this section if the property had included the addition or improvement at the time it was transferred, the addition or improvement is treated as an additional transfer (effective as of the date the addition or improvement is commenced) subject to § 25.2702-2(b)(1).

(d) *Examples.* (1) The following examples illustrate the rules of § 25.2702-1 and § 25.2702-2. Each example assumes that all applicable requirements of those sections not specifically described in the example are met.

Example 1. A transfers property to an irrevocable trust, retaining the right to receive the income of the trust for 10 years. On the expiration of the 10-year term, the trust is to terminate and the trust corpus is to be paid to A's child. However, if A dies during the 10-year term, the entire trust corpus is to be paid to A's estate. Each retained interest is valued at zero because it is not a qualified interest. Thus, the amount of A's gift is the fair market value of the property transferred to the trust.

Example 2. A transfers property to an irrevocable trust, retaining a 10-year annuity interest that meets the requirements set forth in § 25.2702-3 for a qualified annuity interest. Upon expiration of the 10-year term, the trust is to terminate and the trust corpus is to be paid to A's child. The amount of A's gift is the fair market value of the property transferred to the trust less the value of the retained qualified annuity interest determined under section 7520.

Example 3. D transfers property to an irrevocable trust under which the income is payable to D's spouse for life. Upon the death of D's spouse, the trust is to terminate and the trust corpus is to be paid to D's child. D retains no interest in the trust. Although the spouse is an applicable family member of D under section 2702, the spouse has not retained an interest in the trust because the spouse did not hold the interest both before and after the transfer. Section 2702 does not apply because neither the transferor nor an applicable family member has retained an interest in the trust. The result is the same whether or not D elects to treat the transfer as a transfer of qualified terminable interest property under section 2056(b)(7).

Example 4. A transfers property to an irrevocable trust, under which the income is to be paid to A for life. Upon termination of the trust, the trust corpus is to be distributed to A's child. A also retains certain powers over

principal that cause the transfer to be wholly incomplete for federal gift tax purposes. Section 2702 does not apply because no portion of the transfer would be treated as a completed gift.

Example 5. The facts are the same as in *Example 4*, except that the trust is divided into separate fractional shares and A's retained powers apply to only one of the shares. Section 2702 applies except with respect to the share of the trust as to which A's retained powers cause the transfer to be an incomplete gift.

(2) The following facts apply for *Examples 6 through 8* (examples illustrating § 25.2702-2(c)—tangible property exception):

Facts. A transfers a painting having a fair market value of \$2,000,000 to A's child, B, retaining the use of the painting for 10 years. The painting does not possess an ascertainable useful life. Assume that the painting would not be depreciable if it were used in a trade or business or held for the production of income. Assume that the value of A's term interest, determined under section 7520, is \$1,220,000, and that A establishes that a willing buyer of A's interest would pay \$500,000 for the interest.

Example 6. A's term interest is not a qualified interest under § 25.2702-3. However, because of the nature of the property, A's failure to exercise A's rights with regard to the painting would not be expected to cause the value of the painting to be higher than it would otherwise be at the time it passes to B. Accordingly, A's interest is valued under § 25.2702-2(c)(1) at \$500,000. The amount of A's gift is \$1,500,000, the difference between the fair market value of the painting and the amount determined under § 25.2702-2(c)(1).

Example 7. Assume that the only evidence produced by A to establish the value of A's 10-year term interest is the amount paid by a museum for the right to use a comparable painting for 1 year. A asserts that the value of the 10-year term is 10 times the value of the 1-year term. A has not established the value of the 10-year term interest because a series of short-term rentals the aggregate duration of which equals the duration of the actual term interest does not establish what a willing buyer would pay a willing seller for the 10-year term interest. However, the value of the 10-year term interest is not less than the value of the 1-year term because it can be assumed that a willing buyer would pay no less for a 10-year term interest than a 1-year term interest.

Example 8. Assume that after 24 months A and B sell the painting for \$2,000,000 and invest the proceeds in a portfolio of securities. A continues to hold an income interest in the securities for the duration of the 10-year term. Under § 25.2702-2(c)(4) the conversion of

the painting into a type of property a term interest in which would not qualify for valuation under § 25.2702-2(c)(1) is treated as a transfer by A of the value of the unexpired portion of A's original term interest, unless the property is thereafter held in a trust meeting the requirements of a qualified annuity interest. Assume that the value of A's remaining term interest in \$2,000,000 (determined under section 7520 using the section 7520 rate in effect on the date of the original transfer) is \$1,060,000. The value of the unexpired portion of A's interest is \$434,426, the amount that bears the same relation to \$1,060,000 as \$500,000 (the value of A's interest as of the date of the original transfer determined under paragraph (c)(1) of this section) bears to \$1,220,000 (the value of A's interest as of the date of the original transfer determined under section 7520).

[T.D. 8395, 57 FR 4265, Feb. 4, 1992, as amended by T.D. 9181, 70 FR 9223, Feb. 25, 2005]

§ 25.2702-3 Qualified interests.

(a) *In general.* This section provides rules for determining if an interest is a qualified annuity interest, a qualified unitrust interest, or a qualified remainder interest.

(b) *Special rules for qualified annuity interests.* An interest is a qualified annuity interest only if it meets the requirements of this paragraph and paragraph (d) of this section.

(1) *Payment of annuity amount—(i) In general.* A qualified annuity interest is an irrevocable right to receive a fixed amount. The annuity amount must be payable to (or for the benefit of) the holder of the annuity interest at least annually. A right of withdrawal, whether or not cumulative, is not a qualified annuity interest. Issuance of a note, other debt instrument, option, or other similar financial arrangement, directly or indirectly, in satisfaction of the annuity amount does not constitute payment of the annuity amount.

(ii) *Fixed amount.* A fixed amount means—

(A) A stated dollar amount payable periodically, but not less frequently than annually, but only to the extent the amount does not exceed 120 percent of the stated dollar amount payable in the preceding year; or

(B) A fixed fraction or percentage of the initial fair market value of the property transferred to the trust, as finally determined for federal tax pur-

poses, payable periodically but not less frequently than annually, but only to the extent the fraction or percentage does not exceed 120 percent of the fixed fraction or percentage payable in the preceding year.

(iii) *Income in excess of the annuity amount.* An annuity interest does not fail to be a qualified annuity interest merely because the trust permits income in excess of the amount required to pay the annuity amount to be paid to or for the benefit of the holder of the qualified annuity interest. Nevertheless, the right to receive the excess income is not a qualified interest and is not taken into account in valuing the qualified annuity interest.

(2) *Incorrect valuations of trust property.* If the annuity is stated in terms of a fraction or percentage of the initial fair market value of the trust property, the governing instrument must contain provisions meeting the requirements of § 1.664-2(a)(1)(iii) of this chapter (relating to adjustments for any incorrect determination of the fair market value of the property in the trust).

(3) *Period for payment of annuity amount.* The annuity amount may be payable based on either the anniversary date of the creation of the trust or the taxable year of the trust. In either situation, the annuity amount may be paid annually or more frequently, such as semi-annually, quarterly, or monthly. If the payment is made based on the anniversary date, proration of the annuity amount is required only if the last period during which the annuity is payable to the grantor is a period of less than 12 months. If the payment is made based on the taxable year, proration of the annuity amount is required for each short taxable year of the trust during the grantor's term. The prorated amount is the annual annuity amount multiplied by a fraction, the numerator of which is the number of days in the short period and the denominator of which is 365 (366 if February 29 is a day included in the numerator).

(4) *Payment of the annuity amount in certain circumstances.* An annuity amount payable based on the anniversary date of the creation of the trust must be paid no later than 105 days

after the anniversary date. An annuity amount payable based on the taxable year of the trust may be paid after the close of the taxable year, provided the payment is made no later than the date by which the trustee is required to file the Federal income tax return of the trust for the taxable year (without regard to extensions). If the trustee reports for the taxable year pursuant to § 1.671-4(b) of this chapter, the annuity payment must be made no later than the date by which the trustee would have been required to file the Federal income tax return of the trust for the taxable year (without regard to extensions) had the trustee reported pursuant to § 1.671-4(a) of this chapter.

(5) *Additional contributions prohibited.* The governing instrument must prohibit additional contributions to the trust.

(c) *Special rules for qualified unitrust interests.* An interest is a qualified unitrust interest only if it meets the requirements of this paragraph and paragraph (d) of this section.

(1) *Payment of unitrust amount—(i) In general.* A qualified unitrust interest is an irrevocable right to receive payment periodically, but not less frequently than annually, of a fixed percentage of the net fair market value of the trust assets, determined annually. For rules relating to computation of the net fair market value of the trust assets see § 25.2522(c)-3(c)(2)(vii). The unitrust amount must be payable to (or for the benefit of) the holder of the unitrust interest at least annually. A right of withdrawal, whether or not cumulative, is not a qualified unitrust interest. Issuance of a note, other debt instrument, option, or other similar financial arrangement, directly or indirectly, in satisfaction of the unitrust amount does not constitute payment of the unitrust amount.

(ii) *Fixed percentage.* A fixed percentage is a fraction or percentage of the net fair market value of the trust assets, determined annually, payable periodically but not less frequently than annually, but only to the extent the fraction or percentage does not exceed 120 percent of the fixed fraction or percentage payable in the preceding year.

(iii) *Income in excess of unitrust amount.* A unitrust interest does not

fail to be a qualified unitrust interest merely because the trust permits income in excess of the amount required to pay the unitrust amount to be paid to or for the benefit of the holder of the qualified unitrust interest. Nevertheless, the right to receive the excess income is not a qualified interest and is not taken into account in valuing the qualified unitrust interest.

(2) *Incorrect valuations of trust property.* The governing instrument must contain provisions meeting the requirements of § 1.664-3(a)(1)(iii) of this chapter (relating to the incorrect determination of the fair market value of the property in the trust).

(3) *Period for payment of unitrust amount.* The unitrust amount may be payable based on either the anniversary date of the creation of the trust or the taxable year of the trust. In either situation, the unitrust amount may be paid annually or more frequently, such as semi-annually, quarterly, or monthly. If the payment is made based on the anniversary date, proration of the unitrust amount is required only if the last period during which the annuity is payable to the grantor is a period of less than 12 months. If the payment is made based on the taxable year, proration of the unitrust amount is required for each short taxable year of the trust during the grantor's term. The prorated amount is the annual unitrust amount multiplied by a fraction, the numerator of which is the number of days in the short period and the denominator of which is 365 (366 if February 29 is a day included in the numerator).

(4) *Payment of the unitrust amount in certain circumstances.* A unitrust amount payable based on the anniversary date of the creation of the trust must be paid no later than 105 days after the anniversary date. A unitrust amount payable based on the taxable year of the trust may be paid after the close of the taxable year, provided the payment is made no later than the date by which the trustee is required to file the Federal income tax return of the trust for the taxable year (without regard to extensions). If the trustee reports for the taxable year pursuant to § 1.671-4(b) of this chapter, the unitrust payment must be made no later than

the date by which the trustee would have been required to file the Federal income tax return of the trust for the taxable year (without regard to extensions) had the trustee reported pursuant to § 1.671-4(a) of this chapter.

(d) *Requirements applicable to qualified annuity interests and qualified unitrust interests*—(1) *In general.* To be a qualified annuity or unitrust interest, an interest must be a qualified annuity interest in every respect or a qualified unitrust interest in every respect. For example, if the interest consists of the right to receive each year a payment equal to the lesser of a fixed amount of the initial trust assets or a fixed percentage of the annual value of the trust assets, the interest is not a qualified interest. If, however, the interest consists of the right to receive each year a payment equal to the greater of a stated dollar amount or a fixed percentage of the initial trust assets or a fixed percentage of the annual value of the trust assets, the interest is a qualified interest that is valued at the greater of the two values. To be a qualified interest, the interest must meet the definition of and function exclusively as a qualified interest from the creation of the trust.

(2) *Contingencies.* A holder's qualified interest must be payable in any event to or for the benefit of the holder for the fixed term of that interest. Thus, payment of the interest cannot be subject to any contingency other than either the survival of the holder until the commencement, or throughout the term, of that holder's interest, or, in the case of a revocable interest described in § 25.2702-2(a)(6), the transferor's right to revoke the qualified interest of that transferor's spouse.

(3) *Amounts payable to other persons.* The governing instrument must prohibit distributions from the trust to or for the benefit of any person other than the holder of the qualified annuity or unitrust interest during the term of the qualified interest.

(4) *Term of the annuity or unitrust interest.* The governing instrument must fix the term of the annuity or unitrust and the term of the interest must be fixed and ascertainable at the creation of the trust. The term must be for the life of the holder, for a specified term

of years, or for the shorter (but not the longer) of those periods. Successive term interests for the benefit of the same individual are treated as the same term interest.

(5) *Commutation.* The governing instrument must prohibit commutation (prepayment) of the interest of the holder.

(6) *Use of debt obligations to satisfy the annuity or unitrust payment obligation*—

(i) *In general.* In the case of a trust created on or after September 20, 1999, the trust instrument must prohibit the trustee from issuing a note, other debt instrument, option, or other similar financial arrangement in satisfaction of the annuity or unitrust payment obligation.

(ii) *Special rule in the case of a trust created prior to September 20, 1999.* In the case of a trust created prior to September 20, 1999, the interest will be treated as a qualified interest under section 2702(b) if—

(A) Notes, other debt instruments, options, or similar financial arrangements are not issued after September 20, 1999, to satisfy the annuity or unitrust payment obligation; and

(B) Any notes or any other debt instruments that were issued to satisfy the annual payment obligation on or prior to September 20, 1999, are paid in full by December 31, 1999, and any option or similar financial arrangement issued to satisfy the annual payment obligation is terminated by December 31, 1999, such that the grantor receives cash or other trust assets in satisfaction of the payment obligation. For purposes of the preceding sentence, an option will be considered terminated only if the grantor receives cash or other trust assets equal in value to the greater of the required annuity or unitrust payment plus interest computed under section 7520 of the Internal Revenue Code, or the fair market value of the option.

(e) *Examples.* The following examples illustrate the rules of paragraphs (b), (c), and (d) of this section. Each example assumes that all applicable requirements for a qualified interest are met unless otherwise specifically stated.

Example 1. A transfers property to an irrevocable trust, retaining the right to receive the greater of \$10,000 or the trust income in

each year for a term of 10-years. Upon expiration of the 10-year term, the trust is to terminate and the entire trust corpus is to be paid to A's child, provided that if A dies within the 10-year term the trust corpus is to be paid to A's estate. A's annual payment right is a qualified annuity interest to the extent of the right to receive \$10,000 per year for 10 years or until A's prior death, and is valued under section 7520 without regard to the right to receive any income in excess of \$10,000 per year. The contingent reversion is valued at zero. The amount of A's gift is the fair market value of the property transferred to the trust less the value of the qualified annuity interest.

Example 2. U transfers property to an irrevocable trust, retaining the right to receive \$10,000 in each of years 1 through 3, \$12,000 in each of years 4 through 6, and \$15,000 in each of years 7 through 10. The interest is a qualified annuity interest to the extent of U's right to receive \$10,000 per year in years 1 through 3, \$12,000 in years 4 through 6, \$14,400 in year 7, and \$15,000 in years 8 through 10, because those amounts represent the lower of the amount actually payable each year or an amount that does not exceed 120 percent of the stated dollar amount for the preceding year.

Example 3. S transfers property to an irrevocable trust, retaining the right to receive \$50,000 in each of years 1 through 3 and \$10,000 in each of years 4 through 10. S's entire retained interest is a qualified annuity interest.

Example 4. R transfers property to an irrevocable trust retaining the right to receive annually an amount equal to the lesser of 8 percent of the initial fair market value of the trust property or the trust income for the year. R's annual payment right is not a qualified annuity interest to any extent because R does not have the irrevocable right to receive a fixed amount for each year of the term.

Example 5. A transfers property to an irrevocable trust, retaining the right to receive 5 percent of the net fair market value of the trust property, valued annually, for 10 years. The interest of A (and A's estate) to receive the unitrust amount for the specified term of 10 years in all events is a qualified unitrust interest for a term of 10 years.

Example 6. The facts are the same as in *Example 5*, except that if A dies within the 10-year term the unitrust amount will be paid to A's estate for an additional 35 years. As in *Example 5*, the interest of A (and A's estate) to receive the unitrust amount for a specified term of 10 years in all events is a qualified unitrust interest for a term of 10 years. However, the right of A's estate to continue to receive the unitrust amount after the expiration of the 10-year term if A dies within that 10-year period is not fixed and ascer-

tainable at the creation of the interest and is not a qualified unitrust interest.

Example 7. B transfers property to an irrevocable trust retaining the right to receive annually an amount equal to 8 percent of the initial fair market value of the trust property for 10 years. Upon expiration of the 10-year term, the trust is to terminate and the entire trust corpus is to be paid to B's child. The governing instrument provides that income in excess of the annuity amount may be paid to B's child in the trustee's discretion. B's interest is not a qualified annuity interest to any extent because a person other than the individual holding the term interest may receive distributions from the trust during the term.

Example 8. A transfers property to an irrevocable trust, retaining the right to receive an annuity equal to 6 percent of the initial net fair market value of the trust property for 10 years, or until A's prior death. At the expiration of the 10-year term, or on A's death prior to the expiration of the 10-year term, the annuity is to be paid to B, A's spouse, if then living, for 10 years or until B's prior death. A retains an inter vivos and testamentary power to revoke B's interest during the initial 10-year term. If not exercised by A during the initial 10-year term (whether during A's life or on A's death), A's right to revoke B's interest will lapse upon either A's death during the 10-year term, or the expiration of A's 10-year term (assuming A survives the term). Upon expiration of B's interest (or on the expiration of A's interest if A revokes B's interest or if B predeceases A), the trust terminates and the trust corpus is payable to A's child. Because A has made a completed gift of the remainder interest, the transfer of property to the trust is not incomplete as to all interests in the property and section 2702 applies. A's annuity interest (A's right to receive the annuity for 10 years, or until A's prior death) is a retained interest that is a qualified annuity interest under paragraphs (b) and (d) of this section. In addition, because A has retained the power to revoke B's interest, B's interest is treated as an interest retained by A for purposes of section 2702. B's successive annuity interest otherwise satisfies the requirements for a qualified interest contained in paragraph (d) of this section, but for A's power to revoke. The term of B's interest is specified in the governing instrument and is fixed and ascertainable at the creation of the trust, and B's right to receive the annuity is contingent only on B's survival, and A's power to revoke. Following the expiration of A's interest, the annuity is to be paid for a 10-year term or for B's (the successor holder's) life, whichever is shorter. Accordingly, A is treated as retaining B's revocable qualified annuity interest pursuant to § 25.2702-2(a)(6). Because both A's interest and B's interest are treated as qualified interests retained by A,

the value of the gift is the value of the property transferred to the trust less the value of both A's qualified interest and B's qualified interest (subject to A's power to revoke), each valued as a single-life annuity. If A survives the 10-year term without having revoked B's interest, then A's power to revoke lapses and A will make a completed gift to B at that time. Further, if A revokes B's interest prior to the commencement of that interest, A is treated as making an additional completed gift at that time to A's child. In either case, the amount of the gift would be the present value of B's interest determined under section 7520 and the applicable regulations, as of the date the revocation power lapses or the interest is revoked. See § 25.2511-2(f).

Example 9. (i) A transfers property to an irrevocable trust, retaining the right to receive 6 percent of the initial net fair market value of the trust property for 10 years, or until A's prior death. If A survives the 10-year term, the trust terminates and the trust corpus is payable to A's child. If A dies prior to the expiration of the 10-year term, the annuity is payable to B, A's spouse, if then living, for the balance of the 10-year term, or until B's prior death. A retains the right to revoke B's interest. Upon expiration of B's interest (or upon A's death if A revokes B's interest or if B predeceases A), the trust terminates and the trust corpus is payable to A's child. As is the case in *Example 8*, A's retained annuity interest (A's right to receive the annuity for 10 years, or until A's prior death) is a qualified annuity interest under paragraphs (b) and (d) of this section. However, B's interest does not meet the requirements of paragraph (d) of this section. The term of B's annuity is not fixed and ascertainable at the creation of the trust, because it is not payable for the life of B, a specified term of years, or for the shorter of those periods. Rather, B's annuity is payable for an unspecified period that will depend upon the number of years left in the original term after A's death. Further, B's annuity is payable only if A dies prior to the expiration of the 10-year term. Thus, payment of B's annuity is not dependent solely on B's survival, but rather is dependent on A's failure to survive.

(ii) Accordingly, the amount of the gift is the fair market value of the property transferred to the trust reduced by the value of A's qualified interest (A's right to receive the stated annuity for 10 years or until A's prior death). B's interest is not a qualified interest and is thus valued at zero under section 2702.

(f) *Qualified remainder interest*—(1) *Requirements.* An interest is a qualified remainder interest only if it meets all of the following requirements:

(i) It is a qualified remainder interest in every respect.

(ii) It meets the definition of and functions exclusively as a qualified interest from the creation of the interest.

(iii) It is non-contingent. For this purpose, an interest is non-contingent only if it is payable to the beneficiary or the beneficiary's estate in all events.

(iv) All interests in the trust, other than non-contingent remainder interests, are qualified annuity interests or qualified unitrust interests. Thus, an interest is a qualified remainder interest only if the governing instrument does not permit payment of income in excess of the annuity or unitrust amount to the holder of the qualified annuity or unitrust interest.

(2) *Remainder interest.* Remainder interest is the right to receive all or a fractional share of the trust property on termination of all or a fractional share of the trust. Remainder interest includes a reversion. A transferor's right to receive an amount that is a stated or pecuniary amount is not a remainder interest. Thus, the right to receive the original value of the trust corpus (or a fractional share) is not a remainder interest.

(3) *Examples.* The following examples illustrate rules of this paragraph (f). Each example assumes that all applicable requirements of a qualified interest are met unless otherwise specifically stated.

Example 1. A transfers property to an irrevocable trust. The income of the trust is payable to A's child for life. On the death of A's child, the trust is to terminate and the trust corpus is to be paid to A. A's remainder interest is not a qualified remainder interest because the interest of A's child is neither a qualified annuity interest nor a qualified unitrust interest.

Example 2. The facts are the same as in *Example 1*, except that A's child has the right to receive the greater of the income of the trust or \$10,000 per year. A's remainder interest is not a qualified remainder interest because the right of A's child to receive income in excess of the annuity amount is not a qualified interest.

Example 3. A transfers property to an irrevocable trust. The trust provides a qualified annuity interest to A's child for 12 years. An amount equal to the initial value of the trust corpus is to be paid to A at the end of

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that period and the balance is to be paid to A's grandchild. A's interest is not a qualified remainder interest because the amount A is to receive is not a fractional share of the trust property.

Example 4. U transfers property to an irrevocable trust. The trust provides a qualified unitrust interest to U's child for 15 years, at which time the trust terminates and the trust corpus is paid to U or, if U is not then living, to U's child. Because U's remainder interest is contingent, it is not a qualified remainder interest.

[T.D. 8395, 57 FR 4267, Feb. 4, 1992, as amended by T.D. 8536, 59 FR 23157, May 5, 1994; T.D. 8633, 60 FR 66090, Dec. 21, 1995; T.D. 8899, 65 FR 53588, Sept. 5, 2000; 65 FR 70792, Nov. 28, 2000; T.D. 9181, 70 FR 9224, Feb. 25, 2005]

§ 25.2702-4 Certain property treated as held in trust.

(a) *In general.* For purposes of section 2702, a transfer of an interest in property with respect to which there are one or more term interests is treated as a transfer in trust. A term interest is one of a series of successive (as contrasted with concurrent) interests. Thus, a life interest in property or an interest in property for a term of years is a term interest. However, a term interest does not include a fee interest in property merely because it is held as a tenant in common, a tenant by the entirety, or a joint tenant with right of survivorship.

(b) *Leases.* A leasehold interest in property is not a term interest to the extent the lease is for full and adequate consideration (without regard to section 2702). A lease will be considered for full and adequate consideration if, under all the facts and circumstances as of the time the lease is entered into or extended, a good faith effort is made to determine the fair rental value of the property and the terms of the lease conform to the value so determined.

(c) *Joint purchases.* Solely for purposes of section 2702, if an individual acquires a term interest in property and, in the same transaction or series of transactions, one or more members of the individual's family acquire an interest in the same property, the individual acquiring the term interest is treated as acquiring the entire property so acquired, and transferring to each of those family members the interests acquired by that family member in exchange for any consideration

paid by that family member. For purposes of this paragraph (c), the amount of the individual's gift will not exceed the amount of consideration furnished by that individual for all interests in the property.

(d) *Examples.* The following examples illustrate rules of this section:

Example 1. A purchases a 20-year term interest in an apartment building and A's child purchases the remainder interest in the property. A and A's child each provide the portion of the purchase price equal to the value of their respective interests in the property determined under section 7520. Solely for purposes of section 2702, A is treated as acquiring the entire property and transferring the remainder interest to A's child in exchange for the portion of the purchase price provided by A's child. In determining the amount of A's gift, A's retained interest is valued at zero because it is not a qualified interest.

Example 2. K holds rental real estate valued at \$100,000. K sells a remainder interest in the property to K's child, retaining the right to receive the income from the property for 20 years. Assume the purchase price paid by K's child for the remainder interest is equal to the value of the interest determined under section 7520. K's retained interest is not a qualified interest and is therefore valued at zero. K has made a gift in the amount of \$100,000 less the consideration received from K's child.

Example 3. G and G's child each acquire a 50 percent undivided interest as tenants in common in an office building. The interests of G and G's child are not term interests to which section 2702 applies.

Example 4. B purchases a life estate in property from R, B's grandparent, for \$100 and B's child purchases the remainder interest for \$50. Assume that the value of the property is \$300, the value of the life estate determined under section 7520 is \$250 and the value of the remainder interest is \$50. B is treated as acquiring the entire property and transferring the remainder interest to B's child. However, the amount of B's gift is \$100, the amount of consideration (\$100) furnished by B for B's interest.

Example 5. H and W enter into a written agreement relative to their marital and property rights that requires W to transfer property to an irrevocable trust, the terms of which provide that the income of the trust will be paid to H for 10 years. On the expiration of the 10-year term, the trust is to terminate and the trust corpus is to be paid to W. H and W divorce within two years after the agreement is entered into. Pursuant to section 2516, the transfer to H would otherwise be deemed to be for full and adequate consideration. Section 2702 does not apply to

the acquisition of the term interest by H because no member of H's family acquired an interest in the property in the same transaction or series of transactions. The result would not be the same if, on the termination of H's interest in the trust, the trust corpus were distributable to the children of H and W rather than W.

[T.D. 8395, 57 FR 4269, Feb. 4, 1992]

§ 25.2702-5 Personal residence trusts.

(a)(1) *In general.* Section 2702 does not apply to a transfer in trust meeting the requirements of this section. A transfer in trust meets the requirements of this section only if the trust is a personal residence trust (as defined in paragraph (b) of this section). A trust meeting the requirements of a qualified personal residence trust (as defined in paragraph (c) of this section) is treated as a personal residence trust. A trust of which the term holder is the grantor that otherwise meets the requirements of a personal residence trust (or a qualified personal residence trust) is not a personal residence trust (or a qualified personal residence trust) if, at the time of transfer, the term holder of the trust already holds term interests in two trusts that are personal residence trusts (or qualified personal residence trusts) of which the term holder was the grantor. For this purpose, trusts holding fractional interests in the same residence are treated as one trust.

(2) *Modification of trust.* A trust that does not comply with one or more of the regulatory requirements under paragraph (b) or (c) of this section will, nonetheless, be treated as satisfying these requirements if the trust is modified, by judicial reformation (or non-judicial reformation if effective under state law), to comply with the requirements. In the case of a trust created after December 31, 1996, the reformation must be commenced within 90 days after the due date (including extensions) for the filing of the gift tax return reporting the transfer of the residence under section 6075 and must be completed within a reasonable time after commencement. If the reformation is not completed by the due date (including extensions) for filing the gift tax return, the grantor or grantor's spouse must attach a statement to the gift tax return stating that

the reformation has been commenced or will be commenced within the 90-day period. In the case of a trust created before January 1, 1997, the reformation must be commenced within 90 days after December 23, 1997 and must be completed within a reasonable time after commencement.

(b) *Personal residence trust*—(1) *In general.* A personal residence trust is a trust the governing instrument of which prohibits the trust from holding, for the original duration of the term interest, any asset other than one residence to be used or held for use as a personal residence of the term holder and qualified proceeds (as defined in paragraph (b)(3) of this section). A residence is held for use as a personal residence of the term holder so long as the residence is not occupied by any other person (other than the spouse or a dependent of the term holder) and is available at all times for use by the term holder as a personal residence. A trust does not meet the requirements of this section if, during the original duration of the term interest, the residence may be sold or otherwise transferred by the trust or may be used for a purpose other than as a personal residence of the term holder. In addition, the trust does not meet the requirements of this section unless the governing instrument prohibits the trust from selling or transferring the residence, directly or indirectly, to the grantor, the grantor's spouse, or an entity controlled by the grantor or the grantor's spouse, at any time after the original duration of the term interest during which the trust is a grantor trust. For purposes of the preceding sentence, a sale or transfer to another grantor trust of the grantor or the grantor's spouse is considered a sale or transfer to the grantor or the grantor's spouse; however, a distribution (for no consideration) upon or after the expiration of the original duration of the term interest to another grantor trust of the grantor or the grantor's spouse pursuant to the express terms of the trust will not be considered a sale or transfer to the grantor or the grantor's spouse if such other grantor trust prohibits the sale or transfer of the property to the grantor, the grantor's spouse, or an entity controlled by the

grantor or the grantor's spouse. In the event the grantor dies prior to the expiration of the original duration of the term interest, this paragraph (b)(1) does not apply to the distribution (for no consideration) of the residence to any person (including the grantor's estate) pursuant to the express terms of the trust or pursuant to the exercise of a power retained by the grantor under the terms of the trust. Further, this paragraph (b)(1) does not apply to any outright distribution (for no consideration) of the residence to the grantor's spouse after the expiration of the original duration of the term interest pursuant to the express terms of the trust. For purposes of this paragraph (b)(1), a *grantor trust* is a trust treated as owned in whole or in part by the grantor or the grantor's spouse pursuant to sections 671 through 678, and *control* is defined in § 25.2701-2(b)(5)(ii) and (iii). Expenses of the trust whether or not attributable to trust principal may be paid directly by the term holder of the trust.

(2) *Personal residence*—(i) *In general*. For purposes of this paragraph (b), a personal residence of a term holder is either—

(A) The principal residence of the term holder (within the meaning of section 1034);

(B) One other residence of the term holder (within the meaning of section 280A(d)(1) but without regard to section 280A(d)(2)); or

(C) An undivided fractional interest in either.

(ii) *Additional property*. A personal residence may include appurtenant structures used by the term holder for residential purposes and adjacent land not in excess of that which is reasonably appropriate for residential purposes (taking into account the residence's size and location). The fact that a residence is subject to a mortgage does not affect its status as a personal residence. The term personal residence does not include any personal property (e.g., household furnishings).

(iii) *Use of residence*. A residence is a personal residence only if its primary use is as a residence of the term holder when occupied by the term holder. The principal residence of the term holder will not fail to meet the requirements

of the preceding sentence merely because a portion of the residence is used in an activity meeting the requirements of section 280A(c) (1) or (4) (relating to deductibility of expenses related to certain uses), provided that such use is secondary to use of the residence as a residence. A residence is not used primarily as a residence if it is used to provide transient lodging and substantial services are provided in connection with the provision of lodging (e.g. a hotel or a bed and breakfast). A residence is not a personal residence if, during any period not occupied by the term holder, its primary use is other than as a residence.

(iv) *Interests of spouses in the same residence*. If spouses hold interests in the same residence (including community property interests), the spouses may transfer their interests in the residence (or a fractional portion of their interests in the residence) to the same personal residence trust, provided that the governing instrument prohibits any person other than one of the spouses from holding a term interest in the trust concurrently with the other spouse.

(3) *Qualified proceeds*. Qualified proceeds means the proceeds payable as a result of damage to, or destruction or involuntary conversion (within the meaning of section 1033) of, the residence held by a personal residence trust, provided that the governing instrument requires that the proceeds (including any income thereon) be reinvested in a personal residence within two years from the date on which the proceeds are received.

(c) *Qualified personal residence trust*—

(1) *In general*. A qualified personal residence trust is a trust meeting all the requirements of this paragraph (c). These requirements must be met by provisions in the governing instrument, and these governing instrument provisions must by their terms continue in effect during the existence of any term interest in the trust.

(2) *Personal residence*—(i) *In general*. For purposes of this paragraph (c), a personal residence of a term holder is either—

(A) The principal residence of the term holder (within the meaning of section 1034);

(B) One other residence of the term holder (within the meaning of section 280A(d)(1) but without regard to section 280A(d)(2)); or

(C) An undivided fractional interest in either.

(ii) *Additional property.* A personal residence may include appurtenant structures used by the term holder for residential purposes and adjacent land not in excess of that which is reasonably appropriate for residential purposes (taking into account the residence's size and location). The fact that a residence is subject to a mortgage does not affect its status as a personal residence. The term personal residence does not include any personal property (e.g., household furnishings).

(iii) *Use of residence.* A residence is a personal residence only if its primary use is as a residence of the term holder when occupied by the term holder. The principal residence of the term holder will not fail to meet the requirements of the preceding sentence merely because a portion of the residence is used in an activity meeting the requirements of section 280A(c) (1) or (4) (relating to deductibility of expenses related to certain uses), provided that such use is secondary to use of the residence as a residence. A residence is not used primarily as a residence if it is used to provide transient lodging and substantial services are provided in connection with the provision of lodging (e.g., a hotel or a bed and breakfast). A residence is not a personal residence if, during any period not occupied by the term holder, its primary use is other than as a residence. A residence is not a personal residence if, during any period not occupied by the term holder, its primary use is other than as a residence.

(iv) *Interests of spouses in the same residence.* If spouses hold interests in the same residence (including community property interests), the spouses may transfer their interests in the residence (or a fractional portion of their interests in the residence) to the same qualified personal residence trust, provided that the governing instrument prohibits any person other than one of the spouses from holding a term interest in the trust concurrently with the other spouse.

(3) *Income of the trust.* The governing instrument must require that any income of the trust be distributed to the term holder not less frequently than annually.

(4) *Distributions from the trust to other persons.* The governing instrument must prohibit distributions of corpus to any beneficiary other than the transferor prior to the expiration of the retained term interest.

(5) *Assets of the trust—(i) In general.* Except as otherwise provided in paragraphs (c)(5)(ii) and (c)(8) of this section, the governing instrument must prohibit the trust from holding, for the entire term of the trust, any asset other than one residence to be used or held for use (within the meaning of paragraph (c)(7)(i) of this section) as a personal residence of the term holder (the "residence").

(ii) *Assets other than personal residence.* Except as otherwise provided, the governing instrument may permit a qualified personal residence trust to hold the following assets (in addition to the residence) in the amounts and in the manner described in this paragraph (c)(5)(ii):

(A) *Additions of cash for payment of expenses, etc.—(1) Additions.* The governing instrument may permit additions of cash to the trust, and may permit the trust to hold additions of cash in a separate account, in an amount which, when added to the cash already held in the account for such purposes, does not exceed the amount required:

(i) For payment of trust expenses (including mortgage payments) already incurred or reasonably expected to be paid by the trust within six months from the date the addition is made;

(ii) For improvements to the residence to be paid by the trust within six months from the date the addition is made; and

(iii) For purchase by the trust of the initial residence, within three months of the date the trust is created, provided that no addition may be made for this purpose, and the trust may not hold any such addition, unless the trustee has previously entered into a contract to purchase that residence; and

(iv) For purchase by the trust of a residence to replace another residence,

within three months of the date the addition is made, provided that no addition may be made for this purpose, and the trust may not hold any such addition, unless the trustee has previously entered into a contract to purchase that residence.

(2) *Distributions of excess cash.* If the governing instrument permits additions of cash to the trust pursuant to paragraph (c)(5)(ii)(A)(I) of this section, the governing instrument must require that the trustee determine, not less frequently than quarterly, the amounts held by the trust for payment of expenses in excess of the amounts permitted by that paragraph and must require that those amounts be distributed immediately thereafter to the term holder. In addition, the governing instrument must require, upon termination of the term holder's interest in the trust, any amounts held by the trust for the purposes permitted by paragraph (c)(5)(ii)(A)(I) of this section that are not used to pay trust expenses due and payable on the date of termination (including expenses directly related to termination) be distributed outright to the term holder within 30 days of termination.

(B) *Improvements.* The governing instrument may permit improvements to the residence to be added to the trust and may permit the trust to hold such improvements, provided that the residence, as improved, meets the requirements of a personal residence.

(C) *Sale proceeds.* The governing instrument may permit the sale of the residence (except as set forth in paragraph (c)(9) of this section) and may permit the trust to hold proceeds from the sale of the residence, in a separate account.

(D) *Insurance and insurance proceeds.* The governing instrument may permit the trust to hold one or more policies of insurance on the residence. In addition, the governing instrument may permit the trust to hold, in a separate account, proceeds of insurance payable to the trust as a result of damage to or destruction of the residence. For purposes of this paragraph, amounts (other than insurance proceeds payable to the trust as a result of damage to or destruction of the residence) received as a result of the involuntary conver-

sion (within the meaning of section 1033) of the residence are treated as proceeds of insurance.

(6) *Commutation.* The governing instrument must prohibit commutation (prepayment) of the term holder's interest.

(7) *Cessation of use as a personal residence—(i) In general.* The governing instrument must provide that a trust ceases to be a qualified personal residence trust if the residence ceases to be used or held for use as a personal residence of the term holder. A residence is held for use as a personal residence of the term holder so long as the residence is not occupied by any other person (other than the spouse or a dependent of the term holder) and is available at all times for use by the term holder as a personal residence. See § 25.2702-5(c)(8) for rules governing disposition of assets of a trust as to which the trust has ceased to be a qualified personal residence trust.

(ii) *Sale of personal residence.* The governing instrument must provide that the trust ceases to be a qualified personal residence trust upon sale of the residence if the governing instrument does not permit the trust to hold proceeds of sale of the residence pursuant to paragraph (c)(5)(ii)(C) of this section. If the governing instrument permits the trust to hold proceeds of sale pursuant to that paragraph, the governing instrument must provide that the trust ceases to be a qualified personal residence trust with respect to all proceeds of sale held by the trust not later than the earlier of—

(A) The date that is two years after the date of sale;

(B) The termination of the term holder's interest in the trust; or

(C) The date on which a new residence is acquired by the trust.

(iii) *Damage to or destruction of personal residence—(A) In general.* The governing instrument must provide that, if damage or destruction renders the residence unusable as a residence, the trust ceases to be a qualified personal residence trust on the date that is two years after the date of damage or destruction (or the date of termination of the term holder's interest in the trust, if earlier) unless, prior to such date—

(1) Replacement of or repairs to the residence are completed; or

(2) A new residence is acquired by the trust.

(B) *Insurance proceeds.* For purposes of this paragraph (C)(7)(iii), if the governing instrument permits the trust to hold proceeds of insurance received as a result of damage to or destruction of the residence pursuant to paragraph (c)(5)(ii)(D) of this section, the governing instrument must contain provisions similar to those required by paragraph (c)(7)(ii) of this section.

(8) *Disposition of trust assets on cessation as personal residence trust—(i) In general.* The governing instrument must provide that, within 30 days after the date on which the trust has ceased to be a qualified personal residence trust with respect to certain assets, either—

(A) The assets be distributed outright to the term holder;

(B) The assets be converted to and held for the balance of the term holder's term in a separate share of the trust meeting the requirements of a qualified annuity interest; or

(C) In the trustee's sole discretion, the trustee may elect to comply with either paragraph (c)(8)(i) (A) or (B) of this section pursuant to their terms.

(ii) *Requirements for conversion to a qualified annuity interest—(A) Governing instrument requirements.* For assets subject to this paragraph (c)(8) to be converted to and held as a qualified annuity interest, the governing instrument must contain all provisions required by § 25.2702-3 with respect to a qualified annuity interest.

(B) *Effective date of annuity.* The governing instrument must provide that the right of the term holder to receive the annuity amount begins on the date of sale of the residence, the date of damage to or destruction of the residence, or the date on which the residence ceases to be used or held for use as a personal residence, as the case may be ("the cessation date"). Notwithstanding the preceding sentence, the governing instrument may provide that the trustee may defer payment of any annuity amount otherwise payable after the cessation date until the date that is 30 days after the assets are converted to a qualified annuity interest

under paragraph (c)(8)(i)(B) of this section ("the conversion date"); provided that any deferred payment must bear interest from the cessation date at a rate not less than the section 7520 rate in effect on the cessation date. The governing instrument may permit the trustee to reduce aggregate deferred annuity payments by the amount of income actually distributed by the trust to the term holder during the deferral period.

(C) *Determination of annuity amount—*

(1) *In general.* The governing instrument must require that the annuity amount be no less than the amount determined under this paragraph (C).

(2) *Entire trust ceases to be a qualified personal residence trust.* If, on the conversion date, the assets of the trust do not include a residence used or held for use as a personal residence, the annuity may not be less than an amount determined by dividing the lesser of the value of all interests retained by the term holder (as of the date of the original transfer or transfers) or the value of all the trust assets (as of the conversion date) by an annuity factor determined—

(i) For the original term of the term holder's interest; and

(ii) At the rate used in valuing the retained interest at the time of the original transfer.

(3) *Portion of trust continues as qualified personal residence trust.* If, on the conversion date, the assets of the trust include a residence used or held for use as a personal residence, the annuity must not be less than the amount determined under paragraph (c)(8)(ii)(C)(2) of this section multiplied by a fraction. The numerator of the fraction is the excess of the fair market value of the trust assets on the conversion date over the fair market value of the assets as to which the trust continues as a qualified personal residence trust, and the denominator of the fraction is the fair market value of the trust assets on the conversion date.

(9) *Sale of residence to grantor, grantor's spouse, or entity controlled by grantor or grantor's spouse.* The governing instrument must prohibit the trust from selling or transferring the residence, directly or indirectly, to the

grantor, the grantor's spouse, or an entity controlled by the grantor or the grantor's spouse during the retained term interest of the trust, or at any time after the retained term interest that the trust is a grantor trust. For purposes of the preceding sentence, a sale or transfer to another grantor trust of the grantor or the grantor's spouse is considered a sale or transfer to the grantor or the grantor's spouse; however, a distribution (for no consideration) upon or after the expiration of the retained term interest to another grantor trust of the grantor or the grantor's spouse pursuant to the express terms of the trust will not be considered a sale or transfer to the grantor or the grantor's spouse if such other grantor trust prohibits the sale or transfer of the property to the grantor, the grantor's spouse, or an entity controlled by the grantor or the grantor's spouse. In the event the grantor dies prior to the expiration of the retained term interest, this paragraph (c)(9) does not apply to the distribution (for no consideration) of the residence to any person (including the grantor's estate) pursuant to the express terms of the trust or pursuant to the exercise of a power retained by the grantor under the terms of the trust. Further, this paragraph (c)(9) does not apply to an outright distribution (for no consideration) of the residence to the grantor's spouse after the expiration of the retained trust term pursuant to the express terms of the trust. For purposes of this paragraph (c)(9), a *grantor trust* is a trust treated as owned in whole or in part by the grantor or the grantor's spouse pursuant to sections 671 through 678, and *control* is defined in § 25.2701-2(b)(5)(ii) and (iii).

(d) *Examples.* The following examples illustrate rules of this section. Each example assumes that all applicable requirements of a personal residence trust (or qualified personal residence trust) are met unless otherwise stated.

Example 1. C maintains C's principal place of business in one room of C's principal residence. The room meets the requirements of section 280A(c)(1) for deductibility of expenses related to such use. The residence is a personal residence.

Example 2. L owns a vacation condominium that L rents out for six months of the year, but which is treated as L's residence under

section 280A(d)(1) because L occupies it for at least 18 days per year. L provides no substantial services in connection with the rental of the condominium. L transfers the condominium to an irrevocable trust, the terms of which meet the requirements of a qualified personal residence trust. L retains the right to use the condominium during L's lifetime. The trust is a qualified personal residence trust.

Example 3. W owns a 200-acre farm. The farm includes a house, barns, equipment buildings, a silo, and enclosures for confinement of farm animals. W transfers the farm to an irrevocable trust, retaining the use of the farm for 20 years, with the remainder to W's child. The trust is not a personal residence trust because the farm includes assets not meeting the requirements of a personal residence.

Example 4. A transfers A's principal residence to an irrevocable trust, retaining the right to use the residence for a 20-year term. The governing instrument of the trust does not prohibit the trust from holding personal property. The trust is not a qualified personal residence trust.

Example 5. T transfers a personal residence to a trust that meets the requirements of a qualified personal residence trust, retaining a term interest in the trust for 10 years. During the period of T's retained term interest, T is forced for health reasons to move to a nursing home. T's spouse continues to occupy the residence. If the residence is available at all times for T's use as a residence during the term (without regard to T's ability to actually use the residence), the residence continues to be held for T's use and the trust does not cease to be a qualified personal residence trust. The residence would cease to be held for use as a personal residence of T if the trustee rented the residence to an unrelated party, because the residence would no longer be available for T's use at all times.

Example 6. T transfers T's personal residence to a trust that meets the requirements of a qualified personal residence trust, retaining the right to use the residence for 12 years. On the date the residence is transferred to the trust, the fair market value of the residence is \$100,000. After 6 years, the trustee sells the residence, receiving net proceeds of \$250,000, and invests the proceeds of sale in common stock. After an additional eighteen months, the common stock has paid \$15,000 in dividends and has a fair market value of \$260,000. On that date, the trustee purchases a new residence for \$200,000. On the purchase of the new residence, the trust ceases to be a qualified personal residence trust with respect to any amount not reinvested in the new residence. The governing instrument of the trust provides that the trustee, in the trustee's sole discretion, may elect either to distribute the excess proceeds

or to convert the proceeds into a qualified annuity interest. The trustee elects the latter option. The amount of the annuity is the amount of the annuity that would be payable if no portion of the sale proceeds had been reinvested in a personal residence multiplied by a fraction. The numerator of the fraction is \$60,000 (the amount remaining after reinvestment) and the denominator of the fraction is \$260,000 (the fair market value of the trust assets on the conversion date). The obligation to pay the annuity commences on the date of sale, but payment of the annuity that otherwise would have been payable during the period between the date of sale and the date on which the trust ceased to be a qualified personal residence trust with respect to the excess proceeds may be deferred until 30 days after the date on which the new residence is purchased. Any amount deferred must bear compound interest from the date the annuity is payable at the section 7520 rate in effect on the date of sale. The \$15,000 of income distributed to the term holder during that period may be used to reduce the annuity amount payable with respect to that period if the governing instrument so provides and thus reduce the amount on which compound interest is computed.

[T.D. 8395, 57 FR 4269, Feb. 4, 1992; T.D. 8395, 57 FR 11265, Apr. 2, 1992, as amended by T.D. 8743, 62 FR 66988, Dec. 23, 1997]

§ 25.2702-6 Reduction in taxable gifts.

(a) *Transfers of retained interests in trust*—(1) *Inter vivos transfers*. If an individual subsequently transfers by gift an interest in trust previously valued (when held by that individual) under § 25.2702-2 (b)(1) or (c), the individual is entitled to a reduction in aggregate taxable gifts. The amount of the reduction is determined under paragraph (b) of this section. Thus, for example, if an individual transferred property to an irrevocable trust, retaining an interest in the trust that was valued at zero under § 25.2702-2(b)(1), and the individual later transfers the retained interest by gift, the individual is entitled to a reduction in aggregate taxable gifts on the subsequent transfer. For purposes of this section, aggregate taxable gifts means the aggregate sum of the individual's taxable gifts for the calendar year determined under section 2502(a)(1).

(2) *Testamentary transfers*. If either—

(i) A term interest in trust is included in an individual's gross estate solely by reason of section 2033, or

(ii) A remainder interest in trust is included in an individual's gross estate, and the interest was previously valued (when held by that individual) under § 25.2702-2(b)(1) or (c), the individual's estate is entitled to a reduction in the individual's adjusted taxable gifts in computing the Federal estate tax payable under section 2001. The amount of the reduction is determined under paragraph (b) of this section.

(3) *Gift splitting on subsequent transfer*. If an individual who is entitled to a reduction in aggregate taxable gifts (or adjusted taxable gifts) subsequently transfers the interest in a transfer treated as made one-half by the individual's spouse under section 2513, the individual may assign one-half of the amount of the reduction to the consenting spouse. The assignment must be attached to the Form 709 on which the consenting spouse reports the split gift.

(b) *Amount of reduction*—(1) *In general*. The amount of the reduction in aggregate taxable gifts (or adjusted taxable gifts) is the lesser of—

(i) The increase in the individual's taxable gifts resulting from the interest being valued at the time of the initial transfer under § 25.2702-2(b)(1) or (c); or

(ii) The increase in the individual's taxable gifts (or gross estate) resulting from the subsequent transfer of the interest.

(2) *Treatment of annual exclusion*. For purposes of determining the amount under paragraph (b)(1)(ii) of this section, the exclusion under section 2503(b) applies first to transfers in that year other than the transfer of the interest previously valued under § 25.2702-2(b)(1) or (c).

(3) *Overlap with section 2001*. Notwithstanding paragraph (b)(1) of this section, the amount of the reduction is reduced to the extent section 2001 would apply to reduce the amount of an individual's adjusted taxable gifts with respect to the same interest to which paragraph (b)(1) of this section would otherwise apply.

(c) *Examples*. The rules of this section are illustrated by the following examples. The following facts apply for *Examples 1-4*:

Facts. In 1992, X transferred property to an irrevocable trust retaining the right to receive the trust income for life. On the death of X, the trust is to terminate and the trust corpus is to be paid to X's child, C. X's income interest had a value under section 7520 of \$40,000 at the time of the transfer; however, because X's retained interest was not a qualified interest, it was valued at zero under § 25.2702-2(b)(1) for purposes of determining the amount of X's gift. X's taxable gifts in 1992 were therefore increased by \$40,000. In 1993, X transfers the income interest to C for no consideration.

Example 1. Assume that the value under section 7520 of the income interest on the subsequent transfer to C is \$30,000. If X makes no other gifts to C in 1993, X is entitled to a reduction in aggregate taxable gifts of \$20,000, the lesser of the amount by which X's taxable gifts were increased as a result of the income interest being valued at zero on the initial transfer (\$40,000) or the amount by which X's taxable gifts are increased as a result of the subsequent transfer of the income interest (\$30,000 minus \$10,000 annual exclusion).

Example 2. Assume that in 1993, 4 months after X transferred the income interest to C, X transferred \$5,000 cash to C. In determining the increase in taxable gifts occurring on the subsequent transfer, the annual exclusion under section 2503(b) is first applied to the cash gift. X is entitled to a reduction in aggregate taxable gifts of \$25,000, the lesser of the amount by which X's taxable gifts were increased as a result of the income interest being valued at zero on the initial transfer (\$40,000) or the amount by which X's taxable gifts are increased as a result of the subsequent transfer of the income interest (\$25,000 (($\$30,000 + \$5,000$) - \$10,000 annual exclusion)).

Example 3. Assume that the value under section 7520 of the income interest on the subsequent transfer to C is \$55,000. X is entitled to reduce aggregate taxable gifts by \$40,000, the lesser of the amount by which X's taxable gifts were increased as a result of the income interest being valued at zero on the initial transfer (\$40,000) or the amount by which X's taxable gifts are increased as a result of the subsequent transfer of the income interest (\$55,000 minus \$10,000 annual exclusion = \$45,000).

Example 4. Assume that X and X's spouse, S, split the subsequent gift to C. X is entitled to assign one-half the reduction to S. If the assignment is made, each is entitled to reduce aggregate taxable gifts by \$17,500, the lesser of their portion of the increase in taxable gifts on the initial transfer by reason of the application of section 2702 (\$20,000) and their portion of the increase in taxable gifts on the subsequent transfer of the retained interest (\$27,500 - \$10,000 annual exclusion).

Example 5. In 1992, A transfers property to an irrevocable trust, retaining the right to receive the trust income for 10 years. On the expiration of the 10-year term, the trust is to terminate and the trust corpus is to be paid to A's child, B. Assume that A's term interest has a value under section 7520 of \$20,000 at the time of the transfer; however, because A's retained interest was not a qualified interest, it was valued at zero under § 25.2702-2(b)(1) for purposes of determining the amount of A's gift. Assume also that A and A's spouse, S, split the gift of the remainder interest under section 2513. In 1993, A transfers A's term interest to D, A's other child, for no consideration. A is entitled to reduce A's aggregate taxable gifts on the transfer. Assume that A and S also split the subsequent gift to D, and that A dies one month after making the subsequent transfer of the term interest and S dies six months later. The gift of the term interest is included in A's gross estate under section 2035(d)(2). To the extent S's taxable gifts are reduced pursuant to section 2001(e), S is entitled to no reduction in aggregate or adjusted taxable gifts under this section.

Example 6. T transfers property to an irrevocable trust retaining the power to direct the distribution of trust income for 10 years among T's descendants in whatever shares T deems appropriate. On the expiration of the 10-year period, the trust corpus is to be paid in equal shares to T's children. T's transfer of the remainder interest is a completed gift. Because T's retained interest is not a qualified interest, it is valued at zero under § 25.2702-2(b)(1) and the amount of T's gift is the fair market value of the property transferred to the trust. The distribution of income each year is not a transfer of a retained interest in trust. Therefore, T is not entitled to reduce aggregate taxable gifts as a result of the distributions of income from the trust.

Example 7. The facts are the same as in *Example 6*, except that after 3 years T exercises the right to direct the distribution of trust income by assigning the right to the income for the balance of the term to T's child, C. The exercise is a transfer of a retained interest in trust for purposes of this section. T is entitled to reduce aggregate taxable gifts by the lesser of the increase in taxable gifts resulting from the application of section 2702 to the initial transfer or the increase in taxable gifts resulting from the transfer of the retained interest in trust.

Example 8. In 1992, V purchases an income interest for 10 years in property in the same transaction or series of transactions in which G, V's child, purchases the remainder interest in the same property. V dies in 1997 still holding the term interest, the value of which is includible in V's gross estate under section 2033. V's estate would be entitled to a reduction in adjusted taxable gifts in the

amount determined under paragraph (b) of this section.

[T.D. 8395, 57 FR 4272, Feb. 4, 1992]

§ 25.2702-7 Effective dates.

Except as provided in this section, §§ 25.2702-1 through 25.2702-6 apply as of January 28, 1992. With respect to transfers to which section 2702 applied made prior to January 28, 1992, taxpayers may rely on any reasonable interpretation of the statutory provisions. For these purposes, the provisions of the proposed regulations and the final regulations are considered a reasonable interpretation of the statutory provisions. The fourth through eighth sentences of § 25.2702-5(b)(1) and § 25.2702-5(c)(9) apply with respect to trusts created after May 16, 1996. Section 25.2702-2(a)(5), the second and third sentences of § 25.2702-2(a)(6), § 25.2702-3(d)(2), the first two sentences of § 25.2702-3(d)(4), the last sentence of § 25.2702-3(e), *Example 5*, the last two sentences of § 25.2702-3(e), *Example 6*, and § 25.2702-3(e), *Examples 8* and *9*, apply for trusts created on or after July 26, 2004. However, the Internal Revenue Service will not challenge any prior application of the changes to *Examples 5* and *6* in § 25.2702-3(e).

[T.D. 8395, 57 FR 4273, Feb. 4, 1992, as amended by T.D. 8743, 62 FR 66989, Dec. 23, 1997; T.D. 9181, 70 FR 9224, Feb. 25, 2005]

§ 25.2703-1 Property subject to restrictive arrangements.

(a) *Disregard of rights or restrictions—*

(1) *In general.* For purposes of subtitle B (relating to estate, gift, and generation-skipping transfer taxes), the value of any property is determined without regard to any right or restriction relating to the property.

(2) *Right or restriction.* For purposes of this section, right or restriction means—

(i) Any option, agreement, or other right to acquire or use the property at a price less than fair market value (determined without regard to the option, agreement, or right); or

(ii) Any restriction on the right to sell or use the property.

(3) *Agreements, etc. containing rights or restrictions.* A right or restriction may be contained in a partnership agreement, articles of incorporation, cor-

porate bylaws, a shareholders' agreement, or any other agreement. A right or restriction may be implicit in the capital structure of an entity.

(4) *Qualified easements.* A perpetual restriction on the use of real property that qualified for a charitable deduction under either section 2522(d) or section 2055(f) of the Internal Revenue Code is not treated as a right or restriction.

(b) *Exceptions—*(1) *In general.* This section does not apply to any right or restriction satisfying the following three requirements—

(i) The right or restriction is a bona fide business arrangement;

(ii) The right or restriction is not a device to transfer property to the natural objects of the transferor's bounty for less than full and adequate consideration in money or money's worth; and

(iii) At the time the right or restriction is created, the terms of the right or restriction are comparable to similar arrangements entered into by persons in an arm's length transaction.

(2) *Separate requirements.* Each of the three requirements described in paragraph (b)(1) of this section must be independently satisfied for a right or restriction to meet this exception. Thus, for example, the mere showing that a right or restriction is a bona fide business arrangement is not sufficient to establish that the right or restriction is not a device to transfer property for less than full and adequate consideration.

(3) *Exception for certain rights or restrictions.* A right or restriction is considered to meet each of the three requirements described in paragraph (b)(1) of this section if more than 50 percent by value of the property subject to the right or restriction is owned directly or indirectly (within the meaning of § 25.2701-6) by individuals who are not members of the transferor's family. In order to meet this exception, the property owned by those individuals must be subject to the right or restriction to the same extent as the property owned by the transferor. For purposes of this section, members of the transferor's family include the persons described in § 25.2701-2(b)(5) and any other individual who is

a natural object of the transferor's bounty. Any property held by a member of the transferor's family under the rules of § 25.2701-6 (without regard to § 25.2701-6(a)(5)) is treated as held only by a member of the transferor's family.

(4) *Similar arrangement*—(i) *In general.* A right or restriction is treated as comparable to similar arrangements entered into by persons in an arm's length transaction if the right or restriction is one that could have been obtained in a fair bargain among unrelated parties in the same business dealing with each other at arm's length. A right or restriction is considered a fair bargain among unrelated parties in the same business if it conforms with the general practice of unrelated parties under negotiated agreements in the same business. This determination generally will entail consideration of such factors as the expected term of the agreement, the current fair market value of the property, anticipated changes in value during the term of the arrangement, and the adequacy of any consideration given in exchange for the rights granted.

(ii) *Evidence of general business practice.* Evidence of general business practice is not met by showing isolated comparables. If more than one valuation method is commonly used in a business, a right or restriction does not fail to evidence general business practice merely because it uses only one of the recognized methods. It is not necessary that the terms of a right or restriction parallel the terms of any particular agreement. If comparables are difficult to find because the business is unique, comparables from similar businesses may be used.

(5) *Multiple rights or restrictions.* If property is subject to more than one right or restriction described in paragraph (a)(2) of this section, the failure of a right or restriction to satisfy the requirements of paragraph (b)(1) of this section does not cause any other right or restriction to fail to satisfy those requirements if the right or restriction otherwise meets those requirements. Whether separate provisions are separate rights or restrictions, or are integral parts of a single right or restriction, depends on all the facts and circumstances.

(c) *Substantial modification of a right or restriction*—(1) *In general.* A right or restriction that is substantially modified is treated as a right or restriction created on the date of the modification. Any discretionary modification of a right or restriction, whether or not authorized by the terms of the agreement, that results in other than a *de minimis* change to the quality, value, or timing of the rights of any party with respect to property that is subject to the right or restriction is a substantial modification. If the terms of the right or restriction require periodic updating, the failure to update is presumed to substantially modify the right or restriction unless it can be shown that updating would not have resulted in a substantial modification. The addition of any family member as a party to a right or restriction (including by reason of a transfer of property that subjects the transferee family member to a right or restriction with respect to the transferred property) is considered a substantial modification unless the addition is mandatory under the terms of the right or restriction or the added family member is assigned to a generation (determined under the rules of section 2651 of the Internal Revenue Code) no lower than the lowest generation occupied by individuals already party to the right or restriction).

(2) *Exceptions.* A substantial modification does not include—

- (i) A modification required by the terms of a right or restriction;
- (ii) A discretionary modification of an agreement conferring a right or restriction if the modification does not change the right or restriction;
- (iii) A modification of a capitalization rate used with respect to a right or restriction if the rate is modified in a manner that bears a fixed relationship to a specified market interest rate; and
- (iv) A modification that results in an option price that more closely approximates fair market value.

(d) *Examples.* The following examples illustrate the provisions of this section:

Example 1. T dies in 1992 owning title to Blackacre. In 1991, T and T's child entered into a lease with respect to Blackacre. At the time the lease was entered into, the

terms of the lease were not comparable to leases of similar property entered into among unrelated parties. The lease is a restriction on the use of the property that is disregarded in valuing the property for Federal estate tax purposes.

Example 2. T and T's child, C, each own 50 percent of the outstanding stock of X corporation. T and C enter into an agreement in 1987 providing for the disposition of stock held by the first to die at the time of death. The agreement also provides certain restrictions with respect to lifetime transfers. In 1992, as permitted (but not required) under the agreement, T transfers one-half of T's stock to T's spouse, S. S becomes a party to the agreement between T and C by reason of the transfer. The transfer is the addition of a family member to the right or restriction. However, it is not a substantial modification of the right or restriction because the added family member would be assigned to a generation under section 2651 of the Internal Revenue Code no lower than the generation occupied by C.

Example 3. The facts are the same as in *Example 2*. In 1993, the agreement is amended to reflect a change in the company's name and a change of address for the company's registered agent. These changes are not a substantial modification of the agreement conferring the right or restriction because the right or restriction has not changed.

[T.D. 8395, 57 FR 4273, Feb. 4, 1992]

§ 25.2703-2 Effective date.

Section 25.2703-1 applies to any right or restriction created or substantially modified after October 8, 1990, and is effective as of January 28, 1992. With respect to transfers occurring prior to January 28, 1992, and for purposes of determining whether an event occurring prior to January 28, 1992 constitutes a substantial modification, taxpayers may rely on any reasonable interpretation of the statutory provisions. For these purposes, the provisions of the proposed regulations and the final regulations are considered a reasonable interpretation of the statutory provisions.

[T.D. 8395, 57 FR 4274, Feb. 4, 1992]

§ 25.2704-1 Lapse of certain rights.

(a) *Lapse treated as transfer*—(1) *In general.* The lapse of a voting right or a liquidation right in a corporation or partnership (an "entity") is a transfer by the individual directly or indirectly holding the right immediately prior to its lapse (the "holder") to the extent

provided in paragraphs (b) and (c) of this section. This section applies only if the entity is controlled by the holder and members of the holder's family immediately before and after the lapse. The amount of the transfer is determined under paragraph (d) of this section. If the lapse of a voting right or a liquidation right occurs during the holder's lifetime, the lapse is a transfer by gift. If the lapse occurs at the holder's death, the lapse is a transfer includible in the holder's gross estate.

(2) *Definitions.* The following definitions apply for purposes of this section.

(i) *Control.* Control has the meaning given it in § 25.2701-2(b)(5).

(ii) *Member of the family.* Member of the family has the meaning given it in § 25.2702-2(a)(1).

(iii) *Directly or indirectly held.* An interest is directly or indirectly held only to the extent the value of the interest would have been includible in the gross estate of the individual if the individual had died immediately prior to the lapse.

(iv) *Voting right.* Voting right means a right to vote with respect to any matter of the entity. In the case of a partnership, the right of a general partner to participate in partnership management is a voting right. The right to compel the entity to acquire all or a portion of the holder's equity interest in the entity by reason of aggregate voting power is treated as a liquidation right and is not treated as a voting right.

(v) *Liquidation right.* Liquidation right means a right or ability to compel the entity to acquire all or a portion of the holder's equity interest in the entity, including by reason of aggregate voting power, whether or not its exercise would result in the complete liquidation of the entity.

(vi) *Subordinate.* Subordinate has the meaning given it in § 25.2701-3(a)(2)(iii).

(3) *Certain temporary lapses.* If a lapsed right may be restored only upon the occurrence of a future event not within the control of the holder or members of the holder's family, the lapse is deemed to occur at the time the lapse becomes permanent with respect to the holder, *i.e.* either by a transfer of the interest or otherwise.

(4) *Source of right or lapse.* A voting right or a liquidation right may be conferred by and may lapse by reason of a State law, the corporate charter or by-laws, an agreement, or other means.

(b) *Lapse of voting right.* A lapse of a voting right occurs at the time a presently exercisable voting right is restricted or eliminated.

(c) *Lapse of liquidation right*—(1) *In general.* A lapse of a liquidation right occurs at the time a presently exercisable liquidation right is restricted or eliminated. Except as otherwise provided, a transfer of an interest that results in the lapse of a liquidation right is not subject to this section if the rights with respect to the transferred interest are not restricted or eliminated. However, a transfer that results in the elimination of the transferor's right or ability to compel the entity to acquire an interest retained by the transferor that is subordinate to the transferred interest is a lapse of a liquidation right with respect to the subordinate interest.

(2) *Exceptions.* Section 2704(a) does not apply to the lapse of a liquidation right under the following circumstances.

(i) *Family cannot obtain liquidation value*—(A) *In general.* Section 2704(a) does not apply to the lapse of a liquidation right to the extent the holder (or the holder's estate) and members of the holder's family cannot immediately after the lapse liquidate an interest that the holder held directly or indirectly and could have liquidated prior to the lapse.

(B) *Ability to liquidate.* Whether an interest can be liquidated immediately after the lapse is determined under the State law generally applicable to the entity, as modified by the governing instruments of the entity, but without regard to any restriction described in section 2704(b). Thus, if, after any restriction described in section 2704(b) is disregarded, the remaining requirements for liquidation under the governing instruments are less restrictive than the State law that would apply in the absence of the governing instruments, the ability to liquidate is determined by reference to the governing instruments.

(ii) *Rights valued under section 2701.* Section 2704(a) does not apply to the lapse of a liquidation right previously valued under section 2701 to the extent necessary to prevent double taxation (taking into account any adjustment available under § 25.2701-5).

(iii) *Certain changes in State law.* Section 2704(a) does not apply to the lapse of a liquidation right that occurs solely by reason of a change in State law. For purposes of this paragraph, a change in the governing instrument of an entity is not a change in State law.

(d) *Amount of transfer.* The amount of the transfer is the excess, if any, of—

(1) The value of all interests in the entity owned by the holder immediately before the lapse (determined immediately after the lapse as if the lapsed right was nonlapsing); over

(2) The value of the interests described in the preceding paragraph immediately after the lapse (determined as if all such interests were held by one individual).

(e) *Application to similar rights.* [Reserved]

(f) *Examples.* The following examples illustrate the provisions of this section:

Example 1. Prior to D's death, D owned all the preferred stock of Corporation Y and D's children owned all the common stock. At that time, the preferred stock had 60 percent of the total voting power and the common stock had 40 percent. Under the corporate by-laws, the voting rights of the preferred stock terminated on D's death. The value of D's interest immediately prior to D's death (determined as if the voting rights were nonlapsing) was \$100X. The value of that interest immediately after death would have been \$90X if the voting rights had been nonlapsing. The decrease in value reflects the loss in value resulting from the death of D (whose involvement in Y was a key factor in Y's profitability). Section 2704(a) applies to the lapse of voting rights on D's death. D's gross estate includes an amount equal to the excess, if any, of \$90X over the fair market value of the preferred stock determined after the lapse of the voting rights.

Example 2. Prior to D's death, D owned all the preferred stock of Corporation Y. The preferred stock and the common stock each carried 50 percent of the total voting power of Y. D's children owned 40 percent of the common stock and unrelated parties own the remaining 60 percent. Under the corporate by-laws, the voting rights of the preferred stock terminate on D's death. Section 2704(a)

does not apply to the lapse of D's voting rights because members of D's family do not control Y after the lapse.

Example 3. The by-laws of Corporation Y provide that the voting rights of any transferred shares of the single outstanding class of stock are reduced to ½ vote per share after the transfer but are fully restored to the transferred shares after 5 years. D owned 60 percent of the shares prior to death and members of D's family owned the balance. On D's death, D's shares pass to D's children and the voting rights are reduced pursuant to the by-laws. Section 2704(a) applies to the lapse of D's voting rights. D's gross estate includes an amount equal to the excess, if any, of the fair market value of D's stock (determined immediately after D's death as though the voting rights had not been reduced and would not be reduced) over the stock's fair market value immediately after D's death.

Example 4. D owns 84 percent of the single outstanding class of stock of Corporation Y. The by-laws require at least 70 percent of the vote to liquidate Y. D gives one-half of D's stock in equal shares to D's three children (14 percent to each). Section 2704(a) does not apply to the loss of D's ability to liquidate Y, because the voting rights with respect to the corporation are not restricted or eliminated by reason of the transfer.

Example 5. D and D's two children, A and B, are partners in Partnership X. Each has a 3⅓ percent general partnership interest and a 30 percent limited partnership interest. Under State law, a general partner has the right to participate in partnership management. The partnership agreement provides that when a general partner withdraws or dies, X must redeem the general partnership interest for its liquidation value. Also, under the agreement any general partner can liquidate the partnership. A limited partner cannot liquidate the partnership and a limited partner's capital interest will be returned only when the partnership is liquidated. A deceased limited partner's interest continues as a limited partnership interest. D dies, leaving his limited partnership interest to D's spouse. Because of a general partner's right to dissolve the partnership, a limited partnership interest has a greater fair market value when held in conjunction with a general partnership interest than when held alone. Section 2704(a) applies to the lapse of D's liquidation right because after the lapse, members of D's family could liquidate D's limited partnership interest. D's gross estate includes an amount equal to the excess of the value of all D's interests in X immediately before D's death (determined immediately after D's death but as though the liquidation right had not lapsed and would not lapse) over the fair market value of all D's interests in X immediately after D's death.

Example 6. The facts are the same as in *Example 5*, except that under the partnership

agreement D is the only general partner who holds a unilateral liquidation right. Assume further that the partnership agreement contains a restriction described in section 2704(b) that prevents D's family members from liquidating D's limited partnership interest immediately after D's death. Under State law, in the absence of the restriction in the partnership agreement, D's family members could liquidate the partnership. The restriction on the family's ability to liquidate is disregarded and the amount of D's gross estate is increased by reason of the lapse of D's liquidation right.

Example 7. D owns all the stock of Corporation X, consisting of 100 shares of non-voting preferred stock and 100 shares of voting common stock. Under the by-laws, X can only be liquidated with the consent of at least 80 percent of the voting shares. D transfers 30 shares of common stock to D's child. The transfer is not a lapse of a liquidation right with respect to the common stock because the voting rights that enabled D to liquidate prior to the transfer are not restricted or eliminated. The transfer is not a lapse of a liquidation right with respect to the retained preferred stock because the preferred stock is not subordinate to the transferred common stock.

Example 8. D owns all of the single class of stock of Corporation Y. D recapitalizes Y, exchanging D's common stock for voting common stock and non-voting, non-cumulative preferred stock. The preferred stock carries a right to put the stock for its par value at any time during the next 10 years. D transfers the common stock to D's grandchild in a transfer subject to section 2701. In determining the amount of D's gift under section 2701, D's retained put right is valued at zero. D's child, C, owns the preferred stock when the put right lapses. Section 2704(a) applies to the lapse, without regard to the application of section 2701, because the put right was not valued under section 2701 in the hands of C.

Example 9. A and A's two children are equal general and limited partners in Partnership Y. Under the partnership agreement, each general partner has a right to liquidate the partnership at any time. Under State law that would apply in the absence of contrary provisions in the partnership agreement, the death or incompetency of a general partner terminates the partnership. However, the partnership agreement provides that the partnership does not terminate on the incompetency or death of a general partner, but that an incompetent partner cannot exercise rights as a general partner during any period of incompetency. A partner's full rights as general partner are restored if the partner regains competency. A becomes incompetent. The lapse of A's voting right on becoming incompetent is not subject to section 2704(a) because it may be restored to A

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in the future. However, if A dies while incompetent, a lapse subject to section 2704(a) is deemed to occur at that time because the lapsed right cannot thereafter be restored to A.

[T.D. 8395, 57 FR 4274, Feb. 4, 1992]

§ 25.2704-2 Transfers subject to applicable restrictions.

(a) *In general.* If an interest in a corporation or partnership (an “entity”) is transferred to or for the benefit of a member of the transferor’s family, any applicable restriction is disregarded in valuing the transferred interest. This section applies only if the transferor and members of the transferor’s family control the entity immediately before the transfer. For the definition of control, see § 25.2701-2(b)(5). For the definition of member of the family, see § 25.2702-2(a)(1).

(b) *Applicable restriction defined.* An applicable restriction is a limitation on the ability to liquidate the entity (in whole or in part) that is more restrictive than the limitations that would apply under the State law generally applicable to the entity in the absence of the restriction. A restriction is an applicable restriction only to the extent that either the restriction by its terms will lapse at any time after the transfer, or the transferor (or the transferor’s estate) and any members of the transferor’s family can remove the restriction immediately after the transfer. Ability to remove the restriction is determined by reference to the State law that would apply but for a more restrictive rule in the governing instruments of the entity. See § 25.2704-1(c)(1)(B) for a discussion of the term “State law.” An applicable restriction does not include a commercially reasonable restriction on liquidation imposed by an unrelated person providing capital to the entity for the entity’s trade or business operations whether in the form of debt or equity. An unrelated person is any person whose relationship to the transferor, the transferee, or any member of the family of either is not described in section 267(b) of the Internal Revenue Code, provided that for purposes of this section the term “fiduciary of a trust” as used in section 267(b) does not include a bank as defined in section 581 of

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the Internal Revenue Code. A restriction imposed or required to be imposed by Federal or State law is not an applicable restriction. An option, right to use property, or agreement that is subject to section 2703 is not an applicable restriction.

(c) *Effect of disregarding an applicable restriction.* If an applicable restriction is disregarded under this section, the transferred interest is valued as if the restriction does not exist and as if the rights of the transferor are determined under the State law that would apply but for the restriction. For example, an applicable restriction with respect to preferred stock will be disregarded in determining the amount of a transfer of common stock under section 2701.

(d) *Examples.* The following examples illustrate the provisions of this section:

Example 1. D owns a 76 percent interest and each of D’s children, A and B, owns a 12 percent interest in General Partnership X. The partnership agreement requires the consent of all the partners to liquidate the partnership. Under the State law that would apply in the absence of the restriction in the partnership agreement, the consent of partners owning 70 percent of the total partnership interests would be required to liquidate X. On D’s death, D’s partnership interest passes to D’s child, C. The requirement that all the partners consent to liquidation is an applicable restriction. Because A, B and C (all members of D’s family), acting together after the transfer, can remove the restriction on liquidation, D’s interest is valued without regard to the restriction; *i.e.*, as though D’s interest is sufficient to liquidate the partnership.

Example 2. D owns all the preferred stock in Corporation X. The preferred stock carries a right to liquidate X that cannot be exercised until 1999. D’s children, A and B, own all the common stock of X. The common stock is the only voting stock. In 1994, D transfers the preferred stock to D’s child, A. The restriction on D’s right to liquidate is an applicable restriction that is disregarded. Therefore, the preferred stock is valued as though the right to liquidate were presently exercisable.

Example 3. D owns 60 percent of the stock of Corporation X. The corporate by-laws provide that the corporation cannot be liquidated for 10 years after which time liquidation requires approval by 60 percent of the voting interests. In the absence of the provision in the by-laws, State law would require approval by 80 percent of the voting interests to liquidate X. D transfers the stock to a

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trust for the benefit of D's child, A, during the 10-year period. The 10-year restriction is an applicable restriction and is disregarded. Therefore, the value of the stock is determined as if the transferred block could currently liquidate X.

Example 4. D and D's children, A and B, are partners in Limited Partnership Y. Each has a 3.33 percent general partnership interest and a 30 percent limited partnership interest. Any general partner has the right to liquidate the partnership at any time. As part of a loan agreement with a lender who is related to D, each of the partners agree that the partnership may not be liquidated without the lender's consent while any portion of the loan remains outstanding. During the term of the loan agreement, D transfers one-half of both D's partnership interests to each of A and B. Because the lender is a related party, the requirement that the lender consent to liquidation is an applicable restriction and the transfers of D's interests are valued as if such consent were not required.

Example 5. D owns 60 percent of the preferred and 70 percent of the common stock in Corporation X. The remaining stock is owned by individuals unrelated to D. The preferred stock carries a put right that cannot be exercised until 1999. In 1995, D transfers the common stock to D's child in a transfer that is subject to section 2701. The restriction on D's right to liquidate is an applicable restriction that is disregarded in determining the amount of the gift under section 2701.

[T.D. 8395, 57 FR 4276, Feb. 4, 1992; T.D. 8395, 57 FR 11265, Apr. 2, 1992]

§ 25.2704-3 Effective date.

Section 25.2704-1 applies to lapses occurring after January 28, 1992, of rights created after October 8, 1990. Section 25.2704-2 applies to transfers occurring after January 28, 1992, of property subject to applicable restrictions created after October 8, 1990. In determining whether a voting right or a liquidation right has lapsed prior to that date, and for purposes of determining whether the lapse is subject to section 2704(a), taxpayers may rely on any reasonable interpretation of the statutory provisions. For transfers of interests occurring before January 28, 1992, taxpayers may rely on any reasonable interpretation of the statutory provisions in determining whether a restriction is an applicable restriction that must be disregarded in determining the value of the transferred interest. For these purposes, the provisions of the proposed regulations and the final regulations

are considered a reasonable interpretation of the statutory provisions.

[T.D. 8395, 57 FR 4277, Feb. 4, 1992; T.D. 8395, 57 FR 11265, Apr. 2, 1992]

PROCEDURE AND ADMINISTRATION

§ 25.6001-1 Records required to be kept.

(a) *In general.* Every person subject to taxation under Chapter 12 of the Internal Revenue Code of 1954 shall for the purpose of determining the total amount of his gifts, keep such permanent books of account or records as are necessary to establish the amount of his total gifts (limited as provided by section 2503(b)), together with the deductions allowable in determining the amount of his taxable gifts, and the other information required to be shown in a gift tax return. All documents and vouchers used in preparing the gift tax return (see § 25.6019-1) shall be retained by the donor so as to be available for inspection whenever required.

(b) *Supplemental data.* In order that the Internal Revenue Service may determine the correct tax the donor shall furnish such supplemental data as may be deemed necessary by the Internal Revenue Service. It is, therefore, the duty of the donor to furnish, upon request, copies of all documents relating to his gift or gifts, appraisal lists of any items included in the total amount of gifts, copies of balance sheets or other financial statements obtainable by him relating to the value of stock constituting the gift, and any other information obtainable by him that may be necessary in the determination of the tax. See section 2512 and the regulations issued thereunder. For every policy of life insurance listed on the return, the donor must procure a statement from the insurance company on Form 712 and file it with the internal revenue officer with whom the return is filed. If specifically requested by an internal revenue officer, the insurance company shall file this statement direct with the internal revenue officer.

[T.D. 6334, 23 FR 8904, Nov. 15, 1958, as amended by T.D. 7012, 34 FR 7691, May 15, 1969; T.D. 7517, 42 FR 58935, Nov. 14, 1977]

§ 25.6011-1 General requirement of return, statement, or list.

(a) *General rule.* Every person made liable for any tax imposed by Chapter 12 of the Code shall make such returns or statements as are required by the regulations in this part. The return or statement shall include therein the information required by the applicable regulations or forms.

(b) *Use of prescribed forms.* Copies of the forms prescribed by paragraph (b) of § 25.6001-1 and § 25.6019-1 may be obtained from district directors and directors of service centers. The fact that a person required to file a form has not been furnished with copies of a form will not excuse him from the making of a gift tax return, or from the furnishing of the evidence for which the forms are to be used. Application for a form should be made to the district director or director of a service center in ample time to enable the person whose duty it is to file the form to have the form prepared, verified, and filed on or before the date prescribed for the filing thereof.

[T.D. 6334, 23 FR 8904, Nov. 15, 1958, as amended by T.D. 7012, 34 FR 7691, May 15, 1969]

§ 25.6011-4 Requirement of statement disclosing participation in certain transactions by taxpayers.

(a) *In general.* If a transaction is identified as a *listed transaction* or a *transaction of interest* as defined in § 1.6011-4 of this chapter by the Commissioner in published guidance (see § 601.601(d)(2)(ii)(b) of this chapter), and the listed transaction or transaction of interest involves a gift tax under chapter 12 of subtitle B of the Internal Revenue Code, the transaction must be disclosed in the manner stated in such published guidance.

(b) *Effective/applicability date.* This section applies to listed transactions entered into on or after January 1, 2003. This section applies to transactions of interest entered into on or after November 2, 2006.

[T.D. 9350, 72 FR 43153, Aug. 3, 2007]

§ 25.6019-1 Persons required to file returns.

(a) *Gifts made after December 31, 1981.* Subject to section 2523(i)(2), an indi-

vidual citizen or resident of the United States who in any calendar year beginning after December 31, 1981, makes any transfer by gift other than a transfer that, under section 2503 (b) or (e) (relating, respectively, to certain gifts of \$10,000 per donee and the exclusion for payment of certain educational and medical expenses), is not included in the total amount of gifts for that year, or a transfer of an interest with respect to which a marital deduction is allowed for the value of the entire interest under section 2523 (other than a marital deduction allowed by reason of section 2523(f), regarding qualified terminable interest property for which a return must be filed in order to make the election under that section), must file a gift tax return on Form 709 for that calendar year.

(b) *Gifts made after December 31, 1976, and before January 1, 1982.* An individual citizen or resident of the United States who makes a transfer by gift within any calendar year beginning after December 31, 1976, and before January 1, 1982, must file a gift tax return on Form 709 for any calendar quarter in which the sum of the taxable gifts made during that calendar quarter, plus all other taxable gifts made during the year (for which a return has not yet been required to be filed), exceeds \$25,000. If the aggregate transfers made in a calendar year after 1976 and before 1982 that must be reported do not exceed \$25,000, only one return must be filed for the calendar year and it must be filed by the due date for a fourth quarter gift tax return (April 15).

(c) *Gifts made after December 31, 1970, and before January 1, 1977.* An individual citizen or resident of the United States who makes a transfer by gift within any calendar year beginning after December 31, 1970, and before January 1, 1977, must file a gift tax return on Form 709 for the calendar quarter in which any portion of the value of the gift, or any portion of the sum of the values of the gifts to such donee during that calendar year, is not excluded from the total amount of taxable gifts for that year, and must also make a return for any subsequent quarter within the same taxable year in which any additional gift is made to the same donee.

(d) *Gifts by nonresident alien donors.* The rules contained in paragraphs (a) through (c) of this section also apply to a nonresident not a citizen of the United States provided that, under section 2501(a)(1) and § 25.2511-3, the transfer is subject to the gift tax.

(e) *Miscellaneous provisions.* Only individuals are required to file returns and not trusts, estates, partnerships, or corporations. Duplicate copies of the return are not required to be filed. See §§ 25.6075-1 and 25.6091-1 for the time and place for filing the gift tax return. For delinquency penalties for failure to file or pay the tax, see section 6651 and § 301.6651-1 of this chapter (Procedure and Administration Regulations). For criminal penalties for failure to file a return and filing a false or fraudulent return, see sections 7203, 7206, and 7207.

(f) *Return required even if no tax due.* The return is required even though, because of the deduction authorized by section 2522 (charitable deduction) or the unified credit under section 2505, no tax may be payable on the transfer.

(g) *Deceased donor.* If the donor dies before filing his return, the executor or administrator of his estate shall file the return. If the donor becomes legally incompetent before filing his return, his guardian or committee shall file the return.

(h) *Ratification of return.* The return shall not be made by an agent unless by reason of illness, absence, or nonresidence, the person liable for the return is unable to make it within the time prescribed. Mere convenience is not sufficient reason for authorizing an agent to make the return. If by reason of illness, absence or nonresidence, a return is made by an agent, the return must be ratified by the donor or other person liable for its filing within a reasonable time after such person becomes able to do so. If the return filed by the agent is not so ratified, it will not be considered the return required by the statute. Supplemental data may be submitted at the time of ratification. The ratification may be in the form of a statement, executed under the penalties of perjury and filed with the internal revenue officer with whom the return was filed, showing specifically that the return made by the agent has been carefully examined and that the

person signing ratifies the return as the donor's. If a return is signed by an agent, a statement fully explaining the inability of the donor must accompany the return.

[T.D. 7238, 37 FR 28735, Dec. 29, 1972, as amended by T.D. 8522, 59 FR 9663, Mar. 1, 1994]

§ 25.6019-2 Returns required in case of consent under section 2513.

Except as otherwise provided in this section, the provisions of § 25.6019-1 (other than paragraph (d) of § 25.6019-1) apply with respect to the filing of a gift tax return or returns in the case of a husband and wife who consent (see § 25.2513-1) to the application of section 2513. If both spouses are (without regard to the provisions of section 2513) required under the provisions of § 25.6019-1 to file returns, returns must be filed by both spouses. If only one of the consenting spouses is (without regard to the provisions of section 2513) required under § 25.6019-1 to file a return, a return must be filed by that spouse. In the latter case if, after giving effect to the provisions of section 2513, the other spouse is considered to have made a gift not excluded from the total amount of such other spouse's gifts for the taxable year by reason of section 2503 (b) or (e) (relating, respectively, to certain gifts of \$10,000 per donee and the exclusion for certain educational or medical expenses), a return must also be filed by such other spouse. Thus, if during a calendar year beginning after December 31, 1981, the first spouse made a gift of \$18,000 to a child (the gift not being either a future interest in property or an amount excluded under section 2503(e)) and the other spouse made no gifts, only the first spouse is required to file a return for that calendar year. However, if the other spouse had made a gift in excess of \$2,000 to the same child during the same calendar year or if the gift made by the first spouse had amounted to \$21,000, each spouse would be required to file a return if the consent is signified as provided in section 2513.

[T.D. 8522, 59 FR 9664, Mar. 1, 1994]

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§ 25.6019-3 Contents of return.

(a) *In general.* The return must set forth each gift made during the calendar year (or calendar quarter with respect to gifts made after December 31, 1970, and before January 1, 1982) that under sections 2511 through 2515 is to be included in computing taxable gifts; the deductions claimed and allowable under sections 2521 through 2524; and the taxable gifts made for each of the preceding reporting periods. (See § 25.2504-1.) In addition the return shall set forth the fair market value of all gifts not made in money, including gifts resulting from sales and exchanges of property made for less than full and adequate consideration in money or money's worth, giving, as of the date of the sale or exchange, both the fair market value of the property sold or exchanged and the fair market value of the consideration received by the donor. If a donor contends that his retained power over property renders the gift incomplete (see § 25.2511-2) and hence not subject to tax as of the calendar quarter or calendar year of the initial transfer, the transaction should be disclosed in the return for the calendar quarter or calendar year of the initial transfer and evidence showing all relevant facts, including a copy of the instrument of transfer, shall be submitted with the return. The instructions printed on the return should be carefully followed. A certified or verified copy of each document required by the instructions printed on the return form shall be filed with the return. Any additional documents the donor may desire to submit may be submitted with the return.

(b) *Disclosure of transfers coming within provisions of section 2516.* Section 2516 provides that certain transfers of property pursuant to written property settlements between husband and wife are deemed to be transfers for full and adequate consideration in money or money's worth if divorce occurs within 2 years. In any case where a husband and wife enter into a written agreement of the type contemplated by section 2516 and the final decree of divorce is not granted on or before the due date for the filing of a gift tax return for the calendar year (or calendar quarter with respect to periods beginning after De-

ember 31, 1970, and ending before January 1, 1982) in which the agreement became effective (see § 25.6075-1), then, except to the extent § 25.6019-1 provides otherwise, the transfer must be disclosed by the transferor upon a gift tax return filed for the calendar year (or calendar quarter) in which the agreement becomes effective, and a copy of the agreement must be attached to the return. In addition, a certified copy of the final divorce decree shall be furnished the internal revenue officer with whom the return was filed not later than 60 days after the divorce is granted. Pending receipt of evidence that the final decree of divorce has been granted (but in no event for a period of more than 2 years from the effective date of the agreement), the transfer will tentatively be treated as made for a full and adequate consideration in money or money's worth.

[T.D. 7238, 37 FR 28736, Dec. 29, 1972, as amended by T.D. 8522, 59 FR 9664, Mar. 1, 1994]

§ 25.6019-4 Description of property listed on return.

The properties comprising the gifts made during the calendar year (or calendar quarter with respect to gifts made after December 31, 1970, and before January 1, 1982) must be listed on the return and described in a manner that they may be readily identified. Thus, there should be given for each parcel of real estate a legal description, its area, a short statement of the character of any improvements, and, if located in a city, the name of the street and number. Description of bonds shall include the number transferred, principal amount, name of obligor, date of maturity, rate of interest, date or dates on which interest is payable, series number where there is more than one issue, and the principal exchange upon which listed, or the principal business office of the obligor, if unlisted. Description of stocks shall include number of shares, whether common or preferred, and, if preferred, what issue thereof, par value, quotation at which returned, exact name of corporation, and, if the stock is unlisted, the location of the principal business office, the State in

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which incorporated and the date of incorporation, or if the stock is listed, the principal exchange upon which sold. Description of notes shall include name of maker, date on which given, date of maturity, amount of principal, amount of principal unpaid, rate of interest and whether simple or compound, and date to which interest has been paid. If the gift of property includes accrued income thereon to the date of the gift, the amount of such accrued income shall be separately set forth. Description of the seller's interest in land contracts transferred shall include name of buyer, date of contract, description of property, sale price, initial payment, amounts of installment payments, unpaid balance of principal, interest rate and date prior to gift to which interest has been paid. Description of life insurance policies shall show the name of the insurer and the number of the policy. In describing an annuity, the name and address of the issuing company shall be given, or, if payable out of a trust or other fund, such a description as will fully identify the trust or fund. If the annuity is payable for a term of years, the duration of the term and the date on which it began shall be given, and if payable for the life of any person, the date of birth of that person shall be stated. Judgments shall be described by giving the title of the cause and the name of the court in which rendered, date of judgment, name and address of judgment debtor, amount of judgment, rate of interest to which subject, and by stating whether any payments have been made thereon, and, if so, when and in what amounts.

[T.D. 7238, 37 FR 28736, Dec. 29, 1972, as amended by T.D. 8522, 59 FR 9664, Mar. 1, 1994]

§ 25.6060-1 Reporting requirements for tax return preparers.

(a) *In general.* A person that employs one or more tax return preparers to prepare a return or claim for refund of gift tax under chapter 12 of subtitle B of the Internal Revenue Code, other than for the person, at any time during a return period, shall satisfy the record keeping and inspection requirements in the manner stated in §1.6060-1 of this chapter.

(b) *Effective/applicability date.* This section is applicable to returns and claims for refund filed after December 31, 2008.

[T.D. 9436, 73 FR 78451, Dec. 22, 2008]

§ 25.6061-1 Signing of returns and other documents.

Any return, statement, or other document required to be made under any provision of Chapter 12 or Subtitle F of the Code or regulations prescribed thereunder with respect to any tax imposed by Chapter 12 of the Code shall be signed by the donor or other person required or duly authorized to sign in accordance with the regulations, forms, or instructions prescribed with respect to such return, statement, or other document. The person required or duly authorized to make the return may incur liability for the penalties provided for erroneous, false, or fraudulent returns. For criminal penalties see sections 7201, 7203, 7206, 7207, and 7269.

[T.D. 6600, 27 FR 4987, May 29, 1962]

§ 25.6065-1 Verification of returns.

(a) *Penalties of perjury.* If a return, statement, or other document made under the provisions of Chapter 12 or Subtitle F of the Code or the regulations thereunder with respect to any tax imposed by Chapter 12 of the Code, or the form and instructions issued with respect to such return, statement, or other document, requires that it shall contain or be verified by a written declaration that it is made under the penalties of perjury, it must be so verified by the person or persons required to sign such return, statement, or other document. In addition, any other statement or document submitted under any provision of Chapter 12 or Subtitle F of the Code or regulations thereunder with respect to any tax imposed by Chapter 12 of the Code may be required to contain or be verified by a written declaration that it is made under the penalties of perjury.

(b) *Oath.* Any return, statement, or other document required to be submitted under Chapter 12 or Subtitle F of the Code or regulations prescribed

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thereunder with respect to any tax imposed by Chapter 12 of the Code may be required to be verified by an oath.

[T.D. 6600, 27 FR 4987, May 29, 1962]

§ 25.6075-1 Returns, time for filing gift tax returns for gifts made after December 31, 1981.

(a) *In general.* Except as provided in paragraphs (b) (1) and (2) of this section, a return required to be filed under section 6019 for gifts made after December 31, 1981, must be filed on or before the 15th day of April following the close of the calendar year in which the gift was made.

(b) *Special rules—(1) Extensions.* Except as provided in paragraph (b)(2) of this section, if a taxpayer files an income tax return on the calendar year basis and the taxpayer is granted an extension of time for filing the return of income tax imposed by Subtitle A of the Internal Revenue Code, then such taxpayer shall also be deemed to have been granted an extension of time for filing the gift tax return under section 6019 for such calendar year equal to the extension of time granted for filing the income tax return. See section 6081 and the regulations thereunder for rules relating to extension of time for filing returns.

(2) *Death of donor.* Where a gift is made during the calendar year in which the donor dies, the time for filing the return made under section 6019 shall not be later than the time (including extensions) for filing the return made under section 6018 (relating to estate tax returns) with respect to such donor. In addition, should the time for filing the estate tax return fall later than the 15th day of April following the close of the calendar year, the time for filing the gift tax return shall be on or before the 15th day of April following the close of the calendar year, unless an extension (not extending beyond the time for filing the estate tax return) was granted for filing the gift tax return. If no estate tax return is required to be filed, the time for filing the gift tax return shall be on or before the 15th day of April following the close of the calendar year, unless an extension was granted for filing the gift tax return.

(c) Paragraphs (a) and (b) may be illustrated by the following examples.

Example (1). Donor makes a taxable gift on April 1, 1982, for which a return must be made under section 6019. Donor files the income tax return on the calendar year basis. The donor was granted a 4-month extension from April 15, 1983 to August 15, 1983, in which to file the 1982 income tax return. Under these circumstances, the donor is not required to file the gift tax return prior to August 15, 1983. See paragraph (b)(1) of this section.

Example (2). Donor makes a taxable gift on April 1, 1982, for which a return must be made under section 6019. The donor dies on May 1, 1982. Under these circumstances, since the due date for filing the estate tax return, February 1, 1983 (assuming an estate tax return under section 6018 was required to be filed), falls prior to the due date for the gift tax return (as specified in section 6075(b)(1)), the last day for filing the gift tax return is February 1, 1983. See paragraph (b)(2) of this section.

Example (3). The facts are the same as in example (2), except the donor dies on November 30, 1982. Although the estate tax return is due on or before August 30, 1983, the last day for filing the gift tax return is April 15, 1983. See paragraph (b) of this section.

Example (4). The facts are the same as in example (3), except that the executor receives a 4-month extension for filing the decedent's income tax return. Under these circumstances, the last day for filing the gift tax return is August 15, 1983. See paragraphs (b) (1) and (2) of this section.

Example (5). The facts are the same as in example (3), except that the donor-decedent receives an extension of 6 months for filing the gift tax return. See section 6081 and § 25.6081-1. Since section 6075(b)(3) and § 25.6075-2(b) provide that the time for filing the gift tax return made under section 6019 shall not be later than the time (including extensions) for filing the estate tax return made under section 6018, the last day for filing the gift tax return is August 30, 1983.

(d) See section 7503 and § 301.7503-1 concerning the timely filing of a return that falls due on a Saturday, Sunday or legal holiday. As to additions to the tax for failure to file the return within the prescribed time, see section 6651 and § 301.6651-1.

[T.D. 7910, 48 FR 40375, Sept. 7, 1983]

§ 25.6075-2 Returns; time for filing gift tax returns for gifts made after December 31, 1976, and before January 1, 1982.

(a) *Due date for filing quarterly gift tax returns.* (1) Except as provided in paragraph (b) of this section, a return required to be filed under section 6019 for the first, second, or third calendar quarter of any calendar year must be filed on or before the 15th day of the second month following the close of the calendar quarter in which the taxable gift was made.

(2) If a return is required to be filed under section 6019 for the fourth calendar quarter, then—

(i) For gifts made after December 31, 1976 and before January 1, 1979, the return must be filed on or before February 15th following the close of the fourth calendar quarter, or

(ii) For gifts made after December 31, 1978, and before January 1, 1982, the return must be filed on or before April 15th following the close of the fourth calendar quarter.

(b) *Special rule.* (1) If the total amount of taxable gifts (determined after the application of paragraph (c)(1) of this section, relating to split gifts) made by a person during a calendar quarter is \$25,000 or less, the return required under section 6019 for that quarter must be filed on or before the date prescribed in paragraph (a)(1) of this section for filing the return for gifts made in the first subsequent calendar quarter (unless the first subsequent calendar quarter is the fourth calendar quarter in which case see paragraph (b)(2) of this section) in the calendar year in which the sum of—

(i) The taxable gifts made during such subsequent calendar quarter, plus

(ii) All other taxable gifts made in prior quarters of the calendar year for which no return has yet been required to be filed,

exceeds \$25,000. The return must include transfers by gift (as required by section 6019 and the regulations under that section) made during such subsequent and prior quarters of the calendar year for which no return has yet been required to be filed and identify in which quarter such transfers were made. The return must meet all the requirements for a separate return as if a

separate return had been made for each quarter in which a transfer by gift was made. This return will be treated as a separate return for each of the quarters identified on the return.

(2) If a return is not required to be filed under paragraph (b)(1) of this section, then—

(i) For gifts made after December 31, 1976 and before January 1, 1979, the return must be filed on or before February 15th following the close of the fourth calendar quarter, or

(ii) For gifts made after December 31, 1978, and before January 1, 1982, the return must be filed on or before April 15th following the close of the fourth calendar quarter.

The return must include all transfers by gift (as required under section 6019 and the regulations under that section) made during the calendar year for which no return has yet been required to be filed and identify in which quarter such transfers were made. The return must meet all the requirements for a separate return as if a separate return had been made for each quarter in which a transfer by gift was made. This return will be treated as a separate return for each of the quarters identified on the return.

(3) Under section 6075(b)(3), any extension of time granted a taxpayer for filing the return of income taxes imposed by Subtitle A for any taxable year which is a calendar year shall be treated as an extension of time granted the taxpayer for filing any return under section 6019 which is due (under paragraphs (a)(2)(ii) and (b)(2)(ii) of this section) on or before April 15th following the close of the fourth calendar quarter. See also section 6081 and § 25.6081-1 for other rules relating to extensions of time for filing returns.

(4) See section 7503 and § 301.7503-1 for the due date of a return that falls on a Saturday, Sunday, or a legal holiday. As to additions to the tax for failure to file the return within the prescribed time, see section 6651 and § 301.6651-1.

(c) *Effect of section 2513.* (1) In determining whether taxable gifts made during any calendar quarter exceed \$25,000, and in determining whether taxable gifts made in the current calendar quarter and the preceding calendar quarters of the calendar year for which

no return has yet been required to be filed exceed \$25,000, the effect of section 2513 is not taken into account for any gifts made in the current or previous quarters for which a return is now being filed unless an irrevocable consent was made by either spouse on a return that was required to be filed prior to the due date of the current return. See § 25.2513-3 for the rules relating to when a consent becomes irrevocable.

(2) Paragraph (c)(1) of this section may be illustrated by the following examples:

Example (1). During the first quarter of 1980 A made taxable gifts of \$17,000 (\$20,000 - \$3,000 annual exclusion under section 2503(b)) to D. During the second quarter A made another taxable gift of \$10,000 to D. A's taxable gifts for the first two quarters are \$27,000. Therefore, A is required to file a return for the first and second quarters on or before August 15, 1980. On that return A's wife, B, consented to the application of section 2513 (relating to split gifts) for the second quarter. Even though A split the second quarter gift with his wife, A's return is nevertheless required to be filed on or before August 15, 1980 because in determining whether taxable gifts exceed \$25,000, the effect of section 2513 is only taken into account for the quarter in which an irrevocable consent was made on a return required to be filed before August 15, 1980.

Example (2). Assume the same facts as in Example (1). In addition, during the third quarter A made another taxable gift of \$20,000 to D, and B made a taxable gift of \$24,000 to D. B is required to file a return reporting the taxable gifts made during the second and third quarters on or before November 15, 1980 because B's total taxable gifts exceed \$25,000 (second quarter gifts after taking section 2513 into account = $\frac{1}{2}$ (\$10,000) - \$3,000 (annual exclusion under section 2503(b)) = \$2,000 plus a \$24,000 gift in the third quarter). Even if A and B had consented to the application of section 2513 for the third quarter, B's return would nevertheless be due on or before November 15, 1980, because an irrevocable consent was not made on a return that was required to be filed prior to November 15, 1980. However, the effect of section 2513 is taken into account for the second quarter because an irrevocable consent was made on a return that was required to be filed prior to November 15, 1980.

Example (3). During the first quarter of 1980 A made taxable gifts of \$27,000 to F (\$30,000 - \$3,000 annual exclusion under section 2503(b)). A is required to file a return on or before May 15, 1980. A fails to file a return until August 1, 1980. On that return B, A's

spouse, consented to the application of section 2513. The consent on that return is irrevocable under § 25.2513-3. During the second quarter B made taxable gifts of \$14,000 to F. A and B made no other gifts during 1980. B has made total taxable gifts of \$26,000 (\$12,000 for the first quarter and \$14,000 for the second quarter). Therefore, B is required to file a return on or before August 15, 1980. Even if A and B had consented to the application of section 2513 for the second quarter, B's return is nevertheless due on or before August 15, 1980. Assuming no other gifts were made during the year, A's return reporting the second quarter split gift would be due on or before April 15, 1981.

Example (4). During the first quarter of 1980 A made taxable gifts of \$20,000 to G. B, A's spouse, files a gift tax return on June 15, 1980 reporting that gift and both A and B signify their consent to the application of section 2513 on that return. In determining whether either spouse has exceeded the \$25,000 amount for the remainder of 1980, the effect of section 2513 will be taken into account for the transfer by gift made in the first quarter.

(d) *Nonresident not citizens of the United States.* In the case of a donor who is a nonresident not a citizen of the United States, paragraphs (a) and (b) of this section shall be applied by substituting "\$12,500" for "\$25,000" each place it appears. For rules relating to whether certain residents of possessions are considered nonresidents not citizens of the United States, see section 2501(c) and § 25.2501-1(d).

(e) *Effective date.* This section is effective for gifts made after December 31, 1976, and before January 1, 1982.

[T.D. 7757, 46 FR 6929, Jan. 22, 1981. Redesignated and amended by T.D. 7910, 48 FR 40375, Sept. 7, 1983]

§ 25.6081-1 Automatic extension of time for filing gift tax returns.

(a) *In general.* Under section 6075(b)(2), an automatic six-month extension of time granted to a donor to file the donor's return of income under § 1.6081-4 of this chapter shall be deemed also to be a six-month extension of time granted to file a return on Form 709, "United States Gift (and Generation-Skipping Transfer) Tax Return." If a donor does not obtain an extension of time to file the donor's return of income under § 1.6081-4 of this chapter, the donor will be allowed an automatic 6-month extension of time

to file Form 709 after the date prescribed for filing if the donor files an application under this section in accordance with paragraph (b) of this section. In the case of an individual described in § 1.6081-5(a)(5) or (6) of this chapter, the automatic 6-month extension of time to file Form 709 will run concurrently with the extension of time to file granted pursuant to § 1.6081-5 of this chapter.

(b) *Requirements.* To satisfy this paragraph (b), a donor must—

(1) Submit a complete application on Form 8892, “Payment of Gift/GST Tax and/or Application for Extension of Time To File Form 709,” or in any other manner prescribed by the Commissioner;

(2) File the application on or before the later of—

(i) The date prescribed for filing the return; or

(ii) The expiration of any extension of time to file granted pursuant to § 1.6081-5 of this chapter; and

(3) File the application with the Internal Revenue Service office designated in the application’s instructions.

(c) *No extension of time for the payment of tax.* An automatic extension of time for filing a return granted under paragraph (a) of this section will not extend the time for payment of any tax due on such return.

(d) *Termination of automatic extension.* The Commissioner may terminate an extension at any time by mailing to the donor a notice of termination at least 10 days prior to the termination date designated in such notice. The Commissioner must mail the notice of termination to the address shown on the Form 8892, or to the donor’s last known address. For further guidance regarding the definition of last known address, see § 301.6212-2 of this chapter.

(e) *Penalties.* See section 6651 for failure to file a gift tax return or failure to pay the amount shown as tax on the return.

(f) *Effective/applicability dates.* This section is applicable for applications for an extension of time to file Form 709 filed after July 1, 2008.

[T.D. 9407, 73 FR 37368, July 1, 2008]

§ 25.6091-1 Place for filing returns and other documents.

(a) *In general.* If the donor is a resident of the United States, the gift tax return required by section 6019 shall be filed with any person assigned the responsibility to receive returns in the local Internal Revenue Service office that serves the legal residence or principal place of business of the donor. If the donor is a nonresident (whether or not a citizen), and his principal place of business is served by a local Internal Revenue Service office, the gift tax return shall be filed with any person assigned the responsibility to receive returns in that office.

(b) *Returns filed with service centers.* Notwithstanding paragraph (a) of this section, unless a return is filed by hand carrying, whenever instructions applicable to gift tax returns provide that the returns be filed with a service center, the returns must be so filed in accordance with the instructions. Returns which are filed by hand carrying shall be filed with any person assigned the responsibility to receive hand-carried returns in the local Internal Revenue Service office in accordance with paragraph (a) of this section.

(c) *Returns of certain nonresidents.* If the donor is a nonresident (whether or not a citizen), and he does not have a principal place of business in the United States, the gift tax return required by section 6019, whether or not such return is made by hand carrying, shall be filed with the Internal Revenue Service Center, Philadelphia, Pennsylvania, or as designated on the return form or in the instructions issued with respect to such form.

(Secs. 6091, 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805))

[T.D. 7012, 34 FR 7692, May 15, 1969, as amended by T.D. 7238, 37 FR 28737, Dec. 29, 1972; 39 FR 797, Jan. 3, 1974; T.D. 7495, 42 FR 33726, July 1, 1977; T.D. 9156, 69 FR 55745, Sept. 16, 2004]

§ 25.6091-2 Exceptional cases.

Notwithstanding the provisions of § 25.6091-1 the Commissioner may permit the filing of the gift tax return required by section 6019 in any local Internal Revenue Service office.

[T.D. 6600, 27 FR 4987, May 29, 1962, as amended by T.D. 9156, 69 FR 55745, Sept. 16, 2004]

§ 25.6107-1 Tax return preparer must furnish copy of return to taxpayer and must retain a copy or record.

(a) *In general.* A person who is a signing tax return preparer of any return or claim for refund of gift tax under chapter 12 of subtitle B of the Internal Revenue Code shall furnish a completed copy of the return or claim for refund to the taxpayer, and retain a completed copy or record in the manner stated in § 1.6107-1 of this chapter.

(b) *Effective/applicability date.* This section is applicable to returns and claims for refund filed after December 31, 2008.

[T.D. 9436, 73 FR 78451, Dec. 22, 2008]

§ 25.6109-1 Tax return preparers furnishing identifying numbers for returns or claims for refund.

(a) *In general.* Each gift tax return or claim for refund prepared by one or more signing tax return preparers must include the identifying number of the preparer required by § 1.6695-1(b) of this chapter to sign the return or claim for refund in the manner stated in § 1.6109-2 of this chapter.

(b) *Effective/applicability date.* Paragraph (a) of this section is applicable to returns and claims for refund filed after December 31, 2008.

[T.D. 9436, 73 FR 78451, Dec. 22, 2008]

§ 25.6151-1 Time and place for paying tax shown on return.

The tax shown on the gift tax return is to be paid by the donor at the time and place fixed for filing the return (determined without regard to any extension of time for filing the return), unless the time for paying the tax is extended in accordance with the provisions of section 6161. However, for provisions relating to certain cases in which the time for paying the gift tax is postponed by reason of an individual serving in, or in support of, the Armed

Forces of the United States in a combat zone, see section 7508. For provisions relating to the time and place for filing the return, see §§ 25.6075-1 and 25.6091-1.

§ 25.6161-1 Extension of time for paying tax or deficiency.

(a) *In general—(1) Tax shown on return.* A reasonable extension of time to pay the amount of tax shown on the return may be granted by the district director at the request of the donor. The period of such extension shall not be in excess of six months from the date fixed for the payment of the tax, except that if the taxpayer is abroad the period of extension may be in excess of six months.

(2) *Deficiency.* The time for payment of any amount determined as a deficiency in respect of tax imposed by Chapter 12 of the Code, or for payment of any part thereof may be extended by the district director at the request of the donor for a period not to exceed 18 months from the date fixed for the payment of the deficiency, as shown on the notice and demand from the district director, and, in exceptional cases, for a further period not in excess of 12 months. No extension of time for the payment of a deficiency shall be granted if the deficiency is due to negligence, to intentional disregard of rules and regulations, or to fraud with intent to evade tax.

(3) *Extension of time for filing distinguished.* The granting of an extension of time for filing a return does not operate to extend the time for the payment of the tax or any part thereof, unless so specified in the extension.

(b) *Undue hardship required for extension.* An extension of the time for payment shall be granted only upon a satisfactory showing that payment on the due date of the amount with respect to which the extension is desired will result in an undue hardship. The extension will not be granted upon a general statement of hardship. The term “undue hardship” means more than an inconvenience to the taxpayer. It must appear that substantial financial loss, for example, loss due to the sale of property at a sacrifice price, will result to the donor from making payment on

the due date of the amount with respect to which the extension is desired. If a market exists, the sale of the property at the current market price is not ordinarily considered as resulting in an undue hardship.

(c) *Application for extension.* An application for an extension of the time for payment of the tax shown on the return, or for the payment of any amount determined as a deficiency, shall be in writing and shall be accompanied by evidence showing the undue hardship that would result to the donor if the extension were refused. The application shall also be accompanied by a statement of the assets and liabilities of the donor and an itemized statement showing all receipts and disbursements for each of the 3 months immediately preceding the due date of the amount to which the application relates. The application, with supporting documents, must be filed with the applicable district director referred to in paragraph (a) of § 25.6091-1 regardless of whether the return is to be filed with, or the tax is to be paid to, such district director on or before the date prescribed for payment of the amount with respect to which the extension is desired. The application will be examined by the district director, and within 30 days, if possible, will be denied, granted, or tentatively granted subject to certain conditions of which the donor will be notified. If an additional extension is desired, the request therefor must be made to the district director on or before the expiration of the period for which the prior extension is granted.

(d) *Payment pursuant to extension.* If an extension of time for payment is granted, the amount the time for payment of which is so extended shall be paid on or before the expiration of the period of the extension without the necessity of notice and demand from the district director. The granting of an extension of the time for payment of the tax or deficiency does not relieve the donor from liability for the payment of interest thereon during the period of the extension. See section 6601 and § 301.6601-1 of this chapter (Regulations on Procedure and Administration).

[T.D. 6334, 23 FR 8904, Nov. 15, 1958, as amended by T.D. 7012, 34 FR 7692, May 15, 1969]

§ 25.6165-1 Bonds where time to pay tax or deficiency has been extended.

If an extension of time for payment of tax or deficiency is granted under section 6161, the district director may, if he deems it necessary, require a bond for the payment of the amount in respect of which the extension is granted in accordance with the terms of the extension. However, such bond shall not exceed double the amount with respect to which the extension is granted. For provisions relating to form of bonds, see the regulations under section 7101 contained in part 301 of this chapter (Regulations on Procedure and Administration).

[T.D. 6600, 27 FR 4987, May 29, 1962]

§ 25.6302-1 Voluntary payments of gift taxes by electronic funds transfer.

Any person may voluntarily remit by electronic funds transfer any payment of tax to which this part 25 applies. Such payment must be made in accordance with procedures prescribed by the Commissioner.

[T.D. 8828, 64 FR 37676, July 13, 1999]

§ 25.6321-1 Lien for taxes.

For regulations concerning the lien for taxes, see § 301.6321-1 of this chapter (Regulations on Procedure and Administration).

§ 25.6323-1 Validity and priority against certain persons.

For regulations concerning the validity of the lien imposed by section 6321 against certain persons, see §§ 301.6323(a)-1 through 301.6323(i)-1 of this chapter (Regulations on Procedure and Administration).

[T.D. 7429, 41 FR 35498, Aug. 23, 1976]

§ 25.6324-1 Special lien for gift tax.

For regulations concerning the special lien for the gift tax, see § 301.6324-1 of this chapter (Regulations on Procedure and Administration).

§ 25.6601-1 Interest on underpayment, nonpayment, or extensions of time for payment, of tax.

For regulations concerning interest on underpayment, nonpayment, or extensions of time for payment of tax,

§ 25.6694-1

see § 301.6601-1 of this chapter (Regulations on Procedure and Administration).

§ 25.6694-1 Section 6694 penalties applicable to tax return preparer.

(a) *In general.* For general definitions regarding section 6694 penalties applicable to preparers of gift tax returns or claims for refund, see § 1.6694-1 of this chapter.

(b) *Effective/applicability date.* Paragraph (a) of this section is applicable to returns and claims for refund filed, and advice provided, after December 31, 2008.

[T.D. 9436, 73 FR 78451, Dec. 22, 2008, as amended at 74 FR 5105, Jan. 29, 2009]

§ 25.6694-2 Penalties for understatement due to an unreasonable position.

(a) *In general.* A person who is a tax return preparer of any return or claim for refund of gift tax under chapter 12 of subtitle B of the Internal Revenue Code (Code) shall be subject to penalties under section 6694(a) of the Code in the manner stated in § 1.6694-2 of this chapter.

(b) *Effective/applicability date.* This section is applicable to returns and claims for refund filed, and advice provided, after December 31, 2008.

[T.D. 9436, 73 FR 78451, Dec. 22, 2008]

§ 25.6694-3 Penalty for understatement due to willful, reckless, or intentional conduct.

(a) *In general.* A person who is a tax return preparer of any return or claim for refund of gift tax under chapter 12 of subtitle B of the Internal Revenue Code (Code) shall be subject to penalties under section 6694(b) of the Code in the manner stated in § 1.6694-3 of this chapter.

(b) *Effective/applicability date.* This section is applicable to returns and claims for refund filed, and advice provided, after December 31, 2008.

[T.D. 9436, 73 FR 78452, Dec. 22, 2008]

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§ 25.6694-4 Extension of period of collection when tax return preparer pays 15 percent of a penalty for understatement of taxpayer's liability and certain other procedural matters.

(a) *In general.* For rules for the extension of period of collection when a tax return preparer who prepared a return or claim for refund for gift tax under chapter 12 of subtitle B of the Internal Revenue Code pays 15 percent of a penalty for understatement of taxpayer's liability, and procedural matters relating to the investigation, assessment and collection of the penalties under section 6694(a) and (b), the rules under § 1.6694-4 of this chapter will apply.

(b) *Effective/applicability date.* This section is applicable to returns and claims for refund filed, and advice provided, after December 31, 2008.

[T.D. 9436, 73 FR 78452, Dec. 22, 2008]

§ 25.6695-1 Other assessable penalties with respect to the preparation of tax returns for other persons.

(a) *In general.* A person who is a tax return preparer of any return or claim for refund of gift tax under chapter 12 of subtitle B of the Internal Revenue Code (Code) shall be subject to penalties for failure to furnish a copy to the taxpayer under section 6695(a) of the Code, failure to sign the return under section 6695(b) of the Code, failure to furnish an identification number under section 6695(c) of the Code, failure to retain a copy or list under section 6695(d) of the Code, failure to file a correct information return under section 6695(e) of the Code, and negotiation of a check under section 6695(f) of the Code, in the manner stated in § 1.6695-1 of this chapter.

(b) *Effective/applicability date.* This section is applicable to returns and claims for refund filed after December 31, 2008.

[T.D. 9436, 73 FR 78452, Dec. 22, 2008]

§ 25.6696-1 Claims for credit or refund by tax return preparers.

(a) *In general.* For rules for claims for credit or refund by a tax return preparer who prepared a return or claim for refund for gift tax under chapter 12 of subtitle B of the Internal Revenue Code, or by an appraiser that prepared

an appraisal in connection with such a return or claim for refund under section 6695A, the rules under § 1.6696-1 of this chapter will apply.

(b) *Effective/applicability date.* This section is applicable to returns and claims for refund filed, and advice provided, after December 31, 2008.

[T.D. 9436, 73 FR 78452, Dec. 22, 2008]

§ 25.6905-1 Discharge of executor from personal liability for decedent's income and gift taxes.

For regulations concerning the discharge of an executor from personal liability for a decedent's income and gift taxes, see § 301.6905-1 of this chapter (Regulations on Procedure and Administration).

[T.D. 7238, 37 FR 28738, Dec. 29, 1972]

§ 25.7101-1 Form of bonds.

For provisions relating to form of bonds, see the regulations under section 7101 contained in part 301 of this chapter (Regulations on Procedure and Administration).

[T.D. 6600, 27 FR 4987, May 29, 1962]

GENERAL ACTUARIAL VALUATIONS

SOURCE: Sections 25.7520-1 through 25.7520-4 appear at T.D. 8540, 59 FR 30177, June 10, 1994, unless otherwise noted.

§ 25.7520-1 Valuation of annuities, unitrust interests, interests for life or terms of years, and remainder or reversionary interests.

(a) *General actuarial valuations.* (1) Except as otherwise provided in this section and in § 25.7520-3(b) (relating to exceptions to the use of prescribed tables under certain circumstances), in the case of certain gifts after April 30, 1989, the fair market value of annuities, interests for life or for a term of years (including unitrust interests), remainders, and reversions is their present value determined under this section. See § 20.2031-7(d) of this chapter (and, for periods prior to May 1, 2009, § 20.2031-7A) for the computation of the value of annuities, unitrust interests, life estates, terms for years, remainders, and reversions, other than interests described in paragraphs (a)(2) and (a)(3) of this section.

(2) In the case of a gift to a beneficiary of a pooled income fund, see § 1.642(c)-6(e) of this chapter (or, for periods prior to May 1, 2009, § 1.642(c)-6A) with respect to the valuation of the remainder interest.

(3) In the case of a gift to a beneficiary of a charitable remainder annuity trust after April 30, 1989, see § 1.664-2 of this chapter with respect to the valuation of the remainder interest. See § 1.664-4 of this chapter (Income Tax Regulations) with respect to the valuation of the remainder interest in property transferred to a charitable remainder unitrust.

(b) *Components of valuation*—(1) *Interest rate component*—(i) *Section 7520 interest rate.* The section 7520 interest rate is the rate of return, rounded to the nearest two-tenths of one percent, that is equal to 120 percent of the applicable Federal mid-term rate, compounded annually, for purposes of section 1274(d)(1), for the month in which the valuation date falls. In rounding the rate to the nearest two-tenths of a percent, any rate that is midway between one two-tenths of a percent and another is rounded up to the higher of those two rates. For example, if 120 percent of the applicable Federal mid-term rate is 10.30, the section 7520 interest rate component is 10.4. The section 7520 interest rate is published monthly by the Internal Revenue Service in the Internal Revenue Bulletin (See § 601.601(d)(2)(ii)(b) of this chapter).

(ii) *Valuation date.* Generally, the valuation date is the date on which the gift is made. For gift tax purposes, the valuation date is the date on which the gift is complete under § 25.2511-2. For special rules in the case of charitable transfers, see § 25.7520-2.

(2) *Mortality component.* The mortality component reflects the mortality data most recently available from the United States census. As new mortality data becomes available after each decennial census, the mortality component described in this section will be revised and the revised mortality component tables will be published in the regulations at that time. For gifts with valuation dates on or after May 1, 2009, the mortality component table (Table 2000CM) is contained in § 20.2031-7(d)(7). See § 20.2031-7A of

this chapter for mortality component tables applicable to gifts for which the valuation date falls before May 1, 2009.

(c) *Tables.* The present value on the valuation date of an annuity, life estate, term of years, remainder, or reversion is computed by using the section 7520 interest rate component that is described in paragraph (b)(1) of this section and the mortality component that is described in paragraph (b)(2) of this section. Actuarial factors for determining these present values are included in tables in these regulations and in publications by the Internal Revenue Service. If a special factor is required in order to value an interest, the Internal Revenue Service will furnish the factor upon a request for a ruling. The request for a ruling must be accompanied by a recitation of the facts, including the date of birth for each measuring life and copies of relevant instruments. A request for a ruling must comply with the instructions for requesting a ruling published periodically in the Internal Revenue Bulletin (see Rev. Proc. 94-1, 1994-1 I.R.B. 10, and subsequent updates, and §§ 601.201 and 601.601(d)(2)(ii)(b) of this chapter) and include payment of the required user fee.

(1) *Regulation sections containing tables with interest rates between 0.2 and 14 percent for valuation dates on or after May 1, 2009.* Section 1.642(c)-6(e)(6) of this chapter contains Table S used for determining the present value of a single life remainder interest in a pooled income fund as defined in § 1.642(c)-5. See § 1.642(c)-6A for single life remainder factors applicable to valuation dates before May 1, 2009. Section 1.664-4(e)(6) contains Table F (payout factors) and Table D (actuarial factors used in determining the present value of a remainder interest postponed for a term of years). Section 1.664-4(e)(7) contains Table U(1) (unitrust single life remainder factors). These tables are used in determining the present value of a remainder interest in a charitable remainder unitrust as defined in § 1.664-3. See § 1.664-4A for unitrust single life remainder factors applicable to valuation dates before May 1, 2009. Section 20.2031-7(d)(6) of this chapter contains Table B (actuarial factors used in determining the present value of an in-

terest for a term of years), Table K (annuity end-of-interval adjustment factors), and Table J (term certain annuity beginning-of-interval adjustment factors). Section 20.2031-7(d)(7) contains Table S (single life remainder factors), and Table 2000CM (mortality components). These tables are used in determining the present value of annuities, life estates, remainders, and reversions. See § 20.2031-7A for single life remainder factors and mortality components applicable to valuation dates before May 1, 2009.

(2) *Internal Revenue Service publications containing tables with interest rates between 0.2 and 22 percent for valuation dates on or after May 1, 2009.* The following documents are available, at no charge, electronically via the IRS Internet site at <http://www.irs.gov>:

(i) Internal Revenue Service Publication 1457, “Actuarial Valuations Version 3A” (2009). This publication includes tables of valuation factors, as well as examples that show how to compute other valuation factors, for determining the present value of annuities, life estates, terms of years, remainders, and reversions, measured by one or two lives. These factors may also be used in the valuation of interests in a charitable remainder annuity trust as defined in § 1.664-2 and a pooled income fund as defined in § 1.642(c)-5 of this chapter.

(ii) Internal Revenue Service Publication 1458, “Actuarial Valuations Version 3B” (2009). This publication includes term certain tables and tables of one and two life valuation factors for determining the present value of remainder interests in a charitable remainder unitrust as defined in § 1.664-3 of this chapter.

(iii) Internal Revenue Service Publication 1459, “Actuarial Valuations Version 3C” (2009). This publication includes tables for computing depreciation adjustment factors. See § 1.170A-12 of this chapter.

(d) *Effective/applicability date.* This section applies on and after May 1, 2009.

[T.D. 8540, 59 FR 30177, June 10, 1994, as amended by T.D. 8819, 64 FR 23227, 23229, Apr. 30, 1999; 64 FR 33196, June 22, 1999; T.D. 8886, 65 FR 36943, June 12, 2000; T.D. 9448, 74 FR 21516, May 7, 2009; T.D. 9540, 76 FR 49642, Aug. 10, 2011]

§ 25.7520-2 Valuation of charitable interests.

(a) *In general*—(1) *Valuation.* Except as otherwise provided in this section and in § 25.7520-3 (relating to exceptions to the use of prescribed tables under certain circumstances), the fair market value of annuities, interests for life or for a term for years, remainders, and reversions for which a gift tax charitable deduction is allowable is the present value of such interests determined under § 25.7520-1.

(2) *Prior-month election rule.* If any part of the property interest transferred qualifies for a gift tax charitable deduction under section 2522, the donor may elect to compute the present value of the interest transferred by use of the section 7520 interest rate for the month during which the gift is made or the section 7520 interest rate for either of the 2 months preceding the month during which the gift is made. Paragraph (b) of this section explains how a prior-month election is made. The interest rate for the month so elected is the applicable section 7520 interest rate. If the actuarial factor for either or both of the 2 months preceding the month during which the gift is made is based on a mortality experience that is different from the mortality experience at the date of the gift and if the donor elects to use the section 7520 rate for a prior month with the different mortality experience, the donor must use the actuarial factor derived from the mortality experience in effect during the month of the section 7520 rate elected. All actuarial computations relating to the gift must be made by applying the interest rate component and the mortality component of the month elected by the donor.

(3) *Gifts of more than one interest in the same property.* If a donor makes a gift of more than one interest in the same property at the same time, the donor

must, for purposes of valuing the gifts, use the same interest rate and mortality components for the gift of each interest in the property. If the donor has made gifts of more than one interest in the same property at different times, the donor must determine the value of the gift by the use of the interest rate component and mortality component in effect during the month of that gift or, if applicable under paragraph (a)(2) of this section, either of the two months preceding the month of the gift.

(4) *Information required with tax return.* The following information must be attached to the gift tax return (or to the amended return) if the donor claims a charitable deduction for the present value of a temporary or remainder interest in property—

(i) A complete description of the interest that is transferred, including a copy of the instrument of transfer;

(ii) The valuation date of the transfer;

(iii) The names and identification numbers of the beneficiaries of the transferred interest;

(iv) The names and birthdates of any measuring lives, a description of any relevant terminal illness condition of any measuring life, and (if applicable) an explanation of how any terminal illness condition was taken into account in valuing the interest; and

(v) A computation of the deduction showing the applicable section 7520 interest rate that is used to value the transferred interest.

(5) *Place for filing returns.* See section 6091 of the Internal Revenue Code and the regulations thereunder for the place for filing the return or other document required by this section.

(b) *Election of interest rate component*—

(1) *Time for making election.* A taxpayer makes a prior-month election under paragraph (a)(2) of this section by attaching the information described in paragraph (b)(2) of this section to the donor's gift tax return or to an amended return for that year that is filed within 24 months after the later of the date the original return for the year was filed or the due date for filing the return.

(2) *Manner of making election.* A statement that the prior-month election

under section 7520(a) of the Internal Revenue Code is being made and that identifies the elected month must be attached to the gift tax return (or to the amended return).

(3) *Revocability.* The prior-month election may be revoked by filing an amended return within 24 months after the later of the date the original return of tax for that year was filed or the due date for filing the return. The revocation must be filed in the place referred to in paragraph (a)(5) of this section.

(c) *Effective dates.* Paragraph (a) of this section is effective as of May 1, 1989. Paragraph (b) of this section is effective for elections made after June 10, 1994.

§ 25.7520-3 Limitation on the application of section 7520.

(a) *Internal Revenue Code sections to which section 7520 does not apply.* Section 7520 of the Internal Revenue Code does not apply for purposes of—

(1) Part I, subchapter D of subtitle A (section 401 et. seq.), relating to the income tax treatment of certain qualified plans. (However, section 7520 does apply to the estate and gift tax treatment of certain qualified plans and for purposes of determining excess accumulations under section 4980A);

(2) Sections 72 and 101(b), relating to the income taxation of life insurance, endowment, and annuity contracts, unless otherwise provided for in the regulations under sections 72, 101, and 1011 (see, particularly, §§ 1.101-2(e)(1)(iii)(b)(2), and 1.1011-2(c), *Example 8*);

(3) Sections 83 and 451, unless otherwise provided for in the regulations under those sections;

(4) Section 457, relating to the valuation of deferred compensation, unless otherwise provided for in the regulations under section 457;

(5) Sections 3121(v) and 3306(r), relating to the valuation of deferred amounts, unless otherwise provided for in the regulations under those sections;

(6) Section 6058, relating to valuation statements evidencing compliance with qualified plan requirements, unless otherwise provided for in the regulations under section 6058;

(7) Section 7872, relating to income and gift taxation of interest-free loans

and loans with below-market interest rates, unless otherwise provided for in the regulations under section 7872; or

(8) Section 2702(a)(2)(A), relating to the value of a nonqualified retained interest upon a transfer of an interest in trust to or for the benefit of a member of the transferor's family; and

(9) Any other section of the Internal Revenue Code to the extent provided by the Internal Revenue Service in revenue rulings or revenue procedures. (See §§ 601.201 and 601.601 of this chapter).

(b) *Other limitations on the application of section 7520—(1) In general—(i) Ordinary beneficial interests.* For purposes of this section:

(A) An *ordinary annuity interest* is the right to receive a fixed dollar amount at the end of each year during one or more measuring lives or for some other defined period. A standard section 7520 annuity factor for an ordinary annuity interest represents the present worth of the right to receive \$1.00 per year for a defined period, using the interest rate prescribed under section 7520 for the appropriate month. If an annuity interest is payable more often than annually or is payable at the beginning of each period, a special adjustment must be made in any computation with a standard section 7520 annuity factor.

(B) An *ordinary income interest* is the right to receive the income from or the use of property during one or more measuring lives or for some other defined period. A standard section 7520 income factor for an ordinary income interest represents the present worth of the right to receive the use of \$1.00 for a defined period, using the interest rate prescribed under section 7520 for the appropriate month. However, in the case of certain gifts made after October 8, 1990, if the donor does not retain a qualified annuity, unitrust, or reversionary interest, the value of any interest retained by the donor is considered to be zero if the remainder beneficiary is a member of the donor's family. See § 25.2702-2.

(C) An *ordinary remainder or reversionary interest* is the right to receive an interest in property at the end of one or more measuring lives or some

other defined period. A standard section 7520 remainder factor for an ordinary remainder or reversionary interest represents the present worth of the right to receive \$1.00 at the end of a defined period, using the interest rate prescribed under section 7520 for the appropriate month.

(ii) *Certain restricted beneficial interests.* A *restricted beneficial interest* is an annuity, income, remainder, or reversionary interest that is subject to any contingency, power, or other restriction, whether the restriction is provided for by the terms of the trust, will, or other governing instrument or is caused by other circumstances. In general, a standard section 7520 annuity, income, or remainder factor may not be used to value a restricted beneficial interest. However, a special section 7520 annuity, income, or remainder factor may be used to value a restricted beneficial interest under some circumstances. See paragraphs (b)(2)(v) *Example 5* and (b)(4) of this section, which illustrate situations in which special section 7520 actuarial factors are needed to take into account limitations on beneficial interests. See § 25.7520-1(c) for requesting a special factor from the Internal Revenue Service.

(iii) *Other beneficial interests.* If, under the provisions of this paragraph (b), the interest rate and mortality components prescribed under section 7520 are not applicable in determining the value of any annuity, income, remainder, or reversionary interest, the actual fair market value of the interest (determined without regard to section 7520) is based on all of the facts and circumstances if and to the extent permitted by the Internal Revenue Code provision applicable to the property interest.

(2) *Provisions of governing instrument and other limitations on source of payment—(i) Annuities.* A standard section 7520 annuity factor may not be used to determine the present value of an annuity for a specified term of years or the life of one or more individuals unless the effect of the trust, will, or other governing instrument is to ensure that the annuity will be paid for the entire defined period. In the case of an annuity payable from a trust or

other limited fund, the annuity is not considered payable for the entire defined period if, considering the applicable section 7520 interest rate on the valuation date of the transfer, the annuity is expected to exhaust the fund before the last possible annuity payment is made in full. For this purpose, it must be assumed that it is possible for each measuring life to survive until age 110. For example, for a fixed annuity payable annually at the end of each year, if the amount of the annuity payment (expressed as a percentage of the initial corpus) is less than or equal to the applicable section 7520 interest rate at the date of the transfer, the corpus is assumed to be sufficient to make all payments. If the percentage exceeds the applicable section 7520 interest rate and the annuity is for a definite term of years, multiply the annual annuity amount by the Table B term certain annuity factor, as described in § 25.7520-1(c)(1), for the number of years of the defined period. If the percentage exceeds the applicable section 7520 interest rate and the annuity is payable for the life of one or more individuals, multiply the annual annuity amount by the Table B annuity factor for 110 years minus the age of the youngest individual. If the result exceeds the limited fund, the annuity may exhaust the fund, and it will be necessary to calculate a special section 7520 annuity factor that takes into account the exhaustion of the trust or fund. This computation would be modified, if appropriate, to take into account annuities with different payment terms.

(ii) *Income and similar interests—(A) Beneficial enjoyment.* A standard section 7520 income factor for an ordinary income interest is not to be used to determine the present value of an income or similar interest in trust for a term of years or for the life of one or more individuals unless the effect of the trust, will, or other governing instrument is to provide the income beneficiary with that degree of beneficial enjoyment of the property during the term of the income interest that the principles of the law of trusts accord to a person who is unqualifiedly designated as the income beneficiary of a trust for a similar period of time. This

degree of beneficial enjoyment is provided only if it was the transferor's intent, as manifested by the provisions of the governing instrument and the surrounding circumstances, that the trust provide an income interest for the income beneficiary during the specified period of time that is consistent with the value of the trust corpus and with its preservation. In determining whether a trust arrangement evidences that intention, the treatment required or permitted with respect to individual items must be considered in relation to the entire system provided for in the administration of the subject trust. Similarly, in determining the present value of the right to use tangible property (whether or not in trust) for one or more measuring lives or for some other specified period of time, the interest rate component prescribed under section 7520 and § 1.7520-1 of this chapter may not be used unless, during the specified period, the effect of the trust, will or other governing instrument is to provide the beneficiary with that degree of use, possession, and enjoyment of the property during the term of interest that applicable state law accords to a person who is unqualifiedly designated as a life tenant or term holder for a similar period of time.

(B) *Diversions of income and corpus.* A standard section 7520 income factor for an ordinary income interest may not be used to value an income interest or similar interest in property for a term of years, or for one or more measuring lives, if—

(1) The trust, will, or other governing instrument requires or permits the beneficiary's income or other enjoyment to be withheld, diverted, or accumulated for another person's benefit without the consent of the income beneficiary; or

(2) The governing instrument requires or permits trust corpus to be withdrawn from the trust for another person's benefit without the consent of the income beneficiary during the income beneficiary's term of enjoyment and without accountability to the income beneficiary for such diversion.

(iii) *Remainder and reversionary interests.* A standard section 7520 remainder interest factor for an ordinary remainder or reversionary interest may not be

used to determine the present value of a remainder or reversionary interest (whether in trust or otherwise) unless, consistent with the preservation and protection that the law of trusts would provide for a person who is unqualifiedly designated as the remainder beneficiary of a trust for a similar duration, the effect of the administrative and dispositive provisions for the interest or interests that precede the remainder or reversionary interest is to assure that the property will be adequately preserved and protected (e.g., from erosion, invasion, depletion, or damage) until the remainder or reversionary interest takes effect in possession and enjoyment. This degree of preservation and protection is provided only if it was the transferor's intent, as manifested by the provisions of the arrangement and the surrounding circumstances, that the entire disposition provide the remainder or reversionary beneficiary with an undiminished interest in the property transferred at the time of the termination of the prior interest.

(iv) *Pooled income fund interests.* In general, pooled income funds are created and administered to achieve a special rate of return. A beneficial interest in a pooled income fund is not ordinarily valued using a standard section 7520 income or remainder interest factor. The present value of a beneficial interest in a pooled income fund is determined according to rules and special remainder factors prescribed in § 1.642(c)-6 of this chapter and, when applicable, the rules set forth under paragraph (b)(3) of this section if the individual who is the measuring life is terminally ill at the time of the transfer.

(v) *Examples.* The provisions of this paragraph (b)(2) are illustrated by the following examples:

Example 1. Unproductive property. The donor transfers corporation stock to a trust under the terms of which all of the trust income is payable to A for life. Considering the applicable federal rate under section 7520 and the appropriate life estate factor for a person A's age, the value of A's income interest, if valued under this section, would be \$10,000. After A's death, the trust is to terminate and the trust property is to be distributed to B. The trust specifically authorizes, but does not require, the trustee to retain the shares

of stock. The corporation has paid no dividends on this stock during the past 5 years, and there is no indication that this policy will change in the near future. Under applicable state law, the corporation is considered to be a sound investment that satisfies fiduciary standards. The facts and circumstances, including applicable state law, indicate that the income beneficiary would not have the legal right to compel the trustee to make the trust corpus productive in conformity with the requirements for a lifetime trust income interest under applicable local law. Therefore, the life income interest in this case is considered nonproductive. Consequently, A's income interest may not be valued actuarially under this section.

Example 2. Beneficiary's right to make trust productive. The facts are the same as in *Example 1*, except that the trustee is not specifically authorized to retain the shares of corporation stock. Further, the terms of the trust specifically provide that the life income beneficiary may require the trustee to make the trust corpus productive consistent with income yield standards for trusts under applicable state law. Under that law, the minimum rate of income that a productive trust may produce is substantially below the section 7520 interest rate on the valuation date. In this case, because A, the income beneficiary, has the right to compel the trustee to make the trust productive for purposes of applicable local law during A's lifetime, the income interest is considered an ordinary income interest for purposes of this paragraph, and the standard section 7520 life income factor may be used to determine the value of A's income interest. However, in the case of gifts made after October 8, 1990, if the donor was the life income beneficiary, the value of the income interest would be considered to be zero in this situation. See § 25.2702-2.

Example 3. Annuity trust funded with unproductive property. The donor, who is age 60, transfers corporation stock worth \$1,000,000 to a trust. The trust will pay a 6 percent (\$60,000 per year) annuity in cash or other property to the donor for 10 years or until the donor's prior death. Upon the termination of the trust, the trust property is to be distributed to the donor's child. The section 7520 rate for the month of the transfer is 8.2 percent. The corporation has paid no dividends on the stock during the past 5 years, and there is no indication that this policy will change in the near future. Under appli-

cable state law, the corporation is considered to be a sound investment that satisfies fiduciary standards. Therefore, the trust's sole investment in this corporation is not expected to adversely affect the interest of either the annuity beneficiary or the remainder beneficiary. Considering the 6 percent annuity payout rate and the 8.2 percent section 7520 interest rate, the trust corpus is considered sufficient to pay this annuity for the entire 10-year term of the trust, or even indefinitely. The trust specifically authorizes, but does not require, the trustee to retain the shares of stock. Although it appears that neither beneficiary would be able to compel the trustee to make the trust corpus produce investment income, the annuity interest in this case is considered to be an ordinary annuity interest, and a section 7520 annuity factor may be used to determine the present value of the annuity. In this case, the section 7520 annuity factor would represent the right to receive \$1.00 per year for a term of 10 years or the prior death of a person age 60.

Example 4. Unitrust funded with unproductive property. The facts are the same as in *Example 3*, except that the donor has retained a unitrust interest equal to 7 percent of the value of the trust property, valued as of the beginning of each year. Although the trust corpus is nonincome-producing, the present value of the donor's retained unitrust interest may be determined by using the section 7520 unitrust factor for a term of years or a prior death.

Example 5. Eroding corpus in an annuity trust. (i) The donor, who is age 60 and in normal health, transfers property worth \$1,000,000 to a trust on or after May 1, 2009, but before 2019. The trust will pay a 10 percent (\$100,000 per year) annuity to a charitable organization for the life of the donor, payable annually at the end of each period, and the remainder then will be distributed to the donor's child. The section 7520 rate for the month of the transfer is 6.8 percent. First, it is necessary to determine whether the annuity may exhaust the corpus before all annuity payments are made. Because it is assumed that any measuring life may survive until age 110, any life annuity could require payments until the measuring life reaches age 110. Based on a section 7520 interest rate of 6.8 percent, the determination of whether the annuity may exhaust the corpus before the termination of the annuity interest is made as follows:

| | |
|---|--------------|
| Age to which life annuity may continue | 110 |
| less: Age of measuring life at date of transfer | 60 |
| <hr/> | |
| Number of years annuity may continue | 50 |
| Annual annuity payment | \$100,000.00 |
| times: Annuity factor for 50 years. | |

derived from Table B.

| | |
|---|----------------|
| (1-.037277/068) | 14.1577 |
| Present value of term certain annuity | \$1,415,770.00 |

(ii) Because the present value of an annuity for a term of 50 years exceeds the corpus, the annuity may exhaust the trust before all payments are made. Consequently, the annuity must be valued as an annuity payable for a term of years or until the prior death of the annuitant, with the term of years determined by when the fund will be exhausted by the annuity payments.

(iii) The annuity factor for a term of years at 6.8 percent is derived by subtracting the applicable remainder factor in Table B (see § 20.2031-7(d)(6)) from 1.000000 and then dividing the result by .068. An annuity of \$100,000 payable at the end of each year for a period that has an annuity factor of 10.0 would have a present value exactly equal to the principal available to pay the annuity over the term. The annuity factor for 17 years is 9.8999 and the annuity factor for 18 years is 10.2059. Thus, it is determined that the \$1,000,000 initial transfer will be sufficient to make 17 annual payments of \$100,000, but not to make the entire 18th payment. The present value of an annuity of \$100,000 payable at the end of each year for 17 years is \$100,000 times 9.8999 or \$989,990. The remaining amount is \$10,010.00. Of the initial corpus amount, \$10,010.00 is not needed to make payments for 17 years, so this amount, as accumulated for 18 years, will be available for the final payment. The 18-year accumulation factor is $(1 + 0.068)^{18}$ or 3.268004, so the amount available in 18 years is \$10,010.00 times 3.268004 or \$32,712.72. Therefore, for purposes of analysis, the annuity payments are considered to be composed of two distinct annuity components. The two annuity components taken together must equal the total annual amount of \$100,000. The first annuity component is the exact amount that the trust will have available for the final payment, \$32,712.72. The second annuity component then must be \$100,000 minus \$32,712.72, or \$67,287.28. Specifically, the initial corpus will be able to make payments of \$67,287.28 per year for 17 years plus payments of \$32,712.72 per year for 18 years. The total annuity is valued by adding the value of the two separate annuity components.

(iv) Based on Table H of Publication 1457, Actuarial Valuations Version 3A, which may be obtained from the IRS Internet site, the present value of an annuity of \$67,287.28 per year payable for 17 years or until the prior death of a person aged 60 is \$597,013.12 ($\$67,287.28 \times 8.8726$). The present value of an annuity of \$32,712.72 per year payable for 18 years or until the prior death of a person aged 60 is \$296,887.56 ($\$32,712.72 \times 9.0756$). Thus,

the present value of the charitable annuity interest is \$893,900.68 ($\$597,013.12 + \$296,887.56$).

(3) *Mortality component.* The mortality component prescribed under section 7520 may not be used to determine the present value of an annuity, income interest, remainder interest, or reversionary interest if an individual who is a measuring life dies or is terminally ill at the time the gift is completed. For purposes of this paragraph (b)(3), an individual who is known to have an incurable illness or other deteriorating physical condition is considered terminally ill if there is at least a 50 percent probability that the individual will die within 1 year. However, if the individual survives for eighteen months or longer after the date the gift is completed, that individual shall be presumed to have not been terminally ill at the date the gift was completed unless the contrary is established by clear and convincing evidence.

(4) *Example.* The provisions of paragraph (b)(3) of this section are illustrated by the following example:

Example. Terminal illness. The donor transfers property worth \$1,000,000 to a child on or after May 1, 2009 but before 2019, in exchange for the child's promise to pay the donor \$80,000 per year for the donor's life, payable annually at the end of each period. The donor is age 75 but has been diagnosed with an incurable illness and has at least a 50 percent probability of dying within 1 year. The section 7520 interest rate for the month of the transfer is 7.6 percent, and the standard annuity factor at that interest rate for a person age 75 in normal health is 6.6493 ($1 - .49465/.076$). Thus, if the donor were not terminally ill, the present value of the annuity would be \$531,944.00 ($\$80,000 \times 6.6493$). Assuming the presumption provided in paragraph (b)(3) of this section does not apply, because there is at least a 50 percent probability that the donor will die within 1 year, the standard section 7520 annuity factor may not be used to determine the present value of the donor's annuity interest. Instead, a special section 7520 annuity factor must be computed that takes into account the projection of the donor's actual life expectancy.

(5) *Additional limitations.* Section 7520 does not apply to the extent as may

otherwise be provided by the Commissioner.

(c) *Effective/applicability dates.* Section 25.7520-3(a) is effective as of May 1, 1989. The provisions of paragraph (b) of this section, except *Example 5* in paragraph (b)(2)(v) and paragraph (b)(4), are effective with respect to gifts made after December 13, 1995. *Example 5* in paragraph (b)(2)(v) and paragraph (b)(4) are effective with respect to gifts made on or after May 1, 2009.

[T.D. 8540, 59 FR 30177, June 10, 1994, as amended by T.D. 8630, 60 FR 63919, Dec. 13, 1995; T.D. 8819, 64 FR 23228, Apr. 30, 1999; T.D. 8886, 65 FR 36943, June 12, 2000; T.D. 9448, 74 FR 21517, May 7, 2009; T.D. 9540, 76 FR 49642, Aug. 10, 2011]

§ 25.7520-4 Transitional rules.

(a) *Reliance.* If the valuation date is after April 30, 1989, and before June 10, 1994, a donor can rely on Notice 89-24, 1989-1 C.B. 660, or Notice 89-60, 1989-1 C.B. 700 (See § 601.601(d)(2)(ii)(b) of this chapter), in valuing the transferred interest.

(b) *Transfers in 1989.* If a donor transferred an interest in property by gift after December 31, 1988, and before May 1, 1989, retaining an interest in the same property and, after April 30, 1989, and before January 1, 1990, transferred the retained interest in the property, the donor may, at the donor's option, value the transfer of the retained interest under either § 25.2512-5(d) or § 25.2512-5A(d).

(c) *Effective date.* This section is effective as of May 1, 1989.

§ 25.7701-1 Tax return preparer.

(a) *In general.* For the definition of a tax return preparer, see § 301.7701-15 of this chapter.

(b) *Effective/applicability date.* This section is applicable to returns and claims for refund filed, and advice provided, after December 31, 2008.

[T.D. 9436, 73 FR 78452, Dec. 22, 2008]

PART 26—GENERATION-SKIPPING TRANSFER TAX REGULATIONS UNDER THE TAX REFORM ACT OF 1986

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AUTHORITY: 26 U.S.C. 7805 and 26 U.S.C. 2663.

Section 26.2632-1 also issued under 26 U.S.C. 2632 and 2663.