

Proposed Supplement to Hot Topics Luncheon Program

<u>Topic</u>	<u>Materials</u>
Estate Tax Repeal/Reform	Bulletins from McGuire Woods: “Fiduciary Advisory Services: Where the Senate Goes Now That It Has Held Estate Tax Hearings” and “Third Time's a Charm? Senate Finance Committee Holds Hearing on Estate Tax Reform”
IRS Priority Guidance Program 2007 - 2008	Treasury-IRS First Periodic Update for 2007-2008 Priority Guidance Plan
Revenue Ruling 2008 – 22 (Grantor Trust Swap Power)	Copy of Revenue Ruling
Prop. Reg. under Section 2642(g) - extensions of time to make late GST exemption allocation	Copy of Proposed Regulations
Prop. Reg. Alternate Valuation Methods	Copy of Proposed Regulations
Estate of Mirowski (Valuation TC case)	
Preparer Penalties	
Prop. Reg. under Section 2053 – Post Mortem Facts to Value Deductions	



Fiduciary Advisory Services

4/14/2008

Where the Senate Goes Now That It Has Held Estate Tax Hearings

Now that the Senate Finance Committee has concluded its series of hearings on the estate tax (see [Third Time's a Charm? Senate Finance Committee Holds Hearing on Estate Tax Reform](#)), it is time to ask what difference those hearings might make.

The April 3 Senate Finance Committee Hearing

At the hearing on April 3, three Democratic Senators and two Republican Senators were present at various times. (At last month's hearing, there were three Democrats and three Republicans present from time to time.) That might seem to be a rather paltry attendance in a committee of 21 members. But in fact, with other things always going on at the same time, this attendance is really not bad. It is not unusual to have tax hearings with only a chairman, and there have been instances of hearings chaired, at least temporarily, by a senior staff member because no Senator was present at the time.

In any event, the Senators in attendance on April 3 were some of those who have expressed the most interest in estate tax reform. Chairman Max Baucus (D-MT) himself has expressed a preference for repeal of the estate tax, but has offered a public commitment to serious reform as a more achievable alternative. (A good example was his comment to that effect at the first of the three hearings, on November 14, 2007.) Senator Jon Kyl (R-AZ) was once an acknowledged leader in the effort to permanently repeal the estate tax, but more recently has focused on assembling a bipartisan coalition of Senators "in the middle" to forge a compromise with some decrease in rates and some increase in exemptions. Senator Blanche Lincoln (D-AR) has been an active supporter of tax relief targeted to family farms and other family-owned businesses. Senators Ken Salazar (D-CO) and Pat Roberts (R-KS) have cosponsored legislation, such as S. 1994, which would essentially exclude family owned and operated farms from estate tax. All those Senators, when they were able to be present, seemed interested in the topics and the witnesses' testimony and interested in understanding the issues.

Little Likelihood of Sweeping Changes

It has often been assumed that the lower estate tax rates many taxpayers would welcome would be possible only if accompanied by "base-broadening" -- that is, substantive changes to estate tax rules that would partially offset the revenue effect of lower rates. Such changes might "close loopholes" by ending or limiting the use of techniques that trouble the Internal Revenue Service. Or they might be bolder and introduce different rules for calculating the tax for all taxpayers.

Few Congress-watchers expect Congress to abandon the estate tax for a brand new approach, like the largely donee-based (rather than donor-based) tax systems discussed by the witnesses at last month's hearing. But observers who would welcome *some* significant structural changes if they were accompanied by lower rates might have been disappointed by the narrowness of the topics the Finance Committee had asked the witnesses to address on April 3. Bold and sweeping structural changes require a lot of time and attention from Senators and staff, and there are still too many distractions in Congress to expect much of that this year.

Clues to More "Targeted" Estate Tax Relief

Nevertheless, the topics discussed at the April 3 hearing provide clues about the "targeted" relief we might look for in any estate tax legislation -- easier payment of estate tax in deferred installments, possibly reconnecting the lifetime gift tax exemption (currently only \$1 million) to the estate tax exemption (currently \$2 million and scheduled to increase to \$3.5 million next year), and especially "portability" of the estate tax exemption from a deceased spouse to a surviving spouse. These ideas, especially portability of the exemption and installment payments, reflect the middle-class focus and "targeted" priorities of the Democratic leadership, sometimes contrasted with a more across-the-board approach of the Republican-led Congresses in the recent past.

"Portability" of Estate Tax Exemptions

"Portability" that permits a surviving spouse to use the unused exemption of a deceased spouse could simplify estate planning for most married couples, and would be a particularly significant simplification for couples with middle-sized estates -- basically combined estates with a value greater than the estate tax exemption but less than double the exemption. This year, that includes combined estates with values from \$2 to \$4 million. No longer would it be necessary to divide the ownership of assets between spouses in any particular way for estate tax reasons, and owning property jointly with a right of survivorship would create no tax complications for couples who prefer that form of ownership. Even more importantly, it would be unnecessary for many married couples to have complex estate planning documents with multiple trusts to make use of available exemptions, trusts which then require potentially burdensome ongoing administration after one spouse dies.

A form of portability was included in H.R. 5638, called the "Permanent Estate Tax Relief Act of 2006" ("PETRA"), and H.R. 5970, called the "Estate Tax and Extension of Tax Relief Act of 2006" ("ETETRA"), permanent estate tax reduction bills that the House of

Representatives passed in the summer of 2006 but the Senate was unable to secure 60 votes to take up. With that background, and with key Senators continuing to show interest in portability, the estate planning lawyers of McGuireWoods believe that this is a development that bears watching, and we will watch it.

Prospects for 2008

The Senators at the hearings last month and this month, both Democrats and Republicans, showed interest in moving quickly to address the anomalies in current law, under which the estate tax is repealed for 2010 only to be reinstated at a higher level for 2011. For that reason, there may be more reason than ever to be optimistic about legislation, even this year. That is not saying much, though, and there are still plenty of obstacles to congressional action in 2008, including the following:

- *Budgetary constraints.* Congressional leaders are committed to "Pay-Go" -- paying for tax reductions through offsetting increases in taxes or decreases in spending. Senators were blunt at the April 3 hearing about the reality that some of the things they want to do will probably not be affordable. At a minimum, whether Congress acts this year or next year or some other time, it is likely that any relaxation of rates or increases in the exemption would be phased in gradually over at least five years.
- *The presidential election.* No presidential candidate is on the Finance Committee, but the extraordinary presidential campaign is certainly a distraction. With the August recess beginning August 9, the Democratic and Republican national conventions August 25-28 and September 1-4, a target congressional adjournment date of September 26, the November 4 election, and an agenda of many politically-charged issues, there just isn't much time.
- *Political skepticism and inertia.* Later on March 12, Senator Kyl, who had been at the Finance Committee hearing that morning, complained on the floor of the Senate in the debate on the budget resolution that "[e]ach year we pass a budget that, theoretically, allows for a reform of the estate tax, but then we don't do anything about it.... So the chairman of the Finance Committee said: Well, he would have the goal of marking up a bill this spring. He has since advised me he has no plans whatsoever for a real bill on estate tax, and said: It won't happen."
- *The sharply-divided Senate.* Senator Kyl's remarks on the Senate floor were made in support of his proposed amendment to the budget resolution that would mandate a \$5 million estate tax exemption (indexed for inflation) and a top rate of 35%. The amendment was defeated by a vote of 50-50. (Vice President Cheney had been in the presiding officer's chair earlier that day, but he was no longer in the Senate chamber to break the tie.) Normal Senate rules, effectively requiring 60 votes to "call the question" on any legislation, make it very hard to marshal the votes needed to pass tax legislation.
- *The House of Representatives.* Tracking the mood of Senators is important because of the 60-vote requirement and the likelihood that a small bipartisan group of Senators "in the middle" hold the key to a feasible compromise. But the House needs to agree to any legislation, of course, and House Ways and Means Committee Chairman

Charles Rangel (D-NY) has not publicly shown much interest in fixing the 2010-2011 disconnect the Republican-led Congress created in 2001. In addition, the commitment of the Democratic leadership to Pay-Go is even more intense in the House. It is assumed that the House would go along with anything the Senate is able to agree to, but that is only an assumption. Moreover, since the Constitution requires tax legislation to originate in the House, the Senate presumably would need to attach estate tax legislation to an unrelated House-passed bill. There are such possibilities, but legislation dealing, for example, with agriculture or energy might themselves be in political trouble.

- *A presidential veto.* Despite the Bush Administration's official commitment to outright repeal of the estate tax, it has long been assumed that the President would declare any reasonable compromise to be a step in the right direction and sign it into law. But if, to "pay for" any estate tax relief, Congress attaches provisions the White House views as tax increases, the President's support would be in doubt. This is especially true if estate tax reform is attached to any existing bill, like the farm bill, that the President has already threatened to veto for that reason.

It is conceivable that there will be more congressional staff time spent on the estate tax in 2008 than in any year since 2001 or even 1997. The question is whether it will be enough. Only time -- increasingly limited time -- will tell.

4/7/2008

Third Time's a Charm? Senate Finance Committee Holds Hearing on Estate Tax Reform

On April 3, 2008, Chairman Max Baucus (D-MT) led the Senate Finance Committee in a hearing devoted to areas of reform in the estate, gift, and generation-skipping transfer tax system. This was the third hearing that the Senate Finance Committee has held on estate tax reform. The first hearing was on November 14, 2007 during which four separate individuals (an Iowa manufacturer, a Nevada rancher, Warren Buffet, and estate planning attorney, Conrad Teitell) presented their views on reform or repeal. At the second hearing on March 12, 2008, the Committee heard from three academics on possible alternatives to an estate tax. During the April hearing, the Committee heard from four individuals knowledgeable in the field with proposals for changes to the federal wealth transfer tax system. Testifying were: Dennis I. Belcher (Partner, McGuireWoods LLP), Shirley L. Kovar (Shareholder, Branton & Wilson, APC, San Diego, California), Dr. Roby B. Sawyers (North Carolina State University, Department of Accounting, Raleigh, NC), and Diana Aviv (President and Chief Executive Officer, Independent Sector, Washington, DC). Having heard in March about alternatives to the federal wealth transfer tax system, the Committee looked to the experts on the panel for reform ideas to provide efficiency and simplicity for tax payers and tax planners.

Dennis Belcher proposed several changes to the installment payment provisions provided for under section 6166 of the Internal Revenue Code. The installment payment provisions provide for deferral of estate tax liability attributable to closely held business interests in a decedent's gross estate. Because of the illiquid nature of many closely held businesses, the installment payment provisions allow a decedent's family to continue to operate the family enterprise - either

to generate the cash needed to pay the tax in installments or to position the company for sale to maximize the value of the decedent's business. Belcher identified several complications with the operation and interpretation of the installment payment provisions. His recommendations included:

- Modernizing the installment payment provision to keep pace with modern business practices by clarifying the treatment of new forms of business ownership, such as limited liability companies, limited liability partnerships, or business trusts.
- Curing the inadequate treatment of holding companies under the installment payment provisions by clarifying the complex and confusing rules under which a tiered-entity structure qualifies for benefits of the installment payment provisions.
- Improving the definition of passive assets under the installment payment provisions to accommodate the way closely held business owners are conducting businesses and to avoid artificially structured business entities to comply with the rigid requirements of the installment payment provisions.
- Allowing business owners to obtain advance rulings from the Internal Revenue Service on whether the business owner's estate will meet the requirements of the installment payment provisions.
- Improving the burdensome lien procedures under the installment payment provisions to prevent undue and unnecessary impediments to the assets of the closely held business owner's successors or estate.

Shirley Kovar, speaking as a practitioner and on behalf of the American College of Trust and Estate Counsel, encouraged the Committee to adopt a plan for portability of the estate, gift, and generation-skipping transfer tax exemptions. Portability of the exemptions would allow husband and wife, in effect, to combine exemption amounts by transferring a deceased spouse's unused exemption amount to a surviving spouse. Under the current wealth transfer tax regime, taxpayers make use of a "credit-shelter" trust to ensure that husband and wife maximize the use of the estate tax exclusion amount. Kovar suggested in her testimony that this technique - funding two trusts, one with the exemption amount and one with the rest of the estate assets, often with identical provisions - is a step that few estate planning clients would request except for the need to make efficient use of the estate tax exemption amounts. The reasons presented to the Committee for adopting the Portability regime include the following:

- Portability would all but eliminate the need for complicated estate planning for the moderately wealthy (\$2-5M). No two- and three-trust plans would be created for the artificial purpose of maximizing the estate tax exemption. The complicated administration of trusts with identical terms, funded by formula to maximize the exemption, would likewise be all but eliminated.
- Adopting the Portability regime would be consistent with current tax policy recognizing husband and wife as a single economic unit.
- A Portability regime recognizes that most married couples want to maximize the use of their exemptions. Doing so by statute, rather than requiring the use of private trust agreements, accomplishes the same result for the most tax payers.

Dr. Roby Sawyers laid out to the Committee the case for the reunification of the estate and gift tax exemptions. Raising the lifetime gift tax exemption (currently, \$1,000,000) to equal the estate tax exclusion amount (\$2,000,000 for 2008 and increasing to \$3,500,000 in 2009) has the following benefits:

- A reduction in the need for complicated estate and gift tax planning created as a result of the decoupling of the exemption amounts;
- Incentives for individuals to make orderly lifetime gifts that are neither motivated by nor withheld because of gift tax considerations;
- Incentives for small business owners to engage in smart business succession planning; and
- Increased transfer of capital to younger generations for important economic activity, including business investment and creation and home buying.

Ms. Aviv called on the Committee to address abuses in the charitable giving area of estate planning. The primary concerns addressed were:

- The need for greater oversight and compliance with existing regulations regarding charitable giving;
- Requiring electronic filing of charitable organization informational returns (Form 990) and estate tax returns (Form 706), which would allow immediate feedback on these returns. Additionally, electronic filing may free-up Internal Revenue Service personnel and resources currently dedicated to reviewing paper returns, for greater oversight.
- Creating a more reasonable calculation for the remainder interest in a Charitable Lead Trust.

A primary purpose of the three hearings was to keep the issue of estate reform on the table in Congress. While many observers do not expect any action to be taken in 2008, estate tax reform is an issue that Congress must confront soon if the consequences of the one-year repeal of the estate tax and the generation-skipping tax (but not the gift tax) in 2010 as provided under current law are to be avoided. McGuireWoods will continue to monitor developments on possible estate tax reform in Congress and will inform subscribers of the developments as they occur.

The full hearing, including the testimony and questions from the Committee, can be [viewed online](#). For more information on the hearing, see the statements of Senators Baucus and Grassley and the full testimony of the experts on the [U.S. Senate Committee on Finance website](#).

**DEPARTMENT OF THE TREASURY
Washington, DC 20220**

April 22, 2008

**Department of the Treasury
First Periodic Update of the
2007-2008 Priority Guidance Plan**

Joint Statement by:

**Eric Solomon
Assistant Secretary (Tax Policy)
U.S. Department of the Treasury**

**Douglas H. Shulman
Commissioner
Internal Revenue Service**

**Donald L. Korb
Chief Counsel
Internal Revenue Service**

Attached is an update of the 2007-2008 Priority Guidance Plan.

On August 13, 2007, we released the 2007-2008 Priority Guidance Plan listing 303 projects for the plan year beginning July 1, 2007 and ending June 30, 2008. In our Joint Statement that accompanied the release of the 2007-2008 Priority Guidance Plan, we indicated that we would update the plan periodically to reflect additional guidance that we intend to publish during the plan year. Updating the plan also provides flexibility throughout the plan year to consider comments received from taxpayers and tax practitioners relating to additional projects and to respond to developments arising during the plan year.

The attached update sets forth the guidance on the original 2007-2008 Priority Guidance Plan that we have published. Although the update may indicate that a particular item on the plan has been completed, it is possible that one or more additional projects may be completed in the plan year relating to that item. The update also includes 61 items of additional guidance, some of which have already been published. For example, the update reflects the publication of guidance implementing the Economic Stimulus Act of 2008 and responding to recent events in the financial markets. Similarly, the update reflects the publication of guidance relating to topics that were on the original 2007-2008 Priority Guidance Plan such as guidance implementing the Pension Protection Act of 2006, the Small Business and Work Opportunity Tax Act of 2007, and the Tax Relief and Health Care Act of 2006, and additional guidance implementing various provisions of the American Jobs Creation Act of 2004 and the Tax Increase Prevention and Reconciliation Act of 2005.

The published guidance process can be fully successful only if we have the benefit of the insight and experience of taxpayers and practitioners who must apply the rules. Therefore, we invite the public to continue to provide us with their comments and suggestions as we write guidance throughout the plan year.

The updated 2007-2008 Priority Guidance Plan will be republished on the IRS website on the Internet at <http://www.irs.gov/pub/irs-utl/2007-2008pgp.pdf>. Copies can also be obtained by calling Treasury's Office of Public Affairs at (202) 622-2960.

OFFICE OF TAX POLICY AND INTERNAL REVENUE SERVICE

UPDATE TO 2007-2008 PRIORITY GUIDANCE PLAN

APRIL 22, 2008

CONSOLIDATED RETURNS

Original PGP Projects:

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3. Regulations regarding transfers of member stock. Proposed regulations were published on January 23, 2007.

4. Regulations revising section 1.1502-77 regarding agency for a consolidated group.

5. Regulations regarding the application of section 172(h) (corporate equity reduction interest losses) to a consolidated group.

Additional PGP Projects:

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CORPORATIONS AND THEIR SHAREHOLDERS

Original PGP Projects:

1. Guidance regarding the recovery of basis in redemptions of corporate stock governed by section 301. A notice was published in the Federal Register on April 19, 2006.

2. Regulations regarding basis tracing under section 358 and allocation of boot under section 356.

3. Regulations enabling elections for certain transactions under section 336(e).

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6. Regulations regarding predecessors and successors under section 355(e). Proposed regulations were published on November 22, 2004.

7. Regulations regarding the applicability of section 358(h)(2)(B) to the assumption of certain liabilities. Temporary regulations were published on May 23, 2005.

8. Guidance under section 362(e) regarding the importation or duplication of losses. Notice 2005-70 was published on October 11, 2005. Proposed regulations were published on October 23, 2006 and January 23, 2007.

9. Regulations regarding continuity of interest. Temporary regulations were published on March 20, 2007.

10. Regulations regarding transactions involving the transfer or receipt of no net equity value. Proposed regulations were published on March 10, 2005.

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12. Revision of Rev. Proc. 81-70 providing guidelines for estimating stock basis in reorganizations under section 368(a)(1)(B). Comments regarding these guidelines were requested in Notice 2004-44.

13. Guidance regarding the scope of section 368(a)(1)(D). Temporary regulations were published on March 1, 2007.

14. Regulations under section 368(a)(1)(F). Proposed regulations were published on August 12, 2004.

15. Guidance under sections 382 and 384, including regulations regarding built-in items under section 382(h)(6). Built-in items under section 382(h)(6) were previously addressed in Notice 2003-65. Temporary regulations regarding the treatment of prepaid income were published on June 13, 2007.

16. Guidance regarding the transfer of treasury stock to a corporation controlled by the transferor. See Rev. Rul. 2006-2, revoking Rev. Rul. 74-503.

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Additional PGP Projects:

18. Regulations regarding the effect of stock redemptions on the application of Section 355(e).

19. Guidance regarding hot stock under section 355(a)(3)(B).

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EMPLOYEE BENEFITS

A. Retirement Benefits

Original PGP Projects:

1. Guidance on special pay plans for governmental employees.

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4. Update of Employee Plans Compliance Resolution System (EPCRS).

5. Guidance on the transfer of assets from a section 401(a) plan to a Puerto Rico plan.

6. Proposed regulations under section 401(a)(9) on required minimum distribution rules for governmental plans, as directed by the Pension Protection Act of 2006.

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8. Update of model notice under section 402(f) relating to eligible rollover distributions.

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11. Announcement on the reporting of distributions of section 404(k) dividends.

12. Final regulations on converting an IRA annuity to a Roth IRA annuity. Temporary regulations were published on August 22, 2005.

13. Proposed regulations under section 411(a)(11) to provide a description of the consequences of failing to defer, as directed by the Pension Protection Act of 2006.

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20. Final regulations on the funding of single employer plans under section 430, as added by the Pension Protection Act of 2006.

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Additional PGP Projects:

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32. Proposed regulations on accrual rules for defined benefit plans.

B. Executive Compensation, Health Care and Other Benefits, and Employment Taxes

Original PGP Projects:

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2. Guidance under section 162(m) on the definition of outside director.

3. Guidance on discrete issues on Health Savings Accounts (HSAs).

4. Guidance on qualified nonpersonal use vehicles.

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6. Proposed regulations under section 409A on the calculation of income inclusion and additional taxes.

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11. Update of the regulations under section 423 regarding employee stock purchase plans.

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14. Revenue ruling on income tax withholding with respect to supplemental wages for employees who receive no regular wages.

15. Proposed regulation under section 4980B regarding calculation of the applicable premium for COBRA continuation coverage.

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17. Proposed regulations on Health Opportunity Patient Empowerment Act of 2006 changes to section 4980G.

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Additional PGP Projects:

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24. Final regulations for adjusting overpayment or underpayment of employment taxes.

25. Proposed regulations under section 6039.

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27. Notice regarding rollovers from an IRA to an HSA.

EXCISE TAXES

Original PGP Projects:

1. Guidance under sections 4051 and 4071 on heavy trucks, trailers, tractors, and tires to update current regulations and to reflect recent statutory changes, including changes made by the American Jobs Creation Act of 2004.

2. Proposed regulations under sections 4081-4083 and 6427 on fuel tax provisions added or affected by the American Jobs Creation Act of 2004, the Energy Policy Act, and the Safe, Accountable, Flexible,

Efficient Transportation Equity Act, and the Tax Relief and Health Care Act of 2006, including issues that are related to kerosene used in aircraft and the Leaking Underground Storage Tank Trust Fund. Many of these issues were discussed in Notices 2005-4 and 2005-80.

3. Final regulations under section 4082, as amended by the American Jobs Creation Act of 2004, on diesel fuel and kerosene that is dyed by mechanical injection. Temporary regulations were published on April 26, 2005.

4. Update of existing regulations and rulings regarding the tax on the retail sale of trucks, tractors, and trailers under sections 4051- 4053. Current guidance is in temporary regulations, regulations under section 4061 (which was terminated in 1983), and numerous revenue rulings.

5. Guidance under section 4481, as amended by the American Jobs Creation Act of 2004, related to electronic filing of highway use tax returns and the proration of tax when vehicles are sold.

6. Guidance on the eligibility of the credit or payment allowed for fuel used in certain buses described in sections 6421(b) and 6427(b).

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8. Proposed regulations under sections 40, 40A, 6426 and 6427 on fuel tax provisions added or affected by the American Jobs Creation Act of 2004, the Energy Policy Act, and the Safe, Accountable, Flexible, Efficient Transportation Equity Act, including issues that are related to alcohol fuels, biodiesel, renewable diesel, and alternative fuel. Many of these issues were discussed in Notices 2005-4 and 2005-62.

EXEMPT ORGANIZATIONS

Original PGP Projects:

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3. Proposed regulations regarding the new requirements for supporting organizations, as added by the Pension Protection Act of 2006.

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5. Final regulations on excise taxes on prohibited tax shelter transactions and related disclosure requirements.

6. Proposed regulations regarding the new excise taxes on donor advised funds, as added by the Pension Protection Act of 2006.

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8. Regulations to implement Form 990 revisions.

Additional PGP Projects:

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10. Update of Notice 2007-45 reflecting changes in the Technical Corrections Act of 2007 to the rules on disclosure by 501(c)(3) organizations of Form 990-T.

FINANCIAL INSTITUTIONS AND PRODUCTS

Original PGP Projects:

1. Guidance for RICs and REITs concerning the application of section 1(h) to capital gain dividends.
2. Final regulations under section 446 on notional principal contracts (NPC) relating to the inclusion in income or deduction of a contingent nonperiodic payment and guidance relating to the character of payments made pursuant to an NPC. Proposed regulations were published on February 26, 2004.
3. Guidance addressing the correction of minor errors by RICs and REITs.

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5. Final regulations under section 860G(b) regarding withholding obligations of partnerships allocating income from REMIC residual interests to foreign persons. Temporary regulations were published on August 1, 2006.

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7. Final regulations under section 1221 regarding capital asset exclusion for accounts and notes receivable. Proposed regulations were published on August 7, 2006.

8. Guidance under section 1286(f) as added by the American Jobs Creation Act of 2004 regarding treatment of stripped interests in bond and preferred stock funds.

Additional PGP Projects:

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13. Guidance under sections 265 and 291 involving the treatment of bank investment subsidiaries.

GENERAL TAX ISSUES

Original PGP Projects:

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3. Guidance regarding the alternative simplified credit under section 41(c)(5), as added by the Tax Relief and Health Care Act of 2006.

4. Proposed regulations under section 41 regarding the exception from the definition of "qualified research" for internal use software under section 41(d)(4)(E).

5. Guidance under section 41 regarding whether the gross receipts component of the research credit computation for a controlled group under section 41(f) includes gross receipts from transactions between group members.

6. Final regulations under section 42 on applicable utility allowances.

7. Final regulations under section 42 on the requirements for a qualified contract.

8. Proposed regulations under section 45D on how an entity serving targeted populations meets the requirements to be a qualified active low-income community business.

9. Guidance under section 45D relating to the new markets tax credit.

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12. Temporary Regulations concerning the credit for production from advanced nuclear power facilities under section 45J.

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14. Guidance under section 48 on the energy credit for qualified fuel cell and microturbine property.

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16. Revenue ruling under sections 61 and 451 on the inclusion in income of certain federal tax credits, such as credits related to alcohol and biodiesel fuel.

17. Revenue ruling addressing the consequences of certain transactions on the treatment of arrangements as leases for federal income tax purposes.

18. Guidance under section 108(f) regarding law school debt forgiveness programs.

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20. Final regulations under section 152, as amended by the Working Families Tax Relief Act of 2004, regarding the release of a claim for exemption for a child of divorced or separated parents. Proposed regulations were published on May 2, 2007.

21. Regulations regarding the election by state legislators under section 162(h) relating to deemed expenses for travel away from home.

22. Regulations regarding the deductibility of expenses for lodging not incurred in traveling away from home. The expected issuance of these regulations was announced in Notice 2007-47.

23. Guidance under sections 162 and 165 on deducting and accounting for gaming losses and expenses.

24. Proposed regulations under section 170(f)(12), as added by the American Jobs Creation Act of 2004, and related provisions, regarding contributions of qualified vehicles. Interim guidance was issued as Notice 2005-44.

25. Regulations under section 170 regarding substantiation and reporting requirements for cash and noncash charitable contributions to reflect amendments made by the American Jobs Creation Act of 2004 and the Pension Protection Act of 2006. Interim guidance was issued as Notice 2006-96.

26. Guidance under section 174 concerning inventory property.

27. Temporary regulations under section 179B regarding the deduction for capital cost incurred by a refinery in complying with EPA regulations.

28. Guidance under section 179C on the election to expense certain refineries.

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35. Guidance under section 469 involving grouping and regrouping of activities.

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37. Regulations under section 1301(a), as amended by the American Jobs Creation Act of 2004, regarding income averaging for fishermen.

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39. Regulations providing criteria for treating an entity as an integral part of a state, local, or tribal government.

Additional PGP Projects:

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46. Guidance regarding the substantiation requirements of section 274(d)(4) for cellular telephones and other similar telecommunications equipment.

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51. Guidance under sections 163(h) and 6050H(h) on qualified mortgage insurance premiums. Interim guidance was published as Notice 2008-15 (released 01/08/2008).

GIFTS, ESTATES AND TRUSTS

Original PGP Projects:

1. Final regulations under section 67 regarding miscellaneous itemized deductions of a trust or estate.

2. Guidance under section 642(c) concerning the ordering rules for charitable payments made by a charitable lead trust.

3. Revenue ruling on the division of charitable remainder trusts under section 664.

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6. Guidance regarding the consequences under various estate, gift and generation-skipping transfer tax provisions of using a family-owned trust company as the trustee of a trust.

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8. Final regulations under sections 2036 and 2039 regarding the portion of a split-interest trust that is includible in a grantor's gross estate in certain circumstances in which the grantor retains an annuity or other payment for life.

9. Final regulations providing guidance under section 2053 regarding the extent to which post-death events may be considered in determining the value of the taxable estate.

10. Revenue procedure under section 2522 containing sample inter vivos Charitable Lead Unitrusts.

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12. Guidance under section 2703 regarding the gift and estate tax consequences of the transfer of assets to investment accounts that are restricted.

13. Guidance under section 2704 regarding restrictions on the liquidation of an interest in a corporation or partnership.

Additional PGP Projects:

14. Final regulations under section 2642(a)(3) regarding qualified severances and severances that are effective under state law but do not meet the requirements for a qualified severance under section 2642(a)(3).

15. Revenue procedure under section 2055 containing sample testamentary Charitable Lead Unitrusts.

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INSURANCE COMPANIES AND PRODUCTS

Original PGP Projects:

1. Final regulations on the exchange of property for an annuity contract. Proposed regulations were published on October 18, 2006.

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5. Revenue ruling concerning the meaning of the term "statutory reserves" under section 807 where the company is subject to different statutory reserve requirements in different states.

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8. Guidance concerning remediation procedures for life insurance and annuity contracts based on comments received pursuant to Notice 2007-15.

Additional PGP Projects:

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13. Guidance on business-owned life insurance pursuant to section 101(j).

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INTERNATIONAL ISSUES

A. Subpart F/Deferral

Original PGP Projects:

1. Regulations and other guidance under subpart F related to the American Jobs Creation Act of 2004 and the Tax Increase Prevention and Reconciliation Act of 2005. See Notice 2006-48 regarding active aircraft or vessel leasing rents under section 954(c)(2)(A), which was published on May 22, 2006, and Notice 2007-9 regarding section 954(c)(6), which was published on January 29, 2007.

2. Final regulations under section 959 on previously taxed earnings and profits. Proposed regulations were published on August 29, 2006.

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B. Inbound Transactions

Original PGP Projects:

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2. Guidance related to the American Jobs Creation Act of 2004 and other issues under sections 897, 1445, and 1446. Final, temporary, and proposed regulations under section 1446 were published on May 18, 2005. See Notice 2006-46 on the tax treatment of certain restructuring transactions under section 897, which was published on June 12, 2006.

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4. Guidance on documentation, securities lending, and other withholding issues under section 1441.

C. Outbound Transactions

Original PGP Projects:

1. Guidance on the use of parent stock to avoid dividend treatment. See Notice 2006-85 regarding use of parent stock to avoid dividend treatment, which was published on October 10, 2006, and Notice 2007-48, which was published on June 18, 2007.

2. Final regulations under section 1.367(a)-8.

* * *

4. Regulations under section 7874, as added by the American Jobs Creation Act of 2004, regarding the treatment of expatriated entities and their foreign parents. Temporary regulations regarding the determination of ownership under section 7874 were published on December 28, 2005, and temporary regulations regarding the substantial business activities test were published on June 6, 2006.

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D. Foreign Tax Credits

Original PGP Projects:

1. Final regulations under section 901 on legal liability. Proposed regulations relating to the determination of who is considered to pay a foreign tax for purposes of sections 901 and 903 were published on August 4, 2006.

2. Final regulations on the determination of the amount of taxes paid for purposes of section 901 for taxpayers who claim direct and indirect foreign tax credits. Proposed regulations were published on March 30, 2007.

* * *

6. Final regulations related to look-through treatment for 10/50 company dividends and other foreign tax credit guidance. Temporary regulations on look-through treatment for 10/50 company dividends were published on April 25, 2006.

E. Transfer Pricing

Original PGP Projects:

1. Regulations and other guidance on the treatment of cross border services. Proposed regulations under section 482 were published on September 10, 2003, and temporary and final regulations were published on August 4, 2006. See Rev. Proc. 2007-13, which identifies services eligible to be evaluated at cost, and Notice 2007-5, which provides transition rules regarding the temporary regulations, which were both published on January 16, 2007.

2. Regulations and other guidance on global dealing. Proposed regulations under section 482 were published on March 6, 1998.

3. Regulations on cost sharing and other guidance under section 482. Proposed cost sharing regulations were issued on August 22, 2005.

4. Annual Report on the Advance Pricing Agreement Program.

F. Sourcing and Expense Allocation

Original PGP Projects:

1. Regulations or other guidance under the American Jobs Creation Act of 2004 on interest expense apportionment, and other guidance on expense allocation, including issues relating to partnership structures. Proposed and temporary regulations under section 1.882-5 were published on August 17, 2006.

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G. Treaties

Original PGP Projects:

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H. Other

Original PGP Projects:

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3. Regulations or other guidance on the exemption of certain investment income of foreign governments under section 892. Temporary regulations under section 892 were published on June 24, 1988. Regulations finalizing section 1.892-5 were published on July 31, 2002.

* * *

6. Regulations and other guidance concerning the treatment of currency gain or loss. Proposed regulations under section 987 were published on September 7, 2006.

7. Guidance on cross border information reporting and filing issues, including regulations relating to the reporting of bank deposit interest. Proposed regulations under section 6049 were published on January 17, 2001.

PARTNERSHIPS

Original PGP Projects:

1. Proposed regulations under section 108(e)(8), as amended by the American Jobs Creation Act of 2004, regarding debt satisfied by a partnership interest.

2. Guidance under section 465, 704(b) and 752 concerning the interaction of the at-risk provisions, deficit and 752 concerning the interaction of the at-risk provisions, deficit restoration obligations and the partnership liability rules.
 3. Regulations under sections 704 and 737 regarding partnership mergers. Interim guidance was issued as Notice 2005-15.
 4. Proposed regulations under sections 704, 743, and 755, as amended by the American Jobs Creation Act of 2004, regarding the disallowance of certain partnership loss transfers and no reduction of basis in stock held by a partnership in a corporate partner. Interim guidance was issued as Notice 2005-32.
 5. Guidance under section 704 involving remedials and related parties.
 6. Final regulations under section 704(b)(2) regarding whether partnership allocations have substantial economic effect. Proposed regulations were published on November 18, 2005.
 7. Revenue procedure under sections 704(b) and 45 that provides the necessary requirements for partnerships to meet a safe harbor in allocating wind energy production tax credits.
- * * *
8. Modification of Rev. Proc. 2003-84 regarding monthly closing elections for partnership investments in tax-exempt bonds to impose certain additional conditions on the equity investment structure of eligible partnerships.
 9. Proposed regulations under section 706(d) regarding the determination of distributive share when a partner's interest changes.
 10. Final regulations under section 707 regarding disguised sales. Proposed regulations were published on November 26, 2004.
 11. Final regulations under sections 721 and 83 regarding partnership equity issued in connection with the performance of services. Proposed regulations were published on May 24, 2005.
 12. Final regulations under 721 regarding the tax treatment of noncompensatory options and convertible instruments issued by a partnership. Proposed regulations were published on January 22, 2003.
 13. Proposed regulations under section 751(b) regarding unrealized receivables and inventory items of a partnership.

* * *

Additional PGP Projects:

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SUBCHAPTER S

Original PGP Projects:

1. Revenue ruling on S corporation losses/reduction in tax attributes under section 108(b) for discharge of indebtedness income that is excluded from gross income.

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5. Final regulations under section 1363 providing guidance for S corporation banks. Proposed regulations were issued on August 24, 2006.

* * *

7. Final regulations under section 1367 regarding adjustments in basis of indebtedness. Proposed regulations were published on April 12, 2007.

8. Guidance under section 1367 regarding S corporations and back-to-back loans.

9. Guidance under section 1368(e) on whether premiums paid by S corporations for life insurance decrease the corporation's AAA.

Additional PGP Projects:

10. Final regulations under section 1361 to reflect provisions of the American Jobs Creation Act of 2004 and Gulf Opportunity Zone Act of 2005, including the family shareholder provision, and to update obsolete provisions in the current regulations.

* * *

TAX ACCOUNTING

Original PGP Projects:

1. Clarification of Rev. Rul. 2005-28 regarding the treatment of Medicaid rebates incurred by a pharmaceutical manufacturer in determining gross receipts.

* * *

3. Guidance on the treatment of wrap fees.

4. Guidance under section 174 regarding changes in method of accounting from an impermissible method.

5. Regulations under sections 195, 248, and 709, as amended by the American Jobs Creation Act of 2004, regarding the elections to amortize start-up and organizational expenditures.

6. Proposed regulations under section 263(a) regarding the treatment of capitalized transaction costs.

7. Guidance regarding the supporting documentation required under section 1.263(a)-5(f) to allocate success-based fees between activities that facilitate a transaction and activities that do not facilitate a transaction.

8. Guidance under section 263A regarding the treatment of post-production costs, such as sales-based royalties.

9. Guidance under section 263A regarding whether "negative" additional section 263A costs are taken into account under section 1.263A-1(d)(4).

10. Guidance regarding whether an automobile dealership is a producer for purposes of section 263A when it installs parts on customer-owned and dealership-owned vehicles.

* * *

13. Guidance under section 446 regarding whether a change between (1) separately reporting an item as income and deducting a related expense (either in the same or a different tax year) and (2) either (a) excluding the item from income and not deducting the expense, or (b) netting the item of income with the related expense, is a change in method of accounting.

14. Update of Rev. Proc. 2002-9 regarding automatic changes in methods of accounting.

15. Guidance regarding the nonaccrual experience method under section 448.

16. Guidance under section 453 addressing the exchange of property for an annuity.

17. Guidance regarding the application of section 453A to contingent payment installment sales.

18. Regulations under section 460 providing rules for home construction contracts.

19. Guidance under section 460 addressing the application of the lookback interest rules to certain pass-thru entities with tax-exempt owners.

* * *

21. Guidance under section 468B regarding the tax treatment of a single-claimant qualified settlement fund.

22. Regulations under section 468B regarding escrow accounts and other funds used in like-kind exchanges. Proposed regulations were published on February 7, 2006.

23. Guidance regarding the permissibility of a moving average cost method for valuing inventory.

24. Guidance under section 1.472-8 regarding the inventory price index computation (IPIC) method.

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Additional PGP Projects:

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TAX ADMINISTRATION

Original PGP Projects:

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8. Guidance regarding information reporting under section 6041 for commissions paid to insurance agents.

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13. Regulations under section 6081 simplifying the extension process. Temporary regulations were published on November 7, 2005.

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18. Guidance under section 6112 with respect to list maintenance.

19. Regulations under section 6159 regarding installment agreements.

* * *

21. Revenue procedure under section 6213 regarding internet and oral change of address requests.

22. Regulations under section 6231 regarding the special enforcement exception to the application of the TEFRA partnership procedures.

23. Proposed regulations under section 6302 regarding payments under the Electronic Federal Tax Payment System.

24. Regulations under section 6302 regarding the failure-to-deposit penalty under section 6656.

25. Regulations regarding the filing of Form 941 under the Annual Employment Tax Return Program. Proposed regulations were published on January 3, 2006.

* * *

32. Regulations under section 6501(c)(10) regarding the extension of the statute of limitations for assessment relating to failures to report required information concerning listed transactions. Interim guidance was issued as Rev. Proc. 2005-26.

33. Regulations under section 6503 regarding the suspension of the period of limitations for noncompliance with a designated summons. Proposed regulations were published on July 31, 2003.

34. Regulations under section 6611 regarding interest on overpayments by tax exempt organizations.

35. Regulations under sections 6662A, 6662 and 6664 regarding accuracy-related penalties relating to understatements. Interim guidance was issued as Notice 2005-12.

36. Update of Rev. Proc. 94-69 regarding qualified amended returns filed by CIC taxpayers. Final regulations under section 6664 were published on January 9, 2007.

37. Guidance under section 6676 regarding the penalty for erroneous claims for refund.

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40. Guidance under section 6695A, as added by the Pension Protection Act of 2006, regarding the penalty applicable to appraisers.

* * *

42. Regulations under section 6707 regarding the penalty for failure to furnish information required by section 6111.

43. Regulations under section 6707A regarding the penalty for failure to disclose reportable transactions. Prior guidance was issued as Notice 2005-11, Rev. Proc. 2005-51, Rev. Proc. 2007-21 and Rev. Proc. 2007-25.

44. Revenue procedure regarding the procedures to request Appeals consideration of the section 6707A penalty.

45. Regulations under section 6708 regarding the penalty for failure to make a list of advisees available as required by section 6112. Interim guidance was issued as Notice 2004-80.

46. Guidance under section 7122 as amended by the Tax Increase Prevention and Reconciliation Act of 2005 regarding the partial payment requirement for offers in compromise.

47. Guidance regarding Appeals mediation procedures.

48. Guidance regarding fast track procedures for TEGE taxpayers.

* * *

50. Final regulations under section 7425(c) regarding where to send notices of nonjudicial sale and wrongful levy claims. Proposed regulations were published on July 20, 2007.

51. Guidance under section 7430 regarding attorney fees to reflect miscellaneous changes made by the Tax Reform Act of 1997 and the Internal Revenue Service Restructuring and Reform Act of 1998.

52. Proposed regulations under the section 7477 regarding declaratory judgment procedures relating to gift tax valuation issues.

53. Final regulations under section 7502 regarding the timely mailing/delivery of documents. Proposed regulations were published on September 21, 2004.

* * *

55. Amendments to the section 7508A regulations regarding the postponement of certain deadlines by reason of a Presidentially declared disaster or terroristic or military actions.

* * *

57. Final regulations regarding the procedures relating to third party and John Doe summonses.

58. Proposed regulations under section 7811 regarding taxpayer assistance orders.

* * *

61. Guidance regarding the procedures for the imposition of a monetary penalty under Circular 230. Prior guidance was issued as Notice 2007-39.

62. Update of guidance regarding the Appeals function.

63. Revision of Rev. Proc. 2000-43 regarding ex parte communications with Appeals.

Additional PGP Projects:

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TAX EXEMPT BONDS

Original PGP Projects:

1. Temporary regulations on clean renewable energy bonds under section 54. Interim guidance was published as Notices 2005-98, 2006-7 and 2007-26.

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3. Final regulations under section 141, including allocation and accounting principles. Proposed regulations regarding allocation and accounting principles were published on September 26, 2006.

4. Final regulations under section 142 regarding solid waste disposal facilities. Proposed regulations were published on May 10, 2004.

5. Proposed regulations on the public approval requirements for private activity bonds under section 147(f).

6. Update Rev. Proc. 92-63, which sets forth the process for recovery of rebate overpayments under section 148.

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Additional PGP Projects:

8. Further guidance on arbitrage investment restrictions under section 148.

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10. Expand the voluntary resolution program under Notice 2001-60 for tax-exempt bonds subject to section 103 and related sections.

PROPOSED RULES

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 26 and 301

[REG-147775-06]

RIN 1545-BH63

Regulations Under Section 2642(g)

Thursday, April 17, 2008

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations providing guidance under section 2642(g)(1). The proposed regulations describe the circumstances and procedures under which an extension of time will be granted under section 2642(g)(1). The proposed guidance affects individuals (or their estates) who failed to make a timely allocation of generation-skipping transfer (GST) exemption to a transfer, and individuals (or their estates) who failed to make a timely election under section 2632(b)(3) or (c)(5). This document also provides notice of a public hearing.

DATES: Written or electronic comments must be received by July 16, 2008. Outlines of topics to be discussed at the public hearing scheduled for August 5, 2008, must be received by July 15, 2008.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-147775-06), Internal Revenue Service, Room 5203, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-147775-06), 1111 Constitution Avenue, NW., Washington, DC 20224; or sent electronically via the Federal eRulemaking Portal at <http://www.regulations.gov> (IRS-REG-147775-06). The public hearing will be held in the IRS auditorium.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Theresa M. Melchiorre, (202) 622-3090; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Richard Hurst at Richard.A.Hurst@irscounsel.treas.gov or (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of

1995 (44 U.S.C. 3507(d)). Comments on the collections of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by June 16, 2008.

Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the IRS, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information;

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

The reporting requirement in these proposed regulations is in § 26.2642-7(h)(2) and (3). This information must be reported by transferors or the executors of transferors' estates requesting relief under section 2642(g)(1). This information will be used by the IRS to determine whether to grant a transferor or a transferor's estate an extension of time to: (1) Allocate GST exemption, as defined in section 2631, to a transfer; (2) elect under section 2632(b)(3) (the election not to have the deemed allocation of GST exemption apply to a direct skip); (3) elect under section 2632(c)(5)(A)(i) (the election not to have the deemed allocation of GST exemption apply to an indirect skip or transfers made to a particular trust); and (4) elect under section 2632(c)(5)(A)(ii) (the election to treat any trust as a GST trust for purposes of section 2632(c)).

The following estimates are an approximation of the average time expected to be necessary for a collection of information. They are based on the information that is available to the IRS. Individual respondents may require greater or less time, depending on their particular circumstances.

Estimated total annual reporting burden: 1,800 hours.

Estimated average annual burden: 2 hours.

Estimated number of respondents: 900.

Estimated annual frequency of response: When relief is requested.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may

become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

The proposed regulations provide guidance on the application of section 2642(g)(1). Congress added section 2642(g)(1) to the Internal Revenue Code (Code) in section 564 of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), (Pub. L. 107-16, § 564, 115 Stat. 91). This section directs the Secretary to issue regulations describing the circumstances and procedures under which an extension of time will be granted to: (1) Allocate GST exemption, as defined in section 2631(a), to a transfer; (2) elect under section 2632(b)(3) (the election not to have the deemed allocation of GST exemption apply to a direct skip); (3) elect under section 2632(c)(5)(A)(i) (the election not to have the deemed allocation of GST exemption apply to an indirect skip or transfers made to a particular trust); and (4) elect under section 2632(c)(5)(A)(ii) (the election to treat any trust as a GST trust for purposes of section 2632(c)). In determining whether to grant relief, section 2642(g)(1) directs that all relevant circumstances be considered including evidence of intent contained in the trust instrument or the instrument of transfer.

The legislative history accompanying section 2642(g)(1) indicates that Congress believed that, in appropriate circumstances, an individual should be granted an extension of time to allocate GST exemption regardless of whether any period of limitations had expired. Those circumstances include situations in which the taxpayer intended to allocate GST exemption and the failure to allocate the exemption was inadvertent. H.R. Conf. Rep. No. 107-84, 202 (2001).

After the enactment of section 2642(g)(1), the IRS issued Notice 2001-50 (2001-2 CB 189), which announced that transferors may seek an extension of time to make an allocation of GST exemption. The Notice provides, generally, that relief will be granted under § 301.9100-3 of the Procedure and Administration Regulations if the taxpayer satisfies the requirements of those regulations and establishes to the satisfaction of the Commissioner that the taxpayer acted reasonably and in good faith and that a grant of the requested relief will not prejudice the interests of the Government. If relief is granted under § 301.9100-3 and the allocation is made, the amount of GST exemption allocated to the transfer is the Federal gift or estate tax value of the property as of the date of the transfer and the allocation is effective as of the date of the transfer. (Notice 2001-50 will be made obsolete upon the publication of the Treasury decision adopting these proposed regulations as final regulations in the Federal Register.)

On August 2, 2004, the IRS issued Rev. Proc. 2004-46 (2004-2 CB 142), which provides an alternate simplified method to obtain an extension of time to allocate GST exemption in certain situations. Generally, this method is available only with regard to an inter vivos transfer to a trust from which a GST may be made and only if each of the following requirements is met: (1) The transfer qualified for the gift tax annual exclusion under section 2503(b); (2) the sum of the amount of the transfer and all other gifts by the transferor to the donee in the same year did not exceed the applicable annual exclusion amount for that year; (3) no GST exemption was allocated to the transfer; (4) the taxpayer has unused GST exemption to allocate to the transfer as of the filing of the request for relief; and (5) no taxable distributions or taxable terminations have occurred as of the filing of the request for relief.

To date, the IRS has issued numerous private letter rulings under § 301.9100-3 granting an extension of time to timely allocate GST exemption in situations in which transferors (or their executors) failed to allocate GST exemption to a trust on a timely filed Federal gift or estate tax return. These proposed

regulations are intended to replace § 301.9100-3 with regard to relief under section 2642(g)(1).

Accordingly, § 301.9100-3 will be amended to provide that relief under section 2642(g)(1) cannot be obtained through the provisions of §§ 301.9100-1 and 301.9100-3 after the date of publication of the Treasury decision adopting these rules as final regulations in the Federal Register. Relief under § 301.9100-2(b) (the automatic 6-month extension) will continue to be available to transferors or transferor's estates qualifying for that relief. In addition, the procedures contained in Revenue Procedure 2004-46 will remain effective for transferors within the scope of that Revenue Procedure.

Explanation of Provisions

The proposed regulations identify the standards that the IRS will apply in determining whether to grant a transferor or a transferor's estate an extension of time to: (1) Allocate GST exemption, as defined in section 2631, to a transfer; (2) elect under section 2632(b)(3) (the election not to have the deemed allocation of GST exemption apply to a direct skip); (3) elect under section 2632(c)(5)(A)(i) (the election not to have the deemed allocation of GST exemption apply to an indirect skip or transfers made to a particular trust); and (4) elect under section 2632(c)(5)(A)(ii) (the election to treat any trust as a GST trust for purposes of section 2632(c)). The proposed regulations also identify situations with facts that do not satisfy the standards for granting relief and in which, as a result, an extension of time will not be granted.

If an extension of time to allocate GST exemption is granted under section 2642(g)(1), the allocation of GST exemption will be considered effective as of the date of the transfer, and the value of the property transferred for purposes of chapter 11 or chapter 12 will determine the amount of GST exemption to be allocated. If an extension of time to elect out of the automatic allocation of GST exemption under section 2632(b)(3) or (c)(5)(A)(i) is granted under section 2642(g)(1), the election will be considered effective as of the date of the transfer. If an extension of time to elect to treat any trust as a GST trust under section 2632(c)(5)(A)(ii) is granted under section 2642(g)(1), the election will be considered effective as of the date of the first (or each) transfer covered by that election.

The amount of GST exemption that may be allocated to a transfer pursuant to an extension granted under section 2642(g)(1) is limited to the amount of the transferor's unused GST exemption under section 2631(c) as of the date of the transfer. Thus, if the amount of GST exemption has increased since the date of the transfer, no portion of the increased amount may be applied by reason of the grant of relief under section 2642(g)(1) to a transfer taking place in an earlier year and prior to the effective date of that increase.

Requests for relief under section 2642(g)(1) will be granted when the taxpayer establishes to the satisfaction of the IRS that the taxpayer acted reasonably and in good faith, and that the grant of relief will not prejudice the interests of the Government.

For purposes of section 2642(g)(1), the following nonexclusive list of factors will be used to determine whether a transferor or the executor of a transferor's estate acted reasonably and in good faith: (1) The intent of the transferor or the executor of the transferor's estate to timely allocate GST exemption or to timely make an election under section 2632(b)(3) or (c)(5) as evidenced in the trust instrument, instrument of transfer, or contemporaneous documents, such as Federal gift or estate tax returns or correspondence; (2) the occurrence of intervening events beyond the control of the transferor as defined in section 2652(a), or of the executor of the transferor's estate as defined in section 2203, that caused the failure to allocate GST exemption to a transfer or the failure to elect under section

2632(b)(3) or (c)(5); (3) the lack of awareness by the transferor or the executor of the transferor's estate of the need to allocate GST exemption to a transfer after exercising reasonable diligence, taking into account the experience of the transferor or the executor of the transferor's estate and the complexity of the GST issue; (4) evidence of consistency by the transferor in allocating (or not allocating) the transferor's GST exemption, although evidence of consistency may be less relevant if there is evidence of a change of circumstances or change of trust beneficiaries that would otherwise support a deviation from prior GST tax exemption allocation practices; and (5) reasonable reliance by the transferor or the executor of the transferor's estate on the advice of a qualified tax professional retained or employed by either (or both) of them, and the failure of the transferor or executor, in reliance on or consistent with that advice, to allocate GST exemption to the transfer or to make an election described in section 2632(b)(3) or (c)(5). The IRS will consider all relevant facts and circumstances in making this determination.

For purposes of section 2642(g)(1), the following nonexclusive list of factors will be used to determine whether the interests of the Government would be prejudiced: (1) The grant of requested relief would permit the use of hindsight to produce an economic advantage or other benefit that either would not have been available if the allocation or election had been timely made, or that results from the selection of one out of a number of alternatives (other than whether or not to make an allocation or election) that were available at the time the allocation or election could have been made timely; (2) if the transferor or the executor of the transferor's estate delayed the filing of the request for relief with the intent to deprive the IRS of sufficient time (by reason of the expiration or the impending expiration of the applicable statute of limitations or otherwise) to challenge the claimed identity of the transferor, the value of the transferred property that is the subject of the requested relief, or any other aspect of the transfer that is relevant for transfer tax purposes; and (3) a determination by the IRS that, in the event of a grant of relief under section 2642(g)(1), it would be unreasonably disruptive or difficult to adjust the GST tax consequences of a taxable termination or a taxable distribution that occurred between the time for making a timely allocation of GST exemption or a timely election described in section 2632(b)(3) or (c)(5) and the time at which the request for relief under section 2642(g)(1) was filed. The IRS will consider all relevant facts and circumstances in making this determination.

Relief under section 2642(g)(1) will not be granted when the standard of reasonableness, good faith and lack of prejudice to the interests of the Government is not met. This standard is not met in the following situations: (1) The transferor or the executor of the transferor's estate made an allocation of GST exemption as described in § 26.2632-1(b)(4)(ii)(A)(1), or an election under section 2632(b)(3) or (c)(5), on a timely filed Federal gift or estate tax return, and the relief requested would decrease or revoke that allocation or election; (2) the transferor or the transferor's executor delayed in requesting relief in order to preclude the IRS, as a practical matter, from challenging the identity of the transferor, the value of the transferred interest on the Federal estate or gift tax return, or any other aspect of the transaction that is relevant for Federal estate or gift tax purposes; (3) the action or inaction that is the subject of the request for relief reflected or implemented the decision with regard to the allocation of GST exemption or an election described in section 2632(b)(3) or (c)(5) that was made by the transferor or executor of the transferor's estate who had been accurately informed in all material respects by a qualified tax professional retained or employed by either (or both) of them; or (4) the IRS determines that the transferor's request is an attempt to benefit from hindsight.

A request for relief under section 2642(g)(1) does not reopen, suspend or extend the period of limitations on assessment of any estate, gift, or GST tax under section 6501. Thus, the IRS may request that the transferor or the transferor's executor consent under section 6501(c)(4) to extend the period of limitations on assessment of any or all gift and GST taxes on the transfer(s) for which relief under

section 2642(g)(1) has been requested. The transferor or the transferor's executor has the right to refuse to extend the period of limitations, or to limit such extension to particular issues or to a particular period of time. See section 6501(c)(4)(B).

If the grant of relief under section 2642(g)(1) results in a potential tax refund claim, no refund will be paid or credited to the taxpayer or the taxpayer's estate if, at the time of filing the request for relief, the period of limitations for filing a claim for a credit or refund of Federal gift, estate, or GST tax under section 6511 on the transfer for which relief is granted has expired.

Relief provided under section 2642(g)(1) will be granted through the IRS letter ruling program.

Proposed Effective Date

Section 26.2642-7 applies to requests for relief filed on or after the date of publication of the Treasury decision adopting these rules as final regulations in the Federal Register.

Availability of IRS Documents

The IRS notice and revenue procedure cited in this preamble are published in the Cumulative Bulletin and are available at <http://www.irs.gov>.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. Pursuant to the Regulatory Flexibility Act (RFA) (5 U.S.C. chapter 6), it is hereby certified that this regulation will not have a significant economic impact on a substantial number of small entities. The applicability of this rule is limited to individuals (or their estates) and trusts, which are not small entities as defined by the RFA (5 U.S.C. 601). Although it is anticipated that there may be a beneficial economic impact for some small entities, including entities that provide tax and legal services that assist individuals in the private letter ruling program, any benefit to those entities would be indirect. Further, this indirect benefit will not affect a substantial number of these small entities because only a limited number of individuals (or their estates) and trusts would submit a private letter ruling request under this rule. Therefore, only a small fraction of tax and legal services entities would generate business or benefit from this rule. Accordingly, a regulatory flexibility analysis is not required. Pursuant to section 7805(f) of the Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small entities.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and also on how they can be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for August 5, 2008 in the IRS auditorium. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not

be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For more information about having your name placed on the list to attend the hearing, see the FOR FURTHER INFORMATION CONTACT section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written (a signed original and eight (8) copies) or electronic comments by July 16, 2008 and an outline of the topics to be discussed and the time to be devoted to each topic by July 15, 2008. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these regulations is Theresa M. Melchiorre, Office of Chief Counsel, IRS.

List of Subjects

26 CFR Part 26

Estate taxes, Reporting and recordkeeping requirements.

26 CFR Part 301

Employment taxes, Estate taxes, Excise taxes, Gift taxes, Income taxes, Penalties, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR parts 26 and 301 are proposed to be amended as follows:

PART 26--~~GENERATION-SKIPPING~~ TRANSFER TAX REGULATIONS UNDER THE TAX REFORM ACT OF 1986

Paragraph 1. The authority citation for part 26 is amended by adding an entry in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 26.2642-7 also issued under 26 U.S.C. 2642(g) * * *

26 CFR § 26.2642-7

Par. 2. Section 26.2642-7 is added to read as follows:

26 CFR § 26.2642-7

§ 26.2642-7 Relief under section 2642(g)(1).

(a) In general. Under section 2642(g)(1)(A), the Secretary has the authority to issue regulations

describing the circumstances in which a transferor, as defined in section 2652(a), or the executor of a transferor's estate, as defined in section 2203, will be granted an extension of time to allocate generation-skipping transfer (GST) exemption as described in sections 2642(b)(1) and (2). The Secretary also has the authority to issue regulations describing the circumstances under which a transferor or the executor of a transferor's estate will be granted an extension of time to make the elections described in section 2632(b)(3) and (c)(5). Section 2632(b)(3) provides that an election may be made by or on behalf of a transferor not to have the transferor's GST exemption automatically allocated under section 2632(b)(1) to a direct skip, as defined in section 2612(c), made by the transferor during life. Section 2632(c)(5)(A)(i) provides that an election may be made by or on behalf of a transferor not to have the transferor's GST exemption automatically allocated under section 2632(c)(1) to an indirect skip, as defined in section 2632(c)(3)(A), or to any or all transfers made by such transferor to a particular trust. Section 2632(c)(5)(A)(ii) provides that an election may be made by or on behalf of a transferor to treat any trust as a GST trust, as defined in section 2632(c)(3)(B), for purposes of section 2632(c) with respect to any or all transfers made by that transferor to the trust. This section generally describes the factors that the Internal Revenue Service (IRS) will consider when an extension of time is sought by or on behalf of a transferor to timely allocate GST exemption and/or to make an election under section 2632(b)(3) or (c)(5). Relief provided under this section will be granted through the IRS letter ruling program. See paragraph (h) of this section.

(b) Effect of Relief. If an extension of time to allocate GST exemption is granted under this section, the allocation of GST exemption will be considered effective as of the date of the transfer, and the value of the property transferred for purposes of chapter 11 or chapter 12 will determine the amount of GST exemption to be allocated. If an extension of time to elect out of the automatic allocation of GST exemption under section 2632(b)(3) or (c)(5) is granted under this section, the election will be considered effective as of the date of the transfer. If an extension of time to elect to treat any trust as a GST trust under section 2632(c)(5)(A)(ii) is granted under this section, the election will be considered effective as of the date of the first (or each) transfer covered by that election.

(c) Limitation on relief. The amount of GST exemption that may be allocated to a transfer as the result of relief granted under this section is limited to the amount of the transferor's unused GST exemption under section 2631(c) as of the date of the transfer. Thus, if, by the time of the making of the allocation or election pursuant to relief granted under this section, the GST exemption amount under section 2631(c) has increased to an amount in excess of the amount in effect for the date of the transfer, no portion of the increased amount may be applied to that earlier transfer by reason of the relief granted under this section.

(d) Basis for determination--(1) In general. Requests for relief under this section will be granted when the transferor or the executor of the transferor's estate provides evidence (including the affidavits described in paragraph (h) of this section) to establish to the satisfaction of the IRS that the transferor or the executor of the transferor's estate acted reasonably and in good faith, and that the grant of relief will not prejudice the interests of the Government. Paragraphs (d)(2) and (d)(3) of this section set forth nonexclusive lists of factors the IRS will consider in determining whether this standard of reasonableness, good faith, and lack of prejudice to the interests of the Government has been met so that such relief will be granted. In making this determination, IRS will consider these factors, as well as all other relevant facts and circumstances. Paragraph (e) of this section sets forth situations in which this standard has not been met and, as a result, in which relief under this section will not be granted.

(2) Reasonableness and good faith. The following is a nonexclusive list of factors that will be considered to determine whether the transferor or the executor of the transferor's estate acted

reasonably and in good faith for purposes of this section:

(i) The intent of the transferor to timely allocate GST exemption to a transfer or to timely make an election under section 2632(b)(3) or (c)(5), as evidenced in the trust instrument, the instrument of transfer, or other relevant documents contemporaneous with the transfer, such as Federal gift and estate tax returns and correspondence. This may include evidence of the intended GST tax status of the transfer or the trust (for example, exempt, non-exempt, or partially exempt), or more explicit evidence of intent with regard to the allocation of GST exemption or the election under section 2632(b)(3) or (c)(5).

(ii) Intervening events beyond the control of the transferor or of the executor of the transferor's estate as the cause of the failure to allocate GST exemption to a transfer or the failure to make an election under section 2632(b)(3) or (c)(5).

(iii) Lack of awareness by the transferor or the executor of the transferor's estate of the need to allocate GST exemption to the transfer, despite the exercise of reasonable diligence, taking into account the experience of the transferor or the executor of the transferor's estate and the complexity of the GST issue, as the cause of the failure to allocate GST exemption to a transfer or to make an election under section 2632(b)(3) or (c)(5).

(iv) Consistency by the transferor with regard to the allocation of the transferor's GST exemption (for example, the transferor's consistent allocation of GST exemption to transfers to skip persons or to a particular trust, or the transferor's consistent election not to have the automatic allocation of GST exemption apply to transfers to one or more trusts or skip persons pursuant to section 2632(b)(3) or (c)(5)). Evidence of consistency may be less relevant if there has been a change of circumstances or change of trust beneficiaries that would otherwise explain a deviation from prior GST exemption allocation decisions.

(v) Reasonable reliance by the transferor or the executor of the transferor's estate on the advice of a qualified tax professional retained or employed by one or both of them and, in reliance on or consistent with that advice, the failure of the transferor or the executor to allocate GST exemption to the transfer or to make an election described in section 2632(b)(3) or (c)(5). Reliance on a qualified tax professional will not be considered to have been reasonable if the transferor or the executor of the transferor's estate knew or should have known that the professional either--

(A) Was not competent to render advice on the GST exemption; or

(B) Was not aware of all relevant facts.

(3) Prejudice to the interests of the Government. The following is a nonexclusive list of factors that will be considered to determine whether the interests of the Government would be prejudiced for purposes of this section:

(i) The interests of the Government would be prejudiced to the extent to which the request for relief is an effort to benefit from hindsight. The interests of the Government would be prejudiced if the IRS determines that the requested relief is an attempt to benefit from hindsight rather than to achieve the result the transferor or the executor of the transferor's estate intended at the time when the transfer was made. A factor relevant to this determination is whether the grant of the requested relief would permit an economic advantage or other benefit that would not have been available if the allocation or election

had been timely made. Similarly, there would be prejudice if a grant of the requested relief would permit an economic advantage or other benefit that results from the selection of one out of a number of alternatives (other than whether or not to make an allocation or election) that were available at the time the allocation or election could have been timely made, if hindsight makes the selected alternative more beneficial than the other alternatives. Finally, in a situation where the only choices were whether or not to make a timely allocation or election, prejudice would exist if the transferor failed to make the allocation or election in order to wait to see (thus, with the benefit of hindsight) whether or not the making of the allocation or election would be more beneficial.

(ii) The timing of the request for relief will be considered in determining whether the interests of the Government would be prejudiced by granting relief under this section. The interests of the Government would be prejudiced if the transferor or the executor of the transferor's estate delayed the filing of the request for relief with the intent to deprive the IRS of sufficient time to challenge the claimed identity of the transferor of the transferred property that is the subject of the request for relief, the value of that transferred property for Federal gift or estate tax purposes, or any other aspect of the transfer that is relevant for Federal gift or estate tax purposes. The fact that any period of limitations on the assessment or collection of transfer taxes has expired prior to the filing of a request for relief under this section, however, will not by itself prohibit a grant of relief under this section. Similarly, the combination of the expiration of any such period of limitations with the fact that the asset or interest was valued for transfer tax purposes with the use of a valuation discount will not by itself prohibit a grant of relief under this section.

(iii) The occurrence and effect of an intervening taxable termination or taxable distribution will be considered in determining whether the interests of the Government would be prejudiced by granting relief under this section. The interests of the Government may be prejudiced if a taxable termination or taxable distribution occurred between the time for making a timely allocation of GST exemption or a timely election described in section 2632(b)(3) or (c)(5) and the time at which the request for relief under this section was filed. The impact of a grant of relief on (and the difficulty of adjusting) the GST tax consequences of that intervening termination or distribution will be considered in determining whether the occurrence of a taxable termination or taxable distribution constitutes prejudice.

(e) Situations in which the standard of reasonableness, good faith, and lack of prejudice to the interests of the Government has not been met. Relief under this section will not be granted if the IRS determines that the transferor or the executor of the transferor's estate has not acted reasonably and in good faith, and/or that the grant of relief would prejudice the interests of the Government. The following situations provide illustrations of some circumstances under which the standard of reasonableness, good faith, and lack of prejudice to the interests of the Government has not been met, and as a result, in which relief under this section will not be granted:

(1) Timely allocations and elections. Relief will not be granted under this section to decrease or revoke a timely allocation of GST exemption as described in § 26.2632-1(b)(4)(ii)(A)(1), or to revoke an election under section 2632(b)(3) or (c)(5) made on a timely filed Federal gift or estate tax return.

(2) Timing. Relief will not be granted if the transferor or executor delayed the filing of the request for relief with the intent to deprive the IRS of sufficient time to challenge the claimed identity of the transferor or the valuation of the transferred property for Federal gift or estate tax purposes. (However, see paragraph (d)(3)(ii) of this section for examples of facts which alone do not constitute prejudice.)

(3) Failure after being accurately informed. Relief will not be granted under this section if the decision

made by the transferor or the executor of the transferor's estate (who had been accurately informed in all material respects by a qualified tax professional retained or employed by either (or both) of them with regard to the allocation of GST exemption or an election described in section 2632(b)(3) or (c)(5)) was reflected or implemented by the action or inaction that is the subject of the request for relief.

(4) Hindsight. Relief under this section will not be granted if the IRS determines that the requested relief is an attempt to benefit from hindsight rather than an attempt to achieve the result the transferor or the executor of the transferor's estate intended when the transfer was made. One factor that will be relevant to this determination is whether the grant of relief will give the transferor the benefit of hindsight by providing an economic advantage that may not have been available if the allocation or election had been timely made. Thus, relief will not be granted if that relief will shift GST exemption from one trust to another trust unless the beneficiaries of the two trusts, and their respective interests in those trusts, are the same. Similarly, relief will not be granted if there is evidence that the transferor or executor had not made a timely allocation of the exemption in order to determine which of the various trusts achieved the greatest asset appreciation before selecting the trust that should have a zero inclusion ratio.

(f) Period of limitations under section 6501. A request for relief under this section does not reopen, suspend, or extend the period of limitations on assessment or collection of any estate, gift, or GST tax under section 6501. Thus, the IRS may request that the transferor or the transferor's executor consent, under section 6501(c)(4), to an extension of the period of limitation on assessment or collection of any or all gift and GST taxes for the transfer(s) that are the subject of the requested relief. The transferor or the transferor's executor has the right to refuse to extend the period of limitations, or to limit such extension to particular issues or to a particular period of time. See section 6501(c)(4)(B).

(g) Refunds. The filing of a request for relief under section 2642(g)(1) with the IRS does not constitute a claim for refund or credit of an overpayment and no implied right to refund will arise from the filing of such a request for relief. Similarly, the filing of such a request for relief does not extend the period of limitations under section 6511 for filing a claim for refund or credit of an overpayment. In the event the grant of relief under section 2642(g)(1) results in a potential claim for refund or credit of an overpayment, no such refund or credit will be allowed to the taxpayer or to the taxpayer's estate if the period of limitations under section 6511 for filing a claim for a refund or credit of the Federal gift, estate, or GST tax that was reduced by the granted relief has expired. The period of limitations under section 6511 is generally the later of three years from the time the original return is filed or two years from the time the tax was paid. If the IRS and the taxpayer agree to extend the period for assessment of tax, the period for filing a claim for refund or credit will be extended. Section 6511(c). The taxpayer or the taxpayer's estate is responsible for preserving any potential claim for refund or credit. A taxpayer who seeks and is granted relief under section 2642(g)(1) will not be regarded as having filed a claim for refund or credit by requesting such relief. In order to preserve a right of refund or credit, the taxpayer or the executor of the taxpayer's estate also must file before the expiration of the period of limitations under section 6511 for filing such a claim any required forms for requesting a refund or credit in accordance with the instructions to such forms and applicable regulations.

(h) Procedural requirements--(1) Letter ruling program. The relief described in this section is provided through the IRS's private letter ruling program. See Revenue Procedure 2008-1 (2008-1 IRB 1), or its successor, (which are available at <http://www.irs.gov>). Requests for relief under this section that do not meet the requirements of § 301.9100-2 of this chapter must be made under the rules of this section.

(2) Affidavit and declaration of transferor or the executor of the transferor's estate--(i) The transferor

or the executor of the transferor's estate must submit a detailed affidavit describing the events that led to the failure to timely allocate GST exemption to a transfer or the failure to timely elect under section 2632(b)(3) or (c)(5), and the events that led to the discovery of the failure. If the transferor or the executor of the transferor's estate relied on a tax professional for advice with respect to the allocation or election, the affidavit must describe--

(A) The scope of the engagement;

(B) The responsibilities the transferor or the executor of the transferor's estate believed the professional had assumed, if any; and

(C) The extent to which the transferor or the executor of the transferor's estate relied on the professional.

(ii) Attached to each affidavit must be copies of any writing (including, without limitation, notes and e-mails) and other contemporaneous documents within the possession of the affiant relevant to the transferor's intent with regard to the application of GST tax to the transaction for which relief under this section is being requested.

(iii) The affidavit must be accompanied by a dated declaration, signed by the transferor or the executor of the transferor's estate that states: "Under penalties of perjury, I declare that I have examined this affidavit, including any attachments thereto, and to the best of my knowledge and belief, this affidavit, including any attachments thereto, is true, correct, and complete. In addition, under penalties of perjury, I declare that I have examined all the documents included as part of this request for relief, and, to the best of my knowledge and belief, these documents collectively contain all the relevant facts relating to the request for relief, and such facts are true, correct, and complete."

(3) Affidavits and declarations from other parties--(i) The transferor or the executor of the transferor's estate must submit detailed affidavits from individuals who have knowledge or information about the events that led to the failure to allocate GST exemption or to elect under section 2632(b)(3) or (c)(5), and/or to the discovery of the failure. These individuals may include individuals whose knowledge or information is not within the personal knowledge of the transferor or the executor of the transferor's estate. The individuals described in paragraph (h)(3)(i) of this section must include--

(A) Each agent or legal representative of the transferor who participated in the transaction and/or the preparation of the return for which relief is being requested;

(B) The preparer of the relevant Federal estate and/or gift tax return(s);

(C) Each individual (including an employee of the transferor or the executor of the transferor's estate) who made a substantial contribution to the preparation of the relevant Federal estate and/or gift tax return(s); and

(D) Each tax professional who advised or was consulted by the transferor or the executor of the transferor's estate with regard to any aspect of the transfer, the trust, the allocation of GST exemption, and/or the election under section 2632(b)(3) or (c)(5).

(ii) Each affidavit must describe the scope of the engagement and the responsibilities of the individual as well as the advice or service(s) the individual provided to the transferor or the executor of the

transferor's estate.

(iii) Attached to each affidavit must be copies of any writing (including, without limitation, notes and e-mails) and other contemporaneous documents within the possession of the affiant relevant to the transferor's intent with regard to the application of GST tax to the transaction for which relief under this section is being requested.

(iv) Each affidavit also must include the name, and current address of the individual, and be accompanied by a dated declaration, signed by the individual that states: "Under penalties of perjury, I declare that I have personal knowledge of the information set forth in this affidavit, including any attachments thereto. In addition, under penalties of perjury, I declare that I have examined this affidavit, including any attachments thereto, and, to the best of my knowledge and belief, the affidavit contains all the relevant facts of which I am aware relating to the request for relief filed by or on behalf of [transferor or the executor of the transferor's estate], and such facts are true, correct, and complete."

(v) If an individual who would be required to provide an affidavit under paragraph (h)(3)(i) of this section has died or is not competent, the affidavit required under paragraph (h)(2) of this section must include a statement to that effect, as well as a statement describing the relationship between that individual and the transferor or the executor of the transferor's estate and the information or knowledge the transferor or the executor of the transferor's estate believes that individual had about the transfer, the trust, the allocation of exemption, or the election. If an individual who would be required to provide an affidavit under paragraph (h)(3)(i) of this section refuses to provide the transferor or the executor of the transferor's estate with such an affidavit, the affidavit required under paragraph (h)(2) of this section must include a statement that the individual has refused to provide the affidavit, a description of the efforts made to obtain the affidavit from the individual, the information or knowledge the transferor or the executor of the transferor's estate believes the individual had about the transfer, and the relationship between the individual and the transferor or the executor of the transferor's estate.

(i) Effective/applicability date. Section 26.2642-7 applies to requests for relief filed on or after the date of publication of the Treasury decision adopting these proposed rules as final regulations in the Federal Register.

PART 301--PROCEDURE AND ADMINISTRATION

Par. 3. The authority citation for part 301 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

26 CFR § 301.9100-3

Par. 4. Section 301.9100-3 is amended by adding a new paragraph (g) to read as follows:

26 CFR § 301.9100-3

§ 301.9100-3 Other extensions.

* * * * *

(g) Relief under section 2642(g)(1)--(1) Procedures. The procedures set forth in this section are not

applicable for requests for relief under section 2642(g)(1). For requests for relief under section 2642(g)(1), see § 26.2642-7.

(2) Effective/applicability date. Paragraph (g) of this section applies to requests for relief under section 2642(g)(1) filed on or after the date of publication of the Treasury decision adopting these rules as final regulations in the Federal Register.

Linda E. Stiff,

Deputy Commissioner for Services and Enforcement.

Revenue Ruling

SUBSTITUTION POWER

Published: April 21, 2008

Section 2038.--Revocable Transfers, 26 CFR 20.2038-1: Revocable transfers.

Is the corpus of an inter vivos trust includible in the grantor's gross estate under section 2036 or 2038 of the Internal Revenue Code if the grantor retained the power, exercisable in a nonfiduciary capacity, to acquire property held in the trust by substituting other property of equivalent value.

Section 2036.--Transfers With Retained Life Estate, 26 CFR 20.2036-1: Transfers with retained life estate.

Substitution power. This ruling provides guidance regarding whether the corpus of an inter vivos trust is includible in the grantor's gross estate under section 2036 or 2038 of the Code if the grantor retained the power, exercisable in a nonfiduciary capacity, to acquire property held in the trust by substituting other property of equivalent value. The ruling provides that, for estate tax purposes, the substitution power will not, by itself, cause the value of the trust corpus to be includible in the grantor's gross estate, provided the trustee has a fiduciary obligation (under local law) to ensure the grantor's compliance with the terms of this power by satisfying itself that the properties acquired and substituted by the grantor are in fact of equivalent value and further provided that the substitution power cannot be exercised in a manner that can shift benefits among the trust beneficiaries.

ISSUE

Is the corpus of an inter vivos trust includible in the grantor's gross estate under s 2036 or 2038 of the Internal Revenue Code if the grantor retained the power, exercisable in a nonfiduciary capacity, to acquire property held in the trust by substituting other property of equivalent value?

FACTS

In Year 1, D, a United States citizen, established and funded Trust. Trust is an irrevocable inter vivos trust for the benefit of D's descendants. T is the trustee of Trust, and D is prohibited from serving as trustee under the terms of Trust. The governing instrument provides that D has the power, exercisable at any time, to acquire any property held in Trust by substituting other property of equivalent value. The power is exercisable by D in a non-fiduciary capacity, without the approval or consent of any person acting in a fiduciary capacity. To exercise the power of substitution, D must certify in writing that the substituted property and the trust property for which it is substituted are of equivalent value. In addition, under local law, T has a fiduciary obligation to ensure that the properties being exchanged are of equivalent value. Under local law, if a trust has two or more beneficiaries, the trustee has a duty to act impartially in investing and managing the trust assets, taking into account any differing interests of

the beneficiaries. Further, under local law and without restriction in the trust instrument, T has the discretionary power to acquire, invest, reinvest, exchange, sell, convey, control, divide, partition, and manage the trust property in accordance with the standards provided by law.

D dies in Year 2.

LAW AND ANALYSIS

Section 2036(a) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in the case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which the decedent has retained for life or for any period not ascertainable without reference to the decedent's death or for any period that does not in fact end before the decedent's death, (1) the possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income from the property.

Section 2038(a)(1) provides that the value of the gross estate includes the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in the case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of the decedent's death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person to alter, amend, revoke, or terminate, or where any such power is relinquished during the 3-year period ending on the date of the decedent's death.

In *Estate of Jordahl v. Commissioner*, 65 T.C. 92 (1975), acq. in result, 1977-2 C.B. 1, the decedent created an inter vivos trust. Under the terms of the trust, the decedent reserved the power to substitute other securities or property for those held in trust, provided the substituted property was equal in value to the property replaced. After the decedent's death, the Service argued that the trust assets were includible in the decedent's gross estate under s 2038 because the decedent's power to substitute assets of equal value could be exercised to alter the beneficial interests in the trust. The court determined, however, that because the decedent was bound by fiduciary standards and was therefore accountable in equity to the succeeding income beneficiary and remaindermen, the decedent could not exercise the power to deplete the trust or to shift trust benefits among the beneficiaries. Accordingly, the court held that the substitution power was not a power to alter, amend, or revoke the trust within the meaning of s 2038.

In general, a trustee has a fiduciary duty to the trust and its beneficiaries. As a result, the trustee is held to a high standard of conduct with respect to the administration of the trust. A trustee is under a duty to the beneficiaries of the trust to administer the trust solely in the interest of the beneficiaries. The trustee must act fairly, justly, honestly, in the utmost good faith, and with sound judgment and prudence. 90A C.J.S. Trusts s 323 (2007). The trustee is also subject to a duty of impartiality that requires the trustee to take into account the interests of all the beneficiaries for whom the trustee is acting. Restatement (Third) of Trusts ss 183 and 232 (2007); 76 Am. Jur. 2d Trusts s 434 (2008). A trustee must administer the trust solely in the interests of the beneficiaries.

Generally, a sale, encumbrance, or other transaction involving the investment or management of trust property entered into by the trustee for the trustee's own personal account or which is otherwise affected by a conflict between the trustee's fiduciary and personal interests may be voidable by a

beneficiary affected by the transaction. Uniform Trust Code s 802 (2005). If a trust has two or more beneficiaries, the trustee must act impartially in investing, managing, and distributing the trust property, giving due regard to the beneficiaries' respective interests. Uniform Trust Code s 803 (2005). See also, *Sallee v. Fort Knox National Bank, et. al.*, 286 F.3d 878, 891 (6th Cir. 2002) (distinguishing between a duty of good faith and fair dealing, requiring parties to "deal fairly" with one another, and the more onerous fiduciary duty that requires a party to place the interest of the other party before one's own interests).

In situations where the grantor of a trust holds a nonfiduciary power to replace trust assets with assets of equivalent value, the trustee has a duty to ensure that the value of the assets being replaced is equivalent to the value of the assets being substituted. If the trustee knows or has reason to believe that the exercise of the substitution power does not satisfy the terms of the trust instrument because the assets being substituted have a lesser value than the trust assets being replaced, the trustee has a fiduciary duty to prevent the exercise of the power. See Restatement (Third) of Trusts s 75 (2007) and Uniform Trust Code ss 801 and 802 (2005).

In the instant case, unlike the situation presented in *Estate of Jordahl*, the trust instrument expressly prohibits D from serving as trustee and states that D's power to substitute assets of equivalent value is held in a nonfiduciary capacity.

Thus, D is not subject to the rigorous standards attendant to a power held in a fiduciary capacity. However, under the terms of the trust, the assets D transfers into the trust must be equivalent in value to the assets D receives in exchange.

In addition, T has a fiduciary obligation to ensure that the assets exchanged are of equivalent value. Thus, D cannot exercise the power to substitute assets in a manner that will reduce the value of the trust corpus or increase D's net worth.

Further, in view of T's ability to reinvest the assets and T's duty of impartiality regarding the trust beneficiaries, T must prevent any shifting of benefits between or among the beneficiaries that could otherwise result from a substitution of property by D. Under these circumstances, D's retained power will not cause the value of the trust corpus to be included in D's gross estate under s2036 or 2038.

HOLDING

A grantor's retained power, exercisable in a nonfiduciary capacity, to acquire property held in trust by substituting property of equivalent value will not, by itself, cause the value of the trust corpus to be includible in the grantor's gross estate under s 2036 or 2038, provided the trustee has a fiduciary obligation (under local law or the trust instrument) to ensure the grantor's compliance with the terms of this power by satisfying itself that the properties acquired and substituted by the grantor are in fact of equivalent value, and further provided that the substitution power cannot be exercised in a manner that can shift benefits among the trust beneficiaries. A substitution power cannot be exercised in a manner that can shift benefits if: (a) the trustee has both the power (under local law or the trust instrument) to reinvest the trust corpus and a duty of impartiality with respect to the trust beneficiaries; or (b) the nature of the trust's investments or the level of income produced by any or all of the trust's investments does not impact the respective interests of the beneficiaries, such as when the trust is administered as a unitrust (under local law or the trust instrument) or when distributions from the trust are limited to discretionary distributions of principal and income.

DRAFTING INFORMATION

The principal author of this revenue ruling is Mayer Samuels of the Office of the Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling, contact Mr. Samuels at (202) 622-3090 (not a toll-free call).

Rev. Rul. 2008-22, 2008-16 I.R.B. 796

PROPOSED RULES

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 20

[REG-112196-07]

RIN 1545-BH64

Gross Estate; Election to Value on **Alternate Valuation** Date

Friday, April 25, 2008

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that provide guidance relating to the availability of the election to use the alternate valuation method under section 2032 of the Internal Revenue Code (Code). The proposed regulations will affect estates that file Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return, and elect to use the alternate valuation method.

DATES: Written or electronic comments and requests for a public hearing must be received by July 24, 2008.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-112196-07), Internal Revenue Service, Room 5203, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-112196-07), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC 20224; or sent electronically via the Federal eRulemaking Portal at [http:// www.regulations.gov](http://www.regulations.gov) (IRS-REG-112196-07).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Theresa M. Melchiorre, at (202) 622-3090; concerning submissions of comments or to request a hearing, Kelly Banks, at (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to the Estate Tax Regulations (26 CFR part 20) under section 2032 of the Code. Section 2001 imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States. Section 2031(a) provides that the value of the decedent's gross estate includes the value at the time of decedent's death of all property, real or personal, tangible or intangible, wherever situated. Section 2032(a) provides that the value of the gross estate instead may be determined, if the executor so elects, by valuing all the property included in the

gross estate as follows. Property distributed, sold, exchanged, or otherwise disposed of within 6 months after the decedent's death must be valued as of the date of distribution, sale, exchange, or other disposition. I.R.C. section 2032(a)(1). Property not distributed, sold, exchanged, or otherwise disposed of within 6 months after the decedent's death must be valued as of the date that is 6 months after the decedent's death. I.R.C. section 2032(a)(2). Any interest or estate which is affected by the mere lapse of time is included at its value as of the time of death (instead of the later date), with adjustment for any difference in its value as of the later date that is not due to the mere lapse of time. I.R.C. section 2032(a)(3).

The predecessor to section 2032 is section 302(j) of the Revenue Act of 1926, as added by section 202(a) of the Revenue Act of 1935. Revenue Act of 1935, 74 Public Law 407, 49 Stat. 1014 (1935). Section 302(j) allowed executors to elect to use a date that was one year after the date of decedent's death to value estate property. Section 302(j) contained provisions for valuing the property on the date of its sale or disposition during the alternate valuation period and for not taking into account changes in value due to a mere lapse of time. Congress enacted section 302(j) in response to "the hardships which were experienced after 1929 when market values decreased very materially between the period from the date of death and the date of distribution to the beneficiaries." 79 Cong. Rec. 14632 (1935) (statement of Mr. Samuel B. Hill). See, also, H.R. Rep. No. 74-1681, at 9 (1935); S. Rep. No. 74-1240, part 1, at 9-10 (1935); and S. Rep. No. 74-1240, part 2, at 8-9 (1935). Section 302(j) was codified as section 811(j) in the Internal Revenue Code of 1939.

In 1941, the U.S. Supreme Court addressed whether rents, dividends, and interest received and accrued during the alternate valuation period are includible in the decedent's gross estate under section 811(j). Maass v. Higgins, 312 U.S. 443 (1941). In that case, the Court stated that the purpose of section 811(j) is "to mitigate the hardship consequent upon shrinkage in the value of estates during the year following death. Congress enacted it in the light of the fact that, due to such shrinkages, many estates were almost obliterated by the necessity of paying a tax on the value of the assets at the date of decedent's death." Id. at 446.

In 1954, section 811(j) was recodified as section 2032. Congress considered proposals to amend section 811(j) and, again, Congress stated that, "The option to value property [on the alternate valuation date] initially was provided during the Depression of the early 1930s because by the time estate taxes were paid, property values had dropped substantially, sometimes to such an extent that the proceeds of the sale would not pay the estate tax due." H. Rep. No. 83-1337 at 90 (1954). See, also, S. Rep. No. 83-1622, at 122-123 (1954).

In 1958, § 20.2032-1 of the Estate Tax Regulations was published. This regulation restates the rule in section 2032(a)(3) and provides an example that illustrates the rule that only changes in the value of the decedent's gross estate due to market conditions, and not changes to the value due to a mere lapse of time, are to be considered in valuing the decedent's gross estate under the alternate valuation method. See example in § 20.2032-1(f)(1).

Two judicial decisions have interpreted the language of section 2032 and its legislative history differently in determining whether post-death events other than market conditions may be taken into account under the alternate valuation method. In Flanders v. United States, 347 F. Supp. 95 (N.D. Cal. 1972), the district court held that the reduction in value of property included in the decedent's estate as a result of a voluntary act by the trustee, instead of as a result of market conditions, could not be taken into consideration in valuing the property under the alternate valuation method. In that case, a few months after the death of the decedent, the trustee of the trust owning decedent's undivided one-half

interest in real property entered into a Land Conservation Agreement pursuant to the California Land Conservation Act of 1965. In exchange for restricting the property to agricultural uses for a period of 10 years, the trustee was allowed to reduce the assessed value of the land for purposes of paying property taxes. The estate elected to use the alternate valuation method for estate tax purposes and reported the value of the decedent's interest in the land as \$25,000. This value represented one-half of the value of the ranch after the land use restriction was placed upon it, less a lack of marketability discount.

The district court stated that, "It seems clear that Congress intended that the character of the property be established for valuation purposes at the date of death. The option to select the alternate valuation date is merely to allow an estate to pay a lesser tax if unfavorable market conditions (as distinguished from voluntary acts changing the character of the property) result in a lessening of its fair market value." Id. at 98.

In Kohler v. Commissioner, T.C. Memo. 2006-152, the U.S. Tax Court held that valuation discounts attributable to restrictions imposed on closely-held corporate stock pursuant to a post-death reorganization of the Kohler Company should be taken into consideration in valuing stock on the alternate valuation date. In that case, approximately two months after the death of the decedent, the Kohler Company underwent a reorganization that qualified as a tax-free reorganization under section 368(a) and, thus, was not a sale or disposition for purposes of section 2032(a)(1). The estate opted to receive new Kohler shares that were subject to transfer restrictions. The estate elected to use the alternate valuation method under section 2032(a)(2) and took into account discounts attributable to the transfer restrictions on the stock in determining the value for Federal estate tax purposes. In the Internal Revenue Bulletin No. 2008-9 on March 3, 2008, the IRS nonacquiesced to the Tax Court opinion in Kohler (AOD 2008-1).

Explanation of Provisions

The proposed regulations will amend § 20.2032-1 by restructuring paragraph (f) of this section to clarify that the election to use the alternate valuation method under section 2032 is available to estates that experience a reduction in the value of the gross estate following the date of the decedent's death due to market conditions, but not due to other post-death events. The term market conditions is defined in the proposed regulations and examples are provided, which are not intended to be exclusive.

Proposed Effective Date

The fourth sentence of § 20.2032-1(f)(2)(i) is applicable to decedents dying after May 1, 1999, subject to transition rules for certain incapacitated individuals. The fifth sentence of § 20.2032-1(f)(2)(i) is applicable to decedents dying after November 30, 1983, subject to transition rules for certain incapacitated individuals. The first, second, and third sentences of § 20.2032-1(f)(2)(i), § 20.2032-1(f)(2)(ii), and all but the last sentence in § 20.2032-1(f)(2) are applicable to decedent's dying after August 16, 1954. When adopted as final regulations, the rules contained in § 20.2032-1(f)(1), § 20.2032-1(f)(3), and the last sentence of § 20.2032-1(f)(2), will be made applicable to estates of decedents dying on or after April 25, 2008.

Special Analyses

It has been determined that this proposed regulation is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined

that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations and, because these regulations do not impose on small entities a collection of information requirement, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and the Treasury Department also request comments on the clarity of the proposed regulations and how they may be made easier to understand. All comments will be available for public inspection and copying. A public hearing may be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the Federal Register.

Drafting Information

The principal author of these proposed regulations is Theresa M. Melchiorre, Office of Associate Chief Counsel (Passthroughs and Special Industries).

List of Subjects in 26 CFR Part 20

Estate taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 20 is proposed to be amended as follows:

PART 20--ESTATE TAX; ESTATES OF DECEDENTS DYING AFTER AUGUST 16, 1954

Paragraph 1. The authority citation for part 20 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

26 CFR § 20.2032-1

Par. 2. Section 20.2032-1 is amended as follows:

1. Paragraph (f)(1) is redesignated as paragraph (f)(2)(i).
2. Paragraph (f)(2) is redesignated as paragraph (f)(2)(ii).
3. Paragraph (f) introductory text is redesignated as paragraph (f)(2) introductory text and the last sentence is revised.
4. New paragraphs (f)(1) and (f)(3) are added.

5. The heading for paragraph (h) is revised and four sentences are added at the end of the paragraph.

The additions and revisions read as follows.

26 CFR § 20.2032-1

§ 20.2032-1 Alternate valuation.

* * * * *

(f) Post-death market conditions and other post-death events--(1) In general. The election to use the alternate valuation method under section 2032 permits the property included in the gross estate to be valued as of the alternate valuation date to the extent that the change in value during the alternate valuation period is the result of market conditions. The term market conditions is defined as events outside of the control of the decedent (or the decedent's executor or trustee) or other person whose property is being valued that affect the fair market value of the property being valued. Changes in value due to mere lapse of time or to other post-death events other than market conditions will be ignored in determining the value of decedent's gross estate under the alternate valuation method.

(2) Mere lapse of time. * * * The application of this paragraph (f)(2) is illustrated in paragraphs (f)(2)(i) and (f)(2)(ii) of this section:

* * * * *

(3) Post-death events--(i) In general. In order to eliminate changes in value due to post-death events other than market conditions, any interest or estate affected by post-death events other than market conditions is included in a decedent's gross estate under the alternate valuation method at its value as of the date of the decedent's death, with adjustment for any change in value that is due to market conditions. The term post-death events includes, but is not limited to, a reorganization of an entity (for example, corporation, partnership, or limited liability company) in which the estate holds an interest, a distribution of cash or other property to the estate from such entity, or one or more distributions by the estate of a fractional interest in such entity.

(ii) Examples. The following examples illustrate the application of this paragraph (f)(3). In each example, decedent's (D's) estate elects to value D's gross estate under the alternate valuation method, so that the valuation date of the property included in D's gross estate as of D's date of death is either the date the property is distributed, sold, exchanged, or disposed of under section 2032(a)(1) (the date of distribution (distribution date)) or the date that is 6 months after the date of the decedent's death under section 2032(a)(2) (the six month alternate valuation date (AVD)).

Example 1. At D's death, D owned common stock in Corporation, a closely-held subchapter C corporation. At that time, the common stock was not subject to transfer restrictions. D's stock was valued at \$50X at the date of death. Two months after D's death, D's estate participated in a tax-free reorganization of Corporation that qualified under section 368(a) with respect to which no gain or loss was recognized for income tax purposes under section 354 or 355. Pursuant to the reorganization, D's estate opted to exchange its stock for stock subject to transfer restrictions. Although the value of the stock did not change during the alternate valuation period, discounts for lack of marketability and lack of control (totaling \$20X) were applied in determining the value of the stock held by D's estate on the AVD, and D's estate reported the value of the stock on the AVD as \$30X. Because the claimed reduction in value is not attributable to market conditions, the discounts may not be taken into account in determining the value of the stock on the AVD. Accordingly, the value on the AVD is \$50X.

Example 2. The facts are the same as in Example 1 except that the value of the stock declined from \$50X to \$40X during the alternate valuation period because of changes in market conditions during that period. D's estate may report the value of the stock as \$40X on the AVD. As in Example 1, however, no discounts resulting from the reorganization are allowed in computing the value on the AVD.

Example 3. At D's death, D owned property valued at \$100X. Two months after D's death, the executor of D's estate and other family members formed four limited partnerships. The estate contributed the estate's property to the partnerships in exchange for a 25% interest in each partnership. Discounts for lack of marketability and lack of control (totaling \$25X) were applied in determining the value of the estate's partnership interests, and the estate reported \$75X as the total value of the estate's partnership interests on the AVD. Because the reduction in value is not attributable to market conditions, the discounts for lack of marketability and control may not be taken into account in determining the value of the partnership interests on the AVD. The result would be the same if the limited partnerships were formed prior to D's death, and the estate transferred property into the partnerships after D's death but prior to the AVD.

Example 4. At D's death, D owned 100% of the units of a limited liability company (LLC). The executor elected the alternative valuation method. During the 6 months following D's death and in accordance with D's will, the executor made 6 distributions, each to a different residuary legatee on a different date and each of a 10% interest in the LLC. Pursuant to section 2032(a)(1), each distribution is valued on the distribution date. On the AVD, the estate held 40% of the units in the LLC. Pursuant to section 2032(a)(2), the 40% is valued on the AVD. In valuing the 10% interests distributed and the 40% interest held on the AVD, discounts for lack of control and lack of marketability were applied. The reduction in value of the units is not attributable to market conditions. Accordingly, the discounts for lack of marketability and control may not be taken into account in determining the value of the units distributed or held by the estate. The value of each 10% distribution is determined by taking 10% of the value on the distribution date of the units (100%) owned by the estate at D's death. The value of the units held by the estate on the AVD is determined by taking 40% of the value on the AVD of all of the units (100%) owned by the estate at D's death. If because of market conditions, the units had declined in value as of each distribution date or as of the AVD, D's estate would take such reduction in value into account.

Example 5. D died owning 100% of Blackacre. D's will directs that Blackacre be divided between two trusts, 70% to Trust A for the benefit of S, D's surviving spouse, and 30% to Trust B for the benefit of C, D's surviving child. The executor of D's estate distributed a 70% interest in Blackacre to Trust A three months after D's death, and distributed a 30% interest in Blackacre to Trust B four months after D's death. On the estate tax return, the executor elected to value the estate's property under the alternate valuation method under section 2032. There was no change in the value of Blackacre during the four-month period following D's death. The 70% interest in Blackacre is to be valued as of the distribution date to Trust A, and that value is determined by taking 70% of the value of all (100%) of Blackacre as of the distribution date. The 30% interest in Blackacre is to be valued as of the distribution date to Trust B, and that value is determined by taking 30% of the value of all (100%) of Blackacre as of the distribution date. If, however, because of market conditions such as a decline in the real estate market, Blackacre's value had declined by 10% between D's date of death and the distribution date of the 30% interest, the value of the 30% interest would be determined by ascertaining 30% of the value of all (100%) of Blackacre as of the distribution date, which would equal 30% of 90% of the date of death value of Blackacre.

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(h) Effective/applicability date. * * * The fourth sentence of paragraph (f)(2)(i) of this section is applicable to decedents dying after May 1, 1999, subject to transition rules for certain incapacitated individuals. The fifth sentence of paragraph (f)(2)(i) of this section is applicable to decedents dying after November 30, 1983, subject to transition rules for certain incapacitated individuals. The first, second, and third sentences of paragraph (f)(2)(i), paragraph (f)(2)(ii), and all but the last sentence in paragraph (f)(2) of this section are applicable to decedents dying after August 16, 1954. When adopted as final regulations, the rules contained in paragraphs (f)(1), (f)(3), and the last sentence of paragraph (f)(2) of this section, will be made applicable to estates of decedents dying on or after April 25, 2008.

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Linda E. Stiff,

Deputy Commissioner for Services and Enforcement.