

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