

(2) *Exceptions.* A substantial modification does not include—

(i) A modification required by the terms of a right or restriction;

(ii) A discretionary modification of an agreement conferring a right or restriction if the modification does not change the right or restriction;

(iii) A modification of a capitalization rate used with respect to a right or restriction if the rate is modified in a manner that bears a fixed relationship to a specified market interest rate; and

(iv) A modification that results in an option price that more closely approximates fair market value.

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

Example 1. T dies in 1992 owning title to Blackacre. In 1991, T and T's child entered into a lease with respect to Blackacre. At the time the lease was entered into, the terms of the lease were not comparable to leases of similar property entered into among unrelated parties. The lease is a restriction on the use of the property that is disregarded in valuing the property for Federal estate tax purposes.

Example 2. T and T's child, C, each own 50 percent of the outstanding stock of X corporation. T and C enter into an agreement in 1987 providing for the disposition of stock held by the first to die at the time of death. The agreement also provides certain restrictions with respect to lifetime transfers. In 1992, as permitted (but not required) under the agreement, T transfers one-half of T's stock to T's spouse, S. S becomes a party to the agreement between T and C by reason of the transfer. The transfer is the addition of a family member to the right or restriction. However, it is not a substantial modification of the right or restriction because the added family member would be assigned to a generation under section 2651 of the Internal Revenue Code no lower than the generation occupied by C.

Example 3. The facts are the same as in *Example 2*. In 1993, the agreement is amended to reflect a change in the company's name and a change of address for the company's registered agent. These changes are not a substantial modification of the agreement conferring the right or restriction because the right or restriction has not changed.

[T.D. 8395, 57 FR 4273, Feb. 4, 1992]

§ 25.2703-2 Effective date.

Section 25.2703-1 applies to any right or restriction created or substantially

modified after October 8, 1990, and is effective as of January 28, 1992. With respect to transfers occurring prior to January 28, 1992, and for purposes of determining whether an event occurring prior to January 28, 1992 constitutes a substantial modification, taxpayers may rely on any reasonable interpretation of the statutory provisions. For these purposes, the provisions of the proposed regulations and the final regulations are considered a reasonable interpretation of the statutory provisions.

[T.D. 8395, 57 FR 4274, Feb. 4, 1992]

§ 25.2704-1 Lapse of certain rights.

(a) *Lapse treated as transfer—(1) In general.* The lapse of a voting right or a liquidation right in a corporation or partnership (an "entity") 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. 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).

(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) *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. The right to compel the entity to acquire all or a portion of the holder's equity