

family assets that need to be used to satisfy certain obligations, such as obligations pursuant to a prenuptial or postnuptial agreement.⁹⁵

VII. CONCLUSION

Valuation discounts have been a valuable tool for many years for taxpayers to discount interests in family-controlled entities, thereby supercharging estate freeze techniques for transfer tax savings purposes. However, the Proposed Regulations will severely hamper these discounts. Tried-and-true estate planning techniques will remain useful though, and clients should be advised to continue using these techniques to remove future appreciation from their estates. Fractional interest discounts on underlying assets may also still be available, and the charitably inclined may have planning opportunities under the Proposed Regulations. Clients can also utilize promissory notes to continue supercharging the transfer tax savings of an estate freeze technique. The client's particular situation, including his or her marital status and relationship status, should also be considered for potential planning opportunities. Finally, structuring for one valuation methodology over another may be one way to continue to ensure that transfer tax costs are reduced in future planning.

⁹⁵ See *Zoldan v. Zohlman*, 11 So. 3d 982 (Fla. Dist. Ct. App. 2009).

EXHIBIT A

Section 2704

§ 2704 Treatment of certain lapsing rights and restrictions.

(a) Treatment of lapsed voting or liquidation rights.

(1) In general.

For purposes of this subtitle, if-

(A) there is a lapse of any voting or liquidation right in a corporation or partnership, and

(B) the individual holding such right immediately before the lapse and members of such individual's family hold, both before and after the lapse, control of the entity,

such lapse shall be treated as a transfer by such individual by gift, or a transfer which is includible in the gross estate of the decedent, whichever is applicable, in the amount determined under paragraph (2).

(2) Amount of transfer.

For purposes of paragraph (1), the amount determined under this paragraph is the excess (if any) of-

(A) the value of all interests in the entity held by the individual described in paragraph (1) immediately before the lapse (determined as if the voting and liquidation rights were nonlapsing), over

(B) the value of such interests immediately after the lapse.

(3) Similar rights.

The Secretary may by regulations apply this subsection to rights similar to voting and liquidation rights.

(b) Certain restrictions on liquidation disregarded.

(1) In general.

For purposes of this subtitle, if-

(A) there is a transfer of an interest in a corporation or partnership to (or for the benefit of) a member of the transferor's family, and

(B) the transferor and members of the transferor's family hold, immediately before

the transfer, control of the entity,

any applicable restriction shall be disregarded in determining the value of the transferred interest.

(2) Applicable restriction.

For purposes of this subsection, the term "applicable restriction" means any restriction-

(A) which effectively limits the ability of the corporation or partnership to liquidate, and

(B) with respect to which either of the following applies:

(i) The restriction lapses, in whole or in part, after the transfer referred to in paragraph (1).

(ii) The transferor or any member of the transferor's family, either alone or collectively, has the right after such transfer to remove, in whole or in part, the restriction.

(3) Exceptions.

The term "applicable restriction" shall not include-

(A) any commercially reasonable restriction which arises as part of any financing by the corporation or partnership with a person who is not related to the transferor or transferee, or a member of the family of either, or

(B) any restriction imposed, or required to be imposed, by any Federal or State law.

(4) Other restrictions.

The Secretary may by regulations provide that other restrictions shall be disregarded in determining the value of the transfer of any interest in a corporation or partnership to a member of the transferor's family if such restriction has the effect of reducing the value of the transferred interest for purposes of this subtitle but does not ultimately reduce the value of such interest to the transferee.

(c) Definitions and special rules. For purposes of this section -

(1) Control.

The term "control" has the meaning given such term by section 2701(b)(2).

(2) Member of the family.

The term "member of the family" means, with respect to any individual-

(A) such individual's spouse,

(B) any ancestor or lineal descendant of such individual or such individual's spouse,

(C) any brother or sister of the individual, and

(D) any spouse of any individual described in subparagraph (B) or (C).

(3) Attribution.

The rule of section 2701(e)(3) shall apply for purposes of determining the interests held by any individual.

EXHIBIT B

Redline of Treas. Reg. §§ 25.2701-2 and 25.2701-8 as changed by the Proposed Regulations

§ 25.2701-2. Special valuation rules for applicable retained interests.

Effective: January 28, 1992.

(a) In general. In determining the amount of a gift under §25.2701-3, the value of any applicable retained interest (as defined in paragraph (b)(1) of this section) held by the transferor or by an applicable family member is determined using the rules of chapter 12, with the modifications prescribed by this section. See §25.2701-6 regarding the indirect holding of interests.

(1) *Valuing an extraordinary payment right.* Any extraordinary payment right (as defined in paragraph (b)(2) of this section) is valued at zero.

(2) *Valuing a distribution right.* Any distribution right (as defined in paragraph (b)(3) of this section) in a controlled entity is valued at zero, unless it is a qualified payment right (as defined in paragraph (b)(6) of this section). Controlled entity is defined in paragraph (b)(5) of this section.

(3) *Special rule for valuing a qualified payment right held in conjunction with an extraordinary payment right.* If an applicable retained interest confers a qualified payment right and one or more extraordinary payment rights, the value of all these rights is determined by assuming that each extraordinary payment right is exercised in a manner that results in the lowest total value being determined for all the rights, using a consistent set of assumptions and giving due regard to the entity's net worth, prospective earning power, and other relevant factors (the "lower of" valuation rule). See §§20.2031-2(f) and 20.2631-3 for rules relating to the valuation of business interests generally.

(4) *Valuing other rights.* Any other right (including a qualified payment right not subject to the prior paragraph) is valued as if any right valued at zero does not exist and as if any right valued under the lower of rule is exercised in a manner consistent with the assumptions of that rule but otherwise without regard to section 2701. Thus, if an applicable retained interest carries no rights that are valued at zero or under the lower of rule, the value of the interest for purposes of section 2701 is its fair market value.

(5) *Example.* The following example illustrates rules of this paragraph (a).

Example. P, an individual, holds all 1,000 shares of X Corporation's \$1,000 par value preferred stock bearing an annual cumulative dividend of \$100 per share and holds all 1,000 shares of X's voting common stock. P has the right to put all the preferred stock to X at any time for \$900,000. P transfers the common stock to P's child and immediately thereafter holds the preferred stock. Assume that at the time of the transfer, the fair market value of X is \$1,500,000, and the fair market value of P's annual cumulative dividend right is \$1,000,000. Because the preferred stock confers both an extraordinary payment right (the put right) and a qualified payment right (i.e., the right to receive cumulative dividends), the lower of rule applies and the value of these rights is determined as if the put right will be exercised in a manner that results in the lowest total value being determined for the rights (in this case, by assuming that the put will be exercised immediately). The value of P's preferred stock is \$900,000 (the lower of \$1,000,000 or \$900,000). The amount of the gift is \$600,000 (\$1,500,000 minus \$900,000).

(b) Definitions.

(1) *Applicable retained interest.* An applicable retained interest is any equity interest in a corporation or partnership with respect to which there is either-

(i) An extraordinary payment right (as defined in paragraph (b)(2) of this section), or

(ii) In the case of a controlled entity (as defined in paragraph (b)(5) of this section), a distribution right (as defined in paragraph (b)(3) of this section).

(2) *Extraordinary payment right.* Except as provided in paragraph (b)(4) of this section, an extraordinary payment right is any put, call, or conversion right, any right to compel liquidation, or any similar right, the exercise or nonexercise of which affects the value of the transferred interest. A call right includes any warrant, option, or other right to acquire one or more equity interests.

(3)*Distribution right.* A distribution right is the right to receive distributions with respect to an equity interest. A distribution right does not include-

- (i) Any right to receive distributions with respect to an interest that is of the same class as, or a class that is subordinate to, the transferred interest;
- (ii) Any extraordinary payment right; or
- (iii) Any right described in paragraph (b)(4) of this section.

(4)*Rights that are not extraordinary payment rights or distribution rights.* Mandatory payment rights, liquidation participation rights, rights to guaranteed payments of a fixed amount under section 707(c), and non-lapsing conversion rights are neither extraordinary payment rights nor distribution rights.

(i) *Mandatory payment right.* A mandatory payment right is a right to receive a payment required to be made at a specific time for a specific amount. For example, a mandatory redemption right in preferred stock requiring that the stock be redeemed at its fixed par value on a date certain is a mandatory payment right and therefore not an extraordinary payment right or a distribution right. A right to receive a specific amount on the death of the holder is a mandatory payment right.

(ii) *Liquidation participation rights.* A liquidation participation right is a right to participate in a liquidating distribution. If the transferor, members of the transferor's family, or applicable family members have the ability to compel liquidation, the liquidation participation right is valued as if the ability to compel liquidation-

(A) Did not exist, or

(B) If the lower of rule applies, is exercised in a manner that is consistent with that rule.

(iii) *Right to a guaranteed payment of a fixed amount under section 707(c).* The right to a guaranteed payment of a fixed amount under section 707(c) is the right to a guaranteed payment (within the meaning of section 707(c)) the amount of which is determined at a fixed rate (including a rate that bears a fixed relationship to a specified market interest rate). A payment that is contingent as to time or amount is not a guaranteed payment of a fixed amount.

(iv) *Non-lapsing conversion right*

(A) *Corporations.* A non-lapsing conversion right, in the case of a corporation, is a non-lapsing right to convert an equity interest in a corporation into a fixed number or a fixed percentage of shares of the same class as the transferred interest (or into an interest that would be of the same class but for non-lapsing differences in voting rights), that is subject to proportionate adjustments for changes in the equity ownership of the corporation and to adjustments similar to those provided in section 2701(d) for unpaid payments.

(B) *Partnerships.* A non-lapsing conversion right, in the case of a partnership, is a non-lapsing right to convert an equity interest in a partnership into a specified interest (other than an interest represented by a fixed dollar amount) of the same class as the transferred interest (or into an interest that would be of the same class but for non-lapsing differences in management rights or limitations on liability) that is subject to proportionate adjustments for changes in the equity ownership of the partnership and to adjustments similar to those provided in section 2701(d) for unpaid payments.

(C) *Proportionate adjustments in equity ownership.* For purposes of this paragraph (b)(4), an equity interest is subject to proportionate adjustments for changes in equity ownership if, in the case of a corporation, proportionate adjustments are required to be made for splits, combinations, reclassifications, and similar changes in capital stock, or, in the case of a partnership, the equity interest is protected from dilution resulting from changes in the partnership structure.

(D) *Adjustments for unpaid payments.* For purposes of this paragraph (b)(4), an equity interest is subject to adjustments similar to those provided in section 2701(d) if it provides for-

(1) Cumulative payments;

(2) Compounding of any unpaid payments at the rate specified in §25.2701-4(c)(2); and

(3) Adjustment of the number or percentage of shares or the size of the interest into which it is convertible to take account of accumulated but unpaid payments.

(5) Controlled entity.

(i) In general. For purposes of section 2701, a controlled entity is a corporation ~~or~~, partnership, or any other entity or arrangement that is a business entity within the meaning of §301.7701-2(a) of this chapter controlled, immediately before a transfer, by the transferor, applicable family members, and/or any lineal descendants of the parents of the transferor or the ~~transferor's~~ transferor's spouse. The form of the entity determines the applicable test for control. For purposes of determining the form of the entity, any business entity described in §301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8) of this chapter, an S corporation within the meaning of section 1361(a)(1), and a qualified subchapter S subsidiary within the meaning of section 1361(b)(3)(B) is a corporation. For this purpose, a qualified subchapter S subsidiary is treated as a corporation separate from its parent corporation. In the case of any business entity that is not a corporation under these provisions, the form of the entity is determined under local law, regardless of how the entity is classified for federal tax purposes or whether it is disregarded as an entity separate from its owner for federal tax purposes. For this purpose, local law is the law of the jurisdiction, whether domestic or foreign, under whose laws the entity is created or organized. See §25.2701-6 regarding indirect holding of interests.

(ii) Corporations

(A) In general. In the case of a corporation, control means the holding of at least 50 percent of the total voting power or total fair market value of the equity interests in the corporation.

(B) Voting rights. Equity interests that carry no right to vote other than on liquidation, merger, or a similar event are not considered to have voting rights for purposes of this paragraph (b)(5)(ii). Generally, a voting right is considered held by an individual to the extent that the individual, either alone or in conjunction with any other person, is entitled to exercise (or direct the exercise of) the right. However, if an equity interest carrying voting rights is held in a fiduciary capacity, the voting rights are not considered held by the fiduciary, but instead are considered held by each beneficial owner of the interest and by each individual who is a permissible recipient of the income from the interest. A voting right does not include a right to vote that is subject to a contingency that has not occurred, other than a contingency that is within the control of the individual holding the right.

(iii) Partnerships. In the case of any partnership, control means the holding of at least 50 percent of either the capital interest or the profits interest in the partnership. Any right to a guaranteed payment under section 707(c) of a fixed amount is disregarded in making this determination. In addition, in the case of a limited partnership, control means the holding of any equity interest as a general partner. See §25.2701-2(b)(4)(iii) for the definition of a right to a guaranteed payment of a fixed amount under section 707(c).

(iv) Other business entities. In the case of any entity or arrangement that is not a corporation, partnership, or limited partnership, control means the holding of at least 50 percent of either the capital interests or the profits interests in the entity or arrangement. In addition, control means the holding of any equity interest with the ability to cause the liquidation of the entity or arrangement in whole or in part.

(6) Qualified payment right.

(i) In general. A qualified payment right is a right to receive qualified payments. A qualified payment is a distribution that is-

(A) A dividend payable on a periodic basis (at least annually) under any cumulative preferred stock, to the extent such dividend is determined at a fixed rate;

(B) Any other cumulative distribution payable on a periodic basis (at least annually) with respect to an equity interest, to the extent determined at a fixed rate or as a fixed amount; or

(C) Any distribution right for which an election has been made pursuant to paragraph (c)(2) of this section.

(ii) Fixed rate. For purposes of this section a payment rate that bears a fixed relationship to a specified market interest rate is a payment determined at a fixed rate.

(c) Qualified payment elections.

(1)*Election to treat a qualified payment right as other than a qualified payment right.* Any transferor holding a qualified payment right may elect to treat all rights held by the transferor of the same class as rights that are not qualified payment rights. An election may be a partial election, in which case the election must be exercised with respect to a consistent portion of each payment right in the class as to which the election has been made.

(2)*Election to treat other distribution rights as qualified payment rights.* Any individual may elect to treat a distribution right held by that individual in a controlled entity as a qualified payment right. An election may be a partial election, in which case the election must be exercised with respect to a consistent portion of each payment right in the class as to which the election has been made. An election under this paragraph (c)(2) will not cause the value of the applicable retained interest conferring the distribution right to exceed the fair market value of the applicable retained interest (determined without regard to section 2701). The election is effective only to the extent-

(i)Specified in the election, and

(ii)That the payments elected are permissible under the legal instrument giving rise to the right and are consistent with the legal right of the entity to make the payment.

(3)*Elections irrevocable.* Any election under paragraph (c)(1) or (c)(2) of this section is revocable only with the consent of the Commissioner.

(4)*Treatment of certain payments to applicable family members.* Any payment right described in paragraph (b)(6) of this section held by an applicable family member is treated as a payment right that is not a qualified payment right unless the applicable family member elects (pursuant to paragraph (c)(2) of this section) to treat the payment right as a qualified payment right. An election may be a partial election, in which case the election must be exercised with respect to a consistent portion of each payment right in the class as to which the election has been made.

(5)*Time and manner of elections.* Any election under paragraph (c)(1) or (c)(2) of this section is made by attaching a statement to the Form 709, Federal Gift Tax Return, filed by the transferor on which the transfer is reported. An election filed after the time of the filing of the Form 709 reporting the transfer is not a valid election. An election filed as of April 6, 1992, for transfers made prior to its publication is effective. The statement must-

(i)Set forth the name, address, and taxpayer identification number of the electing individual and of the transferor, if different;

(ii)If the electing individual is not the transferor filing the return, state the relationship between the individual and the transferor;

(iii)Specifically identify the transfer disclosed on the return to which the election applies;

(iv)Describe in detail the distribution right to which the election applies;

(v)State the provision of the regulation under which the election is being made; and

(vi)If the election is being made under paragraph (c)(2) of this section-

(A)State the amounts that the election assumes will be paid, and the times that the election assumes the payments will be made;

(B)Contain a statement, signed by the electing individual, in which the electing individual agrees that-

(1)If payments are not made as provided in the election, the individual's subsequent taxable gifts or taxable estate will, upon the occurrence of a taxable event (as defined in §25.2701-4(b)), be increased by an amount determined under §25.2701-4(c), and

(2)The individual will be personally liable for any increase in tax attributable thereto.

(d)Examples. The following examples illustrate provisions of this section:

Example (1). On March 30, 1991, P transfer's non-voting common stock of X Corporation to P's child, while retaining \$100 par value voting preferred stock bearing a cumulative annual dividend of \$10. Immediately before

the transfer, P held 100 percent of the stock. Because X is a controlled entity (within the meaning of paragraph (b)(5) of this section), P's dividend right is a distribution right that is subject to section 2701. See §25.2701-2(b)(3). Because the distribution right is an annual cumulative dividend, it is a qualified payment right. See §25.2701-2(b)(6).

Example (2). The facts are the same as in Example 1, except that the dividend right is non-cumulative. P's dividend right is a distribution right in a controlled entity, but is not a qualified payment right because the dividend is non-cumulative. Therefore, the non-cumulative dividend right is valued at zero under §25.2701-2(a)(2). If the corporation were not a controlled entity, P's dividend right would be valued without regard to section 2701.

Example (3). The facts are the same as in Example 1. Because P holds sufficient voting power to compel liquidation of X, P's right to participate in liquidation is an extraordinary payment right under paragraph (b)(2) of this section. Because P holds an extraordinary payment right in conjunction with a qualified payment right (the right to receive cumulative dividends), the lower of rule applies.

Example (4). The facts are the same as in Example 1, except that immediately before the transfer, P, applicable family members of P, and members of P's family, hold 60 percent of the voting rights in X. Assume that 80 percent of the vote is required to compel liquidation of any interest in X. P's right to participate in liquidation is not an extraordinary payment right under paragraph (b)(2) of this section, because P and P's family cannot compel liquidation of X. P's preferred stock is an applicable retained interest that carries no rights that are valued under the special valuation rules of section 2701. Thus, in applying the valuation method of §25.2701-3, the value of P's preferred stock is its fair market value determined without regard to section 2701.

Example (5). L holds 10-percent non-cumulative preferred stock and common stock in a corporation that is a controlled entity. L transfers the common stock to L's child. L holds no extraordinary payment rights with respect to the preferred stock. L elects under paragraph (c)(2) of this section to treat the noncumulative dividend right as a qualified payment right consisting of the right to receive a cumulative annual dividend of 5 percent. Under §25.2701-2(c)(2), the value of the distribution right pursuant to the election is the lesser of-

(A) The fair market value of the right to receive a cumulative 5-percent dividend from the corporation, giving due regard to the corporation's net worth, prospective earning power, and dividend-paying capacity; or

(B) The value of the distribution right determined without regard to section 2701 and without regard to the terms of the qualified payment election.

Reg § 25.2701-8. Effective dates.

Effective: January 28, 1992.

(a) Except as provided in paragraph (b) of this section, §§25.2701-1 through 25.2701-4 and §§25.2701-6 and 25.2701-7 are effective as of January 28, 1992. * * *

(b) The first six sentences of §25.2701-2(b)(5)(i) and (iv) are effective on the date these regulations are published as final regulations in the Federal Register.

EXHIBIT C

Redline of Treas. Reg. § 25.2704-1 as changed by the Proposed Regulations

§ 25.2704-1. Lapse of certain rights.

Effective: January 28, 1992.

(a) Lapse treated as transfer.

(1) *In general.* ~~The~~ For purposes of subtitle B (relating to estate, gift, and generation-skipping transfer taxes), the lapse of a voting ~~right~~ or a liquidation right in a corporation or a partnership (an "entity"), whether domestic or foreign, is a transfer by the individual directly or indirectly holding the right immediately prior to its lapse (the "holder") to the extent provided in paragraphs (b) and (c) of this section. This section applies only if the entity is controlled by the holder and ~~members of the holder's family immediately before and after the lapse~~ or members of the holder's family immediately before and after the lapse. For purposes of this section, a corporation is any business entity described in §301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8) of this chapter, an S corporation within the meaning of section 1361(a)(1), and a qualified subchapter S subsidiary within the meaning of section 1361(b)(3)(B). For this purpose, a qualified subchapter S subsidiary is treated as a corporation separate from its parent corporation. A partnership is any other business entity within the meaning of §301.7701-2(a) of this chapter regardless of how that entity is classified for federal tax purposes. Thus, for example, the term partnership includes a limited liability company that is not an S corporation, whether or not it is disregarded as an entity separate from its owner for federal tax purposes. The amount of the transfer is determined under paragraph (d) of this section. If the lapse of a voting right or a liquidation right occurs during the holder's lifetime, the lapse is a transfer by gift. If the lapse occurs at the holder's death, the lapse is a transfer includible in the holder's gross estate.

(2) *Definitions.* The following definitions apply for purposes of this section.

(i) Control. Control has the meaning given it in § 25.2701-2(b)(5). For purposes of determining whether the group consisting of the holder, the holder's estate and members of the holder's family control the entity, a member of the group is also treated as holding any interest held indirectly by such member through a corporation, partnership, trust, or other entity under the rules contained in §25.2701-6.

(ii) Member of the family. Member of the family has the meaning given it in §25.2702-2(a)(1).

~~(iii) Directly or indirectly held. An interest is directly or indirectly held only to the extent the value of the interest would have been includible in the gross estate of the individual if the individual had died immediately prior to the lapse.~~

(iv) ~~(iii)~~ Voting right. Voting right means a right to vote with respect to any matter of the entity. In the case of a partnership, the right of a general partner to participate in partnership management is a voting right. In the case of a limited liability company, the right of a member to participate in company management is a voting right. The right to compel the entity to acquire all or a portion of the holder's equity interest in the entity by reason of aggregate voting power is treated as a liquidation right and is not treated as a voting right.

(v) ~~(iv)~~ Liquidation right. Liquidation right means a right or ability to compel the entity to acquire all or a portion of the holder's equity interest in the entity, including by reason of aggregate voting power, whether or not its exercise would result in the complete liquidation of the entity.

(vi) ~~(v)~~ Subordinate. Subordinate has the meaning given it in § 25.2701-3(a)(2)(iii).

(3) *Certain temporary lapses.* If a lapsed right may be restored only upon the occurrence of a future event not within the control of the holder or members of the holder's family, the lapse is deemed to occur at the time the lapse becomes permanent with respect to the holder, i.e. either by a transfer of the interest or otherwise.

(4) *Source of right or lapse.* A voting right or a liquidation right may be conferred by and may lapse

by reason of a State local law, the ~~corporate charter or bylaws~~ governing documents, an agreement, or ~~other means~~ otherwise. For this purpose, local law is the law of the jurisdiction, whether domestic or foreign, that governs voting or liquidation rights.

(5) Assignee interests. A transfer that results in the restriction or elimination of the transferee's ability to exercise the voting or liquidation rights that were associated with the interest while held by the transferor is a lapse of those rights. For example, the transfer of a partnership interest to an assignee that neither has nor may exercise the voting or liquidation rights of a partner is a lapse of the voting and liquidation rights associated with the transferred interest.

(b) Lapse of voting right. A lapse of a voting right occurs at the time a presently exercisable voting right is restricted or eliminated.

(c) Lapse of liquidation right.

(1) In general. A lapse of a liquidation right occurs at the time a presently exercisable liquidation right is restricted or eliminated. Except as otherwise provided, a transfer of an interest occurring more than three years before the transferor's death that results in the lapse of a voting or liquidation right is not subject to this section if the rights with respect to the transferred interest are not restricted or eliminated. However, a transfer that results in the elimination of the transferor's right or ability to compel the entity to acquire an interest retained by the transferor that is subordinate to the transferred interest is a lapse of a liquidation right with respect to the subordinate interest. The lapse of a voting or liquidation right as a result of the transfer of an interest within three years of the transferor's death is treated as a lapse occurring on the transferor's date of death, includible in the gross estate pursuant to section 2704(a).

(2) Exceptions. Section 2704(a) does not apply to the lapse of a liquidation right under the following circumstances.

(i) Family cannot obtain liquidation value

(A) In general. Section 2704(a) does not apply to the lapse of a liquidation right to the extent the holder (or the holder's estate) and members of the holder's family cannot immediately after the lapse liquidate an interest that the holder held directly or indirectly and could have liquidated prior to the lapse.

(B) Ability to liquidate. Whether an interest can be liquidated immediately after the lapse is determined under the State local law generally applicable to the entity, as modified by the governing instruments documents of the entity, but without regard to any restriction ~~described~~ (in section 2704(b). Thus, if, after any restriction the governing documents, applicable local law, or otherwise) described in section 2704(b) and the regulations thereunder. The manner in which the interest may be liquidated is disregarded, the remaining requirements irrelevant for this purpose, whether by voting, taking other action authorized by the governing documents or applicable local law, revising the governing documents, merging the entity with an entity whose governing documents permit liquidation of the interest, terminating the entity, or otherwise. For purposes of making this determination, an interest held by a person other than a member of the holder's family (a nonfamily- member interest) may be disregarded. Whether a nonfamily-member interest is disregarded is determined under the governing instruments are less restrictive than the State law §25.2704-3(b)(4), applying that would apply in the absence of the governing instruments, the ability section as if, by its terms, it also applies to the question of whether the holder (or the holder's estate) and members of the holder's family may liquidate is determined by reference to the governing instruments an interest immediately after the lapse.

(ii) Rights valued under section 2701. Section 2704(a) does not apply to the lapse of a liquidation right previously valued under section 2701 to the extent necessary to prevent double taxation (taking into account any adjustment available under §25.2701-5).

(iii) Certain changes in State law. Section 2704(a) does not apply to the lapse of a liquidation right that occurs solely by reason of a change in State law. For purposes of this paragraph, a change in the governing instrument of an entity is not a change in State law.

(d) Amount of transfer. The amount of the transfer is the excess, if any, of-

(1) The value of all interests in the entity owned by the holder immediately before the lapse (determined immediately after the lapse as if the lapsed right was nonlapsing); over

(2) The value of the interests described in the preceding paragraph immediately after the lapse (determined as if all such interests were held by one individual).

(e) Application to similar rights. [Reserved]

(f) Examples. The following examples illustrate the provisions of this section:

Example (1). Prior to D's death, D owned all the preferred stock of Corporation Y and D's children owned all the common stock. At that time, the preferred stock had 60 percent of the total voting power and the common stock had 40 percent. Under the corporate by-laws, the voting rights of the preferred stock terminated on D's death. The value of D's interest immediately prior to D's death (determined as if the voting rights were nonlapsing) was \$100X. The value of that interest immediately after death would have been

\$90X if the voting rights had been nonlapsing. The decrease in value reflects the loss in value resulting from the death of D (whose involvement in Y was a key factor in Y's profitability). Section 2704(a) applies to the lapse of voting rights on D's death. D's gross estate includes an amount equal to the excess, if any, of \$90X over the fair market value of the preferred stock determined after the lapse of the voting rights.

Example (2). Prior to D's death, D owned all the preferred stock of Corporation Y. The preferred stock and the common stock each carried 50 percent of the total voting power of Y. D's children owned 40 percent of the common stock and unrelated parties own the remaining 60 percent. Under the corporate by-laws, the voting rights of the preferred stock terminate on D's death. Section 2704(a) does not apply to the lapse of D's voting rights because members of D's family do not control Y after the lapse.

Example (3). The by-laws of Corporation Y provide that the voting rights of any transferred shares of the single outstanding class of stock are reduced to ½ vote per share after the transfer but are fully restored to the transferred shares after 5 years. D owned 60 percent of the shares prior to death and members of D's family owned the balance. On D's death, D's shares pass to D's children and the voting rights are reduced pursuant to the by-laws. Section 2704(a) applies to the lapse of D's voting rights. D's gross estate includes an amount equal to the excess, if any, of the fair market value of D's stock (determined immediately after D's death as though the voting rights had not been reduced and would not be reduced) over the stock's fair market value immediately after D's death.

Example (4). D owns 84 percent of the single outstanding class of stock of Corporation Y. The by-laws require at least 70 percent of the vote to liquidate Y. More than three years before D's death, D gives transfers one-half of D's stock in equal shares to D's three children, (14 percent to each). Section 2704(a) does not apply to the loss of ~~D's~~ ability to liquidate Y, because the voting rights with respect to the ~~corporation~~ transferred shares are not restricted or eliminated by reason of the transfer, and the transfer occurs more than three years before D's death. However, had the transfers occurred within three years of D's death, the transfers would have been treated as the lapse of D's liquidation right occurring at D's death.

Example (5). D and D's two children, A and B, are partners in Partnership X. Each has a 3⅓ percent general partnership interest and a 30 percent limited partnership interest. Under State law, a general partner has the right to participate in partnership management. The partnership agreement provides that when a general partner withdraws or dies, X must redeem the general partnership interest for its liquidation value. Also, under the agreement any general partner can liquidate the partnership. A limited partner cannot liquidate the partnership and a limited partner's capital interest will be returned only when the partnership is liquidated. A deceased limited partner's interest continues as a limited partnership interest. D dies, leaving his limited partnership interest to D's spouse. Because of a general partner's right to dissolve the partnership, a limited partnership interest has a greater fair market value when held in conjunction with a general partnership interest than when held alone. Section 2704(a) applies to the lapse of D's liquidation right because after the lapse, members of D's family could liquidate D's limited partnership

interest. D's gross estate includes an amount equal to the excess of the value of all D's interests in X immediately before D's death (determined immediately after D's death but as though the liquidation right had not lapsed and would not lapse) over the fair market value of all D's interests in X immediately after D's death.

Example (6). The facts are the same as in Example 5, except that under the partnership agreement D is the only general partner who holds a unilateral liquidation right. Assume further that the partnership agreement contains a restriction described in section 2704(b) that prevents D's family members from liquidating D's limited partnership interest immediately after D's death. ~~Under State law, in the absence of the restriction in the partnership agreement, D's family members could liquidate the partnership.~~ The restriction on the family's ability to liquidate is disregarded and the amount of D's gross estate is increased by reason of the lapse of D's liquidation right.

Example (7). D owns all the stock of Corporation X, consisting of 100 shares of non-voting preferred stock and 100 shares of voting common stock. ~~Under the by-laws, X can only be liquidated with the consent of at least 80 percent of the voting shares.~~ More than three years before D's death, D transfers 30 shares of common stock to ~~D's~~D's child. The transfer is not a lapse of a liquidation right with respect to the common stock because the voting rights that enabled D to liquidate prior to the transfer are not restricted or eliminated, ~~and the transfer occurs more than three years before D's death.~~ The transfer is not a lapse of a liquidation right with respect to the retained preferred stock because the preferred stock is not subordinate to the transferred common stock. However, had the transfer occurred within three years of D's death, the transfer would have been treated as the lapse of D's liquidation right with respect to the common stock occurring at D's death.

Example (8). D owns all of the single class of stock of Corporation Y. D recapitalizes Y, exchanging D's common stock for voting common stock and non-voting, non-cumulative preferred stock. The preferred stock carries a right to put the stock for its par value at any time during the next 10 years. D transfers the common stock to D's grandchild in a transfer subject to section 2701. In determining the amount of D's gift under section 2701, D's retained put right is valued at zero. D's child, C, owns the preferred stock when the put right lapses. Section 2704(a) applies to the lapse, without regard to the application of section 2701, because the put right was not valued under section 2701 in the hands of C.

Example (9). A and A's two children are equal general and limited partners in Partnership Y. Under the partnership agreement, each general partner has a right to liquidate the partnership at any time. Under State law that would apply in the absence of contrary provisions in the partnership agreement, the death or incompetency of a general partner terminates the partnership. However, the partnership agreement provides that the partnership does not terminate on the incompetence or death of a general partner, but that an incompetent partner cannot exercise rights as a general partner during any period of incompetency. A partner's full rights as general partner are restored If the partner regains competency. A becomes incompetent. The lapse of A's voting right on becoming incompetent is not subject to section 2704(a) because it may be restored to A in the future. However, if A dies while incompetent, a lapse subject to section 2704(a) is deemed to occur at that time because the lapsed right cannot thereafter be restored to A.

EXHIBIT D

Redline of Treas. Reg. § 25.2704-2 as changed by the Proposed Regulations

§ 25.2704-2. Transfers subject to applicable restrictions.

Effective: January 28, 1992.

(a) In general. ~~If~~ For purposes of subtitle B (relating to estate, gift, and generation-skipping transfer taxes), if an interest in a corporation or a partnership (an "entity"), whether domestic or foreign, is transferred to or for the benefit of a member of the ~~transferor's~~ transferor's family, ~~any applicable restriction is disregarded in valuing the transferred interest. This section applies only if and~~ the transferor and/or members of the ~~transferor's~~ transferor's family control the entity immediately before the transfer. ~~For the definition of control, see §25.2701-2(b)(5). For the definition, any applicable restriction is disregarded in valuing the transferred interest. For purposes of member of the family, see §25.2702-2(a)(1).~~ this section, a corporation is any business entity described in §301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8) of this chapter, an S corporation within the meaning of section 1361(a)(1), and a qualified subchapter S subsidiary within the meaning of section 1361(b)(3)(B). For this purpose, a qualified subchapter S subsidiary is treated as a corporation separate from its parent corporation. A partnership is any other business entity within the meaning of §301.7701-2(a) of this chapter, regardless of how that entity is classified for federal tax purposes. Thus, for example, the term partnership includes a limited liability company that is not an S corporation, whether or not it is disregarded as an entity separate from its owner for federal tax purposes.

(b) Applicable restriction defined. ~~An~~ (1) In general. The term applicable restriction ~~is~~ means a limitation on the ability to liquidate the entity ~~(in whole or in part) that is more restrictive than the limitations that would apply under the State law generally applicable to (as opposed to a particular holder's interest in the entity), if, after the entity is transferred, that limitation either lapses or may be removed by the absence of~~ transferor, the restriction ~~transferor's~~ estate, and/or any member of the transferor's family, either alone or collectively. See §25.2704-3 for restrictions on the ability to liquidate a particular holder's interest in the entity.

(2) Source of limitation. An applicable restriction includes a restriction that is imposed under the terms of the governing documents (for example, the corporation's by-laws, the partnership agreement, or other governing documents), a buy-sell agreement, a redemption agreement, or an assignment or deed of gift, or any other document, agreement, or arrangement; and a restriction imposed under local law regardless of whether that restriction may be superseded by or pursuant to the governing documents or otherwise. For this purpose, local law is the law of the jurisdiction, whether domestic or foreign, that governs the applicability of the restriction. For an exception for restrictions imposed or required to be imposed by federal or state law, see paragraph (b)(4)(ii) of this section.

(3) Lapse or removal of limitation. A restriction is an applicable restriction only to the extent that either the restriction by its terms will lapse at any time after the transfer, or the transferor (or the transferor's estate) and any members of the transferor's family can remove the restriction immediately after the transfer. Ability to remove the restriction is determined by reference to the State law that would apply but for a more restrictive rule in the governing instruments of the entity. See § 25.2704-1(c)(1)(B) for a discussion of the term "State law." restriction may be removed after the transfer by any one or more members, either alone or collectively, of the group consisting of the transferor, the transferor's estate, and members of the transferor's family. For purposes of determining whether the ability to remove the restriction is held by any member(s) of this group, members are treated as holding the interests attributed to them under the rules contained in §25.2701-6, in addition to interests held directly. The manner in which the restriction may be removed is irrelevant for this purpose, whether by voting, taking other action authorized by the governing documents or applicable local law, removing the restriction from the governing documents, revising the governing documents to override the restriction prescribed under local law in the absence of a contrary provision in the governing documents, merging the entity with an entity whose governing documents do not contain the restriction, terminating the entity, or otherwise.

(4) Exceptions. A restriction described in this paragraph (b)(4) is not an applicable restriction.

(i) Commercially reasonable restriction. An applicable restriction does not include a

commercially reasonable restriction on liquidation imposed by an unrelated person providing capital to the entity for the ~~entity's~~ entity's trade or business operations, whether in the form of debt or equity. An unrelated person is any person whose relationship to the transferor, the transferee, or any member of the family of either is not described in section 267(b) ~~of the Internal Revenue Code,~~ provided that for purposes of this section the term "fiduciary of a trust" as used in section 267(b) does not include a bank as defined in section 581 ~~of the Internal Revenue Code. That is publicly held.~~

(ii) Imposed by federal or state law. An applicable restriction does not include a restriction imposed or required to be imposed by ~~Federal or State law is not federal or state law.~~ For this purpose, federal or state law means the laws of the United States, of any state thereof, or of the District of Columbia, but does not include the laws of any other jurisdiction. A provision of law that applies only in the absence of a contrary provision in the governing documents or that may be superseded with regard to a particular entity (whether by the shareholders, partners, members and/or managers of the entity or otherwise) is not a restriction that is imposed or required to be imposed by federal or state law. A law that is limited in its application to certain narrow classes of entities, particularly those types of entities (such as family-controlled entities) most likely to be subject to transfers described in section 2704, is not a restriction that is imposed or required to be imposed by federal or state law. For example, a law requiring a restriction that may not be removed or superseded and that applies only to family-controlled entities that otherwise would be subject to the rules of section 2704 is an applicable restriction. In addition, a restriction is not imposed or required to be imposed by federal or state law if that law also provides (either at the time the entity was organized or at some subsequent time) an optional provision that does not include the restriction or that allows it to be removed or overridden, or that provides a different statute for the creation and governance of that same type of entity that does not mandate the restriction, makes the restriction optional, or permits the restriction to be superseded, whether by the entity's governing documents or otherwise. For purposes of determining the type of entity, there are only three types of entities, specifically, the three categories of entities described in §25.2701-2(b)(5): corporations; partnerships (including limited partnerships); and other business entities.

(iii) Certain rights under section 2703. An option, right to use property, or agreement that is subject to section 2703 is not an applicable restriction.

~~(e)~~(iv) Put right of each holder. Any restriction that otherwise would constitute an applicable restriction under this section will not be considered an applicable restriction if each holder of an interest in the entity has a put right as described in §25.2704-3(b)(6).

(c) Other definitions. For the definition of the term controlled entity, see §25.2701-2(b)(5). For the definition of the term member of the family, see §25.2702-2(a)(1).

(d) Attribution. An individual, the individual's estate, and members of the individual's family are treated as also holding any interest held indirectly by such person through a corporation, partnership, trust, or other entity under the rules contained in §25.2701-6.

(e) Effect of disregarding an applicable restriction. If an applicable restriction is disregarded under this section, the fair market value of the transferred interest is valued determined under generally applicable valuation principles as if the restriction (whether in the governing documents, applicable law, or both) does not exist ~~and as if the rights of the transferor are determined under the State law that would apply but for the restriction.~~ For example, an applicable restriction with respect to preferred stock will be disregarded in determining the amount of a transfer of common stock under section 2701.

~~(d)~~(f) Certain transfers at death to multiple persons. Solely for purposes of section 2704(b), if part of a decedent's interest in an entity includible in the gross estate passes by reason of death to one or more members of the decedent's family and part of that includible interest passes to one or more persons who are not members of the decedent's family, and if the part passing to the members of the decedent's family is to be valued pursuant to paragraph (e) of this section, then that part is treated as a single, separate property interest. In that case, the part passing to one or more persons who are not members of the decedent's family is also treated as a single, separate property interest. See paragraph (g) Ex. 4 of §25.2704-3.

(g) Examples. The following examples illustrate the provisions of this section:

Example (1). D owns a 76 percent interest and each of D's children, A and B, owns a 12 percent interest in General Partnership X. The partnership agreement requires the consent of all the partners to liquidate the

partnership. Under the State law that would apply in the absence of the restriction in the partnership agreement, the consent of partners owning 70 percent of the total partnership interests would be required to liquidate X. On D's death, D's partnership interest passes to D's child, C. The requirement that all the partners consent to liquidation is an applicable restriction. Because A, B and C (all members of D's family), acting together after the transfer, can remove the restriction on liquidation, D's interest is valued without regard to the restriction; i.e., as though D's interest is sufficient to liquidate the partnership.

Example (2). D owns all the preferred stock in Corporation X. The preferred stock carries a right to liquidate X that cannot be exercised until 1999. D's children, A and B, own all the common stock of X. The common stock is the only voting stock. In 1994, D transfers the preferred stock to D's child, A. The restriction on D's right to liquidate is an applicable restriction that is disregarded. Therefore, the preferred stock is valued as though the right to liquidate were presently exercisable.

Example (3). D owns 60 percent of the stock of Corporation X. The corporate by-laws provide that the corporation cannot be liquidated for 10 years after which time liquidation requires approval by 60 percent of the voting interests. In the absence of the provision in the by-laws, State law would require approval by 80 percent of the voting interests to liquidate X. D transfers the stock to a trust for the benefit of D's child, A, during the 10-year period. The 10-year restriction is an applicable restriction and is disregarded. Therefore, the value of the stock is determined as if the transferred block could currently liquidate X.

Example (4). D and D's children, A and B, are partners in Limited Partnership Y. Each has a 3.33 percent general partnership interest and a 30 percent limited partnership interest. Any general partner has the right to liquidate the partnership at any time. As part of a loan agreement with a lender who is related to D, each of the partners agree that the partnership may not be liquidated without the lender's consent while any portion of the loan remains outstanding. During the term of the loan agreement, D transfers one-half of both D's partnership interests to each of A and B. Because the lender is a related party, the requirement that the lender consent to liquidation is an applicable restriction and the transfers of D's interests are valued as if such consent were not required.

Example (5). D owns 60 percent of the preferred and 70 percent of the common stock in Corporation X. The remaining stock is owned by individuals unrelated to D. The preferred stock carries a ~~put~~-right to liquidate X that cannot be exercised until 1999. In 1995, D transfers the common stock to D's child in a transfer that is subject to section 2701. The restriction on D's right to liquidate is an applicable restriction that is disregarded in determining the amount of the gift under section 2701.

EXHIBIT E

Prop. Reg. 25.2704-3

§ 25.2704-3 Transfers subject to disregarded restrictions.

(a) *In general.* For purposes of subtitle B (relating to estate, gift and generation-skipping transfer taxes), and notwithstanding any provision of §25.2704-2, if an interest in a corporation or a partnership (an entity), whether domestic or foreign, is transferred to or for the benefit of a member of the transferor's family, and the transferor and/or members of the transferor's family control the entity immediately before the transfer, any restriction described in paragraph (b) of this section is disregarded, and the transferred interest is valued as provided in paragraph (f) of this section. For purposes of this section, a corporation is any business entity described in §301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8) of this chapter, an S corporation within the meaning of section 1361(a)(1), and a qualified subchapter S subsidiary within the meaning of section 1361(b)(3)(B). For this purpose, a qualified subchapter S subsidiary is treated as a corporation separate from its parent corporation. A partnership is any other business entity within the meaning of §301.7701-2(a) of this chapter, regardless of how that entity is classified for federal tax purposes. Thus, for example, the term partnership includes a limited liability company that is not an S corporation, whether or not it is disregarded as an entity separate from its owner for federal tax purposes.

(b) *Disregarded restrictions defined--*(1) In general. The term disregarded restriction means a restriction that is a limitation on the ability to redeem or liquidate an interest in an entity that is described in any one or more of paragraphs (b)(1)(i) through (iv) this section, if the restriction, in whole or in part, either lapses after the transfer or can be removed by the transferor or any member of the transferor's family (subject to paragraph (b)(4) of this section), either alone or collectively.

(i) The provision limits or permits the limitation of the ability of the holder of the interest to compel liquidation or redemption of the interest.

(ii) The provision limits or permits the limitation of the amount that may be received by the holder of the interest on liquidation or redemption of the interest to an amount that is less than a minimum value. The term minimum value means the interest's share of the net value of the entity determined on the date of liquidation or redemption. The net value of the entity is the fair market value, as determined under section 2031 or 2512 and the applicable regulations, of the property held by the entity, reduced by the outstanding obligations of the entity. Solely for purposes of determining minimum value, the only outstanding obligations of the entity that may be taken into account are those that would be allowable (if paid) as deductions under section 2053 if those obligations instead were claims against an estate. For example, and subject to the foregoing limitation on outstanding obligations, if the entity holds an operating business, the rules of §20.2031-2(f)(2) or §20.2031-3 of this chapter apply in the case of a testamentary transfer and the rules of §25.2512-2(f)(2) or §25.2512-3 apply in the case of an inter vivos transfer. The minimum value of the interest is the net value of the entity multiplied by the interest's share of the entity. For this purpose, the interest's share is determined by taking into account any capital, profits, and other rights inherent in the interest in the entity. If the property held by the entity directly or indirectly includes an interest in another entity, and if a transfer of an interest in that other entity by the same transferor (had that transferor owned the interest directly) would be subject to section 2704(b), then the entity will be treated as owning a share of the property held by the other entity, determined and valued in accordance with the provisions of section 2704(b) and the regulations thereunder.

(iii) The provision defers or permits the deferral of the payment of the full amount of the liquidation or redemption proceeds for more than six months after the date the holder gives notice to the entity of the holder's intent to have the holder's interest liquidated or redeemed.

(iv) The provision authorizes or permits the payment of any portion of the full amount of the liquidation or redemption proceeds in any manner other than in cash or property. Solely for this purpose, except as provided in the following sentence, a note or other obligation issued directly or indirectly by the entity, by one or more holders of interests in the entity, or by a person related to either the entity or any

holder of an interest in the entity, is deemed not to be property. In the case of an entity engaged in an active trade or business, at least 60 percent of whose value consists of the non-passive assets of that trade or business, and to the extent that the liquidation proceeds are not attributable to passive assets within the meaning of section 6166(b)(9)(B), such proceeds may include such a note or other obligation if such note or other obligation is adequately secured, requires periodic payments on a non-deferred basis, is issued at market interest rates, and has a fair market value on the date of liquidation or redemption equal to the liquidation proceeds. See §25.2512-8. For purposes of this paragraph (b)(1)(iv), a related person is any person whose relationship to the entity or to any holder of an interest in the entity is described in section 267(b), provided that for this purpose the term fiduciary of a trust as used in section 267(b) does not include a bank as defined in section 581 that is publicly held.

(2) Source of limitation. A disregarded restriction includes a restriction that is imposed under the terms of the governing documents (for example, the corporation's by-laws, the partnership agreement, or other governing documents), a buy-sell agreement, a redemption agreement, or an assignment or deed of gift, or any other document, agreement, or arrangement; and a restriction imposed under local law regardless of whether that restriction may be superseded by or pursuant to the governing documents or otherwise. For this purpose, local law is the law of the jurisdiction, whether domestic or foreign, which governs the applicability of the restriction. For an exception for restrictions imposed or required to be imposed by federal or state law, see paragraph (b)(5)(iii) of this section.

(3) Lapse or removal of limitation. A restriction is a disregarded restriction only to the extent that the restriction either will lapse by its terms at any time after the transfer or may be removed after the transfer by any one or more members, either alone or collectively, of the group consisting of the transferor, the transferor's estate, and members of the transferor's family. For purposes of determining whether the ability to remove the restriction is held by any one or more members of this group, members are treated as holding interests attributed to them under the rules contained in §25.2701-6, in addition to interests held directly. See also paragraph (b)(4) of this section. The manner in which the restriction may be removed is irrelevant for this purpose, whether by voting, taking other action authorized by the governing documents or applicable local law, removing the restriction from the governing documents, revising the governing documents to override the restriction prescribed under local law in the absence of a contrary provision in the governing documents, merging the entity with an entity whose governing documents do not contain the restriction, terminating the entity, or otherwise.

(4) Certain interests held by nonfamily members disregarded--(i) In general. In the case of a transfer to or for the benefit of a member of the transferor's family, for purposes of determining whether the transferor (or the transferor's estate) or any member of the transferor's family, either alone or collectively, may remove a restriction within the meaning of this paragraph (b), an interest held by a person other than a member of the transferor's family (a nonfamily-member interest) is disregarded unless all of the following are satisfied:

(A) The interest has been held by the nonfamily member for at least three years immediately before the transfer;

(B) On the date of the transfer, in the case of a corporation, the interest constitutes at least 10 percent of the value of all of the equity interests in the corporation, and, in the case of a business entity within the meaning of §301.7701-2(a) of this chapter other than a corporation, the interest constitutes at least a 10-percent interest in the business entity, for example, a 10-percent interest in the capital and profits of a partnership;

(C) On the date of the transfer, in the case of a corporation, the total of the equity interests in the corporation held by shareholders who are not members of the transferor's family constitutes at least 20 percent of the value of all of the equity interests in the corporation, and, in the case of a business entity within the meaning of §301.7701-2(a) of this chapter other than a corporation, the total interests in the entity held by owners who are not members of the transferor's family is at least 20 percent of all the interests in the entity, for example, a 20-percent interest in the capital and profits of a partnership; and

(D) Each nonfamily member, as owner, has a put right as described in paragraph (b)(6) of this section.

(ii) Effect of disregarding a nonfamily-member interest. If a nonfamily-member interest is

disregarded under this section, the rules of this section are applied as if all interests other than disregarded nonfamily-member interests constitute all of the interests in the entity.

(iii) Attribution. In applying the 10-percent and 20-percent tests when the property held by the corporation or other business entity is, in whole or in part, an interest in another entity, the attribution rules of paragraph (d) of this section apply both in determining the interest held by a nonfamily member, and in measuring the interests owned through other entities.

(5) Exceptions. A restriction described in this paragraph (b)(5) is not a disregarded restriction.

(i) Applicable restriction. A disregarded restriction does not include an applicable restriction on the liquidation of the entity as defined in and governed by §25.2704-2.

(ii) Commercially reasonable restriction. A disregarded restriction does not include a commercially reasonable restriction on liquidation imposed by an unrelated person providing capital to the entity for the entity's trade or business operations whether in the form of debt or equity. An unrelated person is any person whose relationship to the transferor, the transferee, or any member of the family of either is not described in section 267(b), provided that for purposes of this section the term fiduciary of a trust as used in section 267(b) does not include a bank as defined in section 581 that is publicly held.

(iii) Requirement of federal or state law. A disregarded restriction does not include a restriction imposed or required to be imposed by federal or state law. For this purpose, federal or state law means the laws of the United States, of any state thereof, or of the District of Columbia, but does not include the laws of any other jurisdiction. A provision of law that applies only in the absence of a contrary provision in the governing documents or that may be superseded with regard to a particular entity (whether by the shareholders, partners, members and/or managers of the entity or otherwise) is not a restriction that is imposed or required to be imposed by federal or state law. A law that is limited in its application to certain narrow classes of entities, particularly those types of entities (such as family-controlled entities) most likely to be subject to transfers described in section 2704, is not a restriction that is imposed or required to be imposed by federal or state law. For example, a law requiring a restriction that may not be removed or superseded and that applies only to family-controlled entities that otherwise would be subject to the rules of section 2704 is a disregarded restriction. In addition, a restriction is not imposed or required to be imposed by federal or state law if that law also provides (either at the time the entity was organized or at some subsequent time) an optional provision that does not include the restriction or that allows it to be removed or overridden, or that provides a different statute for the creation and governance of that same type of entity that does not mandate the restriction, makes the restriction optional, or permits the restriction to be superseded, whether by the entity's governing documents or otherwise. For purposes of determining the type of entity, there are only three types of entities, specifically, the three categories of entities described in §25.2701-2(b)(5): corporations; partnerships (including limited partnerships); and other business entities.

(iv) Certain rights described in section 2703. An option, right to use property, or agreement that is subject to section 2703 is not a restriction for purposes of this paragraph (b).

(v) Right to put interest to entity. Any restriction that otherwise would constitute a disregarded restriction under this section will not be considered a disregarded restriction if each holder of an interest in the entity has a put right as described in paragraph (b)(6) of this section.

(6) Put right. The term put right means a right, enforceable under applicable local law, to receive from the entity or from one or more other holders, on liquidation or redemption of the holder's interest, within six months after the date the holder gives notice of the holder's intent to withdraw, cash and/or other property with a value that is at least equal to the minimum value of the interest determined as of the date of the liquidation or redemption. For this purpose, local law is the law of the jurisdiction, whether domestic or foreign, that governs liquidation or redemption rights with regard to interests in the entity. For purposes of this paragraph (b)(6), the term other property does not include a note or other obligation issued directly or indirectly by the entity, by one or more holders of interests in the entity, or by one or more persons related either to the entity or to any holder of an interest in the entity. However, in the case of an entity engaged in an active trade or business, at least 60 percent of whose value consists of the non-passive assets of that trade or business, and to the extent that the liquidation proceeds are not attributable to passive assets within the meaning of section 6166(b)(9)(B), the term other property does include a note or other obligation if such note or other obligation is adequately secured,

requires periodic payments on a non-deferred basis, is issued at market interest rates, and has a fair market value on the date of liquidation or redemption equal to the liquidation proceeds. See §25.2512-8. The minimum value of the interest is the interest's share of the net value of the entity, as defined in paragraph (b)(1)(ii) of this section.

(c)*Other definitions.* For the definition of the term controlled entity, see §25.2701-2(b)(5). For the definition of the term member of the family, see §25.2702-2(a)(1).

(d)*Attribution.* An individual, the individual's estate, and members of the individual's family, as well as any other person, also are treated as holding any interest held indirectly by such person through a corporation, partnership, trust, or other entity under the rules contained in §25.2701-6.

(e)*Certain transfers at death to multiple persons.* Solely for purposes of section 2704(b), if part of a decedent's interest in an entity includible in the gross estate passes by reason of death to one or more members of the decedent's family and part of that includible interest passes to one or more persons who are nonfamily members of the decedent, and if the part passing to the members of the decedent's family is to be valued pursuant to paragraph (f) of this section, then that part is treated as a single, separate property interest. In that case, the part passing to one or more persons who are not members of the decedent's family is also treated as a single, separate property interest. See paragraph (g) Example 4 of this section.

(f)*Effect of disregarding a restriction.* If a restriction is disregarded under this section, the fair market value of the transferred interest is determined under generally applicable valuation principles as if the disregarded restriction does not exist in the governing documents, local law, or otherwise. For this purpose, local law is the law of the jurisdiction, whether domestic or foreign, under which the entity is created or organized.

(g)*Examples.* The following examples illustrate the provisions of this section.

Example 1. (i) D and D's children, A and B, are partners in Limited Partnership X that was created on July 1, 2016. D owns a 98 percent limited partner interest, and A and B each own a 1 percent general partner interest. The partnership agreement provides that the partnership will dissolve and liquidate on June 30, 2066, or by the earlier agreement of all the partners, but otherwise prohibits the withdrawal of a limited partner. Under applicable local law, a limited partner may withdraw from a limited partnership at the time, or on the occurrence of events, specified in the partnership agreement. Under the partnership agreement, the approval of all partners is required to amend the agreement. None of these provisions is mandated by local law. D transfers a 33 percent limited partner interest to A and a 33 percent limited partner interest to B.

(ii) By prohibiting the withdrawal of a limited partner, the partnership agreement imposes a restriction on the ability of a partner to liquidate the partner's interest in the partnership that is not required to be imposed by law and that may be removed by the transferor and members of the transferor's family, acting collectively, by agreeing to amend the partnership agreement. Therefore, under section 2704(b) and paragraph (a) of this section, the restriction on a limited partner's ability to liquidate that partner's interest is disregarded in determining the value of each transferred interest. Accordingly, the amount of each transfer is the fair market value of the 33 percent limited partner interest determined under generally applicable valuation principles taking into account all relevant factors affecting value including the rights determined under the governing documents and local law and assuming that the disregarded restriction does not exist in the governing documents, local law, or otherwise. See paragraphs (b)(1)(i) and (f) of this section.

Example 2. The facts are the same as in Example 1, except that, both before and after the transfer, A's partnership interests are held in an irrevocable trust of which A is the sole income beneficiary. The trustee is a publicly-held bank. A is treated as holding the interests held by the trust under the rules contained in §25.2701-6. The result is the same as in Example 1.

Example 3. The facts are the same as in Example 1, except that, on D's subsequent death, D's remaining 32 percent limited partner interest passes outright to D's surviving spouse, S, who is a U.S. citizen. In valuing the 32 percent interest for purposes of determining both the amount includible in the gross estate and the amount allowable as a marital deduction, the analysis and result are as described in Example 1.

Example 4. (i) The facts are the same as in Example 1, except that D made no gifts and, on D's subsequent death pursuant to D's will, a 53 percent limited partner interest passes to D's surviving spouse who is a U.S. citizen, a 25 percent limited partner interest passes to C, an unrelated individual, and a 20 percent limited partner interest passes to E, a charity. The restriction on a limited partner's ability to liquidate

that partner's interest is a disregarded restriction. In determining whether D's estate and/or D's family may remove the disregarded restriction after the transfer occurring on D's death, the interests of C and E are disregarded because these interests were not held by C and E for at least three years prior to D's death, nor do C and E have the right to withdraw on six months' notice and receive their respective interest's share of the minimum value of X. Thus, the 53 percent interest passing to D's surviving spouse is subject to section 2704(b). D's gross estate will be deemed to include two separate assets: a 53 percent limited partner interest subject to section 2704(b), and a 45 percent limited partner interest not subject to section 2704.

(ii) The fair market value of the 53 percent interest is determined for both inclusion and deduction purposes under generally applicable valuation principles taking into account all relevant factors affecting value, including the rights determined under the governing documents and local law, and assuming that the disregarded restriction does not exist in the governing documents, local law, or otherwise. The 45 percent interest passing to nonfamily members is not subject to section 2704(b), and will be valued as a single interest for inclusion purposes under generally applicable valuation principles, taking into account all relevant factors affecting value including the rights determined under the governing documents and local law as well as the restriction on a limited partner's ability to liquidate that partner's interest. The 20 percent passing to charity will be valued in a similar manner for purposes of determining the allowable charitable deduction. Assuming that, under the facts and circumstances, the 45 percent interest and the 20 percent interest are subject to the same discount factor, the charitable deduction will equal four-ninths of the value of the 45 percent interest.

Example 5. (i) D and D's children, A and B, are partners in Limited Partnership Y. D owns a 98 percent limited partner interest, and A and B each own a 1 percent general partner interest. The partnership agreement provides that a limited partner may withdraw from the partnership at any time by giving six months' notice to the general partner. On withdrawal, the partner is entitled to receive the fair market value of his or her partnership interest payable over a five-year period. Under the partnership agreement, the approval of all partners is required to amend the agreement. None of these provisions are mandated by local law. D transfers a 33 percent limited partner interest to A and a 33 percent limited partner interest to B. Under paragraph (b)(1)(iii) of this section, the provision requiring that a withdrawing partner give at least six months' notice before withdrawing provides a reasonable waiting period and does not cause the restriction to be disregarded in valuing the transferred interests. However, the provision limiting the amount the partner may receive on withdrawal to the fair market value of the partnership interest, and permitting that amount to be paid over a five-year period, may limit the amount the partner may receive on withdrawal to less than the minimum value described in paragraph (b)(1)(ii) of this section and allows the delay of payment beyond the period described in paragraph (b)(1)(iii) of this section. The partnership agreement imposes a restriction on the ability of a partner to liquidate the partner's interest in the partnership that is not required to be imposed by law and that may be removed by the transferor and members of the transferor's family, acting collectively, by agreeing to amend the partnership agreement.

(ii) Under section 2704(b) and paragraph (a) of this section, the restriction on a limited partner's ability to liquidate that partner's interest is disregarded in determining the value of the transferred interests. Accordingly, the amount of each transfer is the fair market value of the 33 percent limited partner interest, determined under generally applicable valuation principles taking into account all relevant factors affecting value, including the rights determined under the governing documents and local law, and assuming that the disregarded restriction does not exist in the governing documents, local law, or otherwise. See paragraph (f) of this section.

Example 6. The facts are the same as in Example 5, except that D sells a 33 percent limited partner interest to A and a 33 percent limited partner interest to B for fair market value (but without taking into account the special valuation assumptions of section 2704(b)). Because section 2704(b) also is relevant in determining whether a gift has been made, D has made a gift to each child of the excess of the value of the transfer to each child as determined in Example 5 over the consideration received by D from that child.

Example 7. The facts are the same as in Example 5, except, in a transaction unrelated to D's prior transfers to A and B, D withdraws from the partnership and immediately receives the fair market value (but without taking into account the special valuation assumptions of section 2704(b)) of D's remaining 32 percent limited partner interest. Because a gift to a partnership is deemed to be a gift to the other partners, D has

made a gift to each child of one-half of the excess of the value of the 32 percent limited partner interest as determined in Example 5 over the consideration received by D from the partnership.

Example 8. D and D's children, A and B, organize Limited Liability Company X under the laws of State Y. D, A, and B each contribute cash to X. Under the operating agreement, X maintains a capital account for each member. The capital accounts are adjusted to reflect each member's contributions to and distributions from X and each member's share of profits and losses of X. On liquidation, capital account balances control distributions. Profits and losses are allocated on the basis of units issued to each member, which are not in proportion to capital. D holds 98 units, A and B each hold 1 unit. D is designated in the operating agreement as the manager of X with the ability to cause the liquidation of X. X is not a corporation. Under the laws of State Y, X is neither a partnership nor a limited partnership. D and D's family have control of X because they hold at least 50 percent of the profits interests (or capital interests) of X. Further, D and D's family have control of X because D holds an interest with the ability to cause the liquidation of X.

Example 9. The facts are the same as in Example 8, except that, under the operating agreement, all distributions are made to members based on the units held, which in turn is based on contributions to capital. Further, X elects to be treated as a corporation for federal tax purposes. Under §25.2701-2(b)(5), D and D's family have control of X (which is not a corporation and, under local law, is not a partnership or limited partnership) because they hold at least 50 percent of the capital interests in X. Further, D and D's family have control of X because D holds an interest with the ability to cause the liquidation of X.

Example 10. D owns a 1 percent general partner interest and a 74 percent limited partner interest in Limited Partnership X, which in turn holds a 50 percent limited partner interest in Limited Partnership Y and a 50 percent limited partner interest in Limited Partnership Z. D owns the remaining interests in partnerships Y and Z. A, an unrelated individual, has owned a 25 percent limited partner interest in partnership X for more than 3 years. The governing documents of all three partnerships permit liquidation of the entity on the agreement of the owners of 90 percent of the interests but, with the exception of A's interest, prohibit the withdrawal of a limited partner. A may withdraw on 6-months' notice and receive A's interest's share of the minimum value of partnership X as defined in paragraph (b)(1)(ii) of this section, which share includes a share of the minimum value of partnership Y and of partnership Z. Under the governing documents of all three partnerships, the approval of all partners is required to amend the documents. D transfers a 40 percent limited partner interest in partnership Y to D's children. For purposes of determining whether D and/or D's family members have the ability to remove a restriction after the transfer, A is treated as owning a 12.5 percent (.25 x .50) interest in partnership Y, thus more than a 10 percent interest, but less than a 20 percent interest, in partnership Y. Accordingly, under paragraph (b)(4)(i)(C) of this section, A's interest is disregarded for purposes of determining whether D and D's family hold the right to remove a restriction after the transfer (resulting in D and D's children being deemed to own 100 percent of Y for this purpose). However, if D instead had transferred a 40 percent limited partner interest in partnership X to D's children, A's ownership of a 25 percent interest in partnership X would not have been disregarded, with the result that D and D's family would not have had the ability to remove a restriction after the transfer.

Example 11. (i) D owns 85 of the outstanding shares of X, a corporation, and A, an unrelated individual, owns the remaining 15 shares. Under X's governing documents, the approval of the shareholders holding 75 percent of the outstanding stock is required to liquidate X. With the exception of nonfamily members, a shareholder may not withdraw from X. Nonfamily members may withdraw on six months' notice and receive their interest's share of the minimum value of X as defined in paragraph (b)(1)(ii) of this section. D transfers 10 shares to C, a charity. Four years later, D dies. D bequeaths 10 shares to B, an unrelated individual, and the remaining 65 shares to trusts for the benefit of D's family.

(ii) The prohibition on withdrawal is a restriction described in paragraph (b)(1)(i) of this section. In determining whether D's estate and/or D's family may remove the restriction after the transfer occurring on D's death, the interest of B is disregarded because it was not held by B for at least three years prior to D's death. The interests of A and C, however, are not disregarded, because each held an interest of at least 10 percent for at least three years prior to D's death, the total of those interests represents at least 20 percent of X, and each had the right to withdraw on six months' notice and receive their interest's share of the minimum value of X. As a result, D and D's family hold 65 of the deemed total of 90 shares in X, or

72 percent, which is less than the 75 percent needed to liquidate X. Thus, D and D's family do not have the ability to remove the restriction after the transfer, and section 2704(b) does not apply in valuing D's interest in X for federal estate tax purposes.

EXHIBIT F

Redline of Treas. Reg. § 25.2704-2 under current law compared to Prop. Reg. § 25.2704-3 under the Proposed Regulations

§ 25.2704-~~2.3~~ Transfers subject to ~~applicable~~disregarded restrictions.

~~Effective: January 28, 1992.~~

(a) *In general.* For purposes of subtitle B (relating to estate, gift, and generation-skipping transfer taxes), and notwithstanding any provision of §25.2704-2, if an interest in a corporation or a partnership (an entity), whether domestic or foreign, is transferred to or for the benefit of a member of the transferor's family, and the transferor and/or members of the transferor's family control the entity immediately before the transfer, any applicable restriction described in paragraph (b) of this section is disregarded ~~in valuing,~~ and the transferred interest is valued as provided in paragraph (f) of this section. For purposes of this section, a corporation is any business entity described in §301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8) of this chapter, an S corporation within the meaning of section 1361(a)(1), and a qualified subchapter S subsidiary within the meaning of section 1361(b)(3)(B). For this purpose, a qualified subchapter S subsidiary is treated as a corporation separate from its parent corporation. A partnership is any other business entity within the meaning of §301.7701-2(a) of this chapter, regardless of how that entity is classified for federal tax purposes. Thus, for example, the term partnership includes a limited liability company that is not an S corporation, whether or not it is disregarded as an entity separate from its owner for federal tax purposes.

(b) ~~—Applicable restriction—Disregarded restrictions defined.—~~(1) *In general.* The term applicable~~disregarded~~ restriction means a restriction that is a limitation on the ability to redeem or liquidate the entity's interest in an entity that is described in any one or more of paragraphs (b)(1)(i) through (iv) of this section, if the restriction, in whole or in part (as opposed to a particular holder's interest in the entity), if, either lapses after the transfer, that limitation either lapses or may can be removed by the transferor ~~, the transferor's estate, and~~ or any member of the transferor's family, (subject to paragraph (b)(4) of this section), either alone or collectively. See §25.2704-3 for restrictions on the

(i) The provision limits or permits the limitation of the ability of the holder of the interest to liquidate~~compel liquidation or redemption of the interest.~~

(ii) The provision limits or permits the limitation of the amount that may be received by the holder of the interest on liquidation or redemption of the interest to an amount that is less than a particular minimum value. The term minimum value means the interest's share of the net value of the entity determined on the date of liquidation or redemption. The net value of the entity is the fair market value, as determined under section 2031 or 2512 and the applicable regulations, of the property held by the entity, reduced by the outstanding obligations of the entity. Solely for purposes of determining minimum value, the only outstanding obligations of the entity that may be taken into account are those that would be allowable (if paid) as deductions under section 2053 if those obligations instead were claims against an estate. For example, and subject to the foregoing limitation on outstanding obligations, if the entity holds an operating business, the rules of §20.2031-2(f)(2) or §20.2031-3 of this chapter apply in the case of a testamentary transfer and the rules of §25.2512-2(f)(2) or §25.2512-3 apply in the case of an inter vivos transfer. The minimum value of the interest is the net value of the entity multiplied by the interest's share of the entity. For this purpose, the interest's share is determined by taking into account any capital, profits, and other rights inherent in the interest in the entity. If the property held by the entity directly or indirectly includes an interest in another entity, and if a transfer of an interest in that other entity by the same transferor (had that transferor owned the interest directly) would be subject to section 2704(b), then the entity will be treated as owning a share of the property held by the other entity, determined and valued in accordance with the provisions of section 2704(b) and the regulations thereunder.

(iii) The provision defers or permits the deferral of the payment of the full amount of the liquidation or redemption proceeds for more than six months after the date the holder gives

notice to the entity of the holder's intent to have the holder's interest in the entity liquidated or redeemed.

(iv) The provision authorizes or permits the payment of any portion of the full amount of the liquidation or redemption proceeds in any manner other than in cash or property. Solely for this purpose, except as provided in the following sentence, a note or other obligation issued directly or indirectly by the entity, by one or more holders of interests in the entity, or by a person related to either the entity or any holder of an interest in the entity, is deemed not to be property. In the case of an entity engaged in an active trade or business, at least 60 percent of whose value consists of the non-passive assets of that trade or business, and to the extent that the liquidation proceeds are not attributable to passive assets within the meaning of section 6166(b)(9)(B), such proceeds may include such a note or other obligation if such note or other obligation is adequately secured, requires periodic payments on a non-deferred basis, is issued at market interest rates, and has a fair market value on the date of liquidation or redemption equal to the liquidation proceeds. See §25.2512-8. For purposes of this paragraph (b)(1)(iv), a related person is any person whose relationship to the entity or to any holder of an interest in the entity is described in section 267(b), provided that for this purpose the term fiduciary of a trust as used in section 267(b) does not include a bank as defined in section 581 that is publicly held.

(2) Source of limitation. ~~An applicable~~A disregarded restriction includes a restriction that is imposed under the terms of the governing documents (for example, the corporation's by-laws, the partnership agreement, or other governing documents), a buy-sell agreement, a redemption agreement, or an assignment or deed of gift, or any other document, agreement, or arrangement; and a restriction imposed under local law regardless of whether that restriction may be superseded by or pursuant to the governing documents or otherwise. For this purpose, local law is the law of the jurisdiction, whether domestic or foreign, ~~that~~which governs the applicability of the restriction. For an exception for restrictions imposed or required to be imposed by federal or state law, see paragraph (b)(4)(~~ii~~5)(iii) of this section.

(3) Lapse or removal of limitation. A restriction is ~~an applicable~~a disregarded restriction only to the extent that ~~either~~ the restriction either will lapse by its terms ~~will lapse~~ at any time after the transfer, or ~~the restriction~~ may be removed after the transfer by any one or more members, either alone or collectively, of the group consisting of the transferor, the transferor's estate, and members of the transferor's family. For purposes of determining whether the ability to remove the restriction is held by any ~~member(s)~~one or more members of this group, members are treated as holding ~~the~~ interests attributed to them under the rules contained in §25.2701-6, in addition to interests held directly. See also paragraph (b)(4) of this section. The manner in which the restriction may be removed is irrelevant for this purpose, whether by voting, taking other action authorized by the governing documents or applicable local law, removing the restriction from the governing documents, revising the governing documents to override the restriction prescribed under local law in the absence of a contrary provision in the governing documents, merging the entity with an entity whose governing documents do not contain the restriction, terminating the entity, or otherwise.

(4) Exceptions. A restriction described in this paragraph (b)(4) is not an applicable restriction. ~~(i)-(4) Certain interests held by nonfamily members disregarded--(i)~~ In general. In the case of a transfer to or for the benefit of a member of the transferor's family, for purposes of determining whether the transferor (or the transferor's estate or any member of the transferor's family, either alone or collectively, may remove a restriction within the meaning of this paragraph (b), an interest held by a person other than a member of the transferor's family (a nonfamily-member interest) is disregarded unless all of the following are satisfied:

(A) The interest has been held by the nonfamily member for at least three years immediately before the transfer;

(B) On the date of the transfer, in the case of a corporation, the interest constitutes at least 10 percent of the value of all of the equity interests in the corporation, and, in the case of a business entity within the meaning of §301.7701-2(a) of this chapter other than a corporation, the interest constitutes at least a 10-

percent interest in the business entity, for example, a 10-percent interest in the capital and profits of a partnership:

(C) On the date of the transfer, in the case of a corporation, the total of the equity interests in the corporations held by shareholders who are not members of the transferor's family constitutes at least 20 percent of the value of all of the equity interests in the corporation, and, in the case of a business entity within the meaning of §301.7701-2(a) of this chapter other than a corporation, the total interests in the entity held by owners who are not members of the transferor's family is at least 20 percent of all the interest in the entity, for example, a 20-percent interest in the capital and profits of a partnership; and

(D) Each nonfamily member, as owner, has a put right as described in paragraph (b)(6) of this section.

(ii) Effect of disregarding a nonfamily-member interest. If a nonfamily-member interest is disregarded under this section, the rules of this section are applied as if all interests other than disregarded nonfamily-member interests constitute all of the interests in the entity.

(iii) Attribution. In applying the 10-percent and 20-percent tests when the property held by the corporation or other business entity is, in whole or in part, an interest in another entity, the attribution rules of paragraph (d) of this section apply both in determining the interest held by a nonfamily member, and in measuring the interests owned through other entities.

(5) Exceptions. A restriction described in this paragraph (b)(5) is not a disregarded restriction. ~~(i) Applicable restriction. A disregarded restriction does not include an applicable restriction on the liquidation of the entity as defined in and governed by §25.2704-2.~~

(ii) Commercially reasonable restriction. An applicableA disregarded restriction does not include a commercially reasonable restriction on liquidation imposed by an unrelated person providing capital to the entity for the entity's trade or business operations, whether in the form of debt or equity. An unrelated person is any person whose relationship to the transferor, the transferee, or any member of the family of either is not described in section 267(b), provided that for purposes of this section the term fiduciary of a trust as used in section 267(b) does not include a bank as defined in section 581 that is publicly held.

(ii) ~~Imposed by~~ Requirement of federal or state law. ~~An applicableA~~ disregarded restriction does not include a restriction imposed or required to be imposed by federal or state law. For this purpose, federal or state law means the laws of the United States, of any state thereof, or of the District of Columbia, but does not include the laws of any other jurisdiction. A provision of law that applies only in the absence of a contrary provision in the governing documents or that may be superseded with regard to a particular entity (whether by the shareholders, partners, members and/or managers of the entity or otherwise) is not a restriction that is imposed or required to be imposed by federal or state law. A law that is limited in its application to certain narrow classes of entities, particularly those types of entities (such as family-controlled entities) most likely to be subject to transfers described in section 2704, is not a restriction that is imposed or required to be imposed by federal or state law. For example, a law requiring a restriction that may not be removed or superseded and that applies only to family-controlled entities that otherwise would be subject to the rules of section 2704 is ~~an applicablea~~ disregarded restriction. In addition, a restriction is not imposed or required to be imposed by federal or state law if that law also provides (either at the time the entity was organized or at some subsequent time) an optional provision that does not include the restriction or that allows it to be removed or overridden, or that provides a different statute for the creation and governance of that same type of entity that does not mandate the restriction, makes the restriction optional, or permits the restriction to be superseded, whether by the entity's governing

documents or otherwise. For purposes of determining the type of entity, there are only three types of entities, specifically, the three categories of entities described in §25.2701-2(b)(5): corporations; partnerships (including limited partnerships); and other business entities.

(iii) ~~iv)~~ Certain rights ~~under described in~~ section 2703. An option, right to use property, or agreement that is subject to section 2703 is not ~~an applicable~~ restriction. ~~for purposes of this paragraph (b).~~

(iv) ~~Put right of each holder.~~ v) Right to put interest to entity. Any restriction that otherwise would constitute ~~an applicable a disregarded~~ restriction under this section will not be considered ~~an applicablea disregarded~~ restriction if each holder of an interest in the entity has a put right as described in ~~§25.2704 3paragraph (b)(6)-) of this section.~~

(6) Put right. The term put right means a right, enforceable under applicable local law, to receive from the entity or from one or more other holders on liquidation or redemption of the holder's interest, within six months after the date the holder gives notice of the holder's intent to withdraw, cash and/or other property with a value that is at least equal to the minimum value of the interest determined as of the date of the liquidation or redemption. For this purpose, local law is the law of the jurisdiction, whether domestic or foreign, that governs liquidation or redemption rights with regard to interests in the entity. For purposes of this paragraph (b)(6), the term other property does not include a note or other obligation issued directly or indirectly by the entity, by one or more holders of interests in the entity, or by one or more persons related either to the entity or to any holder of an interest in the entity. However, in the case of an entity engaged in an active trade or business, at least 60 percent of whose value consists of the non-passive assets of that trade or business, and to the extent that the liquidation proceeds are not attributable to passive assets within the meaning of section 6166(b)(9)(B), the term other property does include a note or other obligation if such note or other obligation is adequately secured, requires periodic payments on a non-deferred basis, is issued at market interest rates, and has a fair market value on the date of liquidation or redemption equal to the liquidation proceeds. See §25.2512-8. The minimum value of the interest is the interest's share of the net value of the entity, as defined in paragraph (b)(1)(ii) of this section.

(c) *Other definitions.* For the definition of the term controlled entity, see §25.2701-2(b)(5). For the definition of the term member of the family, see §25.2702-2(a)(1).

(d) *Attribution.* An individual, the individual's estate, and members of the individual's family, as well as any other person, also are treated as ~~also~~ holding any interest held indirectly by such person through a corporation, partnership, trust, or other entity under the rules contained in §25.2701-6.

~~(e) Effect of disregarding an applicable restriction. If an applicable restriction is disregarded under this section, the fair market value of the transferred interest is determined under generally applicable valuation principles as if the restriction (whether in the governing documents, applicable law, or both) does not exist. For example, an applicable restriction with respect to preferred stock will be disregarded in determining the amount of a transfer of common stock under section 2701.~~

~~(f)(e) Certain transfers at death to multiple persons.~~ Solely for purposes of section 2704(b), if part of a decedent's interest in an entity includible in the gross estate passes by reason of death to one or more members of the decedent's family and part of that includible interest passes to one or more persons who are ~~not nonfamily~~ members of the ~~decedent's family~~ decedent, and if the part passing to the members of the decedent's family is to be valued pursuant to paragraph (ef) of this section, then that part is treated as a single, separate property interest. In that case, the part passing to one or more persons who are not members of the decedent's family is also treated as a single, separate property interest. See paragraph (g) ~~Ex. Example~~ 4 of ~~§25.2704 3~~ this section.

~~(f) Effect of disregarding a restriction. If a restriction is disregarded under this section, the fair market value of the transferred interest is determined under generally applicable valuation principles as if the disregarded restriction does not exist in the governing documents, local law, or otherwise. For this purpose, local law is the law of the jurisdiction, whether domestic or foreign, under which the entity is created or organized.~~

EXHIBIT G

Application of the Proposed Regulations

The changes made by the Proposed Regulations will result in many more restrictions being disregarded for valuation purposes. Patrick Duffey of Holland & Knight prepared the chart below, which is helpful in determining if a given restriction will be disregarded under the new Proposed Regulations.

2704 PROPOSED REGULATIONS			
	STEP	PROVISION	DEFINITIONS/CITES/NOTES
1	<i>IF there is a transfer to a "member of the transferor's family"</i>	25.2704-3(a)	"member of the family" : spouse, ancestor, lineal descendant (of the transferor or spouse), brother, sister, or spouse of any of those. 25.2702-2(a)(1) per 25.2704-3(c). The attribution rules of 25.2701-6 apply to look through corporations, partnerships, trusts, or other entities. 25.2704-3(d).
2	of an interest in an entity that is "controlled" by members of the transferor's family immediately before the transfer	25.2704-3(a)	"control" : means, as to each of the following entity classes: (a) <u>corporations</u> : 50% (by vote or value) of stock [IRC 2701(b)(2)(A)] (b) <u>partnerships</u> : (i) 50% of capital or profits interest or (ii) in LPs, <i>any</i> interest as GP [IRC 2701(b)(2)(B)(i) and (ii)] (c) <u>other business entity</u> : (i) 50% of capital interest or profits interests or (ii) any equity interest with the ability to cause liquidation in whole or part [25.2701-2(b)(5)(iv)] "other business entity" : is not a (a) corp., (b) partnership, or (c) limited partnership
3	that is subject to a "disregarded restriction"	25.2704-3(b)	The restriction must either (a) lapse <u>or</u> (b) be removable by the transferor or family members (alone or collectively) "disregarded restriction" is any restriction under the governing documents or (non-mandatory) local law described in 25.2704-3(b)(1)(i)-(iv)
	permitted "limitation" on liquidation/redemption	25.2704-3(b)(1)(i)	"limitation" : undefined
	Liquidation/redemption for less than "minimum value"	25.2704-3(b)(1)(ii)	"minimum value" : pro-rata share of "net value" of entity "net value" : FMV of entity, determined under IRC 2031 and 2512, reduced by "outstanding obligations" of entity.

			"outstanding obligations" : obligations that would be allowable as deductions under IRC 2053
	Liquidation/redemption deferred beyond six months	25.2704-3(b)(1)(iii)	Six months beyond the date the owner gives notice of intent to liquidate/redeem interest
	Liquidation/redemption payable by other than cash or "property"	25.2704-3(b)(1)(iv)	"property" does not include a promissory note issued by (a) the entity, (b) the other owners, <u>or</u> (c) a person related to another owner <i>unless</i> : (x) the entity is engaged in active trade or business; (y) the entity derives at least 60% of its value from non-passive assets; <u>and</u> (z) the promissory note is: (i) adequately secured; (ii) requires non-deferred periodic payments; (iii) is issued at market interest rates; <u>and</u> (iv) has an FMV equal to the liquidation/redemption proceeds.

AND

4	that can be removed without consent of "nonfamily members" that are not "disregarded"	25.2704-3(b)(4)	<p>In determining whether a restriction may be unilaterally removed by family members, certain nonfamily members are disregarded</p> <p>"disregarded nonfamily members": an owner, other than a family member, with an interest in the entity that does not satisfy each of the following:</p> <ul style="list-style-type: none"> (a) 3-year holding period by nonfamily member prior to transfer (b) nonfamily member owns at least 10% interest in the entity (c) at least 20% of entity is owned by all nonfamily members (who are not disregarded) (d) nonfamily member's interest includes a "put right" <p>"put right": a right to compel liquidation/redemption of an interest, (a) within six months of notice, (b) for cash or "property", and (c) with a value equal to the "minimum value" of the interest. 25.2704-3(b)(6)</p> <p>- "property" and "minimum value" have the same meanings as in 25.2704-3(b)(1)(ii) and (iv)</p>
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AND

5	that does not fall within a delineated exception	25.2704-3(b)(5)	
	"applicable restriction"	25.2704-3(b)(5)(i)	"applicable restriction" : a limitation on liquidation rights at the entity level that is more restrictive than generally applicable state law if (a) it will lapse after the transfer or (b) can be removed by the transferor or family members after the transfer. The definition does not include a commercially reasonable restriction on liquidation imposed by an unrelated person who is providing capital to the entity for the entity's trade or business. 25.2704-2(b)
	"commercially reasonable restriction"	25.2704-3(b)(5)(i)	"commercially reasonable restriction" : a commercially reasonable restriction on liquidation imposed by an unrelated person who is providing capital to the entity for the entity's trade or business. "unrelated person" : a person who is not "related" to (i) the transferor, (ii) transferee, or (iii) a family member of either as "related" is set out in IRC 267(b). That definition is far broader than "family member" and also includes ancestors, half-siblings, controlled companies, and certain fiduciaries.
	restriction "imposed under local law"	25.2704-3(b)(5)(i)	"imposed under local law" does <u>not</u> include laws (a) of foreign jurisdictions; (b) that provide default provisions or rules (i.e. not mandatory); (c) that are limited to "a narrow class of entities" (i.e. "special state entities"); and (d) with opt-out provisions

THEN

6	the restriction is disregarded for transfer tax purposes	25.2704-3(f)	The entity is valued "under generally applicable valuation principals" as if the disregarded restriction does not exist in governing documents, local law, or otherwise. <p style="text-align: center;">Thus, for transfer tax valuation purposes <u>only</u></p> The liquidation/redemption right described in 25.2704-3(b)(1)(i)-(iv), is
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			effectively "read into" the governing instrument of the entity as to the transferred interest.
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