



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

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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR ASSISTANT DISTRICT COUNSEL

FROM: ASSISTANT CHIEF COUNSEL (FIELD SERVICE)
CC:DOM:FS

SUBJECT: Grantor Retained Annuity Trusts

This Field Service Advice responds to your memorandum dated March 27, 1999. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

LEGEND

- Decedent =
- Trustee =

- Date 1 =
- Date 2 =
- Month 1 =
- Year 1 =

- \$a =
- \$b =
- \$c =
- \$d =
- \$e =
- \$f =
- \$g =
- \$h =

- \$i =
- \$j =
- \$k =

- x% =

y

=

ISSUE

Whether any part of the corpus of the grantor retained annuity trust (GRAT) is includable in Decedent's gross estate under Internal Revenue Code §§ 2036 and/or 2039.

CONCLUSION

Section 2036 includes in Decedent's gross estate the amount of corpus necessary to yield the guaranteed annual payment to the decedent, based upon the applicable federal rate, on Decedent's date of death. Section 2039 includes in Decedent's gross estate the value of the entire corpus of the grantor retained annuity trust at the time of Decedent's death.

FACTS

On Date 1, Decedent executed a grantor retained annuity trust ("GRAT") by and between herself as grantor and Trustee. The GRAT's initial principal amount was \$a, which was contributed by Decedent. A gift tax return was filed and audited, and the gift tax liability was agreed upon and paid in full. The Decedent filed a Year 1 Federal gift tax return, Form 709, reporting \$b of gifts made (the remainder interest of the GRAT) and total gift tax owed of \$c. The Internal Revenue Service audited this Federal gift tax return and positively adjusted the tax liability in the amount of \$d for a total tax owed of \$e.

Pursuant to the terms of the GRAT, the decedent would receive an annual annuity in the amount of x% of the GRAT's initial value. The payments were to be made monthly for a term of y years or Decedent's earlier death. The monthly payment was \$f, totaling \$g per year. At the expiration of the term or Decedent's earlier death, the trust corpus was to be transferred lump sum to the remaindermen, who were Decedent's three children.

Decedent died on Date 2, during the third year of the GRAT. From Date 1 through Month 1 of the third year of the GRAT, Decedent received the required \$f per month for a total of \$h. The value of the assets within the GRAT on the date of death was \$i. The executor filed a Federal estate tax return, Form 706, on behalf of Decedent and included \$j of the GRAT in Decedent's gross estate under section 2036. In the statutory notice of deficiency, the Commissioner determined that the entire trust principal in the amount of \$i was includable in the decedent's gross estate under section 2039. Accordingly, the net adjustment for this issue was \$k, the difference between the amount the executor included under section 2036

and the amount includable under section 2039, i.e., the value of the GRAT at Decedent's date of death.

LAW & ANALYSIS

Section 2036(a)(1) provides, in pertinent part, that a decedent's gross estate shall include the value of any interest in property transferred by the decedent if the decedent retained 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, the possession or enjoyment of, or the right to income from, the property. Treas. Reg. § 20.2036-1(a) provides generally that if the decedent retained or reserved an interest or right with respect to all of the property transferred by the decedent, the amount to be included in the gross estate under section 2036 is the value of the entire property on the date of death. If the decedent retained a right with respect to only part of the property transferred, the amount to be included in the decedent's gross estate under section 2036 is the proportionate amount of corpus.

Rev. Rul. 82-105, 1982-1 C.B. 133, involves a situation where the decedent, prior to his death, created a charitable remainder annuity trust, pursuant to which the decedent retained the right to receive an annuity of 12x dollars for life. The ruling concludes that the decedent's retained annuity represents the retained right to receive all of the income from all or a specific portion of the trust for purposes of section 2036. That portion of the trust corpus with respect to which the decedent retained a right to receive all of the income is includable in his gross estate under section 2036(a)(1). See Estate of Pardee v. Commissioner, 49 T.C. 140 (1967), acq. 1973-2 C.B. 3. Under the ruling, the amount of the corpus with respect to which the decedent retained the income is that amount of corpus that would be sufficient to yield the annual annuity based on the assumed rate of return prescribed by the regulations as of the applicable valuation date. The revenue ruling prescribes the following formula for this determination:

$$(\text{Annual Annuity}) / (\text{Assumed Rate of Return}) = \text{Amount Includable}$$

Under the trust agreement in the instant case, Decedent transferred property to the GRAT, but retained the right to receive an annuity payment for a term of y years or his earlier death. Because Decedent died during the term, Decedent retained this interest at death. Accordingly, the portion of the value of the GRAT includable in Decedent's gross estate under section 2036 is the amount of corpus necessary to yield \$g a year (the amount of Decedent's retained annuity), based upon the applicable federal rate under section 7520, as of the date of Decedent's death.

Section 2039(a) provides, in pertinent part, that the gross estate shall include the value of an annuity or other payment receivable by any beneficiary by reason of

surviving the decedent under any form of contract or agreement if, under the contract or agreement, an annuity or other payment was payable to the decedent, or the decedent possessed the right to receive such annuity or payment, either alone or in conjunction with another, 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.

Section 2039(b) provides, in pertinent part, that the amount includable under section 2039(a) is the part of the value of the annuity or other payment receivable under the contract or agreement as is proportionate to the part of the purchase price contributed by the decedent.

Treas. Reg. § 20.2039-1(b)(1) provides, in part, that the term “annuity or other payment” as used with respect to both the decedent and the survivor beneficiary has reference to a payment or payments that may be equal or unequal, conditional or unconditional, periodic or sporadic. Treas. Reg. § 20.2039-1(b)(1) further provides that the term “contract or agreement” includes understandings, arrangements and plans.

Under the facts presented in this case, the entire value of the lump sum payments made to Decedent’s three children upon Decedent’s death is includable in Decedent’s gross estate under section 2039(a). All of the section 2039 (a) requirements are satisfied, as follows:

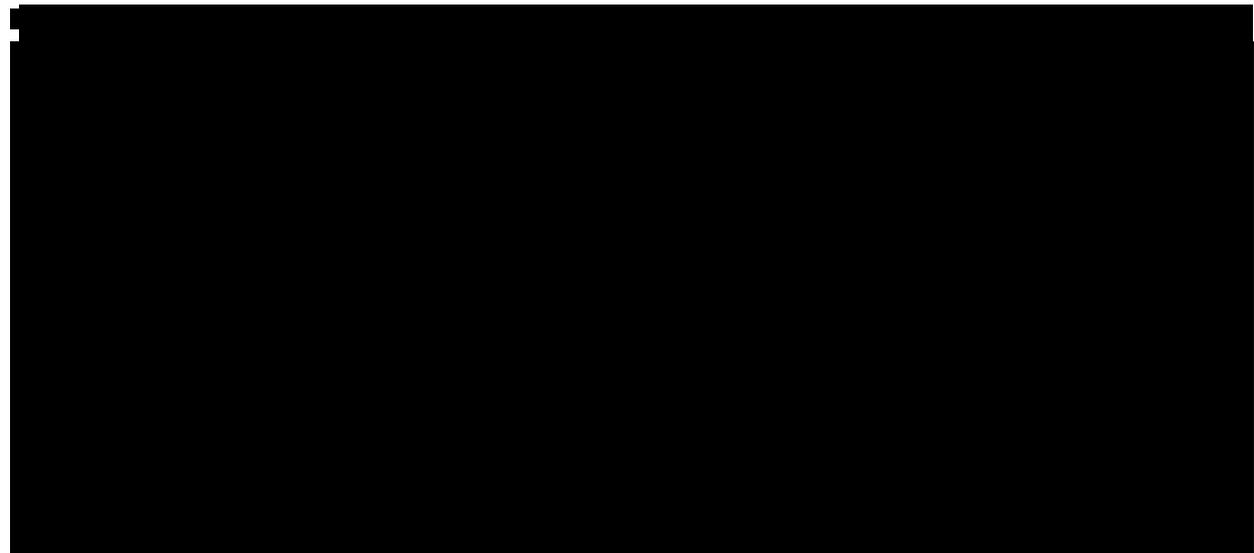
1. The lump sum payments to the survivor beneficiaries qualify as an “annuity or other payment” under Treas. Reg. § 20.2039-1(b)(1). The annuity payments to the decedent similarly qualify.
2. The fact that the payments to the survivor beneficiaries are to be made pursuant to the terms of the GRAT agreement satisfy the “contract or agreement requirement in section 2039 (a).
3. The annuity was in fact payable to Decedent until his death, thus satisfying the requirement that the annuity be payable to the decedent for his life, for a period not ascertainable without reference to his death, or for a period that did not in fact end before his death.

Under section 2039(b), the amount includable is the entire value of the amounts receivable by the survivor beneficiaries if the entire “purchase price” of the annuity was contributed by the decedent. Although the term “purchase price” in section 2039(b) implies the acquisition of a commercial annuity, nothing in the language of section 2039 limits its application to commercial annuities. In fact, the broad reference to “any contract or agreement,” pursuant to which the payment or payments to a beneficiary must be made, indicates such a narrow application was

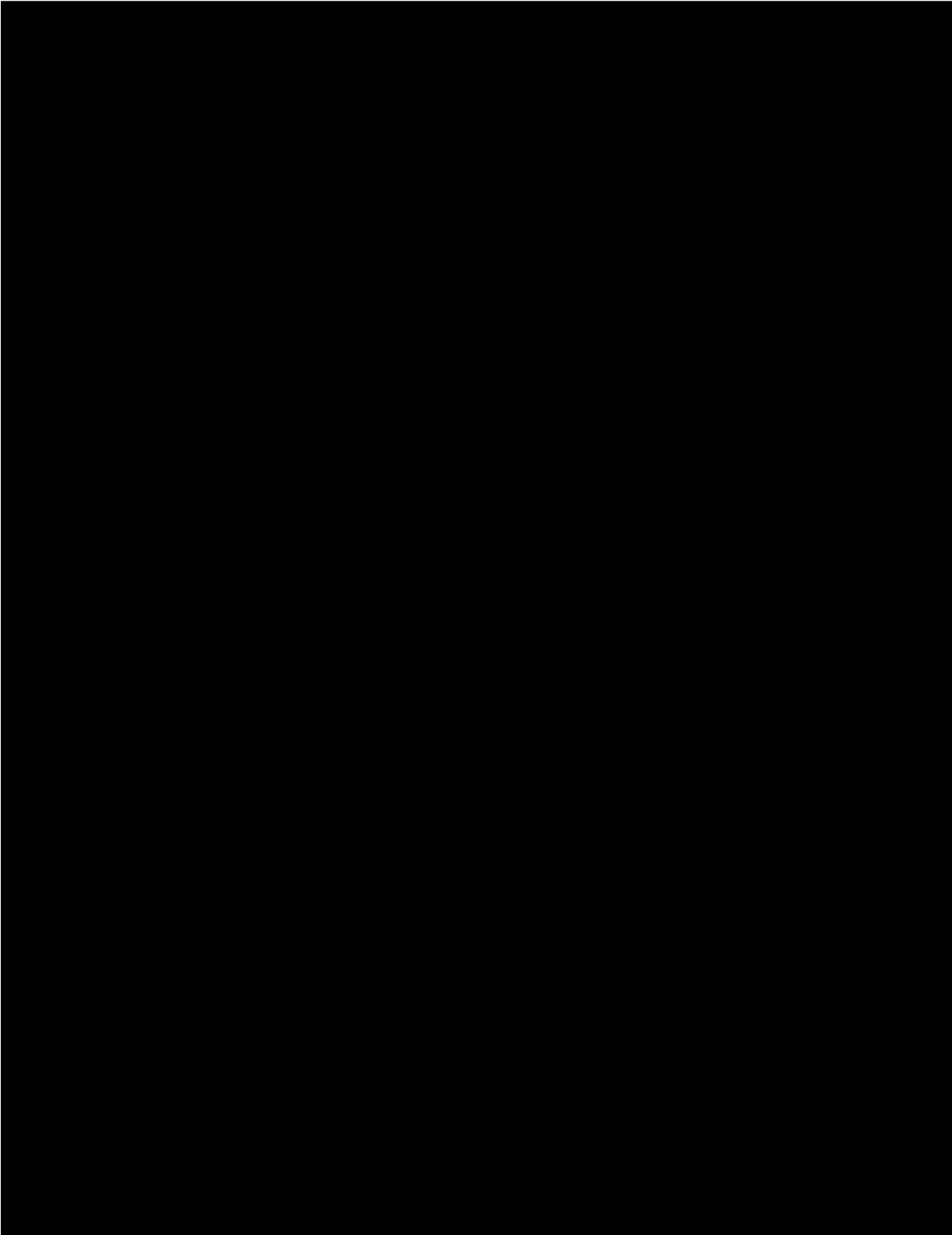
not intended. Furthermore, there is nothing in the legislative history to indicate that the “purchase price” language used in section 2039(b) was intended to limit the types of annuities or other payments to which section 2039 applies. To the contrary, in enacting section 2039(b), the focus of Congress was on the amount contributed by the decedent to the cost of the annuity or other payment as compared with the amount contributed by another. See S. Rep. No. 1622, 83d Cong. 2d Sess. 123 (1954) (section 2039(b) was intended to include in the gross estate only that portion of an annuity's value representing the decedent's contribution to its cost). See also, Neeley v. United States, 613 F.2d 802, 809 (Ct. Cl. 1980) (“In enacting section 2039(b) Congress concluded that it would be inappropriate to include in the gross estate the value of an annuity attributable to contributions by the surviving beneficiary or contributions from another as a gift.”). Accordingly, because the decedent contributed one hundred percent of the assets to the GRAT, the entire value of the trust corpus (the amount receivable by the survivor beneficiaries) is includable in Decedent’s gross estate under section 2039.

Alternatively, as stated above, the amount includable in Decedent’s gross estate under section 2036 is the amount of corpus necessary to yield the amount of Decedent’s retained annuity, based upon the applicable federal rate under section 7520, as of the date of Decedent’s death.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS



¹Although several private letter rulings, the first of which was published in 1993, recommend the application of section 2039 to the remainder interest of a grantor retained annuity trust, private letter rulings reflect nothing more than the position of the Service with respect to a particular taxpayer and are not to be cited as precedent. Section 6110(k)(3).





Please call if you have any further questions.

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