

**UNITED STATES DISTRICT COURT  
MIDDLE DISTRICT OF LOUISIANA**

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**TINCY ANTHONY, ADMINISTRATRIX  
OF THE SUCCESSION OF  
JAMES LOUIS BANKSTON, SR.**

**CIVIL ACTION  
  
NO. 02-304-D-M1**

**V.**

**UNITED STATES OF AMERICA**

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**RULING ON MOTION FOR PARTIAL SUMMARY JUDGMENT**

This matter is before the court on two motions for partial summary judgment. The government filed a motion for partial summary judgment (doc. 22). Tincy Anthony, the administratrix of the Succession of James Louis Bankston, Sr. filed an opposition (“the Estate”) (doc. 30). The United States filed a reply brief (doc. 34). The Estate, filed a cross motion for partial summary judgment (doc. 26). The United States filed an opposition (doc. 32). The Estate has filed a reply brief (doc. 33). Oral argument was held on February 10, 2005. Subsequently, both parties filed post-hearing memoranda (docs. 37 and 38). The Estate filed a surreply (doc. 41). The United States then filed a notice of Supplemental Authority (doc. 46). The Estate filed a Rebuttal to the Notice of Supplemental Authority of the United States (doc. 44). United States then filed a surrebuttal (doc. 47). Subject matter jurisdiction is based upon federal question, 28 U.S.C. §1331. The issue at hand is whether Mr.

Bankston's interest in certain annuity payments at issue should be valued for federal estate tax purposes using the 26 C.F.R. §20.7520-1 actuarial tables or the fair market value method of 26 C.F.R. §20.2031-1. The determination of which is the proper valuation method is a question of law to be decided by this Court.<sup>1</sup> Since both motions concern the same issue, they will be addressed together in this ruling.

After careful consideration of the issue, the United States' motion for partial summary judgment (doc. 22) is hereby GRANTED and the petitioner's cross motion for partial summary judgment is hereby DENIED (doc. 26).

## **I. FACTS**

This lawsuit was filed by the administratrix of the Succession of James Louis Bankston, Sr., who avers that at the time of his death, Mr. Bankston was the beneficiary of several scheduled monthly and annual payments of annuity contracts ("the annuities"). These annuities were made in conjunction with a structured settlement to Mr. Bankston for personal injuries he had sustained in an automobile accident on March 13, 1990.

With regard to the annuities, Georgia Pacific made assignments of its obligation to make periodic payments to Mr. Bankston under 130 (C) of the Internal

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<sup>1</sup>Estate of Dunn v. Comm'r, 301 F.3d 339, 348 (5th Cir. 2002) (citing Estate of Palmer v. Comm'r, 839 F.2d 420, 423 (8<sup>th</sup> Cir. 1988) (citing Powers v. Comm'r, 312 U.S. 259, 260, 61 S.Ct. 509, 85 L.Ed. 817 (1941)(stating that the ultimate determination of fair market value is a finding of fact, while the question of what criteria should be used to determine the value is a question of law subject to de novo review)).

Revenue Code to Transamerica Occidental Life Insurance Company (“Transamerica”), MetLife Insurance Company of Louisiana (“MetLife”) and First Colony Life Insurance Company (“First Colony”) (Collectively known as the “structured payments”).<sup>2</sup> Under this arrangement, the structured payments are restricted from being “accelerated, deferred, increased or decreased” and from being “anticipated, sold, assigned or encumbered.” Further, the structured payments due are “non assignable and exempt from the claims of creditors to the maximum extent permitted by law.”

Mr. Bankston died in Baton Rouge, Louisiana, on July 30, 1996. On April 30, 1997, his Estate filed its United States Estate Tax Return (“Form 706”) with the Internal Revenue Service (“the Service”). On this original form, under Schedule 1 annuities, the Estate identified Mr. Bankston’s total interest in the structured payments using the 26 C.F.R. §20.7520-1 actuarial tables (“the §7520 tables”). As of the date of decedent’s death, Mr. Bankston’s interest was estimated to be

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<sup>2</sup>The first annuity was to be purchased by Transamerica Annuity Service Corporation from Transamerica Occidental Life Insurance Company, guaranteeing Bankston the right to receive 15 guaranteed lump payments, issued as policy No. 911004. The second was owned by Metropolitan Life Insurance Company, and issued by MetLife Security Insurance Company. Under this annuity, Bankston was to receive monthly payments for 15 years guaranteed and for life thereafter, in an amount beginning with nine thousand three hundred fifty dollars (\$9350) on July 1, 1991, and increasing three percent annually thereafter. The third annuity was owned by Jamestown Life Insurance Company and issued by First Colony Life Insurance Company. As the annuitant under this annuity, Bankston was to receive monthly payments, fifteen years guaranteed and for life thereafter, in an amount beginning with seven thousand dollars (\$7000) on July 1, 1991, and increasing three percent annually thereafter.

\$2,371,409. This value was reported on Form 706, filed on April 30, 1997. Based on this figure, the Estate reported its federal tax liability to be \$468,078.

Thereafter, on March 1, 1999, the Service audited Form 706 resulting in an estate tax increase in the amount of \$142,605. In determining this tax deficiency, the Service accepted the values that the Estate originally reported on its Schedule I with the exception of a slight increase in the value of the MetLife Company annuity.<sup>3</sup> In total, the Estate paid \$698,093 in federal estate taxes and interest in installments between May 5, 1997 and March 19, 2001. Subsequently, by letter dated September 13, 2001, the Estate filed an informal claim for a refund (“the informal claim”) with the Service, contending that it had overpaid the estate tax liability in the amount of \$427,624 in taxes, and statutory interest thereon. The Estate argued that the valuation produced using the §7520 tables was unrealistic because the tables fail to consider “that the stream of future receivables is restricted from transfer and is not marketable.” Based on the foregoing, the Estate claimed it was due a refund of \$427,624 in tax and statutory interest thereon.<sup>4</sup>

The Service denied the Estate’s informal claim on April 24, 2002. In denying the refund, the Service specifically stated that the Internal Revenue code “does not recognize any discounts or departures from the values prescribed by the Section 7520 tables based upon an alleged lack of marketability.” In response, the Estate

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<sup>3</sup>This value increased by slightly over \$4,000.00.

<sup>4</sup>See U.S.’s Memo in Supp. For Partial Mot. For Sum. Jud., Exhibit 11.

filed the matter now before the court.

## **II. SUMMARY OF THE ARGUMENTS**

The Estate argues that the value of Mr. Bankston's interest in the structured payments are "restricted beneficial interests" within the meaning of 26 C.F.R. §20.7520-3(b)(1)(ii), requiring valuation pursuant to 26 C.F.R. §20.2031-1. Specifically, under the legislative grant of §20.7520-3, annuities, subject to marketability restrictions, are excepted from valuation under the §7520 tables.

Conversely, the government contends that Mr. Bankston's interest in the structured payments constitutes an "ordinary annuity interest" within the boundaries of the Code of Federal Regulations. Thus, the Service argues that it correctly employed the §7520 actuarial tables to determine the value of Mr. Bankston's interest in the structured payments for his taxable estate as of July 30, 1996.

## **III. ANALYSIS**

### *INCLUSION IN THE DECEDENT'S GROSS ESTATE*

The IRS imposes a tax on the taxable estate of every decedent who is either a resident or a citizen of the United States. 26 U.S.C. 2001(a). This includes, "all property, real or personal, tangible or intangible."<sup>5</sup> Section 26 C.F.R. §20.2039-1(b)(1)(i) provides for the inclusion in a decedents gross estate:

An annuity or other payment receivable by any beneficiary

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<sup>5</sup>26 U.S.C. 2031(a).

under any form of contract or agreement entered into after March 3, 1931, under which--

(i) An annuity or other payment was payable to the decedent, either alone or in conjunction with another person or persons, for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death. . . .

Upon his death, Mr. Bankston was the named payee or annuitant of the structured payments. However, he was not the owner --Transamerica, MetLife, and First Colony obtained the policies and retained ownership. At his death, Mr. Bankston's right to receive payments under the Agreement passed to his beneficiary, the Estate of James Louis Bankston, Sr. Thus, neither party disputes that Mr. Bankston's interest in the annuities are to be included in the estate.

The value of the interest mandated for inclusion in his gross estate is limited to the extent of his interest at the time of his death.<sup>6</sup> 26 C.F.R. §20.2031-1(b) stipulates "the value of every item of property includible in a decedent's gross estate under sections 2031 through 2044 is its *fair market value* at the time of decedent's death."<sup>7</sup> Pursuant to 26 C.F.R. §20.7520-1(a), in the case of estates with valuation dates after April 30, 1989, the fair market value of annuities, interests for life or for a term of years (including unitrust interests), remainders, and reversions, is their present value determined using Section

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<sup>6</sup>26 U.S.C. §2033.

<sup>7</sup> Id. (emphasis supplied), 26 C.F.R. §20.2031.

20.7520-1(a).<sup>8</sup> To determine present value of such items, Section 20.7520-1(a) provides annuity tables using an interest rate component located in 26 C.F.R. §20.7520-1(b)(1)(i) and a mortality rate component described in 26 C.F.R. §20.7520-1(b)(2).

#### *VALUATION UNDER THE TAX CODE*

There are, however, exceptions for computation of the value of annuities, unitrust interests, life estates, terms of years, remainders, and reversions after 1989. Specifically, the Secretary of the Treasury adopted: (1) final regulations in 26 C.F.R. §20.7520-3(a) effective as to the estates of individuals who died after April 30, 1989, regarding specific provisions of the Code of Federal Regulations to which the tables set forth in 26 C.F.R. §20.7520-1(a) did not apply; and (2) additional final regulations in 26 C.F.R. §20.7520-3(b) effective as to estates of individuals who died after December 13, 1995, specifying the limited factual

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<sup>8</sup>See 26 C.F.R. §20.7520-1(a). See also 5 Boris Bittker & Lawrence Lokken, 5 Federal Taxation Income Estate & Gifts 135.4.10 at 135-82 (stating that the willing-seller, willing-buyer standard has never been applied directly to private annuities, life estates, terms of years, remainders, reversions, and similar split interests in property, probably because such interests are rarely sold at arm's length. Instead, these interests are valued by determining the fair market value of the underlying property and dividing this value among the several interests in the property. When making such a division, one should use the Section 7520-1(a) actuarial tables based on assumed interest rates, mortality rates, and other factors unless the annuity, term of interests, or other such agreements are tied to something further, such as an independent underlying asset or an interest rate).

circumstances in which the application of the 26 C.F.R. §20.7520-1 standards in valuing annuities for estate tax purposes is not mandatory.<sup>9</sup>

For estate tax purposes, the valuation date is the date of the decedent's death, unless an alternate valuation date is elected in accordance with 26 C.F.R. §20.2032-1(a).<sup>10</sup> Given that Mr. Bankston died on July 30, 1996, and no alternative valuation date was selected, both 26 C.F.R. §§ 20.7520-3(a) and 20.7520-3(b) apply in the instant case.

Under these regulations, for estate tax purposes, the structured payments must be valued using the §7520 actuarial tables if found to constitute an annuity, life estate, term of years, remainder or reversion. However, should the Estate demonstrate that a specific exception applies under either 26 C.F.R. §20.7520-3(a) or (b), or that the tables produce an unrealistic or unreasonable result, deviation is permissible. The court will now proceed to determine the nature of the property interest below, and whether any exceptions apply which would require using an alternative method of valuation.

#### *THE NATURE OF THE DECEDENT'S ESTATE UNDER LOUISIANA LAW*

The threshold question in this case is whether the structured payments constitute an ordinary annuity interest. It is well established that, in general,

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<sup>9</sup>See 26 C.F.R. §§20.7520-3(b) and 20.7520-3(c).

<sup>10</sup>Here, no alternative date was selected.

“State law creates legal interests and rights. The federal revenue act designates what interests or rights, so created, shall be taxed.”<sup>11</sup> In this case, the nature of decedent’s interest is to be determined under the law of Louisiana, Mr. Anthony’s domicile at the time of his death.<sup>12</sup>

Here, the property at issue is Mr. Bankston’s right to receive periodic payments under the Agreement pursuant to the annuity contracts purchased from Georgia Pacific Corporation. There are two Fifth Circuit decisions on point which help to establish the nature of the interest. First, the court held payments from a structured settlement are annuities under Louisiana law.<sup>13</sup> Second, the court held that the right to receive a series of fixed payments with virtually no risk of default, even when subject to marketability restrictions, constitutes an annuity.<sup>14</sup>

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<sup>11</sup>See Shapiro v. Comm’r of I.R.S., 66 T.C.M. (CCH) 1067 (1993), 1993 WL 415532, aff’d on other grounds, 111 F.3d 1010 (2d. Cir. 1997) (citing Morgan v. Comm’r, 309 U.S. 78, 80 (1940)).

<sup>12</sup>See Cohn v. Heymann, 544 So.2d 1242, 1248 (La.App. 3 Cir. 1989)(citing Succession of King, 170 So.2d 129 (La.App. 4 Cir. 1964), writ denied, 247 La. 409, 171 So.2d 666 (1965)).

<sup>13</sup>See Matter of Orso, 283 F.3d 686, 693-94 (5th Cir. 2002)(analyzing in detail the nature of a Louisiana property interest held by an injured person who owed payments under a structured settlement agreement such as the one Bankston obtained in this action. In doing so, the Court overruled two of its prior decisions in which it had found such payments to be either accounts receivable (as well as an annuity) and installment payments on an underlying debt).

<sup>14</sup>Estate of Cook v. Comm’r of the I.R.S., 349 F.3d 850 (5th Cir. 2003).

In Estate of Cook v. Commissioner of the Internal Revenue Service,<sup>15</sup> an estate executrix appealed a decision from the United States Tax Court, which concluded that a deceased's non-transferable lottery prize payable in 19 annual installments was a private annuity that must be valued, for estate tax purposes, in accordance with 26 C.F.R. §20.7520-1(a).<sup>16</sup> In the opinion, the court concurred with the Tax Court's decision in Grisbauskas, which defined an annuity loosely as "a right to receive fixed, periodic payments, either for life or a term of years."<sup>17</sup> Accordingly, in Cook, the Fifth Circuit defined a private annuity as "the right to a series of fixed payments independent of market forces."<sup>18</sup> Applying this definition to the facts of the case, the Fifth Circuit held that the lottery prize at issue, an unsecured right to a series of fixed payments with virtually no risk of default, constituted a private annuity subject to valuation under the §7520 and related tables.<sup>19</sup>

Similarly, Mr. Bankston was the beneficiary of a series of fixed payments from a settlement. The payments were made monthly and annually to Mr.

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<sup>15</sup>Id.

<sup>16</sup>Id.

<sup>17</sup>Estate of Grisbauskas v. Comm'r of I.R.S., 116 T.C. at 142, 152 (2001), 2001 WL 227025, reconsidered and reversed, 342 F.3d 85.

<sup>18</sup>Cook, 349 F.3d at 855.

<sup>19</sup> Id.

Bankston, and continue to be made to his estate. Virtually no risk of default threatens to end the payments before their completion. Thus, the interest at issue constitutes an annuity under Louisiana law.

*THE NATURE OF THE DECEDENT'S ESTATE UNDER THE CODE OF FEDERAL REGULATIONS*

Mr. Bankston's interest constitutes an "ordinary annuity interest" under the Code of Federal Regulations. Although neither §20.2039 nor §20.7520 defines the term "annuity," the regulations under these sections provide the following definitions. Regulation 26 C.F.R. §20.2039-1(b)(1)(ii) defines an annuity as the right to one or more payments extending over a period of time. Similarly, under the heading entitled, "ordinary beneficial interests" within 26 C.F.R. §20.7520-3(b)(1), are three subsets: (1) ordinary annuity interests; (2) ordinary income interests; and (3) ordinary remainder or reversionary interests. All three subsets are defined within the regulation. These three ordinary interests serve as a baseline in identifying the sorts of interests that must be valued under Section 20.7520-1.

Upon review, the Court has determined the interest at issue here falls within the subset termed "ordinary annuity interests." The current definition under 26 C.F.R. §20.7520-3(b)(1)(i)(a), effective December 14, 1995, states, "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."

<sup>20</sup> As applied to the current facts, Mr. Bankston had a right to a series of fixed payments owed to him over a number of years as a beneficiary of the annuities properly owned by Transamerica, MetLife, and First Colony. As a beneficiary, Mr. Bankston was without the right to transfer his interest in the structured payments to any other person. Upon his death, the Estate of Mr. Bankston automatically operated under law to become the beneficiary of the annuities owned by the above companies. Since becoming the beneficiary, the Estate has received the structured payments monthly and annually. Further, the Estate will continue to receive the entirety of the structured payments, fulfilling the obligations to Mr. Bankston set forth in the Agreement. As such, the structured payments appear to constitute an “ordinary annuity interest” under the Federal Regulations.

### *VALUING THE INTEREST*

Subsequent to December 13, 1995, the only codal exceptions to the use of the Section 7520-1 actuarial tables for valuing ordinary annuity interests, other than commercial annuities or life insurance contracts, are enumerated within 26 C.F.R. §20.7520-3.<sup>21</sup>

The value for estate tax purposes of every private annuity must be determined using the §7520 actuarial tables, provided however, that no specific

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<sup>20</sup> See 26 C.F.R. §20.7520-3(b)(1)(A).

<sup>21</sup>And here, the regulation is applicable because the valuation date is post December 13, 1995.

exception under 26 C.F.R. §20.7520-3(a) or (b) is applicable. Here, the Estate alleges the latter is applicable, meriting deviation from the annuity tables in the instant scenario.

The Estate posits that under the regulations at issue, when a decedent dies after December 13, 1995, and is receiving payments that are restricted from being “accelerated, deferred increased, decreased, sold assigned or encumbered,” then the payments constitute a “restricted beneficial interest” within the meaning of 26 C.F.R. §20.7520-3(b)(1)(ii).

The relevant definition here states:

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. In general, a standard section 7520 annuity, income, or remainder factor may not be used to value a restricted beneficial interest.<sup>22</sup>

The thrust of the Estate’s argument hinges on the phrase “other restriction” within the definition. Specifically, plaintiff contends that the phrase is extraordinarily broad, and encompasses *any* restriction or limitation that hinders a beneficiary’s ability to maximize the economic potential of their interests in an annuity, ie. marketability and assignment restrictions. As explained below, in light

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<sup>22</sup> 26 C.F.R. §20.7520-3(b)(ii).

of the supplementary material of the regulatory section, and the precedential treatment of the regulation, the court finds the Estate's argument unpersuasive.

*EXCEPTIONS TO THE VALUATION OF ANNUITIES UNDER 26 C.F.R. §20.7520-3(b)(1)(ii)*

Prior to December 14, 1995, the effective date of 26 C.F.R. §20.7520-3, federal regulations did not provide enumerated exceptions to valuing an annuity outside the §7520 tables. Additionally, few cases addressed the issue.

Within those limited cases, two separate schools of thought spawned concerning when valuing an ordinary annuity outside the §7520 tables was permissible. The Fifth Circuit, in Cook v. Commissioner,<sup>23</sup> and the Tax Court in Grisbauskas,<sup>24</sup> mandated valuation under the tables, even when an annuity was burdened by a restriction on marketability. Two separate circuits, the Second Circuit in Grisbauskas v. Commissioner,<sup>25</sup> and the Ninth Circuit in Shackleford v. United States, permitted deviation based on an anti-assignability or marketability limitation, provided that valuation under the tables produced an unrealistic and unreasonable result.<sup>26</sup> All of the latter cases addressed the issue under pre-December 14, 1995, regulations; thus, courts were unable to directly address the

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<sup>23</sup>349 F.3d 850 (5th Cir. 2003).

<sup>24</sup>116 T.C. 142 (2001), 2001 WL 227025, reconsidered and rev'd, 342 F.3d 85.

<sup>25</sup>342 F.3d 85 (2d Cir. 2003).

<sup>26</sup>262 F.3d 1028 (9th Cir. 2001).

applicability of the 26 C.F.R. §20.7520-3 exceptions, particularly the “restricted beneficial interests” exception, to the annuity tables.

The Estate urges the court to disregard the latter cases contending the enactment of 26 C.F.R. §20.7520-3(b)(ii) legislatively overruled all prior understanding and precedent concerning exceptions to valuing annuities, directing that all exceptions to the use of the tables be specified only by regulation. Applying this logic, the Estate argues that the court may proceed to decide this issue with a “clean slate,” and may render an opinion without consideration of precedent. Conversely, the thrust of the government’s rebuttal hinges on the court adopting the belief that the regulation merely formalizes and engraves the exceptions, embraced by the majority of existing precedent, on the very slate which the plaintiff is attempting to “wipe clean.”

In assessing the validity of the Treasury regulation, the standard of review depends on whether the regulation is legislative or interpretative. The Fifth Circuit has articulated the following standards that govern the consideration of Treasury regulations by courts:

A legislative regulation is given controlling weight unless it is “arbitrary, capricious, or manifestly contrary to statute.” An interpretative regulation, on the other hand, is accorded less deference, but is nevertheless valid if it is a reasonable interpretation of the statute and if it “harmonizes with the plain language of the statute, its

origin, and its purpose.”<sup>27</sup>

The weight the court accords a regulation depends on the source of authority under which it was promulgated. Regulations issued under a specific grant of authority, prescribing a method of executing a statutory provision, are to be accorded more weight than those promulgated under a more general authority.<sup>28</sup> In the area of tax, courts are “required to treat regulations issued under a general grant of authority with broad deference, although to a somewhat lesser degree than when Congress has made a specific delegation of authority in a specific statute.”<sup>29</sup>

In the instant case, alterations were made to the applicable regulations, specifically §7520, in conjunction with the Treasury Department’s authority granted by §5031 of the Technical and Miscellaneous Revenue Act of 1988 (“TAMRA”).<sup>30</sup> The act was created by Congress for the purpose of making

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<sup>27</sup>Snap-Drape Inc. v. Comm’r, 98 F.3d 194, 197 (5th Cir. 1996)(citations omitted).

<sup>28</sup>See Dresser Industries, Inc. v. Comm’r of I.R.S., 911 F.2d 1128, 1137 (5th Cir. 1990).

<sup>29</sup>See E.I. du Pont de Nemours & Co. v. Comm’r of I.R.S., 41 F.3d 130, 135 (3d Cir. 1994).

<sup>30</sup>See PL 100-647, 1988 HR 4333(a). Short title of the Act is the “Technical and Miscellaneous Act Revenue Act of 1988.” For the modifications to the

“technical corrections relating to the Tax Reform Act of 1986 and for other purposes.”<sup>31</sup> In conjunction with this grant of authority, on June 10, 1994, the IRS published in the Federal Register (59 FR 30180, titled “Actuarial Tables Exceptions”) proposed amendments to the income, estate, and gift tax regulations, prescribing circumstances when the published actuarial tables could not be used to value certain interests. Written comments responding to the notice of proposed rulemaking were received in conjunction with PL 100-647, 1998 HR 4333. After consideration of written comments received, those amendments were revised and adopted by Treasury Decision 8630 (“T.D. 8630”).

In T.D. 8630, the Treasury department instructs that the well-established case law and administrative rulings, effective when 26 C.F.R. §20.7520-3 was enacted, were not to be disturbed until *after* its effective date, December 13, 1995.<sup>32</sup> Thereafter, the material explains the valuation exceptions envisioned within §20.7520-3(b), particularly the scope of “restricted beneficial interests.”<sup>33</sup> Specifically, T.D. 8630 instructs that the exceptions to the actuarial tables of

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regulations in conjunction with the Technical and Miscellaneous Revenue Act of 1988 at issue here, See 59 FR 30180-01, 1994-2 C.B. 899 (1994), 1994 WL 249304 (FR).

<sup>31</sup>Id.

<sup>32</sup>See T.D. 8630.

<sup>33</sup>116 T.C. 142 (2001), 2001 WL 227025 reconsidered and rev'd, 342 F.3d 85.

§20.7520-3(a) and (b) are only to be applied when,

[T]he instrument of the transfer [creating the annuity] does not provide the beneficiary of the annuity. . .with the degree of beneficial enjoyment that is consistent with the traditional character of that property interest under traditional law. . .[t]his 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.<sup>34</sup>

The supplementary information elaborates on those “restricted instances” of beneficial enjoyment, breaking them down to instances where it would be improper to apply either that the mortality component or the interest rate component of §7520-1. T.D. 8630 explains that the mortality rate component of the §7520 tables is not applicable in situations where the annuitant is diagnosed with a terminal illness because, for the purposes of an annuity, the measuring life is projected to survive until the age of 110. Further, the Treasury Decision illustrates two instances when it would be improper to apply the interest rate component of §20.7520-1(b)(2) to an annuity. These two enumerated instances include (1) possible exhaustion of the fund or (2) an annuity’s failure to earn a proper rate of return because it is funded with unproductive property.<sup>35</sup>

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<sup>34</sup>T.D. 8630.

<sup>35</sup>Id.

Additionally, the summary of the decision clearly states that “[t]hese regulations are necessary in order to provide guidance *consistent* with court decisions concluding that the valuation tables are not to be used in certain situations.”<sup>36</sup> Clearly, the Treasury Department was trying to be consistent only with those cases which recognize departure from the tables in limited scenarios, where the facts of a specific case are substantially at variance with factual assumptions underlying the tables.<sup>37</sup> Thus, after examining the Supplementary material to §20.7520-3, T.D. 8630, including the 1994-2 CB 899 (1994 WL 249304 (FR)) documents published in the federal register, the Court holds that the regulation at issue merely codifies and embodies those exceptions contemplated by the Fifth Circuit in Cook<sup>38</sup> and the Tax court in Grisbauskas.<sup>39</sup> The Estate’s argument, that

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<sup>36</sup>T.D. 8630, 1996-1 C.B. 339 (emphasis supplied).

<sup>37</sup> See e.g., Cook, 349 F.3d at 855 (citing Berzon v. Commissioner, 534 F.2d 528, 532 (2d Cir.1976) (departure appropriate when income from an investment could be predicted to be zero but actuarial tables assumed a yield of 3.5%)); O’Reilly, 973 F.2d at 1406 (very low dividends were historically paid, but tables assumed a substantially higher yield); Froh v. Comm’r, 100 T.C. 1, 5 (1993) , 1993 WL 1869 (income stream was expected to be exhausted before expiration of the income term); Estate of Jennings v. Comm’r, 10 T.C. 323, 327,(1948), 1948 WL 147(decendent's husband, a beneficiary for life, was not expected to live longer than a year from decedent's death); Hanley v. United States, 105 Ct.Cl. 638, 63 F.Supp. 73, 81-82 (1945) (actual interest rate was 3%, but tables assumed rate of 4%).

<sup>38</sup>349 F.3d 850.

<sup>39</sup>116 T.C. 142 (2001).

the passage of 20.7520-3 renders past precedent irrelevant, is without merit.

*CODAL EXAMPLES FOR DEVIATION FROM THE ANNUITY TABLES BASED ON “RESTRICTED BENEFICIAL INTERESTS”*

Moreover, 26 C.F.R. §20.7520-3 provides examples of special factors to which the application of §20.7520-3(b)(1)(ii) is required. These examples focus on limitations that make it problematical for the annuity to be paid for the defined period, including (1) the power to invade a trust corpus that could diminish the income interest to be valued and (2) an annuity payment measured by the life of one with a terminal illness.<sup>40</sup> While it is possible this list is merely illustrative, it seems the most obvious prohibition, the one that is at issue here, i.e. a restriction on marketability, is not contemplated within the definition of “restricted beneficial interest.”

Thus, only when the interest and mortality rate components prescribed under 26 C.F.R. §§20.7520-1(b)(1) and 20.7520-1(b)(2) are not applicable in determining the value of an annuity will the tables not provide the annuitant “with the degree of beneficial enjoyment that is consistent with the traditional character of that property interest under applicable law.”<sup>41</sup> Here, the facts of the instant

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<sup>40</sup>See §20.7520-3(b)(2)(v) Examples 1-5. Specifically, 26 C.F.R. §20.7520-3(b)(2)(v) Example 5 (styled “Eroding corpus in an annuity trust” which sets forth the facts creating a situation where there exists the possible exhaustion of the corpus before the final payment is made on the annuity, application of a standard Section 7520-1 actuarial table is not permitted).

<sup>41</sup>See 26 C.F.R. §20-7520-3(b).

case do not present any of the above exceptions to the court.

### *TECHNICAL ADVICE MEMORANDA*

Furthermore, the government provided this court with a private “letter ruling” known as a Technical Advice Memorandum (“TAM”).<sup>42</sup> This TAM was issued to an unidentified tax payer on December 29, 1995, sixteen days after the regulation became effective. It was also publicly issued on April 19, 1996.<sup>43</sup> Pursuant to 26 C.F.R. §301.6110 (k)(3)<sup>44</sup> of the Internal Revenue Code, written determinations, under 6110(b)(1)(A), including “Technical Advice Memoranda,” may not be used or cited as precedent. Such memoranda, however, are still recognized as relevant.<sup>45</sup> In Hanover Bank v. Commissioner, the Supreme Court stated, “[A]lthough the petitioners are not entitled to rely upon unpublished private

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<sup>42</sup> See Attachment 1 to Supp. Mem. of the U.S. in Support of Motion for Part. Sum. Jud., 9616004 (1996 WL 188042)(IRS TAM).

<sup>43</sup> See Attachment 1 to Supp. Mem. of the U.S. in Support of Motion for Part. Sum. Jud., 9616004 (1996 WL 188042)(IRS TAM).

<sup>44</sup> Formerly, 26 USC 6110(j)(3), amended by the 1998 Amendments Pub.L.105-206, Section 3509(b), redesignated former subsec. (j) as (k).

<sup>45</sup> Transco Exploration Co. v. Comm’r of I.R.S., 949 F.2d 837, 840 (5th Cir. 1992) (citing Amato v. Western Union Int’l, 773 F.2d 1402, 1412-3 (2d. Cir. 1985), cert. denied. 474 U.S. 1113, 106 S.Ct. 1167, 89 L.Ed.2d 288 (1986)). See also, Watts Copy Systems Inc. v. Comm’r, 67 T.C.M. (CCH) 2480 (1994), 1994 WL 100652 (acknowledging lack of precedential effect of TAM but finding factors identified therein “particularly significant” in construing transactions.”)

rulings which were not issued specifically to them, such rulings do reveal the interpretation put upon the statute by the agency charged with the responsibility of administering the revenue laws.”<sup>46</sup> Accordingly, the court relied solely on private letter rulings as “further evidence” that its construction of the statutory term at issue was “compelled by the language of the statute.”<sup>47</sup> This is the extent to which this Court intends to review the TAM.

In the TAM, the IRS advised the estate of a decedent lottery winner as to whether, for estate tax purposes, the present value of lottery winnings payable in the form of an annuity were to be valued using the annuity tables.<sup>48</sup> Primarily, the estate contended that because the annuity required judicial approval before it could be assigned, the annuity constituted a “restricted beneficial interest” within the meaning of 26 C.F.R. §20.7520-3(b)(1)(ii). The Service ultimately rejected the estate’s interpretation of the phrase, explaining that “restricted beneficial interest” encompasses those “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 is to be made), such that receipt of the annuity payments by the

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<sup>46</sup>369 U.S. 672, 686 (1962).

<sup>47</sup>*Id.* at 687.

<sup>48</sup>See 9616004 (1996 WL 188042)(IRS TAM).

beneficiary becomes questionable.”<sup>49</sup> Further, the Service explained that 26 C.F.R. §20.7520-3(b)(2) makes it clear that the phrase “other restriction” references only limitations that impact the ability to pay the annuity interest for the entirety of the defined period. As examples of these limitations, the Service listed the following (1) terminal illness of the annuitant and (2) possible exhaustion of the corpus prior to fulfillment of the entirety of the payments to the beneficiary. The analysis concluded with this statement:

[W]e [the Service] 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 the annuity is restricted or limited by the governing instrument or other circumstances. *The estate’s interpretation of the term “restriction” as including a restriction on the right to assign the annuity, totally disregards the balance of the regulation and takes the term entirely out of context.*<sup>50</sup>

Moreover, in a similar Technical Advice Memoranda issued publicly by the Service on March 5, 1999, the Service applied the identical analysis to another lottery prize with similar restrictions.<sup>51</sup> Here, the Service contemplated whether

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<sup>49</sup>Id.

<sup>50</sup>Id. (emphasis supplied).

<sup>51</sup>TAM 1999-09-001, 1999 WL 113072 (IRS TAM).

lottery winnings which were only assignable by judicial order or if the prize winner died before the prize was paid, constituted a “restricted beneficial interest” within the meaning of 26 C.F.R. §20.7520-3.

The TAM ultimately stated that the assignability restrictions of the annuity were not the types of “restrictions” contemplated within 26 C.F.R. §20.7520-3. Specifically, the memoranda stated “[n]one 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.*”<sup>52</sup> Because none of the latter restrictions were present, the Service held that the lottery winnings plainly constituted an annuity to be valued using the actuarial tables.<sup>53</sup>

Such reasoning is consistent with all except for the Second and Ninth Circuit decisions the Estate is asking this Court to follow. Namely, that the lack of marketability of a private annuity is not a basis for departure from valuation unless the effect of the trust or the will or other governing instrument is to ensure that the annuity will be paid for the entire defined period. Particularly, the court interprets these situations to include where (1) the mortality rate is not warranted

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<sup>52</sup>Id. (emphasis supplied).

<sup>53</sup>Id.

because a beneficiary is terminally ill at the time of the transaction, or (2) the income interest rate consistent with the tables is not applicable because the fund is in danger of exhausting before the entirety of the interest is paid in full. Absent either scenario, deviation based solely on a prohibition concerning marketability is not warranted.

### **III. APPLICATION OF §20.7520-3 IN PRECEDENT**

The District of Massachusetts rendered a recent decision concerning valuation under 26 C.F.R. §20.7520-3. In Estate of Donovan v. USA,<sup>54</sup> an estate brought a similar action for an estate tax refund on future payments of lottery winnings. The threshold question considered by the court was whether the lottery winnings constituted an “ordinary annuity interest” to be valued under the §7520 tables, or a “restricted beneficial interest” excepted from valuation under the tables.

Donovan concerns the valuation of a decedent’s interest in winnings from the Massachusetts’ lottery in 1999. Under Massachusetts’ law, the lottery winnings were not permitted to be assigned or accelerated.<sup>55</sup> After decedent passed, his Estate valued his annuity for estate tax purposes pursuant to the §7520 tables. Subsequently, the Estate sought a tax refund, alleging that the

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<sup>54</sup>95 A.F.T.R.2d 05-2131 (D.Mass 2005), 2005 WL 958403.

<sup>55</sup>Id.

assignment restrictions under Massachusetts law, rendered the lottery annuity a “restricted beneficial interest,” or in the alternative, its valuation under the tables was unrealistic or unreasonable. The Estate argued, based on the restrictions, that the valuation must include consideration of the non-marketability restriction of the property interest. Accordingly, the Estate demanded a “fair market valuation” pursuant to 26 C.F.R. §20.2031-(b), rather than the interest rate component and mortality rate component of §20.7520-1. After a detailed analysis, the court concurred with the Tax Court’s decision in Grisbauskas,<sup>56</sup> stating,

In light of the examples given ... the intent of this provision was to formalize the existing case law regarding the validity of the tabular assumptions in situations where facts show a clear risk that the payee will not receive the anticipated return. Thus, a restriction within the meaning of the regulation is one which jeopardizes receipt of the payment stream, not one which merely impacts the ability of the payee to dispose of his or her right thereto.<sup>57</sup>

In accordance with this reasoning, the court held that the phrase “restricted beneficial interests” encompasses only those restrictions which jeopardize a decedent’s assurance in receiving or enjoying the entirety of their interest in an annuity. Therefore, only when the right to receive the entirety of the payments is

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<sup>56</sup>Noting the inability to consider §20.7520-3 in the Tax Court’s ruling.

<sup>57</sup> Id. (citing Grisbauskas, 116 T.C. at 164-65) (citations omitted).

compromised may the situation warrant diverging from the annuity tables under the guise of being a “restricted beneficial interest.”

While the inability to market or transfer the Estate’s interest in the structured payments is undoubtedly a restriction to the Bankston heirs, it is not the type of “other restriction” contemplated by 26 C.F.R. §20.7520-3(b). Such an interpretation of the phrase “restricted beneficial interest” thwarts the historical and legislative basis behind the creation of the exceptions in 26 C.F.R. §20.7520-3(b). Consequently, this Court will hold that the “contingency, power and other restriction” language used in the regulation refers only to those limitations that would divest Mr. Bankston’s estate of all of the periodic payments due under the Agreement, as of July 30, 1996, and not to limitations on the ability of Bankston and his heirs to market their right to periodic payments. Thus, Mr. Bankston’s interest constitutes an ordinary annuity interest to be valued under the §7520 tables.

#### **IV. THE APPLICATION OF A PERCENTAGE DISCOUNT**

In the alternative, should the Court hold that the valuation is proper, the Estate requests a further discount than is required under the §7520 tables, based on the alleged “limited market” available to Mr. Bankston’s interests. Specifically, petitioner argues that the Court, in applying the §7520 tables, applies by default the standard marketability discount underlying the tables. The Estate asserts that

in addition to the market discount provided by the tables, the court should also apply the additional 32% discount utilized by the Fifth Circuit in Cook.<sup>58</sup> Petitioner alleges the additional discount is necessary because here, as in Cook, there is a limited market for the structured settlement payments, meriting a larger discount than is provided by the tables.<sup>59</sup>

The determination of the proper valuation method in a federal estate tax case is a matter of law; however, the mathematical computation of a fair market value is a factual issue.<sup>60</sup> Since this is a Motion for Summary Judgment, the Court will only concern itself with the procedural issue at hand---determining the proper method of valuation of the interests at issue.

As previously established, this right clearly constitutes an “ordinary annuity interest” subject to valuation as prescribed in 26 C.F.R. §20.7520-3(b)(1)(i)(A) and the implementing regulations under 26 C.F.R. §§20.7520-1(a)(1) and 20.2031-7(a). Thus, valuation under the §7520-1 tables was proper.

However, in so holding, the Court also inadvertently upholds the government’s calculation of Mr. Bankston’s interest in the structured payments. Though this is a factual conclusion, it is one that the Court cannot avoid. As the

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<sup>58</sup>349 F.3d 850.

<sup>59</sup> Id.

<sup>60</sup>Dunn, 301 F.3d 339, 348 (5th Cir. 2002).

government correctly points out, the Estate did not directly contest the calculation by the Service in the event that the court determined the annuity tables were the appropriate source for valuation.<sup>61</sup> Instead, the Estate merely asked the Court to apply a larger discount, which is factually inapplicable to this case. Thus, the court will uphold the government's value of the Estate's interest in the structured payments, calculated by application of the §7520 actuarial tables.

## **V. UNREALISTIC OR UNREASONABLE RESULT**

The determination that the property interest here is an “ordinary annuity interest” presupposes the application of the §7520 tables. Thus, the tables are to be used unless, “it is shown that the result is so unrealistic and unreasonable that either some modification in the prescribed method should be made, or complete departure from the method should be taken, and a more reasonable and realistic means of determining value is available.”<sup>62</sup> In this connection, “[t]he party challenging applicability of the tables has the substantial burden of demonstrating that the tables produce an unreasonable result.”<sup>63</sup>

The Code of Federal Regulations defines the phrase “fair market value” as

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<sup>61</sup>See Petitioner's memorandum in support, pg. 4 n. 1 (rec. doc. no. 28).

<sup>62</sup>See Weller v. Comm'r, 38 T.C. 790, 803 (1962) (citations omitted); See also Cook, 349 F.3d at 854; Shackleford, 262 F.3d at 1031; O'Reilly, 973 F.2d 1403, 1407 (8th Cir. 1992).

<sup>63</sup>Cook, 349 F. 3d at 854-55 (citing O'Reilly, 973 F.2d at 1409).

“the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts.”<sup>64</sup> Here, the Estate argues there is an alleged, albeit “limited market,” for Mr. Bankston’s interest in the structured payments. Under this alleged market, the value of the annuities, as of July 30, 1998, decreases from \$2,375,710, the value calculated using the §7520 actuarial tables, to \$1,198,900. Consequently, the calculation produced using the §7520 tables is unrealistic and unreasonable.

Few circuits have squarely addressed this issue, and those which had addressed it only in the context of lottery winnings. Although what is at issue here are payments from a structured settlement and not lottery winnings, both types of cases concern annuities, making the analysis applicable to the Estate’s interests.

The Fifth Circuit held that departure from the §7520 actuarial tables based on a value differential created by a marketability restriction on an annuity is not appropriate.<sup>65</sup> Moreover, the Fifth Circuit opposes such deviation from the mortality and annuity rates assigned by the tables, except in those limited situations where the underlying assumptions of the actuarial tables do not fit the facts of the specific valuation at issue. In particular, those cases where the

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<sup>64</sup>26 C.F.R. §20.2031-1(b).

<sup>65</sup>See Cook, 349 F.3d 850.

mortality rate and/or interest rate assumptions are not applicable because of specific factual abnormalities.<sup>66</sup>

In Cook<sup>67</sup> the estate hired experts who estimated the fair market value of the partnership interest in a decedent's lottery prize to be \$671,465 less than the value reflected by the §7520 actuarial tables. Despite the differential, the Fifth Circuit held that the §20.7520-1 valuation was realistic because the non-marketability of a private annuity was an assumption underlying the annuity tables. Only assumptions not contemplated by the mechanical application of the tables—the annuity not earning a proper rate of return, danger of the fund exhausting or being otherwise diverted, or the individual measuring life having an unexpected shortened period due to a terminal illness—require a method other than that dictated under the actuarial tables.

This viewpoint has created a split in the Circuits, with the Second and Ninth

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<sup>66</sup> Id. at 855 (citing Berzon v. Comm'r, 534 F.2d 528, 532 (2d Cir.1976) (departure appropriate when income from an investment could be predicted to be zero but actuarial tables assumed a yield of 3.5%)); O'Reilly v. Comm'r, 973 F.2d 1403,1406 (very low dividends were historically paid, but tables assumed a substantially higher yield); Froh v. Comm'r, 100 T.C. 1, 5, 1993 WL 1869 (1993) (income stream was expected to be exhausted before expiration of the income term); Estate of Jennings v. Commissioner, 10 T.C. 323, 327(1948) (decedent's husband, a beneficiary for life, was not expected to live longer than a year from decedent's death); Hanley v. United States, 105 Ct.Cl. 638, 63 F.Supp. 73, 81-82 (1945) (actual interest rate was 3%, but tables assumed a rate of 4%).

<sup>67</sup>349 F.3d 850.

Circuits holding that non-marketability should be factored into the valuation of such interests.<sup>68</sup> In Grisbaukas<sup>69</sup> the Second Circuit departed from valuation of the §7520 tables based on the large value differential created by an annuity's prohibition on marketability. The court was largely guided by the Ninth Circuit decision in Shackleford.<sup>70</sup> In Shackleford the Ninth Circuit permitted departure from the §7520 tables when determining the fair market value of a California lottery prize because it was subject to anti-assignment restrictions. In so holding, the Ninth Circuit stated that the application of the §7520 tables was inappropriate where a taxpayer provided a more realistic and reasonable valuation method to determine the value of the annuity.<sup>71</sup> Both cases were premised on the general principle of property, namely that the "right to transfer is 'one of the most essential

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<sup>68</sup>Grisbaukas, 342 F.3d 85 (2d Cir. 2003); Shackleford, 262 F.3d 1028. The Court would be remiss not to clarify that all these cases addressed the question under the pre-December 14, 1995 regulations, and consequently did not address the applicability of the §20.7520-3(b) exceptions to the annuity tables. The provisions of that section, however, only emphasize and reiterate the position taken by the Tax Court in Grisbaukas, and the Fifth Circuit, clearly elucidated that an interest should only be excepted when the assumptions underlying the annuity tables are inapplicable, i.e. when the interest rate or the mortality rate are not applicable, as in the event that the decedent was not to receive the entirety of the payments or the decedent was inflicted with a terminal illness that would warrant diversion from the mortality rate.

<sup>69</sup>342 F.3d 85.

<sup>70</sup>262 F.3d 1028.

<sup>71</sup>Id.

sticks in the bundle of rights that are commonly characterized as property.”<sup>72</sup> And further, that “an asset subject to marketability restrictions is, as a rule, worth less than an identical item that is not so burdened.”<sup>73</sup>

The Fifth Circuit decision of Cook, rendered subsequent to both Grisbauskas and Shackleford clearly establishes the court’s stance that an unsecured right to a series of fixed payments, with virtually no risk of default, is subject to valuation under §7520 and related tables.<sup>74</sup> Further, the Fifth Circuit blatantly opposes the Second and Ninth Circuits’ assertions that the reasonable valuation for annuity requires a discount which is already contemplated by the tables and based upon the premise that the right to alienate is fundamental to the valuation of any property.<sup>75</sup>

The Fifth Circuit’s decision to adhere to the Section 7520 tables, was largely fueled by Congress’ desire for uniformity in valuing annuities. The court reasoned it was paramount for Congress to have convenience and certainty in valuation of annuities over accuracy, while providing uniform assumptions for

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<sup>72</sup>Id. at 1032 (citation omitted).

<sup>73</sup>Grisbauskas, 342 F.3d at 88 (citing Shackleford, 262 F.3d at 1032).

<sup>74</sup> 349 F.3d at 850.

<sup>75</sup> Id. at 856-57.

consideration of minor restrictions therein.<sup>76</sup> More plainly stated, Congress acknowledges that the tables would not produce the same valuation as would an actual free market, but when applied in the aggregate, error costs will be small.<sup>77</sup> Further, that the tables' value is to be upheld unless found to be vastly unrealistic and unreasonable due to an assumption not contemplated by the tables. Such an intention directly contradicts the Second Circuit's stance that Congress' desire for uniformity in valuation of annuities is "not so demanding."<sup>78</sup>

Based on the foregoing, the Court is not persuaded by plaintiff's argument that a hypothetical "economic reality" is sufficient to empower an administratrix of an estate to shop for a hypothetical market for their interests in order to pay less estate taxes. Instead, the factual scenario at hand is entirely harmonious with the premises and assumptions that underlie the actuarial tables. As such, the Court will hold that the valuation calculated by the actuarial tables, though it is substantially less in comparison to the plaintiff's alleged "free market" valuation, does not create an unrealistic or unreasonable value.

## VI. EVIDENTIARY ISSUES

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<sup>76</sup>Id. at 854.

<sup>77</sup>Id. at 854 (citing Bank of Cal. v. United States, 672 F.2d 758, 760 (9th Cir. 1982); Continental Ill. Natl. Bank & Trust Co. v. U.S., 504 F.2d 586 (7th Cir. 1974)).

<sup>78</sup>Grisbauskas, 342 F.3d at 87.

Defendants allege that several of the Estate's statements of uncontested fact refer to documents and their specific contents, but no copies of the documents have been submitted by the Estate for the Court's consideration as mandated by Rule 56(E). For the purposes of this motion, these documents are unnecessary to aid the court in reaching a decision. The Court's decision, regardless of these documents, would be rendered in conformity with the reasoning set out above.

## **VII. CONCLUSION**

The United States' partial motion for summary judgment (doc. 22) is hereby GRANTED and the petitioner's cross motion for partial summary judgment (doc. 26) is hereby DENIED.

Baton Rouge, Louisiana, June 17, 2005.

S/ James Brady  
JAMES BRADY, DISTRICT JUDGE  
MIDDLE DISTRICT OF LOUISIANA