DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG—104946—07]

RIN 1545—BG36

Hybrid Retirement Plans; Correction

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to notice of proposed rulemaking.

SUMMARY: This document contains corrections to a notice of proposed rulemaking (REG—104946—07) that was published in the Federal Register on Friday, December 28, 2007 (72 FR 73680) providing guidance relating to sections 411(a)(13) and 411(b)(5) of the Internal Revenue Code concerning certain hybrid defined benefit plans.

FOR FURTHER INFORMATION CONTACT: Lasona C. Green or Linda S. F. Marshall at (202) 622—6090 (not a toll-free number).

SUPPLEMENTAL INFORMATION:

Background

The correction notice that is the subject of this document is under section 411 of the Internal Revenue Code.

Need for Correction

As published, the notice of proposed rulemaking (REG—104946—07) contains errors that may prove to be misleading and are in need of clarification.

Correction of Publication

Accordingly, the publication of the notice of proposed rulemaking (REG—104946—07), which was the subject of FR Doc. E7—25025, is corrected as follows:

1. On page 73683, column 3, in the preamble, first paragraph of the column, line 15, the language “reasonably expected to result in a larger” is corrected to read “reasonably expected to result in a smaller”.

2. On page 73685, column 1, third paragraph of the column, line 8, the language “‘capital’ rule of section 411(b)(5)(i)(II)” is corrected to read “‘capital’ rule of section 411(b)(5)(i)(II)”.

3. On page 73689, column 2, line 3 from the bottom of the fifth paragraph of the column, the language “section 411(d)(6) relief is available for the” is corrected to read “section 411(d)(6) relief is available for the”.

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

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
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 change 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)(ii), § 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 * * *

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.

§ 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 a $20X 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 valued 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 property to the partnerships in exchange for a $40X interest, 25% of the value of the stock as of the date of death. The value on the AVD is $40X. Pursuant to section 355, the estate transferred property to the partnerships and the distribution date of the 25% interest, valued at $40X, was determined by taking 25% of the value on the distribution date to Trust A. During the alternate valuation period, the value of the stock declined by 10% from $50X to $40X. Because of the reduction in the stock, 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 B, 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, the stock 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 as ascertainable on the stock. The 30% interest in Blackacre, as of the distribution date, which would equal 30% of 90% of the date of death value of Blackacre.

Example 4. At D’s death, D owned 100% of the units of a limited liability company (LLC). The executor selected 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 the 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, the stock 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 as ascertainable on the stock. The 30% interest in Blackacre, as of the distribution date, which would equal 30% of 90% of the date of death value of Blackacre.

(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)(ii), paragraph (f)(2)(ii), and all but the last sentence in paragraph (f)(2) of this section are applicable to decedents dying on or after April 25, 2008.

* * * * *
Linda E. Stiff,
Deputy Commissioner for Services and Enforcement.
[FR Doc. E8–9025 Filed 4–24–08; 8:45 am]
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