

imply in any manner whatsoever that such person has been sponsored, recommended or approved, or that such person's abilities or qualifications, the content, quality or accuracy of his training program, or the positions taken in the course of resolving any actual or hypothetical situations presenting ethical or legal issues, have in any respect been passed upon or endorsed, by the Commission, a registered futures association, or any representative thereof. Any promotional or instructional material used in connection with the training required by this section must prominently state that the Commission and any registered futures association have not reviewed or approved the specific content of the training program and do not recommend the provider of such training: *Provided, however*, that this paragraph shall not be construed to prohibit a statement that a person is included on a list of ethics training providers maintained by a registered futures association if such statement is true in fact and if the effect of such a listing is not misrepresented.

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Issued in Washington, D.C. on December 7, 1995, by the Commission.

Jean A. Webb,

Secretary of the Commission.

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1, 20, and 25

[TD 8630]

RIN 1545-AR56

Actuarial Tables Exceptions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final income, estate, and gift tax regulations relating to exceptions to the use of the valuation tables in the regulations for valuing annuities, interests for life or a term of years, and remainder or reversionary interests, the valuation of which was the subject of final regulations published on June 10, 1994. These regulations are necessary in order to provide guidance consistent with court decisions concluding that the valuation tables are not to be used in certain situations.

EFFECTIVE DATE: These regulations are effective December 13, 1995.

FOR FURTHER INFORMATION CONTACT: William L. Blodgett, telephone (202) 622-3090 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On June 10, 1994, the IRS published in the Federal Register (59 FR 30100) final income tax regulations under sections 170, 642, 664 and 7520 of the Internal Revenue Code (Code), and final estate and gift tax regulations under sections 2031, 2512 and 7520 of the Code providing actuarial tables to be used in valuing annuities, interests for life or a term of years, and remainder or reversionary interests under section 7520. On June 10, 1994, the IRS also published in the Federal Register (59 FR 30180) proposed amendments to the income, estate, and gift tax regulations prescribing circumstances when the published actuarial tables cannot be used to value interests. This regulation finalizes those amendments.

Written comments responding to the notice of proposed rulemaking were received. Requests for a public hearing were also received but were subsequently withdrawn. After consideration of all the comments received, those amendments are revised and adopted by this Treasury decision.

Explanation of Provisions

Section 7520(a), which is effective for transfers after April 30, 1989, provides that the value of annuities, interests for life or a term of years, and remainder or reversionary interests is to be determined under tables published by the IRS. Section 7520(e) provides that, for purposes of section 7520, the term *tables* includes formulas. Section 7520(b) provides that section 7520 shall not apply for purposes of any provision specified in regulations. The Conference Report accompanying the Technical and Miscellaneous Revenue Act of 1988, H.R. Conf. Rep. No. 1104, 100th Cong., 2d Sess. 113 (1988) (1988-3 C.B. 603), states that section 7520 does not apply in "situations specified in Treasury regulations." A summary of the principal comments received and revisions made in the final regulations in response to those comments is provided below.

1. Valuation of Annuities, Income Interests, etc.

Under the proposed regulations, the tables cannot be used if the instrument of transfer does not provide the beneficiary of the annuity, income interest, or remainder interest with the degree of beneficial enjoyment that is consistent with the traditional character of that property interest under

applicable local law. One comment letter suggested that, as a result of enactment of section 2702, it may no longer be necessary to prescribe special rules in the case of a trust corpus consisting of nonproductive property. It was decided to retain these rules because this issue will continue to arise in certain situations where section 2702 does not apply; e.g., the valuation of a gift of an income interest for purposes of determining the section 2503(b) gift tax exclusion; the valuation of the bequest of an income interest for purposes of the section 2013 estate tax credit.

In response to comments, the final regulations provide additional guidance for determining under what circumstances a life tenant or term certain beneficiary of tangible property possesses adequate beneficial use such that the tables would be used to value the interest.

A number of comments were received on the valuation of an annuity that is payable from a trust corpus that will exhaust prior to the annuitant reaching the presumed terminal age prescribed by the tables (age 110). Under the proposed regulations, the interest would be valued, not as a right to receive the annuity for the life of the annuitant, but rather as the right to receive the annuity for the shorter of the life of the annuitant or the date on which the corpus will exhaust. One commentator agreed that the possibility of exhaustion of corpus should be taken into account in cases of relatively severe underfunding of the trust. However, it was suggested that, if the underfunding was relatively less severe, it should be disregarded. After further consideration of this issue, the IRS has concluded that the method described in the proposed regulations for determining the value of the annuity is consistent with fundamental principles for determining present value and long-standing IRS position. See, Rev. Rul. 77-454 (1977-2 C.B. 351); Rev. Rul. 70-452 (1970-2 C.B. 199); *Moffett v. Commissioner*, 269 F.2d 738 (4th Cir. 1959); *United States v. Dean*, 224 F.2d 26 (1st Cir. 1955). However, in response to requests, the explanation of the methodology and computation has been amplified.

2. Terminal Illness

Under the proposed regulations, the tables cannot be used if the individual, who is the measuring life with respect to the property interest, is terminally ill. Under the proposed regulations, the individual is terminally ill if that individual was known to have an incurable illness or deteriorating physical condition such that there is at

least a 50 percent probability that the individual will die within one year.

One commentator suggested that the value of a property interest that is dependent upon a measuring life should be determined in all events based on the mortality component contained in Table 80CNSMT (which is based on the life experience of the general population), rather than a mortality component that reflects the actual terminally ill condition of the individual. The commentator also suggested that if departure from the actuarial tables is deemed appropriate in the case of terminally ill individuals, then the standard in Rev. Rul. 80-80 (1980-1 C.B. 194), which is not explicitly expressed in the form of a percentage probability of survival (as is the standard in the proposed regulations), adequately differentiates between individuals that should not be considered terminally ill and those that should. This commentator also questioned whether a percentage probability standard, such as the one used in the proposed regulations, would be feasible to administer.

The IRS continues to believe that mortality tables such as Table 80CNSMT should not be used to predict the survival probabilities of an individual whose time of death is reasonably predictable based on the facts presented. To determine whether the proposed test for classifying an individual as terminally ill would be feasible, the IRS consulted with a number of medical specialists. Medical experts called upon to assess the probability of survival of a terminally ill individual base their assessment on statistical compilations of the percentage of individuals who survive for a specified period of time when suffering with a particular disease. Thus, the IRS believes that a test for classifying an individual as terminally ill can reasonably be based upon the probability of survival for a specified period of time.

One commentator suggested that the mortality test should take into account the actual period of survival after the transfer. For example, if the individual actually survived for one year, that individual should not be deemed to have been terminally ill. Although post-transaction events are not ordinarily determinative for valuation purposes, such events may provide evidence of value as of the valuation date. Accordingly, the final regulations provide a presumption that if the individual who is the measuring life survives for eighteen months or longer after the transfer, that individual shall be presumed to have not been

terminally ill on the date of the transfer unless the contrary is established by clear and convincing evidence.

The commentator also questioned whether the proposed test for classifying an individual as terminally ill would result in the classification of elderly people suffering from the general infirmities of old age as "terminally ill." The IRS continues to believe that the test should be consistently applied to people of all ages. Under the regulations, the individual must be inflicted with an incurable illness or other deteriorating physical condition that is life threatening. Thus, elderly people suffering from the general infirmities of old age, but not from a specific incurable life-threatening illness, would not be considered terminally ill under the test. Consequently, if an elderly person has one or more illnesses, none of which, standing alone or considered together, is life-threatening, that person would not be considered to be terminally ill.

The same commentator suggested that "knowledge" of the terminal illness should be limited to actual knowledge by the taxpayer or the decedent, rather than to "knowledge" by any of the parties involved. However, limitation of the requisite "knowledge" to the taxpayer or decedent would present a significant burden to the IRS regarding proof and would present opportunities for easy circumvention. Thus, the IRS believes that the requirement that the condition of the individual be "known," although not necessarily by the taxpayer or decedent, is reasonable.

Commentators suggested that the regulations should make it clear that a special actuarial factor taking into account a transferor's terminal illness may be used in valuing a transfer to a pooled income fund. The final regulations incorporate that suggestion.

Comments were received that the language in § 20.7520-3(b)(3)(ii) of the proposed regulations regarding the valuation of a property interest that is based upon a terminally ill measuring life, for purposes of determining the applicable credit for tax on prior transfers under section 2013, was ambiguous. Generally, if the final determination of the estate tax liability in the transferor's estate was dependent on the valuation of the life interest received by the transferee, then the value of the property transferred, for purposes of determining the credit allowable for the transferee's estate, is the value determined previously for the transferor's estate. Section 20.7520-3(b)(3)(ii) of the final regulations clarifies this rule. The IRS invites comments on whether the value of a

reversionary interest under section 673 should be determined without regard to the physical condition of the decedent immediately before death, a related issue that was raised by commentators.

3. Application of Actuarial Tables

One commentator suggested that the tables prescribed by the regulations must be used for valuing all interests transferred between April 30, 1989 (the effective date of section 7520) and December 13, 1995 (the effective date of the regulations). However, these regulations generally adopt principles established in case law and published IRS positions. See, e.g., *O'Reilly v. Commissioner*, 973 F.2d 1403 (8th Cir. 1992), *rem'd*, T.C.M. 1994-61 (underproductive income interest); *Estate of McLendon v. Commissioner*, T.C.M. 1993-459; Rev. Rul. 80-80 (1980-1 C.B. 194) (terminal illness of measuring life); *Moffett v. Commissioner*, 269 F.2d 738 (4th Cir. 1959); Rev. Rul. 77-454 (1977-2 C.B. 351) (exhausting corpus). There is no indication that Congress intended to supersede this well-established case law and administrative ruling position when it enacted section 7520. Consequently, in the case of transfers prior to the effective date of these regulations, the question of whether a particular interest must be valued based on the tables will be resolved based on applicable case law and revenue rulings.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 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) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is William L. Blodgett, Office of Assistant Chief Counsel (Passthroughs and Special Industries), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects

26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

26 CFR Part 20

Estate taxes, Reporting and recordkeeping requirements.

26 CFR Part 25

Gift taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1, 20 and 25 are amended as follows:

PART 1—INCOME TAXES

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

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

PAR. 2. Section 1.7520-3 is amended by revising paragraph (b) and adding a sentence at the end of paragraph (c) to read as follows:

§ 1.7520-3 Limitation on the application of section 7520.

* * * * *

(b) *Other limitations on the application of section 7520—(1) In general—(i) Ordinary beneficial interests.* For purposes of this section:

(A) An *ordinary annuity interest* is the right to receive a fixed dollar amount at the end of each year during one or more measuring lives or for some other defined period. A standard section 7520 annuity factor for an ordinary annuity interest represents the present worth of the right to receive \$1.00 per year for a defined period, using the interest rate prescribed under section 7520 for the appropriate month. If an annuity interest is payable more often than annually or is payable at the beginning of each period, a special adjustment must be made in any computation with a standard section 7520 annuity factor.

(B) An *ordinary income interest* is the right to receive the income from, or the use of, property during one or more measuring lives or for some other defined period. A standard section 7520 income factor for an ordinary income interest represents the present worth of the right to receive the use of \$1.00 for a defined period, using the interest rate prescribed under section 7520 for the appropriate month.

(C) An *ordinary remainder or reversionary interest* is the right to receive an interest in property at the end of one or more measuring lives or some other defined period. A standard section

7520 remainder factor for an ordinary remainder or reversionary interest represents the present worth of the right to receive \$1.00 at the end of a defined period, using the interest rate prescribed under section 7520 for the appropriate month.

(ii) *Certain restricted beneficial interests.* A *restricted beneficial interest* is an annuity, income, remainder, or reversionary interest that is subject to a contingency, power, or other restriction, whether the restriction is provided for by the terms of the trust, will, or other governing instrument or is caused by other circumstances. In general, a standard section 7520 annuity, income, or remainder factor may not be used to value a restricted beneficial interest. However, a special section 7520 annuity, income, or remainder factor may be used to value a restricted beneficial interest under some circumstances. See paragraph (b)(4) *Example 2* of this section, which illustrates a situation where a special section 7520 actuarial factor is needed to take into account the shorter life expectancy of the terminally ill measuring life. See § 1.7520-1(c) for requesting a special factor from the Internal Revenue Service.

(iii) *Other beneficial interests.* If, under the provisions of this paragraph (b), the interest rate and mortality components prescribed under section 7520 are not applicable in determining the value of any annuity, income, remainder, or reversionary interest, the actual fair market value of the interest (determined without regard to section 7520) is based on all of the facts and circumstances if and to the extent permitted by the Internal Revenue Code provision applicable to the property interest.

(2) *Provisions of governing instrument and other limitations on source of payment—(i) Annuities.* A standard section 7520 annuity factor may not be used to determine the present value of an annuity for a specified term of years or the life of one or more individuals unless the effect of the trust, will, or other governing instrument is to ensure that the annuity will be paid for the entire defined period. In the case of an annuity payable from a trust or other limited fund, the annuity is not considered payable for the entire defined period if, considering the applicable section 7520 interest rate at the valuation date of the transfer, the annuity is expected to exhaust the fund before the last possible annuity payment is made in full. For this purpose, it must be assumed that it is possible for each measuring life to survive until age 110. For example, for a fixed annuity payable

annually at the end of each year, if the amount of the annuity payment (expressed as a percentage of the initial corpus) is less than or equal to the applicable section 7520 interest rate at the date of the transfer, the corpus is assumed to be sufficient to make all payments. If the percentage exceeds the applicable section 7520 interest rate and the annuity is for a definite term of years, multiply the annual annuity amount by the Table B term certain annuity factor, as described in § 1.7520-1(c)(1), for the number of years of the defined period. If the percentage exceeds the applicable section 7520 interest rate and the annuity is payable for the life of one or more individuals, multiply the annual annuity amount by the Table B annuity factor for 110 years minus the age of the youngest individual. If the result exceeds the limited fund, the annuity may exhaust the fund, and it will be necessary to calculate a special section 7520 annuity factor that takes into account the exhaustion of the trust or fund. This computation would be modified, if appropriate, to take into account annuities with different payment terms. See § 25.7520-3(b)(2)(v) *Example 5* of this chapter, which provides an illustration involving an annuity trust that is subject to exhaustion.

(ii) *Income and similar interests—(A) Beneficial enjoyment.* A standard section 7520 income factor for an ordinary income interest may not be used to determine the present value of an income or similar interest in trust for a term of years or for the life of one or more individuals unless the effect of the trust, will, or other governing instrument is to provide the income beneficiary with that degree of beneficial enjoyment of the property during the term of the income interest that the principles of the law of trusts accord to a person who is unqualifiedly designated as the income beneficiary of a trust for a similar period of time. This degree of beneficial enjoyment is provided only if it was the transferor's intent, as manifested by the provisions of the governing instrument and the surrounding circumstances, that the trust provide an income interest for the income beneficiary during the specified period of time that is consistent with the value of the trust corpus and with its preservation. In determining whether a trust arrangement evidences that intention, the treatment required or permitted with respect to individual items must be considered in relation to the entire system provided for in the administration of the subject trust. Similarly, in determining the present

value of the right to use tangible property (whether or not in trust) for one or more measuring lives or for some other specified period of time, the interest rate component prescribed under section 7520 and § 1.7520-1 may not be used unless, during the specified period, the effect of the trust, will or other governing instrument is to provide the beneficiary with that degree of use, possession, and enjoyment of the property during the term of interest that applicable state law accords to a person who is unqualifiedly designated as a life tenant or term holder for a similar period of time.

(B) *Diversions of income and corpus.* A standard section 7520 income factor for an ordinary income interest may not be used to value an income interest or similar interest in property for a term of years or for one or more measuring lives if—

(1) The trust, will, or other governing instrument requires or permits the beneficiary's income or other enjoyment to be withheld, diverted, or accumulated for another person's benefit without the consent of the income beneficiary; or

(2) The governing instrument requires or permits trust corpus to be withdrawn from the trust for another person's benefit during the income beneficiary's term of enjoyment without the consent of and accountability to the income beneficiary for such diversion.

(iii) *Remainder and reversionary interests.* A standard section 7520 remainder interest factor for an ordinary remainder or reversionary interest may not be used to determine the present value of a remainder or reversionary interest (whether in trust or otherwise) unless, consistent with the preservation and protection that the law of trusts would provide for a person who is unqualifiedly designated as the remainder beneficiary of a trust for a similar duration, the effect of the administrative and dispositive provisions for the interest or interests that precede the remainder or reversionary interest is to assure that the property will be adequately preserved and protected (e.g., from erosion, invasion, depletion, or damage) until the remainder or reversionary interest takes effect in possession and enjoyment. This degree of preservation and protection is provided only if it was the transferor's intent, as manifested by the provisions of the arrangement and the surrounding circumstances, that the entire disposition provide the remainder or reversionary beneficiary with an undiminished interest in the property transferred at the time of the termination of the prior interest.

(iv) *Pooled income fund interests.* In general, pooled income funds are created and administered to achieve a special rate of return. A beneficial interest in a pooled income fund is not ordinarily valued using a standard section 7520 income or remainder interest factor. The present value of a beneficial interest in a pooled income fund is determined according to rules and special remainder factors prescribed in § 1.642(c)-6 and, when applicable, the rules set forth in paragraph (b)(3) of this section, if the individual who is the measuring life is terminally ill at the time of the transfer.

(3) *Mortality component.* The mortality component prescribed under section 7520 may not be used to determine the present value of an annuity, income interest, remainder interest, or reversionary interest if an individual who is a measuring life is terminally ill at the time of the transaction. For purposes of this paragraph (b)(3), an individual who is known to have an incurable illness or other deteriorating physical condition is considered terminally ill if there is at least a 50 percent probability that the individual will die within 1 year. However, if the individual survives for eighteen months or longer after the date of the transaction, that individual shall be presumed to have not been terminally ill at the time of the transaction unless the contrary is established by clear and convincing evidence.

(4) *Examples.* The provisions of this paragraph (b) are illustrated by the following examples:

Example 1. Annuity funded with unproductive property. The taxpayer transfers corporation stock worth \$1,000,000 to a trust. The trust provides for a 6 percent (\$60,000 per year) annuity in cash or other property to be paid to a charitable organization for 25 years and for the remainder to be distributed to the donor's child. The trust specifically authorizes, but does not require, the trustee to retain the shares of stock. The section 7520 interest rate for the month of the transfer is 8.2 percent. The corporation has paid no dividends on this stock during the past 5 years, and there is no indication that this policy will change in the near future. Under applicable state law, the corporation is considered to be a sound investment that satisfies fiduciary standards. Therefore, the trust's sole investment in this corporation is not expected to adversely affect the interest of either the annuitant or the remainder beneficiary. Considering the 6 percent annuity payout rate and the 8.2 percent section 7520 interest rate, the trust corpus is considered sufficient to pay this annuity for the entire 25-year term of the trust, or even indefinitely. Although it appears that neither beneficiary would be able to compel the

trustee to make the trust corpus produce investment income, the annuity interest in this case is considered to be an ordinary annuity interest, and the standard section 7520 annuity factor may be used to determine the present value of the annuity. In this case, the section 7520 annuity factor would represent the right to receive \$1.00 per year for a term of 25 years.

Example 2. Terminal illness. The taxpayer transfers property worth \$1,000,000 to a charitable remainder unitrust described in section 664(d)(2) and § 1.664-3. The trust provides for a fixed-percentage 7 percent unitrust benefit (each annual payment is equal to 7 percent of the trust assets as valued at the beginning of each year) to be paid quarterly to an individual beneficiary for life and for the remainder to be distributed to a charitable organization. At the time the trust is created, the individual beneficiary is age 60 and has been diagnosed with an incurable illness and there is at least a 50 percent probability of the individual dying within 1 year. Assuming the presumption in paragraph (b)(3) of this section does not apply, because there is at least a 50 percent probability that this beneficiary will die within 1 year, the standard section 7520 unitrust remainder factor for a person age 60 from the valuation tables may not be used to determine the present value of the charitable remainder interest. Instead, a special unitrust remainder factor must be computed that is based on the section 7520 interest rate and that takes into account the projection of the individual beneficiary's actual life expectancy.

(5) *Additional limitations.* Section 7520 does not apply to the extent as may otherwise be provided by the Commissioner.

(c) * * * The provisions of paragraph (b) of this section are effective with respect to transactions after December 13, 1995.

PART 20—ESTATE TAX; ESTATES OF DECEDENTS DYING AFTER AUGUST 16, 1954

Par. 3. The authority citation for part 20 continues to read in part as follows:

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

Par. 4. Section 20.7520-3 is amended by revising paragraph (b) and adding a sentence at the end of paragraph (c) to read as follows:

§ 20.7520-3 Limitation on the application of section 7520.

* * * * *

(b) *Other limitations on the application of section 7520—* (1) *In general—*(i) *Ordinary beneficial interests.* For purposes of this section: (A) An *ordinary annuity interest* is the right to receive a fixed dollar amount at the end of each year during one or more measuring lives or for some other defined period. A standard section 7520 annuity factor for an ordinary annuity

interest represents the present worth of the right to receive \$1.00 per year for a defined period, using the interest rate prescribed under section 7520 for the appropriate month. If an annuity interest is payable more often than annually or is payable at the beginning of each period, a special adjustment must be made in any computation with a standard section 7520 annuity factor.

(B) An *ordinary income interest* is the right to receive the income from or the use of property during one or more measuring lives or for some other defined period. A standard section 7520 income factor for an ordinary income interest represents the present worth of the right to receive the use of \$1.00 for a defined period, using the interest rate prescribed under section 7520 for the appropriate month.

(C) An *ordinary remainder or reversionary interest* is the right to receive an interest in property at the end of one or more measuring lives or some other defined period. A standard section 7520 remainder factor for an ordinary remainder or reversionary interest represents the present worth of the right to receive \$1.00 at the end of a defined period, using the interest rate prescribed under section 7520 for the appropriate month.

(ii) *Certain restricted beneficial interests.* A *restricted beneficial interest* is an annuity, income, remainder, or reversionary interest that is subject to any contingency, power, or other restriction, whether the restriction is provided for by the terms of the trust, will, or other governing instrument or is caused by other circumstances. In general, a standard section 7520 annuity, income, or remainder factor may not be used to value a restricted beneficial interest. However, a special section 7520 annuity, income, or remainder factor may be used to value a restricted beneficial interest under some circumstances. See paragraphs (b)(2)(v) *Example 4* and (b)(4) *Example 1* of this section, which illustrate situations where special section 7520 actuarial factors are needed to take into account limitations on beneficial interests. See § 20.7520-1(c) for requesting a special factor from the Internal Revenue Service.

(iii) *Other beneficial interests.* If, under the provisions of this paragraph (b), the interest rate and mortality components prescribed under section 7520 are not applicable in determining the value of any annuity, income, remainder, or reversionary interest, the actual fair market value of the interest (determined without regard to section 7520) is based on all of the facts and circumstances if and to the extent

permitted by the Internal Revenue Code provision applicable to the property interest.

(2) *Provisions of governing instrument and other limitations on source of payment*—(i) *Annuities.* A standard section 7520 annuity factor may not be used to determine the present value of an annuity for a specified term of years or the life of one or more individuals unless the effect of the trust, will, or other governing instrument is to ensure that the annuity will be paid for the entire defined period. In the case of an annuity payable from a trust or other limited fund, the annuity is not considered payable for the entire defined period if, considering the applicable section 7520 interest rate at the valuation date of the transfer, the annuity is expected to exhaust the fund before the last possible annuity payment is made in full. For this purpose, it must be assumed that it is possible for each measuring life to survive until age 110. For example, for a fixed annuity payable annually at the end of each year, if the amount of the annuity payment (expressed as a percentage of the initial corpus) is less than or equal to the applicable section 7520 interest rate at the date of the transfer, the corpus is assumed to be sufficient to make all payments. If the percentage exceeds the applicable section 7520 interest rate and the annuity is for a definite term of years, multiply the annual annuity amount by the Table B term certain annuity factor, as described in § 20.7520-1(c)(1), for the number of years of the defined period. If the percentage exceeds the applicable section 7520 interest rate and the annuity is payable for the life of one or more individuals, multiply the annual annuity amount by the Table B annuity factor for 110 years minus the age of the youngest individual. If the result exceeds the limited fund, the annuity may exhaust the fund, and it will be necessary to calculate a special section 7520 annuity factor that takes into account the exhaustion of the trust or fund. This computation would be modified, if appropriate, to take into account annuities with different payment terms. See § 25.7520-3(b)(2)(v) *Example 5* of this chapter, which provides an illustration involving an annuity trust that is subject to exhaustion.

(ii) *Income and similar interests*—(A) *Beneficial enjoyment.* A standard section 7520 income factor for an ordinary income interest may not be used to determine the present value of an income or similar interest in trust for a term of years, or for the life of one or more individuals, unless the effect of

the trust, will, or other governing instrument is to provide the income beneficiary with that degree of beneficial enjoyment of the property during the term of the income interest that the principles of the law of trusts accord to a person who is unqualifiedly designated as the income beneficiary of a trust for a similar period of time. This degree of beneficial enjoyment is provided only if it was the transferor's intent, as manifested by the provisions of the governing instrument and the surrounding circumstances, that the trust provide an income interest for the income beneficiary during the specified period of time that is consistent with the value of the trust corpus and with its preservation. In determining whether a trust arrangement evidences that intention, the treatment required or permitted with respect to individual items must be considered in relation to the entire system provided for in the administration of the subject trust. Similarly, in determining the present value of the right to use tangible property (whether or not in trust) for one or more measuring lives or for some other specified period of time, the interest rate component prescribed under section 7520 and § 1.7520-1 of this chapter may not be used unless, during the specified period, the effect of the trust, will or other governing instrument is to provide the beneficiary with that degree of use, possession, and enjoyment of the property during the term of interest that applicable state law accords to a person who is unqualifiedly designated as a life tenant or term holder for a similar period of time.

(B) *Diversions of income and corpus.* A standard section 7520 income factor for an ordinary income interest may not be used to value an income interest or similar interest in property for a term of years, or for one or more measuring lives, if—

(1) The trust, will, or other governing instrument requires or permits the beneficiary's income or other enjoyment to be withheld, diverted, or accumulated for another person's benefit without the consent of the income beneficiary; or

(2) The governing instrument requires or permits trust corpus to be withdrawn from the trust for another person's benefit without the consent of the income beneficiary during the income beneficiary's term of enjoyment and without accountability to the income beneficiary for such diversion.

(iii) *Remainder and reversionary interests.* A standard section 7520 remainder interest factor for an ordinary remainder or reversionary interest may not be used to determine the present

value of a remainder or reversionary interest (whether in trust or otherwise) unless, consistent with the preservation and protection that the law of trusts would provide for a person who is unqualifiedly designated as the remainder beneficiary of a trust for a similar duration, the effect of the administrative and dispositive provisions for the interest or interests that precede the remainder or reversionary interest is to assure that the property will be adequately preserved and protected (e.g., from erosion, invasion, depletion, or damage) until the remainder or reversionary interest takes effect in possession and enjoyment. This degree of preservation and protection is provided only if it was the transferor's intent, as manifested by the provisions of the arrangement and the surrounding circumstances, that the entire disposition provide the remainder or reversionary beneficiary with an undiminished interest in the property transferred at the time of the termination of the prior interest.

(iv) *Pooled income fund interests.* In general, pooled income funds are created and administered to achieve a special rate of return. A beneficial interest in a pooled income fund is not ordinarily valued using a standard section 7520 income or remainder interest factor. The present value of a beneficial interest in a pooled income fund is determined according to rules and special remainder factors prescribed in § 1.642(c)-6 of this chapter and, when applicable, the rules set forth under paragraph (b)(3) of this section if the individual who is the measuring life is terminally ill at the time of the transfer.

(v) *Examples.* The provisions of this paragraph (b)(2) are illustrated by the following examples:

Example 1. Unproductive property. A died, survived by B and C. B died two years after A. A's will provided for a bequest of corporation stock in trust under the terms of which all of the trust income was paid to B for life. After the death of B, the trust terminated and the trust property was distributed to C. The trust specifically authorized, but did not require, the trustee to retain the shares of stock. The corporation paid no dividends on this stock during the 5 years before A's death and the 2 years before B's death. There was no indication that this policy would change after A's death. Under applicable state law, the corporation is considered to be a sound investment that satisfies fiduciary standards. The facts and circumstances, including applicable state law, indicate that B did not have the legal right to compel the trustee to make the trust corpus productive in conformity with the requirements for a lifetime trust income interest under applicable local law. Therefore, B's life income interest in this case

is considered nonproductive. Consequently, B's income interest may not be valued actuarially under this section.

Example 2. Beneficiary's right to make trust productive. The facts are the same as in *Example 1*, except that the trustee is not specifically authorized to retain the shares of stock. Further, the terms of the trust specifically provide that B, the life income beneficiary, may require the trustee to make the trust corpus productive consistent with income yield standards for trusts under applicable state law. Under that law, the minimum rate of income that a productive trust may produce is substantially below the section 7520 interest rate for the month of A's death. In this case, because B has the right to compel the trustee to make the trust productive for purposes of applicable local law during the beneficiary's lifetime, the income interest is considered an ordinary income interest for purposes of this paragraph, and the standard section 7520 life income interest factor may be used to determine the present value of B's income interest.

Example 3. Discretionary invasion of corpus. The decedent, A, transferred property to a trust under the terms of which all of the trust income is to be paid to A's child for life and the remainder of the trust is to be distributed to a grandchild. The trust authorizes the trustee without restriction to distribute corpus to A's surviving spouse for the spouse's comfort and happiness. In this case, because the trustee's power to invade trust corpus is unrestricted, the exercise of the power could result in the termination of the income interest at any time. Consequently, the income interest is not considered an ordinary income interest for purposes of this paragraph, and may not be valued actuarially under this section.

Example 4. Limited invasion of corpus. The decedent, A, bequeathed property to a trust under the terms of which all of the trust income is to be paid to A's child for life and the remainder is to be distributed to A's grandchild. The trust authorizes the child to withdraw up to \$5,000 per year from the trust corpus. In this case, the child's power to invade trust corpus is limited to an ascertainable amount each year. Annual invasions of any amount would be expected to progressively diminish the property from which the child's income is paid. Consequently, the income interest is not considered an ordinary income interest for purposes of this paragraph, and the standard section 7520 income interest factor may not be used to determine the present value of the income interest. Nevertheless, the present value of the child's income interest is ascertainable by making a special actuarial calculation that would take into account not only the initial value of the trust corpus, the section 7520 interest rate for the month of the transfer, and the mortality component for the child's age, but also the assumption that the trust corpus will decline at the rate of \$5,000 each year during the child's lifetime. The child's right to receive an amount not in excess of \$5,000 per year may be separately valued in this instance and, assuming the trust corpus would not exhaust before the child would attain age 110, would be considered an ordinary annuity interest.

Example 5. Power to consume. The decedent, A, devised a life estate in 3 parcels of real estate to A's surviving spouse with the remainder to a child, or, if the child doesn't survive, to the child's estate. A also conferred upon the spouse an unrestricted power to consume the property, which includes the right to sell part or all of the property and to use the proceeds for the spouse's support, comfort, happiness, and other purposes. Any portion of the property or its sale proceeds remaining at the death of the surviving spouse is to vest by operation of law in the child at that time. The child predeceased the surviving spouse. In this case, the surviving spouse's power to consume the corpus is unrestricted, and the exercise of the power could entirely exhaust the remainder interest during the life of the spouse. Consequently, the remainder interest that is includible in the child's estate is not considered an ordinary remainder interest for purposes of this paragraph and may not be valued actuarially under this section.

(3) *Mortality component*—(i) *Terminal illness.* Except as provided in paragraph (b)(3)(ii) of this section, the mortality component prescribed under section 7520 may not be used to determine the present value of an annuity, income interest, remainder interest, or reversionary interest if an individual who is a measuring life is terminally ill at the time of the decedent's death. For purposes of this paragraph (b)(3), an individual who is known to have an incurable illness or other deteriorating physical condition is considered terminally ill if there is at least a 50 percent probability that the individual will die within 1 year. However, if the individual survives for eighteen months or longer after the date of the decedent's death, that individual shall be presumed to have not been terminally ill at the date of death unless the contrary is established by clear and convincing evidence.

(ii) *Terminal illness exceptions.* In the case of the allowance of the credit for tax on a prior transfer under section 2013, if a final determination of the federal estate tax liability of the transferor's estate has been made under circumstances that required valuation of the life interest received by the transferee, the value of the property transferred, for purposes of the credit allowable to the transferee's estate, shall be the value determined previously in the transferor's estate. Otherwise, for purposes of section 2013, the provisions of paragraph (b)(3)(i) of this section shall govern in valuing the property transferred. The value of a decedent's reversionary interest under sections 2037(b) and 2042(2) shall be determined without regard to the physical condition, immediately before the decedent's death, of the individual who is the measuring life.

(iii) *Death resulting from common accidents.* The mortality component prescribed under section 7520 may not be used to determine the present value of an annuity, income interest, remainder interest, or reversionary interest if the decedent, and the individual who is the measuring life, die as a result of a common accident or other occurrence.

(4) *Examples.* The provisions of paragraph (b)(3) of this section are illustrated by the following examples:

Example 1. Terminal illness. The decedent bequeaths \$1,000,000 to a trust under the terms of which the trustee is to pay \$103,000 per year to a charitable organization during the life of the decedent's child. Upon the death of the child, the remainder in the trust is to be distributed to the decedent's grandchild. The child, who is age 60, has been diagnosed with an incurable illness, and there is at least a 50 percent probability of the child dying within 1 year. Assuming the presumption provided for in paragraph (b)(3)(i) of this section does not apply, the

standard life annuity factor for a person age 60 may not be used to determine the present value of the charitable organization's annuity interest because there is at least a 50 percent probability that the child, who is the measuring life, will die within 1 year. Instead, a special section 7520 annuity factor must be computed that takes into account the projection of the child's actual life expectancy.

Example 2. Deaths resulting from common accidents, etc. The decedent's will establishes a trust to pay income to the decedent's surviving spouse for life. The will provides that, upon the spouse's death or, if the spouse fails to survive the decedent, upon the decedent's death the trust property is to pass to the decedent's children. The decedent and the decedent's spouse die simultaneously in an accident under circumstances in which it was impossible to determine who survived the other. Even if the terms of the will and applicable state law presume that the decedent died first with the result that the property interest is considered to have passed in trust for the benefit of the spouse for life, after which the remainder is to be distributed to the decedent's children,

the spouse's life income interest may not be valued by use of the mortality component described under section 7520. The result would be the same even if it was established that the spouse survived the decedent.

(5) *Additional limitations.* Section 7520 does not apply to the extent as may otherwise be provided by the Commissioner.

(c) * * * The provisions of paragraph (b) of this section are effective with respect to estates of decedents dying after December 13, 1995.

PART 25—GIFT TAX; GIFTS MADE AFTER DECEMBER 31, 1954

Par. 5. The authority citation for part 25 continues to read in part as follows:

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

Par. 6. In the list below, for each section indicated in the left column, remove the language in the middle column and add the language in the right column:

| Section | Remove | Add |
|--|---|---------------------------------------|
| 25.2522(c)-3(c)(2)(i) 6th sentence | (e)(2) (ii), (iii), and (iv) | (c)(2) (ii), (iii), and (iv). |
| 25.2522(c)-3(c)(2) (vi)(a) 2nd sentence | Subdivision (v) | Paragraph (c)(2)(vi). |
| 25.2522(c)-3(c)(2) (vii)(a) 2nd sentence | Subdivision (vi) | Paragraph (c)(2)(vii). |
| 25.2522(c)-3(d)(2) introductory text | Subdivision (iv), (v), or (vi) of paragraph (c)(2) .. | Paragraph (c)(2) (v), (vi), or (vii). |
| 25.2522(c)-3(d)(2) (iv) 1st sentence | Paragraph (c)(2)(v) | Paragraph (c)(2)(vi). |
| 25.2522(c)-3(d)(2)(iv), <i>Example (1)</i> 1st sentence. | Paragraph (c)(2)(v) | Paragraph (c)(2)(vi). |
| 25.2522(c)-3(d)(2)(iv), <i>Example (2)</i> 1st sentence. | Paragraph (c)(2)(v) | Paragraph (c)(2)(vi). |
| 25.2522(c)-3(d)(2)(iv), <i>Example (3)</i> 1st sentence (each place it appears). | Paragraph (c)(2)(v) | Paragraph (c)(2)(vi). |
| 25.2522(c)-3(d)(2)(iv), <i>Example (4)</i> last sentence. | Paragraph (c)(2)(v)(e) | Paragraph (c)(2)(vi)(e) |
| 25.2522(c)-3(d)(2)(v) | Paragraph (c)(2)(vi) | Paragraph (c)(2)(vii). |

Par. 7. Section 25.7520-3 is amended by revising paragraph (b) and adding a sentence at the end of paragraph (c) to read as follows:

§ 25.7520-3 Limitation on the application of section 7520.

* * * * *

(b) *Other limitations on the application of section 7520—(1) In general—(i) Ordinary beneficial interests.* For purposes of this section:

(A) An *ordinary annuity interest* is the right to receive a fixed dollar amount at the end of each year during one or more measuring lives or for some other defined period. A standard section 7520 annuity factor for an ordinary annuity interest represents the present worth of the right to receive \$1.00 per year for a defined period, using the interest rate prescribed under section 7520 for the appropriate month. If an annuity interest is payable more often than annually or is payable at the beginning of each period, a special adjustment

must be made in any computation with a standard section 7520 annuity factor.

(B) An *ordinary income interest* is the right to receive the income from or the use of property during one or more measuring lives or for some other defined period. A standard section 7520 income factor for an ordinary income interest represents the present worth of the right to receive the use of \$1.00 for a defined period, using the interest rate prescribed under section 7520 for the appropriate month. However, in the case of certain gifts made after October 8, 1990, if the donor does not retain a qualified annuity, unitrust, or reversionary interest, the value of any interest retained by the donor is considered to be zero if the remainder beneficiary is a member of the donor's family. See § 25.2702-2.

(C) An *ordinary remainder or reversionary interest* is the right to receive an interest in property at the end of one or more measuring lives or some

other defined period. A standard section 7520 remainder factor for an ordinary remainder or reversionary interest represents the present worth of the right to receive \$1.00 at the end of a defined period, using the interest rate prescribed under section 7520 for the appropriate month.

(ii) *Certain restricted beneficial interests.* A *restricted beneficial interest* is an annuity, income, remainder, or reversionary interest that is subject to any contingency, power, or other restriction, whether the restriction is provided for by the terms of the trust, will, or other governing instrument or is caused by other circumstances. In general, a standard section 7520 annuity, income, or remainder factor may not be used to value a restricted beneficial interest. However, a special section 7520 annuity, income, or remainder factor may be used to value a restricted beneficial interest under some circumstances. See paragraphs

(b)(2)(v) *Example 5* and (b)(4) of this section, which illustrate situations in which special section 7520 actuarial factors are needed to take into account limitations on beneficial interests. See § 25.7520-1(c) for requesting a special factor from the Internal Revenue Service.

(iii) *Other beneficial interests.* If, under the provisions of this paragraph (b), the interest rate and mortality components prescribed under section 7520 are not applicable in determining the value of any annuity, income, remainder, or reversionary interest, the actual fair market value of the interest (determined without regard to section 7520) is based on all of the facts and circumstances if and to the extent permitted by the Internal Revenue Code provision applicable to the property interest.

(2) *Provisions of governing instrument and other limitations on source of payment—(i) Annuities.* A standard section 7520 annuity factor may not be used to determine the present value of an annuity for a specified term of years or the life of one or more individuals unless the effect of the trust, will, or other governing instrument is to ensure that the annuity will be paid for the entire defined period. In the case of an annuity payable from a trust or other limited fund, the annuity is not considered payable for the entire defined period if, considering the applicable section 7520 interest rate on the valuation date of the transfer, the annuity is expected to exhaust the fund before the last possible annuity payment is made in full. For this purpose, it must be assumed that it is possible for each measuring life to survive until age 110. For example, for a fixed annuity payable annually at the end of each year, if the amount of the annuity payment (expressed as a percentage of the initial corpus) is less than or equal to the applicable section 7520 interest rate at the date of the transfer, the corpus is assumed to be sufficient to make all payments. If the percentage exceeds the applicable section 7520 interest rate and the annuity is for a definite term of years, multiply the annual annuity amount by the Table B term certain annuity factor, as described in § 25.7520-1(c)(1), for the number of years of the defined period. If the percentage exceeds the applicable section 7520 interest rate and the annuity is payable for the life of one or more individuals, multiply the annual annuity amount by the Table B annuity factor for 110 years minus the age of the youngest individual. If the result exceeds the limited fund, the annuity may exhaust the fund, and it will be

necessary to calculate a special section 7520 annuity factor that takes into account the exhaustion of the trust or fund. This computation would be modified, if appropriate, to take into account annuities with different payment terms.

(ii) *Income and similar interests—(A) Beneficial enjoyment.* A standard section 7520 income factor for an ordinary income interest is not to be used to determine the present value of an income or similar interest in trust for a term of years or for the life of one or more individuals unless the effect of the trust, will, or other governing instrument is to provide the income beneficiary with that degree of beneficial enjoyment of the property during the term of the income interest that the principles of the law of trusts accord to a person who is unqualifiedly designated as the income beneficiary of a trust for a similar period of time. This degree of beneficial enjoyment is provided only if it was the transferor's intent, as manifested by the provisions of the governing instrument and the surrounding circumstances, that the trust provide an income interest for the income beneficiary during the specified period of time that is consistent with the value of the trust corpus and with its preservation. In determining whether a trust arrangement evidences that intention, the treatment required or permitted with respect to individual items must be considered in relation to the entire system provided for in the administration of the subject trust. Similarly, in determining the present value of the right to use tangible property (whether or not in trust) for one or more measuring lives or for some other specified period of time, the interest rate component prescribed under section 7520 and § 1.7520-1 of this chapter may not be used unless, during the specified period, the effect of the trust, will or other governing instrument is to provide the beneficiary with that degree of use, possession, and enjoyment of the property during the term of interest that applicable state law accords to a person who is unqualifiedly designated as a life tenant or term holder for a similar period of time.

(B) *Diversions of income and corpus.* A standard section 7520 income factor for an ordinary income interest may not be used to value an income interest or similar interest in property for a term of years, or for one or more measuring lives, if—

(1) The trust, will, or other governing instrument requires or permits the beneficiary's income or other enjoyment to be withheld, diverted, or accumulated for another person's

benefit without the consent of the income beneficiary; or

(2) The governing instrument requires or permits trust corpus to be withdrawn from the trust for another person's benefit without the consent of the income beneficiary during the income beneficiary's term of enjoyment and without accountability to the income beneficiary for such diversion.

(iii) *Remainder and reversionary interests.* A standard section 7520 remainder interest factor for an ordinary remainder or reversionary interest may not be used to determine the present value of a remainder or reversionary interest (whether in trust or otherwise) unless, consistent with the preservation and protection that the law of trusts would provide for a person who is unqualifiedly designated as the remainder beneficiary of a trust for a similar duration, the effect of the administrative and dispositive provisions for the interest or interests that precede the remainder or reversionary interest is to assure that the property will be adequately preserved and protected (e.g., from erosion, invasion, depletion, or damage) until the remainder or reversionary interest takes effect in possession and enjoyment. This degree of preservation and protection is provided only if it was the transferor's intent, as manifested by the provisions of the arrangement and the surrounding circumstances, that the entire disposition provide the remainder or reversionary beneficiary with an undiminished interest in the property transferred at the time of the termination of the prior interest.

(iv) *Pooled income fund interests.* In general, pooled income funds are created and administered to achieve a special rate of return. A beneficial interest in a pooled income fund is not ordinarily valued using a standard section 7520 income or remainder interest factor. The present value of a beneficial interest in a pooled income fund is determined according to rules and special remainder factors prescribed in § 1.642(c)-6 of this chapter and, when applicable, the rules set forth under paragraph (b)(3) of this section if the individual who is the measuring life is terminally ill at the time of the transfer.

(v) *Examples.* The provisions of this paragraph (b)(2) are illustrated by the following examples:

Example 1. Unproductive property. The donor transfers corporation stock to a trust under the terms of which all of the trust income is payable to A for life. Considering the applicable federal rate under section 7520 and the appropriate life estate factor for a person A's age, the value of A's income interest, if valued under this section, would

be \$10,000. After A's death, the trust is to terminate and the trust property is to be distributed to B. The trust specifically authorizes, but does not require, the trustee to retain the shares of stock. The corporation has paid no dividends on this stock during the past 5 years, and there is no indication that this policy will change in the near future. Under applicable state law, the corporation is considered to be a sound investment that satisfies fiduciary standards. The facts and circumstances, including applicable state law, indicate that the income beneficiary would not have the legal right to compel the trustee to make the trust corpus productive in conformity with the requirements for a lifetime trust income interest under applicable local law. Therefore, the life income interest in this case is considered nonproductive. Consequently, A's income interest may not be valued actuarially under this section.

Example 2. Beneficiary's right to make trust productive. The facts are the same as in Example 1, except that the trustee is not specifically authorized to retain the shares of corporation stock. Further, the terms of the trust specifically provide that the life income beneficiary may require the trustee to make the trust corpus productive consistent with income yield standards for trusts under applicable state law. Under that law, the minimum rate of income that a productive trust may produce is substantially below the section 7520 interest rate on the valuation date. In this case, because A, the income beneficiary, has the right to compel the trustee to make the trust productive for purposes of applicable local law during A's lifetime, the income interest is considered an

ordinary income interest for purposes of this paragraph, and the standard section 7520 life income factor may be used to determine the value of A's income interest. However, in the case of gifts made after October 8, 1990, if the donor was the life income beneficiary, the value of the income interest would be considered to be zero in this situation. See § 25.2702-2.

Example 3. Annuity trust funded with unproductive property. The donor, who is age 60, transfers corporation stock worth \$1,000,000 to a trust. The trust will pay a 6 percent (\$60,000 per year) annuity in cash or other property to the donor for 10 years or until the donor's prior death. Upon the termination of the trust, the trust property is to be distributed to the donor's child. The section 7520 rate for the month of the transfer is 8.2 percent. The corporation has paid no dividends on the stock during the past 5 years, and there is no indication that this policy will change in the near future. Under applicable state law, the corporation is considered to be a sound investment that satisfies fiduciary standards. Therefore, the trust's sole investment in this corporation is not expected to adversely affect the interest of either the annuity beneficiary or the remainder beneficiary. Considering the 6 percent annuity payout rate and the 8.2 percent section 7520 interest rate, the trust corpus is considered sufficient to pay this annuity for the entire 10-year term of the trust, or even indefinitely. The trust specifically authorizes, but does not require, the trustee to retain the shares of stock. Although it appears that neither beneficiary would be able to compel the trustee to make the trust corpus produce investment income,

the annuity interest in this case is considered to be an ordinary annuity interest, and a section 7520 annuity factor may be used to determine the present value of the annuity. In this case, the section 7520 annuity factor would represent the right to receive \$1.00 per year for a term of 10 years or the prior death of a person age 60.

Example 4. Unitrust funded with unproductive property. The facts are the same as in Example 3, except that the donor has retained a unitrust interest equal to 7 percent of the value of the trust property, valued as of the beginning of each year. Although the trust corpus is nonincome-producing, the present value of the donor's retained unitrust interest may be determined by using the section 7520 unitrust factor for a term of years or a prior death.

Example 5. Eroding corpus in an annuity trust. (i) The donor, who is age 60 and in normal health, transfers property worth \$1,000,000 to a trust. The trust will pay a 10 percent (\$100,000 per year) annuity to a charitable organization for the life of the donor, payable annually, and the remainder will be distributed to the donor's child. The section 7520 rate for the month of the transfer is 6.8 percent. First, it is necessary to determine whether the annuity may exhaust the corpus before all annuity payments are made. Because it is assumed that any measuring life may survive until age 110, any life annuity could require payments until the measuring life reaches age 110. Based on a section 7520 interest rate of 6.8 percent, the determination of whether the annuity may exhaust the corpus before the annuity payments are made is computed as follows:

| | |
|---|--------------|
| Age to which life annuity may continue | 110 |
| Less: Age of measuring life at date of transfer | 60 |
| <hr/> | |
| Number of years annuity may continue | 50 |
| Annual annuity payment | \$100,000.00 |
| Times: Table B annuity factor for 50 years | 14.1577 |
| <hr/> | |
| Present value of term certain annuity | 1,415,770.00 |

(ii) Since the present value of an annuity for a term of 50 years exceeds the corpus, the annuity may exhaust the trust before all payments are made. Consequently, the annuity must be valued as an annuity payable for a term of years or until the prior death of the annuitant, with the term of years determined by when the fund will be exhausted by the annuity payments.

(iii) Using factors based on Table 80CNSMT at 6.8 percent, it is determined that the fund will be sufficient to make 17 annual payments, but not to make the entire 18th payment. Specifically, the initial corpus will be able to make payments of \$67,287.26 per year for 17 years plus payments of \$32,712.74 per year for 18 years. The annuity is valued by adding the value of the two separate temporary annuities.

(iv) Based on Table H of Publication 1457 (a copy of this publication may be purchased from the Superintendent of Documents, United States Government Printing Office, Washington, DC 20402), the present value of an annuity of \$67,287.26 per year payable for 17 years or until the prior death of a person

aged 60 is \$579,484.61 ($\$67,287.26 \times 8.6121$). The present value of an annuity of \$32,712.74 per year payable for 18 years or until the prior death of a person aged 60 is \$287,731.45 ($\$32,712.74 \times 8.7957$). Thus, the present value of the charitable annuity interest is \$867,216.06 ($\$579,484.61 + \$287,731.45$).

(3) **Mortality component.** The mortality component prescribed under section 7520 may not be used to determine the present value of an annuity, income interest, remainder interest, or reversionary interest if an individual who is a measuring life dies or is terminally ill at the time the gift is completed. For purposes of this paragraph (b)(3), an individual who is known to have an incurable illness or other deteriorating physical condition is considered terminally ill if there is at least a 50 percent probability that the individual will die within 1 year.

However, if the individual survives for eighteen months or longer after the date the gift is completed, that individual shall be presumed to have not been terminally ill at the date the gift was completed unless the contrary is established by clear and convincing evidence.

(4) **Example.** The provisions of paragraph (b)(3) of this section are illustrated by the following example:

Example. Terminal illness. The donor transfers property worth \$1,000,000 to a child in exchange for the child's promise to pay the donor \$103,000 per year for the donor's life. The donor is age 60 but has been diagnosed with an incurable illness and has at least a 50 percent probability of dying within 1 year. The section 7520 interest rate for the month of the transfer is 10.6 percent, and the standard annuity factor at that interest rate for a person age 60 in normal health is 7.4230. Thus, if the donor were not terminally ill, the present value of the

annuity would be \$764,569 (\$103,000 × 7.4230). Assuming the presumption provided in paragraph (b)(3) of this section does not apply, because there is at least a 50 percent probability that the donor will die within 1 year, the standard section 7520 annuity factor may not be used to determine the present value of the donor's annuity interest. Instead, a special section 7520 annuity factor must be computed that takes into account the projection of the donor's actual life expectancy.

(5) *Additional limitations.* Section 7520 does not apply to the extent as may otherwise be provided by the Commissioner.

(c) * * * The provisions of paragraph (b) of this section are effective with respect to gifts made after December 13, 1995.

Michael P. Dolan,

Acting Commissioner of Internal Revenue.

Approved: October 29, 1995.

Leslie Samuels,

Assistant Secretary of the Treasury.

[FR Doc. 95-30272 Filed 12-12-95; 8:45 am]

BILLING CODE 4830-01-U

DEPARTMENT OF THE INTERIOR

Office of Surface Mining Reclamation and Enforcement

30 CFR Part 943

[SPATS No. TX-024-FOR]

Texas Regulatory Program

AGENCY: Office of Surface Mining Reclamation and Enforcement (OSM), Interior.

ACTION: Final rule; approval of amendment.

SUMMARY: OSM is approving a proposed amendment to the Texas regulatory program (hereinafter referred to as the "Texas program") under the Surface Mining Control and Reclamation Act of 1977 (SMCRA). Texas proposed revisions to its regulations pertaining to self-bonding. The amendment is intended to revise the Texas program to be consistent with the corresponding Federal regulations, provide additional safeguards, and improve operational efficiency.

EFFECTIVE DATE: December 13, 1995.

FOR FURTHER INFORMATION CONTACT: Jack R. Carson, Acting Director, Tulsa Field Office, Office of Surface Mining Reclamation and Enforcement, 5100 East Skelly Drive, Suite 470, Tulsa, Oklahoma 74135-6548, Telephone: (918) 581-6430.

SUPPLEMENTARY INFORMATION:

- I. Background on the Texas Program
- II. Submission of the Proposed Amendment
- III. Director's Findings
- IV. Summary and Disposition of Comments
- V. Director's Decision
- VI. Procedural Determinations

I. Background on the Texas Program

On February 16, 1980, the Secretary of the Interior conditionally approved the Texas program. Background information on the Texas program, including the Secretary's findings, the disposition of comments, and the conditions of approval can be found in the February 27, 1980, Federal Register (45 FR 12998). Subsequent actions concerning the conditions of approval and program amendments can be found at 30 CFR 943.10, 943.15, 943.16.

II. Submission of the Proposed Amendment

By letter dated August 11, 1995 (Administrative Record No. TX-593), Texas submitted a proposed amendment to its program pursuant to SMCRA. Texas submitted the proposed amendment at its own initiative. Texas proposed to revise 16 Texas Administrative Code 11.221, Texas Coal Mining Regulations (TCMR) at subsection 806.309(j)(2)(C)(iv) concerning alternative criteria for acceptance of self-bonds to ensure reclamation performance.

OSM announced receipt of the proposed amendment in the September 12, 1995, Federal Register (60 FR 47316), and in the same document opened the public comment period and provided an opportunity for a public hearing on the adequacy of the proposed amendment. The public comment period would have closed on October 12, 1995.

During its review of the amendment, OSM identified a concern relating to TCMR 806.309(j)(2)(C)(iv)(II)(C). Specifically OSM needed clarification on what effect, if any, Texas' existing 25 percent net worth limitation provision at TCMR 806.309(j)(5)(A) would have on the proposed 16 $\frac{2}{3}$ percent net worth limitation provision at TCMR 806.309(j)(2)(C)(iv)(II)(C). OSM notified Texas of this concern by telephone on September 23, 1995 (Administrative Record No. TX-593.03).

By letter dated September 25, 1995 (Administrative Record No. TX-593.02), Texas responded to OSM's concern by submitting a revision to its proposed program amendment. Texas proposed an additional revision to TCMR 806.309(j)(2)(C)(iv) by adding the following clarification provision.

The limitation contained in subparagraph (II)(C) of this section applies to applicants or guarantors qualifying pursuant to subparagraph (II) only and does not affect the limitation set out in Section 806.309(j)(5)(A) for applicants or guarantors seeking acceptance of a self-bond pursuant to paragraphs i-iii or subparagraph (I) of this section.

Based upon the additional explanatory revision to the proposed program amendment submitted by Texas, OSM reopened the public comment period in the October 16, 1995, Federal Register (60 FR 53567). The public comment period closed on October 31, 1995.

III. Director's Findings

Set forth below, pursuant to SMCRA and the Federal regulations at 30 CFR 732.15 and 732.17, are the Director's findings concerning the proposed amendment.

TCMR 806.309(j)(2)(C)(iv) Self-Bonding: Requirements for a Business and Governmental Entities, Alternative Financial Eligibility Criteria

1. Existing State Regulation Requirements

Like the Federal self-bonding regulations at 30 CFR 800.23(b)(3) (i), (ii), and (iii), Texas has standard financial criteria for self-bonding at § 806.309(j)(2)(C) (i), (ii), and (iii) that are substantively identical to the corresponding Federal regulations. Under the State's standard criteria, an applicant can qualify for self-bonding by meeting one of three criteria that pertain to having either a bond rating of A or higher; or \$10 million net worth and certain financial ratio values; or having fixed assets of \$20 million and certain financial ratio values.

To provide additional flexibility to financially strong firms, Texas proposed an alternative four-part test at § 806.309(j)(2)(C)(iv) that was approved by OSM on February 19, 1992, as an alternative test under the Texas self-bonding program (57 FR 5983). Texas' alternative test allows an applicant to qualify if it meets four criteria in combination. Specifically, an applicant applying for self-bonding under § 806.309(j)(2)(C)(iv) must have an investment-grade bond rating (§ 806.309(j)(2)(C)(iv)(I)); tangible net worth of at least \$10 million and fixed assets in the United States of \$20 million (§ 806.309(j)(2)(C)(iv)(II)); a ratio of total liabilities to net worth that is equal to or less than the industry median (§ 806.309(j)(2)(C)(iv)(III)); and a ratio of current assets to current liabilities that is equal to or greater than the industry median or a current credit