

[4830-01-p]

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 25

REG-163679-02

RIN 1545-BB72

Qualified Interests

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: These proposed regulations amend the regulations under the gift tax special valuation rules to provide that a unitrust amount or annuity payable for a specified term of years to the grantor, or to the grantor's estate if the grantor dies prior to the expiration of the term, is a qualified interest for the specified term. The proposed regulations also clarify that the exception treating a spouse's revocable successor interest as a retained qualified interest applies only if the spouse's annuity or unitrust interest, standing alone, would constitute a qualified interest that meets the requirements of §25.2702-3(d)(3), but for the grantor's revocation power. This document also provides a notice of a public hearing on these proposed regulations.

DATES: Written and electronic comments must be received by October 25, 2004.

Outlines of topics to be discussed at the public hearing scheduled for October 28, 2004, must be received by October 7, 2004.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-163679-02), room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044.

Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG-163679-02), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. Alternatively, taxpayers may submit electronic comments directly to the IRS Internet site at [www.irs.gov/regs](http://www.irs.gov/regs) or via the Federal eRulemaking Portal at [www.regulations.gov](http://www.regulations.gov) (indicate IRS and REG-163679-02). The public hearing will be held in the auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Juli Ro Kim, (202) 622-3090; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Guy Traynor, (202) 622- 7180 (not toll-free numbers).

#### SUPPLEMENTARY INFORMATION:

##### **Background**

Section 2702 provides special rules for valuing gifts in trust when the donor or an applicable family member retains an interest in the trust. If the retained interest is not a qualified interest, the retained interest is valued at zero, and the amount of the gift is the entire value of the transferred property. If the retained interest is a qualified interest, the retained interest is valued under section 7520 using prescribed actuarial tables and interest rates, and the amount of the gift is the value of the transferred property reduced by the value of the retained interest. Under section 2702(b), a qualified interest is: (1) an interest that consists of a right to receive fixed amounts payable not less frequently than annually (a qualified annuity interest); (2) an interest that consists of a right to receive

amounts that are payable at least annually and are a fixed percentage of the net fair market value of the trust assets determined annually (a qualified unitrust interest); and (3) a right to receive a noncontingent remainder interest if all other interests in the trust are qualified annuity or unitrust interests (a qualified remainder interest). Under §25.2702-3(d)(3) of the Gift Tax Regulations, the qualified annuity or unitrust interest must be payable, for the life of the term holder, for a specified term of years, or for the shorter (but not longer) of those periods.<sup>6</sup> Under §25.2702-2(a)(5) the retention of a power to revoke a qualified annuity interest (or unitrust interest) of the transferor's spouse is treated as the retention of a qualified annuity interest (or unitrust interest).

These qualified interest requirements were the subject of litigation in two cases (described more fully below) before the United States Tax Court and, on appeal in one case, the Ninth Circuit Court of Appeals. These proposed regulations are being issued to clarify the existing regulations with respect to the issues raised in the cases and to revise an example in the regulations that the Tax Court held to be invalid.

### **Walton v. Commissioner**

In Walton v. Commissioner, 115 T.C. 589 (2000), the Tax Court considered a situation similar to that presented in Example 5 of §25.2702-3(e). In this example, A transfers property to an irrevocable trust, retaining the right to receive a unitrust amount for 10 years. If A dies within the 10-year term, the unitrust amount is to be paid to A's estate for the balance of the term. The example concludes that A's interest is a qualified unitrust interest to the extent of the right to receive the unitrust amount for 10 years or until A's prior

death. The example also concludes, however, that the unitrust amount payable to A's estate if A dies within the term of the trust is not a qualified interest.

In Example 6 of §25.2702-3(e), the facts are the same as in Example 5, except that, if A dies within the 10-year term, the unitrust amount will be paid to A's estate for an additional 35 years. The example concludes that the result is the same as in Example 5; that is, A's interest is a qualified unitrust interest to the extent of the right to receive the unitrust amount for 10 years or until A's prior death.

In Walton, the grantor established a grantor retained annuity trust (GRAT), pursuant to which the grantor was to receive an annuity for a term of 2 years. If the grantor died before the expiration of the 2-year term, the annuity was to be paid to the grantor's estate for the balance of the term. Upon expiration of the 2-year term, the trust corpus was to be distributed to a designated remainder beneficiary. After considering the legislative history and purpose of section 2702, the court held that Example 5 is an unreasonable interpretation and invalid extension of section 2702. The court concluded that a retained annuity payable for a specified term of years to the grantor, or to the grantor's estate if the grantor dies prior to expiration of the term, is a qualified interest under section 2702 for the specified term of years.

### **Schott v. Commissioner**

As noted above, §25.2702-2(a)(5) provides that the retention of a power to revoke a qualified annuity interest (or unitrust interest) of the transferor's spouse is treated as the retention by the transferor of a qualified annuity interest (or unitrust interest). Section 25.2702-2(d)(1), Examples 6 and 7 illustrate the application of this rule.

In Example 6 of §25.2702-2(d)(1), A transfers property to an irrevocable trust, retaining the right to receive the income for 10 years. Upon the expiration of 10 years, the income of the trust is payable to A's spouse for 10 years, if living. Upon expiration of the spouse's interest, the trust terminates and the trust corpus is payable to A's child. A retains the right to revoke the spouse's interest. Because A has made a completed gift of the remainder interest, the transfer of property to the trust is not incomplete as to all interests in the property and section 2702 applies. A's power to revoke the spouse's term interest is treated as a retained interest for purposes of section 2702. The example concludes that, because neither one of the interests retained by A (that is, A's income interest and the spouse's revocable income interest) is a qualified interest, the amount of the gift is the fair market value of the property transferred to the trust.

In Example 7 of §25.2702-2(d)(1), the facts are the same as in Example 6, except that both the term interest retained by A and the interest transferred to A's spouse (subject to A's right of revocation) are qualified annuity or unitrust interests. The example concludes that the amount of the gift is the fair market value of the property transferred to the trust reduced by the value of both A's qualified interest and the qualified interest transferred to A's spouse (subject to A's power to revoke).

In Schott v. Commissioner, T.C.M. 2001-110, rev'd and remanded 319 F. 3d 1203 (9<sup>th</sup> Cir. 2003), the GRAT at issue provided for fixed annuity payments to the grantor for a 15-year term, or until the grantor's prior death. If the grantor died prior to the end of the 15-year term and the grantor's spouse survived the grantor, then the annuity was to be paid to the spouse for the balance of the 15-year term. The grantor retained the right to revoke the

spouse's interest. The Tax Court, relying on its earlier opinion in Cook v. Commissioner, 115 T.C. 15 (2000), aff'd 269 F. 3d 854 (7<sup>th</sup> Cir. 2001), concluded that the successor spousal interest was not a qualified interest, and thus, that the successor spousal interest must be valued at zero. The court noted that the term of the revocable spousal interest was contingent upon the death of the grantor and thus was not fixed and ascertainable under the governing instrument as required by §25.2702-3(d)(3). Further, because the revocable spousal interest was deemed to be an interest retained by the grantor, the possibility existed that the retained annuity interest could extend beyond the life of the term holder (the grantor) but for less than the specified 15-year term, which is not consistent with the requirement in §25.2702-3(d)(3) that the qualified annuity or unitrust interest be payable "for the life of the term holder, for a specified term of years, or for the shorter (but not longer) of those periods." The Tax Court, following its opinion in Cook, distinguished the Schott GRAT from §25.2702-2(d)(1), Example 7, because, in the Court's view, in Example 7, the spouse or the estate of the spouse would receive the annuity regardless of whether the spouse was living at the end of the grantor's initial 10-year term. Thus, the court viewed the spouse's interest in Example 7 as a noncontingent interest for a fixed term of years. In contrast, the Schott spousal interest would pass to the spouse only if the grantor died within the term of the trust and the spouse was living when the grantor died.

However, on appeal, the Ninth Circuit concluded that the Schott spousal interest was a qualified interest. The Ninth Circuit distinguished Cook because the revocable spousal interest in Cook was also contingent upon the grantor and the spouse being married to each other at the grantor's death, which could not be accounted for by an annuity

table. Further, the Ninth Circuit rejected the Commissioner's contention that a spousal interest contingent on the death of the grantor lacks the fixed term required by the regulations. Rather, the court stated that every annuity given to a person, if living, is contingent on that person's survival. The court also stated that the present value of the spouse's interest (even if dependent on the grantor's death prior to expiration of the specified term) can be ascertained using the actuarial tables.

### **Explanation of Provisions**

#### **Walton v. Commissioner**

In Notice 2003-72 (2003-44 I.R.B. 964) (released October 15, 2003), the IRS announced that it will follow the Walton decision. Consistent with Notice 2003-72, the proposed regulations revise Example 5 and Example 6 of §25.2702-3(e) to conform to the Walton decision. Under the examples as revised, a unitrust amount payable for a specified term of years to the grantor, or to the grantor's estate if the grantor dies prior to the expiration of the term, is a qualified interest for the specified term. Thus, in Example 5, the interest of A (and A's estate) to receive the unitrust amount for a specified term of 10 years in all events is a qualified interest. Similarly, in Example 6, the unitrust interest, to the extent payable to either A or A's estate for a 10-year period in all events, is a qualified interest for a 10-year term. However, in Example 6, the interest of A's estate to receive the unitrust amount after the 10-year period for the remaining balance of the additional 35-year term if A dies within the 10-year period, is a contingent interest that is not fixed or ascertainable at the creation of the interest and, therefore, is not a qualified interest.

The result in Example 6, in which only a discrete portion of the grantor's retained 35-year unitrust interest (specifically, that portion payable in all events for a 10-year term) is a qualified interest, does not change the result in Example 1 of §25.2702-3(e). In Example 1, A retains the right to receive an annuity for a 10-year term, or until A's prior death. If A dies prior to the expiration of the 10-year term, the entire trust corpus reverts to A's estate. The example concludes that the estate's contingent reversion is valued at zero, notwithstanding that, economically, this reversion of the entire trust corpus includes the equivalent value of the annuity that would be payable for the balance of the 10-year term. The Tax Court in Walton addressed Example 1, noting that, in the case of a reversion, even though the equivalent of the term annuity's value would be payable to the grantor or the grantor's estate in all events, Congress was entitled to require that interests be cast in one of three specified forms to receive the favorable treatment afforded qualified interests. The Court stated A. . . the Commissioner is equally justified in assigning a zero value to reversionary interests outside the scope of the statutory definition and refusing to consider whether such interests can have the practical effect of a different form of interest not chosen by the grantor. See §25.2702-3(e), Example (1), Gift Tax Regs.@ Walton, 115 T.C. at 602. Thus, in Example 1, the reversion, even though including the equivalent value of an annuity payable for the balance of the 10-year term, is not in a qualified form prescribed by the statute and is, therefore, not a qualified interest to any extent. On the other hand, in Example 6 of §25.2702-3(e), the retained interest is in the form of a unitrust interest and, therefore, is a qualified interest to the extent payable to A or A's estate for a 10-year period in all events.

**Schott v. Commissioner**

The proposed regulations also clarify when a revocable spousal interest is a qualified interest.

Sections 2702(a)(3)(A)(i) and (B) confirm that the valuation rules of section 2702 do not apply to a gift that is incomplete. Section 25.2702-2(a)(5) provides a regulatory exception to this statutory rule by providing that the retention of a power to revoke a qualified annuity or unitrust interest of the transferor's spouse is a qualified interest. The annuity or unitrust interest payable to the transferor's spouse must be a qualified interest to meet this exception. Thus, the regulatory exception focuses on the spouse's annuity or unitrust interest and applies only if that interest is a qualified interest as described in §25.2702-3(d).

The references to "term holder" in §25.2702-3(d)(3) or "holder of the qualified ... interest" in §25.2702-3(b) and (c) refer to the person to whom the annuity or unitrust interest is payable during the fixed term. In the case of a revocable successor interest held by the transferor's spouse, although the spouse's interest (if qualified) is valued as a retained qualified interest of the transferor and may thus be deducted from the total value of the assets transferred in computing the taxable gift under section 2702, the spouse is the holder during the period when an interest is payable to the spouse. Thus, each qualified interest must meet the fixed duration requirements of §25.2702-3(d)(3), and each holder's separate interest must be valued as a single life annuity or unitrust interest.

In addition to the requirement that a qualified interest be for a fixed term, payment of the interest cannot be contingent on any event other than the survival of the term holder

(subject to the transferor's retained right of revocation). A revocable spousal interest is contingent, and therefore not a qualified interest, if the spouse will not receive any payments if the transferor survives the fixed term during which the transferor is the holder.

Section 25.2702-2(d)(1), Example 7, illustrates the revocable spousal interest exception. In Example 7, beginning at the expiration of a 10-year term, the spouse's annuity is payable to the spouse for 10 years or until the spouse's prior death. Thus, the spouse's annuity in the example meets the requirements of §25.2702-3(d)(3), that the term of the annuity must be for either the life of the holder (the spouse), for a specified term of years, or for the shorter but not the longer of these two periods and, assuming the spouse survives until the commencement of his or her interest, the spouse will receive that interest in all events (subject to the transferor's retained right of revocation). In contrast, in Schott, the spouse's annuity does not meet the requirements of §25.2702-3(d)(3) because the spousal annuity is payable, if at all, only if the grantor dies prior to the termination of the term of the trust and, if payable at all, is payable for a period that depends on the length of the unexpired portion of the trust's term when the grantor dies.

The proposed regulations clarify that the revocable spousal interest exception applies only if the spouse's interest, standing alone, would constitute a qualified interest that meets the requirements of §25.2702-3(d)(3), but for the grantor's revocation power.

### **Special Analyses**

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the

Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these proposed regulations, and because these proposed regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the proposed regulations will be submitted to the Small Business Administration for comment on their impact on small business.

### **Comments and Public Hearing**

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

A public hearing has been scheduled for October 28, 2004 at 10:00 a.m. in the auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the **FOR FURTHER INFORMATION CONTACT** section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit comments by October 25, 2004, and submit an

outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by October 7, 2004.

A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

### **Drafting Information**

The principal author of these proposed regulations is Juli Ro Kim, Office of the Associate Chief Counsel (Passthroughs and Special Industries), IRS. Other personnel from the IRS and the Treasury Department participated in their development. If you have any questions concerning these proposed regulations, please contact Ms. Kim at (202) 622-3090.

### **List of Subjects in 26 CFR Part 25**

Gift taxes, Reporting and recordkeeping requirements.

### **Proposed Amendments to the Regulations**

Accordingly, 26 CFR part 25 is proposed to be amended as follows:

#### **PART 25 -- GIFT TAX; GIFTS MADE AFTER DECEMBER 31, 1954**

Paragraph 1. The authority citation for part 25 continues to read, in part, as follows:

Authority: 25 U.S.C. 7805 \* \* \*

Par. 2. In §25.2702-0, the table is amended as follows:

1. The entries for §25.2702-2(a)(5) through §25.2702-2(a)(9) are redesignated as

§25.2702-2(a)(6) through §25.2702-2(a)(10), respectively.

2. A new entry for §25.2702-2(a)(5) is added.

3. The entries for §25.2702-3(d)(2) through §25.2702-3(d)(4) are redesignated as §25.2702-3(d)(3) through §25.2702-3(d)(5), respectively.

4. A new entry for §25.2702-3(d)(2) is added.

5. An entry for §25.2702-3(d)(6) is added.

The additions read as follows:

§25.2702-0 Table of contents.

\* \* \* \* \*

§25.2702-2 Definitions and valuation rules.

(a) \* \* \*

(5) Holder.

\* \* \* \* \*

§25.2702-3 Qualified interests.

\* \* \* \* \*

(d) \* \* \*

(2) Contingencies.

\* \* \* \* \*

(6) Use of debt obligations to satisfy the annuity or unitrust payment obligation.

Par. 3. Section 25.2702-2 is amended as follows:

1. Paragraphs (a)(5) through (a)(9) are redesignated as paragraphs (a)(6) through (a)(10), respectively.

2. A new paragraph (a)(5) is added.

3. In redesignated paragraph (a)(6), the second sentence is removed and two

sentences are added in its place.

4. In paragraph (d)(1), Example 6 and Example 7 are removed.

5. In paragraph (d)(2), introducing text, the phrase "Examples 8-10" is revised to read "Examples 6 through 8".

6. In paragraph (d)(2), Examples 8, 9 and 10 are redesignated Examples 6, 7 and 8, respectively.

The additions read as follows:

§25.2702-2 Definitions and valuation rules.

(a) \* \* \*

(5) Holder. The holder is the person to whom the annuity or unitrust interest is payable during the fixed term of that interest. References to holder shall also include the estate of that person.

(6) \* \* \* If a transferor retains a power to revoke a qualified annuity interest or qualified unitrust interest of the transferor's spouse, then the revocable qualified annuity or unitrust interest of the transferor's spouse is treated as a retained qualified interest of the transferor. In order for the transferor to be treated as having retained a qualified interest under the preceding sentence, the interest of the transferor's spouse (the successor holder) must be an interest that meets the requirements of a qualified annuity interest in accordance with §25.2702-3(b) and (d), or a qualified unitrust interest in accordance with §25.2702-3(c) and (d), but for the transferor's retained power to revoke the interest.

\* \* \* \* \*

Par. 4. Section 25.2702-3 is amended as follows:

1. Paragraphs (d)(2) through (d)(5) are redesignated as paragraphs (d)(3) through (d)(6), respectively.
2. A new paragraph (d)(2) is added.
3. In redesignated paragraph (d)(4), the first two sentences are revised.
4. Redesignated paragraph (d)(5) is revised.
5. In paragraph (e), Example 5, the last sentence is revised.
6. In paragraph (e), Example 6, the last sentence is removed and two new sentences are added in its place.
7. In paragraph (e), new Example 8 and new Example 9 are added.

The revisions and additions read as follows:

§25.2702-3 Qualified interests.

\* \* \* \* \*

(d) \* \* \*

(2) Contingencies. A holder's qualified interest must be payable in any event to or for the benefit of the holder for the fixed term of that interest. Thus, payment of the interest cannot be subject to any contingency other than either the survival of the holder until the commencement, or throughout the term, of that holder's interest, or, in the case of a revocable interest described in §25.2702-2(a)(6), the transferor's right to revoke the qualified interest of that transferor's spouse.

\* \* \* \* \*

(4) Term of the annuity or unitrust interest. The governing instrument must fix the term of the annuity or unitrust and the term of the interest must be fixed and ascertainable at

the creation of the trust. The term must be for the life of the holder, for a specified term of years, or for the shorter (but not the longer) of those periods. \* \* \*

(5) Commutation. The governing instrument must prohibit commutation (prepayment) of the interest of the holder. \* \* \*

\* \* \* \* \*

(e) \* \* \*

Example 5. \* \* \* The interest of A (and A's estate) to receive the unitrust amount for the specified term of 10 years in all events is a qualified unitrust interest for a term of 10 years.

Example 6. \* \* \* As in Example 5, the interest of A (and A's estate) to receive the unitrust amount for a specified term of 10 years in all events is a qualified unitrust interest for a term of 10 years. However, the right of A's estate to continue to receive the unitrust amount after the expiration of the 10-year term if A dies within that 10-year period is not fixed and ascertainable at the creation of the interest and is not a qualified unitrust interest.

\* \* \* \* \*

Example 8. A transfers property to an irrevocable trust, retaining the right to receive an annuity equal to 6 percent of the initial net fair market value of the trust property for 10 years, or until A's prior death. At the expiration of the 10-year term, or on A's death prior to the expiration of the 10-year term, the annuity is to be paid to B, A's spouse, if then living, for 10 years or until B's prior death. A retains the right to revoke B's interest. Upon expiration of B's interest (or if A revokes B's interest, or if B predeceases A, then on the expiration of A's interest), the trust terminates and the trust corpus is payable to A's child. Because A has made a completed gift of the remainder interest, the transfer of property to the trust is not incomplete as to all interests in the property and section 2702 applies. A's annuity interest (A's right to receive the annuity for 10 years, or until A's prior death) is a retained interest that is a qualified annuity interest under paragraphs (b) and (d) of this section. In addition, because A has retained the power to revoke B's interest, B's interest is treated as an interest retained by A for purposes of section 2702. B's successive annuity interest otherwise satisfies the requirements for a qualified interest contained in paragraph (d) of this section, but for A's power to revoke. The term of B's interest is specified in the governing instrument and is fixed and ascertainable at the creation of the trust, and B's right to receive the annuity is contingent only on B's survival, and A's power to revoke. Following the expiration of A's interest, the annuity is to be paid for a 10-year term

or for

B's (the successor holder's) life, whichever is shorter. Accordingly, A is treated as retaining B's revocable qualified annuity interest pursuant to §25.2702-2(a)(6). Because both A's interest and B's interest are treated as qualified interests retained by A, the value of the gift is the value of the property transferred to the trust less the value of both A's qualified interest and B's qualified interest (subject to A's power to revoke), each valued as a single-life annuity. Further, if A revokes B's interest prior to the commencement of that interest, A is treated as making a completed gift at that time to A's child. The amount of the gift would be the present value of B's interest determined under section 7520 and the applicable regulations, as of the date the interest is revoked. See §25.2511-2(b) and (f).

Example 9. (i) A transfers property to an irrevocable trust, retaining the right to receive 6 percent of the initial net fair market value of the trust property for 10 years, or until A's prior death. If A survives the 10-year term, the trust terminates and the trust corpus is payable to A's child. If A dies prior to the expiration of the 10-year term, the annuity is payable to B, A's spouse, if then living, for the balance of the 10-year term, or until B's prior death. A retains the right to revoke B's interest. Upon expiration of B's interest (or upon A's death if A revokes B's interest), the trust terminates and the trust corpus is payable to A's child. As is the case in Example 8, A's retained annuity interest (A's right to receive the annuity for 10 years, or until A's prior death) is a qualified annuity interest under paragraphs (b) and (d) of this section. However, B's interest does not meet the requirements of paragraph (d) of this section. The term of B's annuity is not fixed and ascertainable at the creation of the trust, because it is not payable for the life of B, a specified term of years, or for the shorter of those periods. Rather, B's annuity is payable for an unspecified period that will depend upon the number of years left in the original term after A's death. Further, B's annuity is payable only if A dies prior to the expiration of the 10-year term. Thus, payment of B's annuity is not dependent solely on B's survival, but rather is dependent on A's failure to survive.

(ii) Accordingly, the amount of the gift is the fair market value of the property transferred to the trust reduced by the value of A's qualified interest (A's right to receive the stated annuity for 10 years or until A's prior death). B's interest is not a qualified interest and is thus valued at zero under section 2702.

\* \* \* \* \*

Par. 5. Section 25.2702-7 is amended to add two new sentences at the end of that section. The addition reads as follows:

§25.2702-7 Effective dates.

\* \* \*Section 25.2702-2(a)(5), the second and third sentences of §25.2702-2(a)(6), §25.2702-3(d)(2), the first two sentences of §25.2702-3(d)(4), the last sentence of §25.2702-3(e), Example 5, the last two sentences of §25.2702-3(e), Example 6, and §25.2702-3(e), Examples 8 and 9, are effective for trusts created on or after July 26, 2004. However, the Internal Revenue Service will not challenge any prior application of the changes to Examples 5 and 6 in §25.2702-3(e).

Mark E. Matthews,  
Deputy Commissioner for Services and Enforcement.