

**Internal Revenue Service**

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

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Date:

January 5, 2000

Partnership =

Partnership Agreement =

Partner 1 =

Partner 2 =

Partner 3 =

Partner 4 =

Dear \_\_\_\_\_ :

This responds to your letter dated December 8, 1999, and prior correspondence, on behalf of Partnership and Partners 1-4, requesting a ruling that the proposed amendment to a partnership agreement will not cause §§ 2703 and 2704 of the Internal Revenue Code to apply to Partnership Agreement.

You represent the facts to be as follows: Partnership is a general partnership created prior to October 8, 1990, under the terms of the Partnership Agreement. The Partnership Agreement has not been amended. Partnership's four general partners are Partner 1, Partner 2, Partner 3, and Partner 4.

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Under §§ 17.01, 17.03, and 20.01 of the Partnership Agreement, upon the death of a person who is the beneficial owner of a general partner (1) 49% of such person's interest must be purchased on a date specified in a written notice from the Partnership, but not later than 90 days after the end of the fiscal year in which the death occurs, and (2) the remaining 51% may be purchased at any time within ten years after death, but must be purchased, in any event, on the tenth anniversary of death.

Section 19.01 of the Partnership Agreement provides that the price for the interest to be purchased is to be paid in ten equal annual installments. The first installment is to be paid on the first anniversary of the closing date, together with interest on the unpaid balance, at the rate of 5% per annum, to be paid on each anniversary of the closing date, commencing with the first anniversary of the closing date. The Partnership's obligation is to be evidenced by the execution and delivery of ten non-negotiable promissory notes, bearing interest at the rate of 5% per annum. The promissory notes are to mature at annual intervals. The Partnership has the right to prepay the promissory notes, in whole or in part, with interest thereon.

The parties propose to amend § 19.01 of the Partnership Agreement to provide that interest on any unpaid balance of the purchase price will be at a rate equal to the greater of (1) 5% per annum, or (2) the long-term applicable federal rate under § 1274, compounded annually. You request a ruling that this proposed amendment to § 19.01 of the Partnership Agreement will not cause §§ 2703 or 2704 to apply to any of the provisions of the Partnership Agreement.

#### Application of Section 2703

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

Under Public Law 101-508, § 11602(e)(1)(A)(ii), § 2703 applies to agreements, options, rights, or restrictions entered into or granted after October 8, 1990, and agreements, options, rights, or restrictions in existence prior to October 8, 1990, that are "substantially modified" after that date. See also, § 25.2703-2.

Section 25.2703-1(c)(1) provides that a right or restriction that is substantially modified is treated as a right or restriction created on the date of the modification. Any discretionary modification of a right or restriction, whether or not authorized by the terms of the agreement, that results in other than a de minimis change to the quality, value, or timing of the rights of any party with respect to property that is subject to the right or restriction is a substantial modification. If the terms of the right or restriction

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require periodic updating, the failure to update is presumed to substantially modify the right or restriction unless it can be shown that updating would not have resulted in a substantial modification. The addition of any family member as a party to a right or restriction (including by reason of a transfer of property that subjects the transferee family member to a right or restriction with respect to the transferred property) is considered a substantial modification, unless the addition is mandatory under the terms of the right or restriction or the added family member is assigned to a generation (determined under the rules of § 2651) no lower than the lowest generation occupied by individuals already a party to the right or restriction. Under § 25.2703-1(c)(2), a substantial modification does not include: (1) a modification required by the terms of a right or restriction; (2) a discretionary modification of an agreement conferring a right or restriction if the modification does not change the right or restriction; (3) 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 (4) a modification that results in an option price that more closely approximates fair market value.

In the present case, the Partnership Agreement was executed prior to October 8, 1990, and has not been amended since that date. The parties propose to change the interest rate on installment payments under § 19.01 of the Partnership Agreement from the current 5% per annum to the greater of 5% per annum or the long-term applicable federal rate under § 1274, compounded annually. This modification will result in an option price that more closely approximates fair market value. Therefore, we conclude that the proposed amendment to § 19.01 of the Partnership Agreement will not constitute a substantial modification of the Partnership Agreement for purposes of § 2703.

#### Application of Section 2704

Section 2704(a)(1) provides, generally, that if there is a lapse of a voting or liquidation right in a family-controlled corporation or partnership, the lapse is treated as a transfer of an amount equal to the loss in the value of the interest attributable to such lapse. Section 2704(b)(1) provides, in general, that if there is a transfer of an interest in a corporation or partnership to a member of the transferor's family and the transferor's family controls the entity immediately before the transfer, then any "applicable restriction" is disregarded in determining the value of the transferred interest. An "applicable restriction" is defined in § 2704(b)(2) as any restriction which effectively limits the ability of the corporation or partnership to liquidate.

Under Public Law 101-508, § 11602(e)(1)(A)(iii), and § 25.2704-3, § 2704 applies to restrictions or rights (or limitations on rights) created after October 8, 1990. In the present case, the Partnership Agreement was executed prior to October 8, 1990. The proposed amendment to § 19.01 of the Partnership Agreement does not involve the creation of any new restrictions or rights (or limitations on rights) after

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October 8, 1990. Therefore, we conclude that the proposed amendment will not cause § 2704 to apply to any restrictions or rights (or limitations on rights) contained in the Partnership Agreement.

Except as we have specifically ruled herein, we express no opinion under the cited provisions or under any other provision of the Code.

This ruling is based on the facts and applicable law in effect on the date of this letter. If there is a change in material fact or law (local or Federal) before the transactions considered in the ruling take effect, the ruling will have no force or effect. If the taxpayer is in doubt whether there has been a change in material fact or law, a request for reconsideration of this ruling should be submitted to this office.

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

Sincerely yours,  
Assistant Chief Counsel  
(Passthroughs and Special Industries)  
By: George Masnik  
Chief, Branch 4

Enclosure  
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