

Example (4).—Individual *A* owns 55 percent of the stock of corporation *X*. Another 25 percent of corporation *X*'s stock is owned in the aggregate by individuals *B*, *C*, *D*, and *E*. On June 15, 1963, individual *A* transfers property to corporation *Y* (newly created for the purpose of acquiring such property) in exchange for 60 percent of the stock of *Y*, and *B*, *C*, and *D* acquire all of the remaining stock of *Y*. The transfer is within the scope of section 1551(a)(3).

(h) PURPOSE OF TRANSFER.—In determining, for purposes of this section, whether the securing of the surtax exemption or accumulated earnings credit constituted “a major purpose” of the transfer, all circumstances relevant to the transfer shall be considered. “A major purpose” will not be inferred from the mere purchase of inventory by a subsidiary from a centralized warehouse maintained by its parent corporation or by another subsidiary of the parent corporation. For disallowance of the surtax exemption and accumulated earnings credit under section 1551, it is not necessary that the obtaining of either such credit or exemption, or both, have been the sole or principal purpose of the transfer of the property. It is sufficient if it appears, in the light of all the facts and circumstances, that the obtaining of such exemption or credit, or both, was one of the major considerations that prompted the transfer. Thus, the securing of the surtax exemption or the accumulated earnings credit may constitute “a major purpose” of the transfer, notwithstanding that such transfer was effected for a valid business purpose and qualified as a reorganization within the meaning of section 368. The taxpayer's burden of establishing by the clear preponderance of the evidence that the securing of either such exemption or credit or both was not “a major purpose” of the transfer may be met, for example, by showing that the obtaining of such exemption, or credit, or both, was not a major factor in relationship to the other consideration or considerations which prompted the transfer.

(This Treasury Decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).)

SHELDON S. COHEN,
Commissioner of Internal Revenue.

Approved February 17, 1967.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

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SUBTITLE B.—ESTATE AND GIFT TAXES

CHAPTER 11.—ESTATE TAX

SUBCHAPTER A.—ESTATES OF CITIZENS OR RESIDENTS

PART II.—CREDITS AGAINST TAX

SECTION 2012.—CREDIT FOR GIFT TAX

26 CFR 20.2012-1: Credit for gift tax.

The computation of the gift tax credit applicable to an estate against which a credit for tax on prior transfers is also allowable requires the computation of a hypothetical gift tax credit which is made on the basis of the transferee-decedent's reduced gross estate. See Rev. Rul. 67-110, page 262.

SECTION 2013.—CREDIT FOR TAX ON PRIOR TRANSFERS

26 CFR 20.2013-1: Credit for tax on prior transfers. Rev. Rul. 67-110

(Also Section 2012; 20. 2012-1.)

Where a credit is allowable under section 2013(a) of the Internal Revenue Code of 1954, for tax on prior transfers, and a gift tax credit is also allowable under section 2012(a), the computation of the limitation on credit provided for in section 2013(c) requires, for purposes of section 2013(c)(1)(B), the computation of a hypothetical gift tax credit, which is made on the basis of the transferee's reduced gross estate, in order to determine the net Federal estate tax under section 2013(c)(1)(B).

Advice has been requested concerning the method of computing the credit allowable under section 2013 of the Internal Revenue Code of 1954, where the decedent's estate is also entitled to a credit under section 2012 of the Code.

In the instant case, the decedent received the entire net estate of his predeceased brother who died in 1961. The value of such inherited property was included in the brother's gross estate and a Federal estate tax was paid thereon. The decedent died in the year 1966, which was within 10 years after the death of the brother.

The decedent gratuitously transferred a parcel of real estate to his son. A Federal gift tax return was filed, a gift tax was paid, and the decedent died 6 months later. The transfer of the real property was admittedly made in contemplation of death and, consequently, its value was included in the decedent's gross estate under the provisions of section 2035 of the Code.

Under section 2012(a) of the Code, a credit is allowed against the Federal estate tax for gift tax paid with respect to the transfer by gift of property that is subsequently included in the donor-decedent's gross estate. The credit is limited to the lesser of two limitations. The "first limitation" is the amount of the gift tax paid on the included gift. And the "second limitation" is the amount of the estate tax attributable to the inclusion of the gift property in the gross estate.

Section 2013 of the Code provides that the estate of a deceased who had received property from another decedent shall be credited with all or a part of the amount of the Federal estate tax paid with respect to such property in the transferor-decedent's estate, provided that the decedents died within the statutory period. Section 2013(c)(1) imposes a limitation on the amount of the credit as computed in section 2013(b); that is, the credit cannot be greater than the amount by which the estate tax imposed by either section 2001 or 2101 (after deducting the credits for State death taxes, gift tax, and foreign death taxes provided in sections 2011, 2012, and 2014) and computed without regard to section 2013 exceeds "such tax computed by excluding from the decedent's gross estate the value of such property transferred * * *." In other words, in determining the amount of the credit allowable under section 2013(c)(1), it is necessary to make two computations of the Federal estate tax, both of which are to be made without regard to the credit under section 2013, but which must take into account the allowance of the credits provided for in sections 2011, 2012, and 2014, that is, the credits for State death taxes paid, gift taxes paid, and foreign death taxes paid.

The first computation, under section 2013(c)(1)(A), is made on the basis of the entire value of the present decedent's (transferee) gross estate.

The second computation, under section 2013(c)(1)(B), is made on the basis of the value of the decedent's gross estate less the value of the property received from the prior decedent (transferor). If a gift tax credit is involved, the second computation requires the computation of a hypothetical gift tax credit, which is likewise made on the basis of the reduced gross estate, in order to determine the amount of the Federal estate tax on the reduced gross estate.

The computation was made as follows:

Decedent's taxable estate

Gross estate.....		\$500,000.00
Less:		
Debts and charges.....	\$10,000.00	
Marital deduction.....	30,000.00	
Specific exemption.....	60,000.00	100,000.00
Taxable estate.....		\$400,000.00
Gross estate tax.....		\$113,700.00
Less credit for State death taxes.....		8,720.00
Gross estate tax less credit for State death taxes.....		\$104,980.00
Less:		
Credit for Federal gift taxes (1st limitation) ..	\$20,025.00	
Credit for tax on prior transfers (2d limitation) ..	49,984.64	70,009.64
Net estate tax payable.....		\$34,970.36

Computation of credit for Federal gift taxes

<i>1st limitation:</i>		
Value of gift to son.....		\$153,000.00
Less annual exclusion.....		3,000.00
Amount of included gift for year.....		\$150,000.00
Less specific exemption.....		30,000.00
Amount of taxable gifts for year.....		\$120,000.00
Gift tax paid on taxable gifts.....		\$20,025.00
 1st limitation expressed as a fraction:		
$\frac{\$153,000.00 - \$3,000.00 \text{ (Value of gift, less annual exclusion)}}{\$120,000.00 + \$30,000.00 \text{ (Total taxable gift, plus specific exemption allowed)}} \times \$20,025.00 \text{ (Total gift tax paid)} = \$20,025.00$		
 2d limitation:		
Value of gift as included in gross estate.....		\$153,000.00
Gross estate.....		500,000.00
Less marital deduction.....		30,000.00
Value of gross estate less marital deduction.....		470,000.00
 2d limitation expressed as a fraction:		
$\frac{\$153,000.00 - \$3,000.00 \text{ (Value of gift for estate tax purpose, less annual exclusion)}}{\$500,000.00 - \$30,000.00 \text{ (Value of gross estate, less marital deduction)}} \times \$104,980.00 \text{ (Gross estate tax, less credit for State death taxes)} = \$33,504.26$		

Computation of credit for tax on prior transfers

Assuming that State death taxes are \$6,800.00, the maximum credit allowable, the computation of Federal estate tax in the brother's estate would be as follows:

Brother's total gross estate.....		\$440,000.00
Less:		
Debts and charges.....	\$40,000.00	
Specific exemption.....	60,000.00	100,000.00
		<u>340,000.00</u>
Taxable estate.....		\$340,000.00
Net estate tax payable.....		\$87,700.00

The computation of the credit, under 2013(b) of the Code, in the decedent's estate was as follows:

First limitation

Net value of transfers:

Brother's gross estate.....		\$440,000.00
Less:		
Debts and charges.....	\$40,000.00	
Federal estate tax.....	87,700.00	
State death taxes.....	6,800.00	134,500.00
		<u>305,500.00</u>
Net value of transfers.....		\$305,500.00

Value of transferor's estate, adjusted:

Taxable estate.....		\$340,000.00
Plus specific exemption.....		60,000.00
		<u>400,000.00</u>
Federal estate tax.....	\$87,700.00	
State death taxes.....	6,800.00	94,500.00
		<u>305,500.00</u>
Value of transferor's adjusted estate.....		\$305,500.00

Tax on transferor's estate, adjusted:

Federal estate tax paid.....		\$87,700.00
Plus:		
Credit for Federal gift taxes.....	0.00	
Credit for tax on prior transfers.....	0.00	0.00
		<u>87,700.00</u>
Transferor's adjusted estate tax.....		\$87,700.00
Transferor's tax on prior transfers (1st limitation)		
\$305,500.00 (Net value of transfers) × \$87,700.00 (Tax on		= \$87,700.00
\$305,500.00 (Value of transferor's adjusted estate) × transferor's estate)		

Second limitation

Transferee's tax computed without regard to credit for tax on prior transfers:

Gross estate tax.....		\$113,700.00
Less credit for State death taxes.....		8,720.00
		<u>104,980.00</u>
Gross estate less credit for State death taxes.....		104,980.00
Less credit for Federal gift taxes.....		20,025.00
		<u>84,955.00</u>
Estate tax before credit for tax on prior transfers.....		\$84,955.00

Transferee's reduced gross estate:

Gross estate.....		500,000.00
Less net value of transfers.....		305,500.00
		<u>194,500.00</u>
Reduced gross estate.....		\$194,500.00

<i>Transferee's deductions:</i>	
Debts and charges-----	\$10,000.00
Marital deduction-----	30,000.00
Specific exemption-----	60,000.00
Total deductions-----	<u>100,000.00</u>
<i>Transferee's reduced taxable estate:</i>	
Reduced gross estate-----	194,500.00
Less transferee's deductions-----	100,000.00
Reduced taxable estate-----	<u>94,500.00</u>
<i>Transferee's tax on reduced taxable estate:</i>	
Gross estate tax-----	19,160.00
Less credit for State death taxes-----	472.00
Gross estate tax less credit for State death taxes-----	18,688.00
Less credit for Federal gift tax (2d limitation, as computed below)-----	17,040.73
Net estate tax on reduced taxable estate-----	<u>1,647.27</u>

Computation of hypothetical gift tax credit applicable to transferee's reduced gross estate

1st limitation (\$20,025.00, unchanged).

<i>2d limitation:</i>	
Value of gift as included in gross estate-----	\$153,000.00
Transferee's reduced gross estate-----	194,500.00
Less marital deduction-----	30,000.00
Value of reduced gross estate, less marital deduction-----	<u>164,500.00</u>

2nd limitation expressed as a fraction:

$$\frac{\$153,000.00 - \$3,000.00 \text{ (Value of gift for estate tax purpose, less annual exclusion)}}{\$194,500.00 - \$30,000.00 \text{ (Value of reduced gross estate, less marital deduction)}} \times \frac{\$18,688.00 \text{ (Gross estate tax on reduced taxable estate, less credit for State death taxes)}}{\$17,040.73} = \$17,040.73$$

Transferee's tax on prior transfers (2nd limitation):

Transferee's estate tax before credit for tax on prior transfers--	\$84,955.00
Less transferee's tax on reduced taxable estate-----	1,647.27
Transferee's tax on prior transfer-----	<u>\$83,307.73</u>

Since the tax in the transferee's estate attributable to the transferred property is smaller than that in the transferor's estate, the "second limitation" applies. Inasmuch as the two deaths occurred within 5 years, the credit is limited to 60 percent of the tax attributable to the property, or $\$83,307.73 \times .60 = \$49,984.64$.

Where a decedent-transferee received a property interest which was not susceptible of valuation by recognized valuation principles on the date of death of the transferor, a credit under section 2013 of the Internal Revenue Code of 1954 for Federal estate tax paid on

the transfer of such an interest from the estate of the transferor is not allowed against the Federal estate tax imposed upon the estate of the decedent-transferee.

Advice has been requested regarding the allowance of the credit for Federal estate tax paid on prior transfers under section 2013 of the Internal Revenue Code of 1954, where, at the time of the transferor's death, the property interest of the transferee was not susceptible of valuation by recognized valuation principles.

A grantor created a trust during his lifetime under the terms of which he reserved the right to net income for his life. The trust instrument provided that at his death net income was payable to the grantor's wife for life, subject to the power of the trustee, in his absolute and uncontrolled discretion, to withhold any or all of such income and to add all or any part of it to the principal of the trust. The instrument also provided that at the grantor's death or at the death of his wife, whichever occurred last, the principal and any accumulated income of the trust were to be paid to the grantor's then living children. At the grantor's death the principal of the trust was includible in his gross estate for Federal estate tax purposes. Thereafter, the trustee annually paid out the entire amount of net income of the trust to the wife of the grantor until her death.

Section 2013(a) of the Code provides, in part, that the tax imposed by section 2001 of the Code shall be credited with all or a part of the amount of the Federal estate tax paid with respect to the transfer of an interest in property to a decedent (designated as a transferee) from a person (designated as a transferor) who died within 10 years before, or within 2 years after, the decedent's death. The amount of the credit is based upon the value of the property used for the purpose of determining the Federal estate tax of the transferor, notwithstanding the fact that the property transferred cannot be identified in, or traced through, the transferee's estate. See Rev. Rul. 59-9, C.B. 1959-1, 232.

Section 20.2013-4(a) of the Estate Tax Regulations provides that if a transferee received a life estate or a remainder or other limited interest in property included in the transferor's gross estate the value of such an interest is determined as of the date of the transferor's death on the basis of recognized valuation principles. Any action, transaction, or event occurring subsequent to the death of the transferor is not to be taken into account in the valuation of such transferred property.

Where a trustee possesses the power, in his absolute and uncontrolled discretion, to pay out net income to the income beneficiary of a trust or to accumulate such income, the beneficiary's interest cannot be valued according to recognized valuation principles as of the date of the transferor's death. Therefore, notwithstanding the fact that such income was actually paid to the decedent-transferee, the credit for tax on prior transfers under section 2013 of the Code is not allowable with respect to such an interest.