

(B) A date other than the date of distribution, but only if the pecuniary payment must be satisfied on a basis that fairly reflects net appreciation and depreciation (occurring between the valuation date and the date of distribution) in all of the assets from which the distribution could have been made.

(4) *Appropriate interest*—(i) *In general.* For purposes of this section and § 26.2654-1 (relating to certain trusts treated as separate trusts), appropriate interest means that interest must be payable from the date of death of the transferor (or from the date specified under applicable State law requiring the payment of interest) to the date of payment at a rate—

(A) At least equal to—

(1) The statutory rate of interest, if any, applicable to pecuniary bequests under the law of the State whose law governs the administration of the estate or trust; or

(2) If no such rate is indicated under applicable State law, 80 percent of the rate that is applicable under section 7520 at the death of the transferor; and

(B) Not in excess of the greater of—

(1) The statutory rate of interest, if any, applicable to pecuniary bequests under the law of the State whose law governs the administration of the trust; or

(2) 120 percent of the rate that is applicable under section 7520 at the death of the transferor.

(ii) *Pecuniary payments deemed to carry appropriate interest.* For purposes of this paragraph (b)(4), if a pecuniary payment does not carry appropriate interest, the pecuniary payment is considered to carry appropriate interest to the extent—

(A) The entire payment is made or property is irrevocably set aside to satisfy the entire pecuniary payment within 15 months of the transferor's death; or

(B) The governing instrument or applicable local law specifically requires the executor or trustee to allocate to the pecuniary payment a pro rata share of the income earned by the fund from which the pecuniary payment is to be made between the date of death of the transferor and the date of payment. For purposes of paragraph

(b)(4)(ii)(A) of this section, property is irrevocably set aside if it is segregated and held in a separate account pending distribution.

(c) *Examples.* The following examples illustrate the provisions of this section:

*Example 1.* T transfers \$100,000 to a newly-created irrevocable trust on December 15, 1996. The trust provides that income is to be paid to T's child for 10 years. At the end of the 10-year period, the trust principal is to be paid to T's grandchild. T does not allocate any GST exemption to the trust on the gift tax return reporting the transfer. On November 15, 1997, T files a Form 709 allocating \$50,000 of GST exemption to the trust. Because the allocation was made on a late filed return, the value of the property transferred to the trust is determined on the date the allocation is filed (unless an election is made pursuant to paragraph (a)(2) of this section to value the trust property as of the first day of the month in which the allocation document is filed with the Internal Revenue Service). On November 15, 1997, the value of the trust property is \$150,000. Effective as of November 15, 1997, the applicable fraction with respect to the trust is .333 (\$50,000 (the amount of GST exemption allocated to the trust) over \$150,000 (the value of the trust principal on the effective date of the GST exemption allocation)), and the inclusion ratio is .667 (1.0 - .333).

*Example 2.* The facts are the same as in *Example 1*, except the value of the trust property is \$80,000 on November 15, 1997. The applicable fraction is .625 (\$50,000 over \$80,000) and the inclusion ratio is .375 (1.0 - .625).

*Example 3.* T transfers \$100,000 to a newly-created irrevocable trust on December 15, 1996. The trust provides that income is to be paid to T's child for 10 years. At the end of the 10-year period, the trust principal is to be paid to T's grandchild. T does not allocate any GST exemption to the trust on the gift tax return reporting the transfer. On November 15, 1997, T files a Form 709 allocating \$50,000 of GST exemption to the trust. T elects to value the trust principal on the first day of the month in which the allocation is made pursuant to the election provided in paragraph (a)(2) of this section. Because the late allocation is made in November, the value of the trust is determined as of November 1, 1997.

[T.D. 8644, 60 FR 66903, Dec. 27, 1995; 61 FR 29654, June 12, 1996]

**§ 26.2642-3 Special rule for charitable lead annuity trusts.**

(a) *In general.* In determining the applicable fraction with respect to a charitable lead annuity trust—

(1) The numerator is the adjusted generation-skipping transfer tax exemption (adjusted GST exemption); and

(2) The denominator is the value of all property in the trust immediately after the termination of the charitable lead annuity.

(b) *Adjusted GST exemption defined.* The adjusted GST exemption is the amount of GST exemption allocated to the trust increased by an amount equal to the interest that would accrue if an amount equal to the allocated GST exemption were invested at the rate used to determine the amount of the estate or gift tax charitable deduction, compounded annually, for the actual period of the charitable lead annuity. If a late allocation is made to a charitable lead annuity trust, the adjusted GST exemption is the amount of GST exemption allocated to the trust increased by the interest that would accrue if invested at such rate for the period beginning on the date of the late allocation and extending for the balance of the actual period of the charitable lead annuity. The amount of GST exemption allocated to a charitable lead annuity trust is not reduced even though it is ultimately determined that the allocation of a lesser amount of GST exemption would have resulted in an inclusion ratio of zero. For purposes of chapter 13, a charitable lead annuity trust is any trust providing an interest in the form of a guaranteed annuity described in § 25.2522(c)-3(c)(2)(vi) of this chapter for which the transferor is allowed a charitable deduction for Federal estate or gift tax purposes.

(c) *Example.* The following example illustrates the provisions of this section:

*Example.* T creates a charitable lead annuity trust for a 10-year term with the remainder payable to T's grandchild. T timely allocates an amount of GST exemption to the trust which T expects will ultimately result in a zero inclusion ratio. However, at the end of the charitable lead interest, because the property has not appreciated to the extent T anticipated, the numerator of the applicable fraction is greater than the denominator. The inclusion ratio for the trust is zero. No portion of the GST exemption allocated to the trust is restored to T or to T's estate.

**§ 26.2642-4 Redetermination of applicable fraction.**

(a) *In general.* The applicable fraction for a trust is redetermined whenever additional exemption is allocated to the trust or when certain changes occur with respect to the principal of the trust. Except as otherwise provided in this paragraph (a), the numerator of the redetermined applicable fraction is the sum of the amount of GST exemption currently being allocated to the trust (if any) plus the value of the nontax portion of the trust, and the denominator of the redetermined applicable fraction is the value of the trust principal immediately after the event occurs. The nontax portion of a trust is determined by multiplying the value of the trust assets, determined immediately prior to the event, by the then applicable fraction.

(1) *Multiple transfers to a single trust.* If property is added to an existing trust, the denominator of the redetermined applicable fraction is the value of the trust immediately after the addition reduced as provided in § 26.2642-1(c).

(2) *Consolidation of separate trusts.* If separate trusts created by one transferor are consolidated, a single applicable fraction for the consolidated trust is determined. The numerator of the redetermined applicable fraction is the sum of the nontax portions of each trust immediately prior to the consolidation.

(3) *Property included in transferor's gross estate.* If the value of property held in a trust created by the transferor, with respect to which an allocation was made at a time that the trust was not subject to an ETIP, is included in the transferor's gross estate, the applicable fraction is redetermined if additional GST exemption is allocated to the property. The numerator of the redetermined applicable fraction is an amount equal to the nontax portion of the property immediately after the death of the transferor increased by the amount of GST exemption allocated by the executor of the transferor's estate to the trust. If additional GST exemption is not allocated to the trust, then, except as provided in this paragraph (a)(3), the applicable fraction immediately before death is not