DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

Number: **INFO 2000-0057**
Release Date: 6/30/2000

MAY 09, 2000
2001-00.00

The Honorable Frank R. Wolf
Member, U.S. House of Representatives
13873 Park Center Road, Suite 130
Herndon, VA 20171

Attention: Sharon Snyder

Dear Congressman Wolf:

This letter is in response to your inquiry dated March 16, 2000, to Mr. Floyd Williams, National Director for Legislative Affairs, Internal Revenue Service (IRS), on behalf of [redacted], your constituent. [redacted] sought your help in computing the value of an annuity for estate tax purposes. We cannot provide [redacted] with an exact value for his annuities; however, we can provide the following general information that will help him calculate the value of an annuity that is included in a decedent's gross estate.

Determining Whether the Value of an Annuity is Included in a Decedent's Gross Estate

Section 2001(a) of the Internal Revenue Code (the Code) imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States. However, under section 2010, every decedent's estate is allowed a credit against the estate tax. The credit allowed for people dying during the year 2000 is $220,550, based on an applicable exclusion amount of $675,000. This credit increases each year until it reaches a maximum of $345,800 in the year 2006 or later, when the applicable exclusion amount equals $1,000,000. As a result of this credit, an estate generally is not liable for estate tax unless the fair market value of the estate (plus the value of all gifts made by the decedent during his lifetime) exceeds the applicable exclusion amount in the year in which the decedent dies.

In calculating the value of an estate, sections 2039(a) and (b) generally provide that the gross estate includes the value of an annuity or other payment receivable by any beneficiary by reason of surviving the decedent under certain agreements or plans. The Instructions for Form 706, Schedule I (Annuities), explain the general requirements for determining whether an annuity is included in a decedent's gross estate and provide examples to assist with this determination. For your convenience, I have enclosed a copy of the Form 706 Instructions.

Determining the Amount of an Annuity Included in a Decedent's Gross Estate

If an annuity should be included in a decedent's gross estate, the estate must calculate the amount to be included. This calculation depends upon the value of the annuity and the amount of contributions towards the annuity's purchase price attributable to the decedent or the decedent's employer. The following formula illustrates this calculation:

$$\text{Amount of annuity included in the decedent's gross estate} = \frac{\text{Contributions to the purchase of the annuity attributable to the decedent}}{\text{Purchase price of the annuity}} \times \text{Value of the annuity}$$

To use this formula, the estate must value the annuity. If the company that issued the annuity regularly engages in the selling of annuities, the value of the annuity is established by determining the price of comparable annuities sold by that company. Usually, the value of the annuity would equal the cost of acquiring an annuity policy with benefits similar to the annuity in question at the date of decedent's death. Welliver v. Commissioner, 8 TC 165 (1947). If, however, annuity payments received by survivor beneficiaries are not paid by a company that regularly engages in such business, the annuity is valued using the appropriate interest rate and valuation tables.

Valuing an Annuity Using the Appropriate Interest Rate and Valuation Tables

The valuation tables assign a value to the annuity using the following formula:

$$\text{Value} = \text{Annuity Payment Amount} \times \text{Table Annuity Factor Based On Age of Surviving Annuitant (Table S or R(2))} \times \text{Table Adjustment Factor For Timing/Number of Payments, if applicable (Table J or K)}$$

To use the valuation tables, the estate first must determine the appropriate interest rate and the ages of the surviving annuity recipient or recipients as of the decedent's date of death.

The appropriate interest rate (known as the section 7520 rate) is calculated by multiplying the applicable Federal mid-term rate, compounded annually, for the month in which the decedent dies, by 120 percent and rounding the product to the nearest two-tenths of one percent. Each month the IRS publishes the section 7520 rate in the Internal Revenue Bulletin. You can obtain this rate from the IRS website at www.irs.ustreas.gov by selecting the "Tax Info For You" category and then selecting "Applicable Federal Rates."

Using the appropriate interest rate and the ages of the surviving annuity recipient or recipients, the estate next determines which tables to use for the calculation: Table S or R(2), and Table J or K, if applicable. Table S is used when the annuity payment is made at the end of each year for a term of years or the life of one individual. If the payment is to be made for the lives of two individuals, Table R(2) is used. If the annuity payments are more frequent than annually and/or are made at the beginning of a period, an adjustment factor from either Table J or K must be included in the calculation. An adjustment factor from Table J must be used when the payments are made at the beginning of a period, regardless of whether the annuity payments are more frequent than annually. An adjustment factor from Table K must be used when the payments are made at the end of specified periods, when such payments are more frequent than annually.

Tables S, R(2), and K used for valuation dates after April 30, 1999, can be found in the IRS Publication 1457, "Actuarial Values, Book Aleph." Table J, used for valuation dates after April 30, 1989, can be found in section 20.2031-7(d)(6) of the Estate Tax Regulations. For purposes of the examples below, I have enclosed copies of specific pages from the Book Aleph, as well as Table J. However, a copy of the Book Aleph can be purchased from the Superintendent of Documents, United States Government Printing Office, Washington, DC 20402. It can also be purchased by phone by calling the Superintendent of Documents, at (202) 512-1800 (not a toll-free number), and requesting IRS Publication 1457, Book Aleph (document number 048-004-024-14-4). Furthermore, if a special factor is required for an actual decedent, the executor may request a ruling from the IRS.

Examples for Calculating the Amount of an Annuity Which Will Be Included in a Decedent's Gross Estate

The following examples (derived from section 20.2031-7T(d)(5), Example 3, of the Estate Tax Regulations) illustrate the calculations involved in determining the amount of an annuity included in a decedent's gross estate. Assume that A purchased an annuity for the benefit of both A and B. Under the terms of the annuity contract, at A's death, a survivor annuity of $10,000 a year payable in equal semiannual installments made at the end of each interval is payable to B for life. At A's death, B was 45 years, 7 months old. Also at A's death, the section 7520 rate was 9.6 percent.

Under Table S, the annuity factor at 9.6 percent for determining the present value of an annuity payable until the death of a person age 46 (the number of years nearest B's actual age) is 9.3737. The adjustment factor from Table K at an interest rate of 9.6 percent for semiannual annuity payments made at the end of the period is 1.0235. The present value of the annuity at the date of A's death is, therefore, $95,938.82 ($10,000 x 9.3737 x 1.0235). If, however, the semiannual installments were to be made at the beginning of each interval, the adjustment factor would be determined under Table J.

If the annuity contract was payable in equal semiannual installments made at the end of each interval to B for life and then to C for life, Tables R(2) and K would be applicable. If we assume that the interest rate is 9.6 percent and B and C are ages 46 and 25, respectively, the value of the annuity is calculated as follows:

(1) Determining the Remainder Factor. Under Table R(2), based on an interest rate of 9.6 percent, the factor for a remainder interest payable on the death of the last to die of two persons, age 25 and 46, is .01433.

(2) Calculating the Annuity Factor. The Annuity Factor is 10.2674, determined as follows:

$$\frac{1 - .01433 \text{ (remainder factor)}}{.096 \text{ (interest rate)}} = 10.2674$$

(3) Calculating the Value of the Annuity. The present value of the annuity is $105,086.83, determined as follows:

> $10,000 (annual annuity payment) x 10.2674 (annuity factor) x 1.0235 (Table K adjustment factor at an interest rate of 9.6 percent for semiannual annuity payments made at the end of the period)= $105,086.83 (value of the annuity).

I hope this information is helpful to you and your constituent. If you need further assistance, please call Caroline Watson, Identification Number 50-11660, at (202) 622-3090.

Sincerely,

Paul F. Kugler
Assistant Chief Counsel
(Passthroughs and Special Industries)

Enclosures (3)