

**Office of Chief Counsel  
Internal Revenue Service  
Memorandum**

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to: Miles D. Friedman, (CC:SB:8:LN:2)  
(Associate Area Counsel)

from: Blaise Dusenberry, STR, Branch 1  
(Procedure & Administration)

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subject: A, Decedent

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

LEGEND

A =

B =

C =

D =

E =

F =

G =

H =

I =

J =

Trust X =

Company =

Date 1=

Date 2=

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Date 8 =

Date 9 =

Year A =

Year B =

\$A =

\$B =

\$C =

\$D =

\$E =

amount 1 =

State A =

ISSUE

Whether transactions in the calendar year B involving the sale of interests in a family LLC in exchange for an annuity were adequately disclosed under section 6501(c)(9) of the Internal Revenue Code and section 301.6501(c)-1(f)(2) of the Procedure and Administration Regulations on Decedent's Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return filed for the year B?

FACTS

Decedent and her spouse ("Spouse") resided in a community property state. In year A, they executed a revocable trust (the "Trust") and contributed their separate and community property to the Trust. On Spouse's death in date 9, the Trust became irrevocable. Pursuant to the terms of the Trust, on Spouse's death, the community and separate property contributed by Decedent was distributed to Trust A, a survivor's trust under which Decedent was entitled to all of the income for life. In addition, Decedent had the right, exercisable at any time, to demand distribution to herself of all the property. She also had a general power to appoint the property at her death. If Decedent died without exercising power, the property was to be divided equally among the four children.

A portion of the property contributed by Spouse in an amount determined pursuant to a marital deduction formula was distributed to Trust C, a marital trust for the benefit of Decedent. Decedent was entitled to all trust income for life and principal as necessary for her support (after exhausting other resources). At her death, Trust C was to be divided equally among the couple's four children. On the estate tax return filed for Spouse's estate, the executor elected to treat the Trust C property as qualified terminable interest property, and a marital deduction was allowed under section 2056(b)(7) for the value of the property. The Trust provided for the creation of third trust, Trust B, a "bypass trust." This trust was not involved in the transactions at issue.

Decedent's and Spouse's four children were designated as the trustees of Trust A and Trust C. At the time of Spouse's death, Decedent suffered from a disease and other illnesses, was under hospice care, and was totally incapacitated. The facts indicated that contemporaneously with the transactions described below, Decedent was twice certified by her physician as suffering from a terminal condition such that her life expectancy was less than six months. Despite this prognosis, Decedent lived four more years and died in date 1 .

At Spouse's death, the Trust held marketable securities valued at \$A. These securities passed primarily to Trust A and Trust C. In March 2000, two months after Spouse's death, the trustees formed an LLC, and transferred the marketable securities passing to the two trusts to the LLC in exchange for LLC units. Each trust received a 50% interest in the LLC. One month later, the LLC liquidated the securities and thereupon held \$B of cash and cash equivalents.

In date 2, the following transaction took place. Trust A and Trust C each “sold” a 12.5% LLC interest to each of the four children. In exchange, each child agreed to pay to the two trusts a monthly annuity for the remainder of Decedent’s life. Commencing thereon, the LLC made monthly cash distributions to each child equal to the annuity amount to be paid. Each child also received a note reminding the child to pay the amount to the respective trust.

A gift tax return, Form 709, was timely filed for Decedent for the calendar year 2000. On Schedule A of the return, in response to the question “Does the value of any item listed on Schedule A reflect any valuation discount,” the box indicating a “Yes” is checked. An addendum to Schedule A attached to the return contains the following statement:

On date 3, the donor (through the Survivor’s Trust created under the Trust X, dated date 4) sold amount 1 limited liability company units in Company, a state A Limited Liability Company, to her daughter, B . In consideration for said units, the donor (through the Survivor’s Trust) received a private annuity that will pay her \$C monthly beginning date 5 and termination upon the donor’s death. According to the values as reported on this return, the present value of the annuity equals the fair market value of the LLC interest.

An attached statement lists the following exhibits as included with the return.

- Private Annuity Agreement (B)
- Private Annuity Agreement (C)
- Private Annuity Agreement (D)
- Private Annuity Agreement (E)
- Private Annuity Calculation
- Company Operating Agreement
- Trust X, dated date 4
- Valuation of LLC Interest
- F Irrevocable Trust dated date 6
- G Irrevocable Trust dated date 6
- H Irrevocable Trust dated date 6
- I Irrevocable Trust dated date 6
- J Irrevocable Trust dated date 6
- Power of Attorney

These exhibits were not submitted with the request for assistance. We are assuming that these items were attached to the return. In addition, we are assuming that the exhibit described as Valuation of LLC Interest satisfies the requirements of sections 301.6501(c)-1(f)(2)(iv) or (f)(3). In addition, since we have not reviewed the “Private

Annuity Calculation,” we can not ascertain at this time whether the Taxpayer utilized the proper actuarial tables and discount rate prescribed under section 7520 in computing the value of the annuity. We note that section 25.7520-1(a) provides that, except as provided in section 25.7520-3(b) (discussed below), the value of an annuity for an individual's life is determined using the appropriate interest rate prescribed under section 7520 and the actuarial tables contained in section 20.2031-7(d). Section 20.2031-7(d)(2)(iv) discusses the calculation and section 20.2031-7(d)(5), Example 3, provides an example of the calculation.

At the time of Decedent's death, the net asset value of the LLC had decreased to approximately \$D due to decreases in the value of its investments and distributions to the children. The estate tax return filed for Decedent's estate (Form 706) does not report any interests in the LLC. Schedule G of the return reports “Annuity Receivable” from each of the four children in the amount of \$E.

Decedent's gift tax return filed for the calendar year B is currently under examination. The return was filed on or around date 7, and the general three-year statute of limitation would have expired in date 8. Therefore, a gift tax may be assessed only for gifts not reported or not adequately disclosed in this return.

#### ANALYSIS

Section 7520(a) provides that the value of any annuity, any interest for life or a term of years, or any remainder or reversionary interest shall be determined--

(1) under tables prescribed by the Secretary, and

(2) by using an interest rate (rounded to the nearest 2/10ths of 1 percent) equal to 120 percent of the Federal midterm rate in effect under § 1274(d)(1) for the month in which the valuation date falls.

Section 7520(c)(3) provides generally that the actuarial tables to be prescribed under section 7520(a) are to be revised at least every ten years to take into account the most recent mortality experience available.

Section 25.7520-3(b) delineates the circumstances in which the published actuarial tables are not to be used to value the interests described in section 7520(a). See Treas. Reg. § 25.7520-1(a)(1) (annuities, etc. are valued using the actuarial tables prescribed under section 7520 “[e]xcept as otherwise provided in this section and § 25.7520-3... .”)

Section 25.7520-3(b)(3)(i) provides, in part, that 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. 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. (The estate tax regulations contain similar provisions. See Treas. Reg. § 20.7520-3(b)(3)).

Section 25.7520-3(b)(4), Example 1, describes a situation where the decedent bequeaths \$1,000,000 to a trust under the terms of which the trustee is to pay \$103,000 per year to a charitable organization during the life of the decedent's child. Upon the death of the child, the remainder in the trust is to be distributed to the decedent's grandchild. The child, who is age 60, has been diagnosed with an incurable illness, and there is at least a 50 percent probability of the child dying within 1 year. The example concludes that assuming the eighteen month presumption provided in section 25.7520-3(b)(3)(i) does not apply, the standard life annuity factor for a person age 60 may not be used to determine the present value of the charitable organization's annuity interest because there is at least a 50 percent probability that the child, who is the measuring life, will die within 1 year. Instead, a special section 7520 annuity factor must be computed that takes into account the projection of the child's actual life expectancy.

Section 6501(a) provides that, except as otherwise provided, the amount of any tax shall be assessed within 3 years after the return was filed.

Section 6501(c)(9) provides, in part, that, if any gift of property the value of which (or any increase in taxable gifts required under section 2701(d)) is required to be shown on a gift tax return (Form 709), and is not shown on such return, any gift tax imposed on such gift may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time. The statute provides, however, that this rule does not apply "to any item which is disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the Secretary of the nature of such item."

Section 301.6501(c)-1(f)(1) of the Procedure and Administration Regulations provides, in part, that if a transfer of property is not adequately disclosed on a gift tax return, or in a statement attached to the return, filed for the calendar period in which the transfer occurs, then any gift tax imposed on the transfer may be assessed, or a proceeding in court for the collection of the appropriate tax may be begun without assessment, at any time.

Section 301.6501(c)-1(f)(2) provides, in part, that a transfer will be adequately disclosed on the return only if it is reported in a manner adequate to apprise the Internal Revenue Service of the nature of the gift and the basis for the value so reported. Transfers reported on the gift tax return as transfers of property by gift will be considered adequately disclosed if the return (or a statement attached to the return) provides the following information--

- (i) A description of the transferred property and any consideration received by the transferor;
- (ii) The identity of, and relationship between, the transferor and each transferee;
- (iii) If the property is transferred in trust, the trust's tax identification number and a brief description of the terms of the trust, or in lieu of a brief description of the trust terms, a copy of the trust instrument;
- (iv) A detailed description of the method used to determine the fair market value of property transferred, including any financial data (for example, balance sheets, etc. with explanations of any adjustments) that were utilized in determining the value of the interest, any restrictions on the transferred property that were considered in determining the fair market value of the property, and a description of any discounts, such as discounts for blockage, minority or fractional interests, and lack of marketability, claimed in valuing the property. In the case of the transfer of an interest in an entity (for example, a corporation or partnership) that is not actively traded, a description must be provided of any discount claimed in valuing the interests in the entity or any assets owned by such entity. In addition, if the value of the entity or of the interests in the entity is properly determined based on the net value of the assets held by the entity, a statement must be provided regarding the fair market value of 100 percent of the entity (determined without regard to any discounts in valuing the entity or any assets owned by the entity), the pro rata portion of the entity subject to the transfer, and the fair market value of the transferred interest as reported on the return. If 100 percent of the value of the entity is not disclosed, the taxpayer bears the burden of demonstrating that the fair market value of the entity is properly determined by a method other than a method based on the net value of the assets held by the entity; and
- (v) A statement describing any position taken that is contrary to any proposed, temporary or final Treasury regulations or revenue rulings published at the time of the transfer.

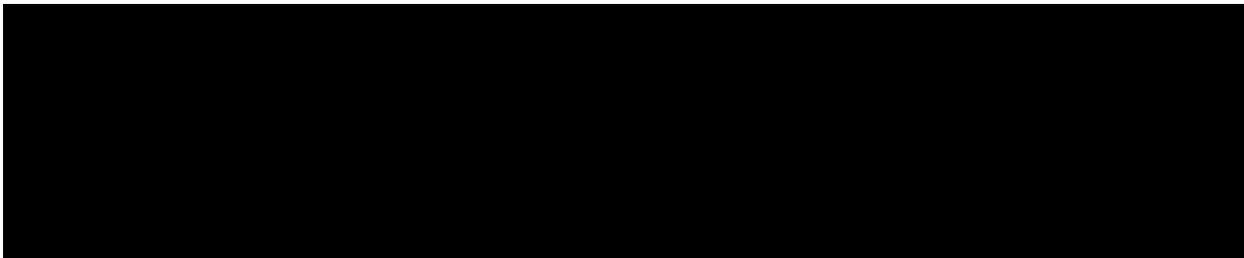
Section 301.6501(c)-1(f)(3) provides that the requirements of paragraph (f)(2)(iv) will be satisfied if the donor submits an appraisal of the transferred property that meets certain enumerated requirements.

Section 301.6501(c)-1(f)(4) provides, in part, that completed transfers to members of the transferor's family that are made in the ordinary course of operating a business are deemed to be adequately disclosed, even if the transfer is not reported on a gift tax return, provided the transfer is properly reported by all parties for income tax purposes. Further, any other completed transfer that is reported, in its entirety, as not constituting

a transfer by gift will be considered adequately disclosed only if the following information is provided on, or attached to, the return--

(i) The information required for adequate disclosure under paragraphs (f)(2)(i), (ii), (iii) and (v) of section 301.6501(c)-1; and

(ii) An explanation as to why the transfer is not a transfer by gift under chapter 12 of the Internal Revenue Code.



[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]



RECOMMENDATION



Please call  
questions.

if you have any further