

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. [Reserved] For further guidance, see § 25.7520-3T(b)(2)(v) *Example 5*.

(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) [Reserved] For further guidance, see § 25.7520-3T(b)(4).

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

(c) *Effective date.* Section 25.7520-3(a) is effective as of May 1, 1989. The provisions of paragraph (b) of this section are effective with respect to gifts made after December 13, 1995.

[T.D. 8540, 59 FR 30177, June 10, 1994, as amended by T.D. 8630, 60 FR 63919, Dec. 13, 1995; T.D. 8819, 64 FR 23228, Apr. 30, 1999; T.D. 8886, 65 FR 36943, June 12, 2000; T.D. 9448, 74 FR 21517, May 7, 2009]

§ 25.7520-3T Limitation on the application of section 7520 (temporary).

(a) through (b)(2)(iv) [Reserved] For further guidance, see § 25.7520-3(a) through (b)(2)(iv).

(b)(2)(v) *Examples 1* through 4. [Reserved] For further guidance, see § 25.7520-3(b)(2)(v) *Examples 1* through 4.

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 on or after May 1, 2009. The trust will pay a 10 percent (\$100,000 per year) annuity to a charitable organization for the life of the donor, payable annually at the end of each period, and the remainder then 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: Annuity factor for 50 years derived from Table B (1—.037277/.068) | 14.1577 |
| <hr/> | |
| Present value of term certain annuity | \$1,415,770.00 |

(ii) Because 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) The annuity factor for a term of years at 6.8 percent is derived by subtracting the applicable remainder factor in Table B (see § 20.2031-7(d)(6)) from 1.000000 and then dividing the result by .068. An annuity of \$100,000 payable at the end of each year for a period that has an annuity factor of 10.0 would have a present value exactly equal to the principal available to pay the annuity over the term. The annuity factor for 17 years is 9.8999 and the annuity factor for 18 years is 10.2059. Thus, it is determined that the \$1,000,000 initial transfer will be sufficient to make 17 annual payments of \$100,000, but not to make the entire 18th payment. The present value of an annuity of \$100,000 payable at the end of each year for 17 years certain is \$100,000 times 9.8999 or \$989,990. The remaining amount is \$10,010.00. Of the initial corpus amount, \$10,010.00 is not needed to make payments for 17 years, so this amount, as accumulated for 18 years, will be available for the final payment. The 18-year accumulation factor is $(1 + 0.068)^{18}$ or 3.268004. Then the amount available in 18 years is \$10,010.00 times 3.268004 or \$32,712.72. Therefore, for purposes of analysis we consider the annuity payments as being composed of two distinct annuity components. The two annuity components taken together must equal the total annual amount of \$100,000. The first annuity is the exact amount that the trust will have available for the final payment, \$32,712.72. The second annuity component then must be \$100,000 minus \$32,712.72, or \$67,287.28. Specifically, the initial corpus will be able to make payments of \$67,287.28 per year for 17 years plus payments of \$32,712.72 per year for 18 years. The total annuity is valued by adding the value of the two separate temporary component annuities.

(iv) Based on Table H of Publication 1457, Actuarial Valuations Version 3A, which may be obtained from the IRS Internet site, the present value of an annuity of \$67,287.28 per year payable for 17 years or until the prior death of a person aged 60 is \$597,013.12 ($\$67,287.28 \times 8.8726$). The present value of an annuity of \$32,712.72 per year payable for 18 years or until the prior death of a person aged 60 is \$296,887.56 ($\$32,712.72 \times 9.0756$). Thus, the present value of the charitable annuity interest is \$893,900.68 ($\$597,013.12 + \$296,887.56$).

(3) [Reserved] For further guidance, see § 25.7520-3(b)(3).

(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 on or after May 1, 2009, in exchange for the child's

promise to pay the donor \$80,000 per year for the donor's life, payable annually at the end of each period. The donor is age 75 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 7.6 percent, and the standard annuity factor at that interest rate for a person age 75 in normal health is 6.6493 ($1 - .49465/.076$). Thus, if the donor were not terminally ill, the present value of the annuity would be \$531,944.00 ($\$80,000 \times 6.6493$). 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) [Reserved] For further guidance, see § 25.7520-3(b)(5).

(c) *Effective/applicability dates.* Section 25.7520-3(a) is effective as of May 1, 1989. The provisions of paragraph (b) of this section, except *Example 5* in paragraph (b)(2)(v) and paragraph (b)(4), are effective with respect to gifts made after December 13, 1995. *Example 5* in paragraph (b)(2)(v) and paragraph (b)(4) are effective with respect to gifts made on or after May 1, 2009.

[T.D. 9448, 74 FR 21517, May 7, 2009]

§ 25.7520-4 Transitional rules.

(a) *Reliance.* If the valuation date is after April 30, 1989, and before June 10, 1994, a donor can rely on Notice 89-24, 1989-1 C.B. 660, or Notice 89-60, 1989-1 C.B. 700 (See § 601.601(d)(2)(ii)(b) of this chapter), in valuing the transferred interest.

(b) *Transfers in 1989.* If a donor transferred an interest in property by gift after December 31, 1988, and before May 1, 1989, retaining an interest in the same property and, after April 30, 1989, and before January 1, 1990, transferred the retained interest in the property, the donor may, at the donor's option, value the transfer of the retained interest under either § 25.2512-5(d) or § 25.2512-5A(d).

(c) *Effective date.* This section is effective as of May 1, 1989.