

[4830-01-P]

Published July 22, 2002

DEPARTMENT OF TREASURY

Internal Revenue Service

26 CFR Part 25

[REG-123345-01]

RIN 1545-AY91

Net Gift Treatment under Section 2519

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed amendments to the regulations relating to the amount treated as a transfer under section 2519 of the Internal Revenue Code when there is a right to recover gift tax under section 2207A(b) and the related gift tax consequences if the right to recover the gift tax is not exercised. The proposed regulations will affect donee spouses who make lifetime dispositions of all or part of a qualifying income interest in qualified terminable interest property. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written comments and outlines of topics to be discussed at the public hearing scheduled for Tuesday, October 15, 2002, at 10 a.m., must be received by Tuesday, September 24, 2002.

ADDRESSES: Send submissions to: CC:ITA:RU (REG-123345-01), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may also be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:ITA:RU (REG-123345-01), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC. Alternatively, taxpayers may submit comments electronically directly to the IRS internet site at www.irs.gov/regs. The public hearing will be held in room 4718, Internal Revenue Building, 1111 Constitution Avenue NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, DeAnn K. Malone, (202) 622-7830; 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

A marital deduction for qualified terminable interest property is allowed for estate tax purposes under section 2056(b)(7) and for gift tax purposes under section 2523(f). Qualified terminable interest property is property transferred by the decedent or donor spouse, in which the donee spouse has

a qualifying income interest for life, and for which an election has been made. If the donee spouse makes a lifetime disposition of all or a portion of the qualifying income interest, section 2519 provides that the donee spouse is treated for estate and gift tax purposes as transferring all interests in the property other than the qualifying income interest. Under section 2207A(b), the donee spouse is entitled to recover any gift tax paid with respect to a transfer under section 2519 from the person receiving the transferred property.

Proposed regulations under several sections including sections 2519 and 2207A(b) were issued on May 21, 1984 (49 FR 21350 [LR-211-76, 1984-1 C.B. 598]). The proposed regulations provided that the amount of the gift under section 2519 is reduced by the amount of the gift tax that the donee spouse is entitled to recover under section 2207A(b) and that the donee spouse makes an additional gift if the donee spouse fails to exercise the right to recover the gift tax. These two provisions were not included in the regulations when they were finalized (TD 8522, 1994-1 C.B. 236). The preamble to the final regulations stated that these issues would be the subject of future proposed regulations. Sections 25.2519-1(c)(4) and 25.2207A-1(b) were reserved for those provisions.

Explanation of Provisions

Section 2207A(b) statutorily shifts the burden for paying the gift tax imposed on a transfer under section 2519 from the donee spouse to the person receiving the transferred property. The payment of gift tax by the person receiving the property benefits the donee spouse because the donee spouse is liable for the payment of this tax and, absent the right of recovery, would be required to pay the tax from the donee spouse's own assets.

The proposed regulations will amend the regulations under section 2519 to provide that the amount of the transfer under section 2519 is reduced by the amount of the gift tax that the donee spouse is entitled to recover under section 2207A(b). The amount of gift tax recoverable and the amount of the remainder interest treated as transferred under section 2519 are determined by using the interrelated computation applicable to other transfers in which the transferee agrees to pay the gift tax. See Rev. Rul. 81-23 (1981-2 C.B. 189).

In addition, the proposed regulations will amend the regulations under section 2207A(b) to provide that if the donee spouse fails to exercise the right to recover the gift tax, the donee spouse makes a gift in the amount of the unrecovered gift tax to the person from whom the recovery of

gift tax could have been obtained.

Proposed Effective Date

The regulations will apply to any transfer under section 2519 where there is a right to recover gift tax under section 2207A(b) that occurs on or after the date final regulations are published in the **Federal Register**.

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 regulations, and because these 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 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

comments (a signed original and eight (8) copies) that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rule and how it may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for Tuesday, October 15, 2002, at 10 a.m., in room 4718, Internal Revenue Building, 1111 Constitution Avenue NW., Washington, DC. Due to building security procedures, visitors must use the main building entrance on Constitution Avenue, NW. 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 and an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by Tuesday, September 24, 2002. 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 DeAnn K. Malone, Office of the Chief Counsel, IRS. Other personnel from the IRS and Treasury Department participated in their development.

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

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

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

Par. 2. Section 25.2207A-1 is amended by adding the text of paragraph (b) to read as follows:

§25.2207A-1 Right of recovery of gift taxes in the case of certain marital deduction property.

* * * * *

(b) Failure of a person to exercise the right of recovery. The failure of a person to exercise a right of recovery provided by section 2207A(b) upon a lifetime transfer subject to section 2519 is treated as a transfer for Federal gift tax purposes of the unrecovered amounts to the person(s) from whom the recovery could have been obtained. See §25.2511-1. The transfer is considered to be made when the right to recovery is no longer enforceable and is treated as a gift even if recovery is impossible. Any delay in the exercise of the right of recovery shall be treated as an interest-free loan with the appropriate gift tax consequences.

* * * * *

Par. 3. Section 25.2519-1 is amended as follows:

1. Paragraph (c)(1) is amended by adding a sentence to the end of the paragraph.

2. The paragraph heading for paragraph (c)(4) is revised and the text of paragraph (c)(4) is added.

3. Paragraph (g) introductory text is revised.

The additions and revisions read as follows:

§25.2519-1 Disposition of certain life estates.

* * * * *

(c) * * *(1) * * * See paragraph (c)(4) of this section for the effect of gift tax that the donee spouse is entitled

to recover under section 2207A.

* * * * *

(4) Effect of gift tax entitled to be recovered under section 2207A on the amount of the transfer. The amount treated as a transfer under paragraph (c)(1) of this section is further reduced by the amount the donee spouse is entitled to recover under section 2207A(b) (relating to the right to recover gift tax attributable to the remainder interest). If the spouse is entitled to recover gift tax under section 2207A(b), the amount of gift tax recoverable and the value of the remainder interest treated as transferred under section 2519 are determined by using the same interrelated computation applicable for other transfers in which the transferee assumes the gift tax liability. The gift tax consequences of failing to exercise the right of recovery are determined separately under §25.2207A-1(b).

* * * * *

(g) Examples. The following examples illustrate the application of paragraphs (a) through (f) of this section. Except as provided otherwise in the examples, assume that the decedent, D, was survived by spouse, S, that in each example the section 2503(b) exclusion has already been fully utilized for each year with respect to the donee in question, that

section 2503(e) is not applicable to the amount deemed transferred, and that the gift taxes on the amount treated as transferred under

paragraph (c) are offset by S's unified credit. The examples are as follows:

* * * * *

Robert E. Wenzel,
Deputy Commissioner of Internal
Revenue.