within 1 year. However, if the individual survives for eighteen months or longer after the date of the transaction, that individual shall be presumed to have not been terminally ill at the time of the transaction unless the contrary is established by clear and convincing evidence.

(4) *Examples.* The provisions of this paragraph (b) are illustrated by the following examples:

Example 1. Annuity funded with unproductive property. The taxpayer transfers corporation stock worth $1,000,000 to a trust. The trust provides for a 6 percent ($60,000 per year) annuity in cash or other property to be paid to a charitable organization for 25 years and for the remainder to be distributed to the donor's child. The trust specifically authorizes, but does not require, the trustee to retain the shares of stock. The section 7520 interest rate for the month of the transfer is 8.2 percent. The corporation has paid no dividends on this stock during the past 5 years, and there is no indication that this policy will change in the near future. Under applicable state law, the corporation is considered to be a sound investment that satisfies fiduciary standards. Therefore, the trust's sole investment in this corporation is not expected to adversely affect the interest of either the annuitant or the remainder beneficiary. Considering the 6 percent annuity payout rate and the 8.2 percent section 7520 interest rate, the trust corpus is considered sufficient to pay this annuity for the entire 25-year term of the trust, or even indefinitely. Although it appears that neither beneficiary would be able to compel the trustee to make the trust corpus produce investment income, the annuity interest in this case is considered to be an ordinary annuity interest, and the standard section 7520 annuity factor may be used to determine the present value of the annuity. In this case, the section 7520 annuity factor would represent the right to receive $1.00 per year for a term of 25 years.

Example 2. Terminal illness. The taxpayer transfers property worth $1,000,000 to a charitable remainder unitrust described in section 664(d)(2) and § 1.664–3. The trust provides for a fixed-percentage 7 percent unitrust benefit (each annual payment is equal to 7 percent of the trust assets as valued at the beginning of each year) to be paid quarterly to an individual beneficiary for life and for the remainder to be distributed to a charitable organization. At the time the trust is created, the individual beneficiary is age 60 and has been diagnosed with an incurable illness and there is at least a 50 percent probability of the individual dying within 1 year. Assuming the presumption in paragraph (b)(3) of this section does not apply, because there is at least a 50 percent probability that this beneficiary will die within 1 year, the standard section 7520 unitrust remainder factor for a person age 60 from the valuation tables may not be used to determine the present value of the charitable remainder interest. Instead, a special unitrust remainder factor must be computed that is based on the section 7520 interest rate and that takes into account the projection of the individual beneficiary's actual life expectancy.

(5) *Additional limitations.* Section 7520 does not apply to the extent as may otherwise be provided by the Commissioner.

(c) *Effective date.* Section 1.7520–3(a) is effective as of May 1, 1989. The provisions of paragraph (b) of this section are effective with respect to transactions after December 13, 1995.

[T.D. 8540, 59 FR 30150, June 10, 1994, as amended by T.D. 8630, 60 FR 63915, Dec. 13, 1995]

§ 1.7520–4 Transitional rules.

(a) *Reliance.* If the valuation date is after April 30, 1989, and before June 10, 1994, a taxpayer can rely on Notice 89–24, 1989–1 C.B. 660, or Notice 89–60, 1989–1 C.B. 700 (See § 601.601(d)(2)(ii)(*b*) of this chapter), in valuing the transferred interest.

(b) *Effective date.* This section is effective as of May 1, 1989.

[T.D. 8540, 59 FR 30150, June 10, 1994]

§ 1.7701(l)–0 Table of contents.

This section lists captions that appear in §§ 1.7701(l)–1 and 1.7701(l)–3:

(iii) Relationship between fast-pay shareholders and corporation.
(3) Other rules.
(i) Character of the financing instruments.
(ii) Multiple types of benefited stock.
(iii) Transactions affecting benefited stock.
(A) Sale of benefited stock.
(B) Transactions other than sales.
(iv) Adjustment to basis for amounts accrued or paid in taxable years ending before February 27, 1997.
(d) Prohibition against affirmative use of recharacterization by taxpayers.
(e) Examples.
(f) Reporting requirement.
(1) Filing requirements.
(i) In general.
(ii) Controlled foreign corporation.
(iii) Foreign personal holding company.
(iv) Passive foreign investment company.
(2) Statement.
(g) Effective date.
(1) In general.
(2) Election to limit taxable income attributable to a recharacterized fast-pay arrangement for periods before April 1, 2000.
(i) Limit.
(ii) Adjustment and statement.
(iii) Examples.
(3) Rule to comply with this section.
(4) Reporting requirements.

[T.D. 8853, 65 FR 1313, Jan. 10, 2000]

§ 1.7701(l)–1 Conduit financing arrangements.

Section 7701(l) authorizes the issuance of regulations that recharacterize any multiple-party financing transaction as a transaction directly among any two or more of such parties where the Secretary determines that such recharacterization is appropriate to prevent avoidance of any tax imposed by title 26 of the United States Code.

[T.D. 8611, 60 FR 41015, Aug. 11, 1995, as amended by T.D. 8735, 62 FR 53502, Oct. 14, 1997]

§ 1.7701(l)–3 Recharacterizing financing arrangements involving fast-pay stock.

(a) *Purpose and scope.* This section is intended to prevent the avoidance of tax by persons participating in fast-pay arrangements (as defined in paragraph (b)(1) of this section) and should be interpreted in a manner consistent with this purpose. This section applies to all fast-pay arrangements. Paragraph (c) of this section recharacterizes certain fast-pay arrangements to ensure the participants are taxed in a manner reflecting the economic substance of the arrangements. Paragraph (f) of this section imposes reporting requirements on certain participants.

(b) *Definitions*—(1) *Fast-pay arrangement.* A fast-pay arrangement is any arrangement in which a corporation has fast-pay stock outstanding for any part of its taxable year.

(2) *Fast-pay stock*—(i) *Defined.* Stock is fast-pay stock if it is structured so that dividends (as defined in section 316) paid by the corporation with respect to the stock are economically (in whole or in part) a return of the holder's investment (as opposed to only a return on the holder's investment). Unless clearly demonstrated otherwise, stock is presumed to be fast-pay stock if—

(A) It is structured to have a dividend rate that is reasonably expected to decline (as opposed to a dividend rate that is reasonably expected to fluctuate or remain constant); or

(B) It is issued for an amount that exceeds (by more than a de minimis amount, as determined under the principles of § 1.1273–1(d)) the amount at which the holder can be compelled to dispose of the stock.

(ii) *Determination.* The determination of whether stock is fast-pay stock is based on all the facts and circumstances, including any related agreements such as options or forward contracts. A related agreement includes any direct or indirect agreement or understanding, oral or written, between the holder of the stock and the issuing corporation, or between the holder of the stock and one or more other shareholders in the corporation. To determine if it is fast-pay stock, stock is examined when issued, and, for stock that is not fast-pay stock when issued, when there is a significant modification in the terms of the stock or the related agreements or a significant change in the relevant facts and circumstances. Stock is not fast-pay stock solely because a redemption is treated as a dividend as a result of section 302(d) unless there is a principal purpose of achieving the same economic and tax effect as a fast-pay arrangement.