

INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

October 19, 1998

Index Numbers: 2031.10-00, 7520.02-00
Control Number: TAM 112920-98
Number: **199909001**
Release Date: 3/5/1999
Taxpayer's Name:
Taxpayer's SSN:
Taxpayer's Address:

Date of Death:
Date of Conference:
District Director:

LEGEND:

Decedent =
Sister-in-law =
State X =
a =
b =
X Partners =
c =
y dollars =
d =
e =

ISSUE:

For estate tax purposes, what is the proper method for valuing lottery winnings that are payable over a specified period to a partnership?

CONCLUSION:

The present value of lottery winnings payable in the form of an annuity to a partnership should be determined under the actuarial tables contained in § 20.2031-7(d)(6) using the interest rate specified in Internal Revenue Code § 7520.

FACTS:

Decedent and Sister-in-law won the State X lottery on a. According to an affidavit executed by Sister-in-law, the winning ticket was purchased on behalf of their partnership. According to the affidavit, Sister-in-law and Decedent always pooled their money and shared any winnings equally.

CC:DOM - TAM-112920-98

On b, Decedent and Sister-in-law executed a document entitled "Limited Partnership Agreement X Partners Ltd., A State X Limited Partnership." The agreement gave a two percent general partnership interest and a 48 percent limited partnership interest to each of the two partners.

The winning lottery ticket was endorsed "X Partners, Sister-in-law, General Partner." On c, the State Lottery Commission announced Decedent and sister-in-law as the winners of the y dollars Lotto Jackpot, and presented the first of twenty annual payments to X Partners.

On d, Decedent executed a revocable living trust. The beneficiaries of the trust were Decedent (during her life) and her nieces and nephews (upon Decedent's death). Prior to her death, Decedent transferred her interests in X Partners to her living trust. Decedent died on e.

Decedent's estate timely filed the estate tax return. In valuing Decedent's interests in X Partners, the estate first determined the value of the partnership's underlying assets. The partnership's sole assets were cash and nineteen lottery payments receivable. The estate discounted the payments to present value using a discount rate based on the AAA rated general obligation bond yield. The estate further discounted each payment by 39.6 percent for federal income taxes and 25 percent for lack of marketability. After taking additional discounts in valuing the partnership for lack of control (20 percent) and lack of marketability (25 percent), the executor allocated a proportionate value to Decedent's limited and general partnership interests.

LAW:

Section 2031 provides that the value of the gross estate of the decedent shall be determined by including to the extent provided for in Subtitle B, Ch. 11A, Part III, the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated.

Section 2033 includes in the decedent's gross estate, the value of all property to the extent of the interest therein of the decedent at the time of the decedent's death.

Section 2039 provides for the inclusion in a decedent's gross estate of the value of an annuity or other payment receivable by any beneficiary by reason of surviving the decedent under any form of contract or agreement, if the annuity or other payment was payable to the decedent or the decedent possessed the

CC:DOM - TAM-112920-98

right to receive the annuity or payment.

Section 7520(a) states that the value of any annuity, any interest for life or a term of years, or any remainder or reversionary interest is determined under tables prescribed by the Secretary, and by using an interest rate equal to 120 percent of the Federal midterm rate for the month in which the valuation date falls. Section 7520(b) provides that § 7520(a) is applicable for all purposes of the Internal Revenue Code, except for §§ 401 through 420 and other provisions specified in regulations.

Section 20.2031-7(d)(1) states, in part, that except as provided for under § 20.7520-3(b), if the valuation date for the decedent's estate is after April 30, 1989, the fair market value of an annuity is its present value determined by use of standard or special § 7520 actuarial factors. These factors are derived by using the appropriate § 7520 interest rate and, if applicable, the mortality component for the valuation date of the interest that is being valued. See §§ 20.7520-1 and 20.7520-4.

Section 20.7520-1 provides that, generally, the present value of an annuity is determined by use of the interest rate component under § 7520 and the appropriate mortality component. The § 7520 interest rate component is the rounded interest rate that is equal to 120 percent of the applicable federal midterm rate for the month in which the valuation date falls. Section 20.7520-(1)(b)(1). For estate tax purposes, the valuation date is the date of the decedent's death, unless the alternate valuation date is elected in accordance with § 2032. The mortality component is contained in the tables under § 20.2031-7 based on the appropriate interest rate component on the valuation date. Section 20.7520-(1)(b)(2). The present value of the annuity is computed by using the methodology described in § 20.2031-7, i.e., by multiplying the aggregate amount payable annually by an annuity factor derived from the tables with any appropriate adjustment for periodic payments.

Section 20.7520-3(b) provides exceptions to the use of the standard actuarial factors and is effective for estates of decedents dying after December 13, 1995. Section 20.7520-3(b)(1)(ii) states that, generally, a standard § 7520 annuity, income, or remainder factor may not be used to value a "restricted beneficial interest." 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."

CC:DOM - TAM-112920-98

Section 20.7520-3(b)(2)(i) states that a standard § 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.

Section 20.7520-3(b)(3) provides that except as provided in paragraph (b)(3)(ii) of this section, the mortality component prescribed under § 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. A special § 7520 annuity factor must be computed that takes into account the projections of actual life expectancy. See § 20.7520-3(b)(3), Example 1.

Revenue Ruling 80-80, 1980-1 C.B. 194, obsoleted, Rev. Rul. 96-3, 1996-1 C.B. 348, provides that the actuarial tables in the regulations may be disregarded only if the individual is known to have been afflicted, at the time of transfer, with an incurable physical condition that is in such an advanced state that death is clearly imminent.

Revenue Ruling 77-454, 1977-2 C.B. 351, provides that where an annuitant has the right to receive an annuity until death or until the fund is exhausted, the present value of the annuity is based on the use of a special factor which the Service will compute upon request in accordance with § 25.2512-9(e).

State X law provides that prizes in the lottery are not assignable except: (1) if the prize winner dies before the prize is paid, the director shall pay the prize as required by law; or (2) pursuant to an appropriate judicial order, which order shall not include an order issued to enforce or approve an agreement between a prize winner and any third party where the prize winner has agreed to transfer future prize payments to a third party in exchange for consideration.

ANALYSIS:

The present value of the right to receive annuity payments is computed by use of the standard § 7520 annuity factors, unless an exception to the use of the standard actuarial factors is applicable. Section 20.7520-3(b) provides exceptions to the use of the standard actuarial factors. That section is effective for decedent's dying after the Decedent's date of death. However, the regulations incorporate longstanding valuation principles and Service position. Thus, the principles outlined in the

CC:DOM - TAM-112920-98

regulations are equally applicable to the instant case.

The lottery winnings at issue represent the right to receive a fixed dollar amount annually for a defined period of time. Thus, the same method should be used for valuing the lottery winnings as is used for valuing an annuity. Unless an exception applies, the § 7520 standard annuity factor must be used to determine the value of the lottery winnings payable for estate tax purposes.

None of the exceptions to using the standard actuarial factors applies in this case. The lottery winnings will not be paid from a fund that is expected to exhaust prior to the last annuity payment, and the payment of the annuity is not based on a measuring life of an individual who is terminally ill.

Further, the restrictions on transferring the lottery winnings are not the types of restrictions referenced in the regulations that would justify departure from the use of the actuarial tables. Initially, we note that § 20.7520-3(b)(1)(ii) provides a general rule defining a "restricted beneficial interest" as an annuity, etc., that is subject to a contingency, power, or other restriction. Used in this manner, the term "restriction" references other limitations similar to contingencies (e.g., events that if occurring can result in termination of the payment of the annuity) or powers (e.g., powers to divert the annuity payments or the funds from which the annuity payment is to be made), such that receipt of the annuity payments by the beneficiary becomes questionable.

Section 20.7520-3(b)(2) provides specific rules regarding annuities and makes it clear that "contingency, power, or other restriction" references only limitations that impact on the payment of the annuity. Examples illustrating limitations on annuity, income, remainder, and reversionary interests that constitute "restricted beneficial interests" are set forth in § 20.7520-3(b)(2)(v), Examples 1 through 5, and § 25.7520-3(b)(2)(v), Example 5. Those examples involve income, remainder, and reversionary interests focusing on limitations or invasion powers that impinge on the ability to pay the interest. Similarly, the example illustrating an annuity that is a restricted beneficial interest focuses on limitations that make it problematical whether the annuity will be paid for the defined period. See, e.g., § 25.7520-3(b)(2)(v), Example 5. Thus, we believe it is clear that under § 20.7520-3(b)(1) and (2), the standard annuity tables and factors are to be used to determine the present value of an annuity, unless the right to receive the annuity is restricted or limited by the governing instrument or other circumstances, or the ability of the underlying fund to pay

CC:DOM - TAM-112920-98

the annuity is restricted or limited by the governing instrument or other circumstances.

In this case, the right of the partnership to receive any and all of the lottery winnings payable has not been restricted or limited in any way. State X law restricting transfers does not affect the right of an annuitant to receive all of the future payments. Accordingly, it is not a restriction on the annuity such that the annuity would constitute a restricted beneficial interest under § 20.7520-(3)(b)(1).

Accordingly, the present value of the right to receive the remaining annuity payments is computed by use of the standard § 7520 annuity factor contained in the appropriate table under § 20.2031-7(d) reflecting the § 7520 interest rate on the valuation date. Consequently, in valuing the lottery winnings payable to X Partners, the executor may not take a discount for lack of marketability nor a reduction for income taxes payable on receipt of the winnings. See Estate of G.R. Robinson v. Commissioner, 69 T.C. 222 (1977). We will not address whether, in valuing X Partners, the executor may take discounts for lack of marketability and lack of control, due to the factual nature of the issues involved.

CAVEAT:

A copy of this technical advice memorandum is to be given to the taxpayer(s). Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.