

Number: **200852029**
Release Date: 12/26/2008
Index Number: 2703.02-00

Date:
September 19, 2008

The facts provided are as follows. On Date 1, in Year 1, Taxpayer and two other unrelated individuals, X and Y (collectively the Joint Venturers), executed Agreement 1, whereby Joint Venture was formed. Joint Venture was formed primarily to acquire, hold, lease, and sell real property. The relative interests of the Joint Venturers in Joint Venture are as follows: Taxpayer – x%, X – y%, and Y – z%.

Section 12 of Agreement 1 provides that a Joint Venturer may sell, assign, transfer, or pledge his interest in Joint Venture. Any transfer of an interest must be of the entire interest of Joint Venture, except with the unanimous written consent of the Joint Venturers, or as otherwise provided herein. Subject to any transfer or assignment of any interest in Joint Venture, the interest shall remain subject to the restrictions of the agreement. Any person purchasing an interest in Joint Venture is a Joint Venturer.

Agreement 1 does not contain any provisions to provide for the purchase of the interest of a deceased Joint Venturer. Accordingly, on Date 2, the Joint Venturers executed Agreement 2 which provides that upon the death of each Joint Venturer, Joint Venture shall purchase and the estate of the deceased Joint Venturer shall sell all of his interest to Joint Venture at a price equal to the deceased Joint Venturer's equity in the book value of Joint Venture as of the end of the most recent fiscal quarter. It is represented that the actual fair market value of the assets in Joint Venture exceeds their book value.

Since Year 1, Joint Venture has continued to own and lease real estate, and operate in accordance with Agreement 1. Agreements 1 and 2 are in full force and effect. The identity and interests of the Joint Venturers has not changed. Joint Venture is classified as a partnership for federal income tax purposes. Agreements 1 and 2 were entered into prior to October 8, 1990, and have not been substantially modified since Date 1 and Date 2, respectively.

Taxpayer plans to sell his x% interest in Joint Venture to Trust. Trust is an irrevocable trust to benefit Taxpayer's children, Child 1 and Child 2. It is represented that the sales price of Taxpayer's interest in Joint Venture will be equal to the fair market value of Taxpayer's interest. Trust will assume Taxpayer's right and obligation, as a surviving Joint Venturer, to cause Joint Venture to purchase the other Joint Venturer's interests upon their deaths at book value. However, Taxpayer's life (and not the lives of his children) will continue to be treated as the measuring life for purposes of Agreement 2. Therefore, if Taxpayer dies before either of the other Joint Venturers, Trust will be required to sell its interest in Joint Venture to the other Joint Venturers at book value. Conversely, if one of the Joint Venturer's dies before Taxpayer, then Trust and the other surviving Joint Venturer will be obligated to purchase the interest of the deceased Joint Venturer at book value. Taxpayer's children are in a lower generation than X and Y.

Article Two of Trust provides that while Taxpayer is living, the trustees shall distribute the net income of Trust one-half to Child 1 and one-half to Child 2, provided that the share of either who is not in life shall be distributed to his or her living lineal descendants, per stirpes, and, if none, shall be added to the other share. Article Three provides that following Taxpayer's death, the trust property shall be distributed one-half to Child 1 and one-half to Child 2, provided that the share of either who is not then in life shall be distributed to his or her living lineal descendants, per stirpes, or, if none, shall be added to the other share.

Article Five (f) provides that Taxpayer shall have no right to alter, amend, revoke, or terminate Trust and Taxpayer shall have no right, title, or interest in, and no power or privilege to control or affect, the trust property or the income therefrom. Article Five (a) provides that it is Taxpayer's intention that the trust be a grantor trust for income tax purposes. Accordingly, Taxpayer has the power during his lifetime at any time and from time to time, acting in a non-fiduciary capacity, without the approval or consent of any person, including the trustees, to reacquire the trust corpus by substituting other property of an equivalent value. The trustees of Trust are Child 1 and Child 2.

Taxpayer requests a ruling that the exception under § 25.2703-1(b)(3) of the Gift Tax Regulations will apply to the transfer of Taxpayer's interest to Trust and, therefore, § 2703 will not apply to the valuation of Taxpayer's interest.

LAW AND ANALYSIS

Section 2703(a) provides that for purposes of subtitle B of the Code (relating to estate, gift, and generation-skipping transfer taxes), the value of any property is determined without regard to (1) any option, agreement, or other right to acquire or use the property at a price less than the fair market value of the property (without regard to such option, agreement, or right) or (2) any restriction on the right to sell or use such property.

Section 25.2703-1(a)(3) provides that a right or restriction may be contained in a partnership agreement, articles of incorporation, corporate bylaws, a shareholder agreement, or any other agreement.

Section 2703(b) provides that § 2703(a) shall not apply to any option, agreement, right, or restriction which meets each of the following requirements: (1) It is a bona fide business arrangement; (2) It is not a device to transfer such property to members of the decedent's family for less than full and adequate consideration in money or money's worth; and (3) Its terms are comparable to similar arrangements entered into by persons in an arms' length transaction. Section 25.2703-1(b)(1) sets forth the same requirements.

Section 25.2703-1(b)(3) provides that a right or restriction is considered to meet each of the three requirements described in § 25.2703-1(b)(1) if more than 50 percent by value of the property subject to the right or restriction is owned directly or indirectly (within the meaning of § 25.2701-6) by individuals who are not members of the transferor's family. In order to meet this exception, the property owned by those individuals must be subject to the right or restriction to the same extent as the property owned by the transferor.

Section 25.2703-2 provides that § 25.2703-1 applies to any right or restriction created or substantially modified after October 8, 1990, and is effective as of January 28, 1992. With respect to transfers occurring prior to January 28, 1992, and for purposes of determining whether an event occurring prior to January 28, 1992 constitutes a

substantial modification, taxpayers may rely on any reasonable interpretation of the statutory provisions.

Section 25.2703-1(c)(1) provides that a right or restriction that is substantially modified is treated as a right or restriction created on the date of the modification. Any discretionary modification of a right or restriction, whether or not authorized by the terms of the agreement, that results in other than a *de minimis* change to the quality, value, or timing of the rights of any party with respect to property that is subject to the right or restriction is a substantial modification. The addition of any family member as a party to a right or restriction (including by reason of a transfer of property that subjects the transferee family member to a right or restriction with respect to the transferred property) is considered a substantial modification unless the addition is mandatory under the terms of the right or restriction or the added family member is assigned to a generation (determined under the rules of § 2651) no lower than the lowest generation occupied by individuals already party to the right or restriction. There are exceptions to this rule in § 25.2703-1(c)(2) which do not apply to this case.

The generation to which any person (other than the transferor) belongs is determined under § 2651. Section 2651(a) provides that an individual who is not assigned to a generation by reason of § 2651(b) and (c) is assigned to a generation on the basis of the date of such individual's birth with an individual born more than 12 ½ years but not more than 37 ½ years after the date of the birth of the transferor assigned to the first generation younger than the transferor and similar rules for a new generation every 25 years.

Agreements 1 and 2 were entered into prior to October 8, 1990 and have not been substantially modified since Date 1 and Date 2, respectively. When Taxpayer transfers his interest in Joint Venture to Trust, Trust and the beneficiaries of Trust, Child 1 and Child 2, will be subject to the restrictions in Agreements 1 and 2. This addition of Taxpayer's children as parties to the restrictions in the agreements is not mandatory under the terms of the agreements. Further, Child 1 and Child 2 are assigned to a lower generation than Taxpayer, X, and Y, as determined under § 2651. Therefore, we conclude that the transfer of Taxpayer's interest in Joint Venture to Trust is a substantial modification of Agreements 1 and 2 under § 25.2703-1(c). However, more than 50 percent of Joint Venture is owned directly by members who are not members of Taxpayer's family. X and Y's combined interest in Joint Venture exceeds 50 percent. Further, X and Y's interests in Joint Venture are subject to the restrictions in Agreements 1 and 2 to the same extent as the Taxpayer's interest in Joint Venture. Therefore, the exception under § 25.2703-(b)(3) applies. Accordingly, the restrictions in the agreements are considered to meet each of the three requirements in § 25.2703-(b)(1).

Based upon the facts and representations made, we conclude that the exception under § 25.2703-1(b)(3) applies to the transfer of Taxpayer's interest in Joint Venture to Trust

and, therefore, § 2703 does not apply to the valuation of Taxpayer's interest on the date of the transfer.

We are specifically not expressing any opinion regarding the applicability of § 2703 to: (i) X and Y's interests in Joint Venture, as they have not requested any rulings on this matter, and (ii) any subsequent transfers of Taxpayer's or X and Y's interest in Joint Venture either during the duration of Trust; during the lives of the Joint Venturers; or upon the death's of X and Y. Further, we are specifically not expressing any opinion regarding the applicability of §§ 2501 and 2702 to the proposed transfer by Taxpayer to Trust. Finally, we are specifically not expressing any opinion regarding whether Trust is a grantor trust for income tax purposes or whether Trust is includible in Taxpayer's gross estate under § 2036.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The ruling requested in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for a ruling, it is subject to verification on examination.

Sincerely,

Lorraine E. Gardner
Senior Counsel, Branch 4
(Passthroughs & Special Industries)

Enclosure (1)
Copy for § 6110 purposes