

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.