**INTERNAL REVENUE SERVICE**
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

December 17, 2002

Number: **200319001**
Release Date: 5/9/2003
Index (UIL) No.: 2702.00-00
CASE MIS No.: TAM-132867-02/CC:PSI:B04

Taxpayer's Name:

Taxpayer's Identification No: SSN:

Date of Conference:

LEGEND:

Grantor A =

Grantor B =

Trustee =

Date 1 =
Date 2 =
Date 3 =
Date 4 =

GRAT 1 =

GRAT 2 =

GRAT 3 =

GRAT 4 =

State =

Corporation =

ISSUES:

(1) Whether the retroactive reformation of GRATs 1-4 to provide for a retained annuity payable for a specified term of years that was upheld in Walton v. Commissioner, 115 T.C. 589 (2000), as a qualified annuity interest under § 2702 of the Internal Revenue Code, is effective for gift tax purposes.

(2) Whether or not the amendments to GRATs 1-4 are effective, should the value of the Grantor's retained interest be determined based on the value of an annuity payable for a specified term to either the Grantor or the Grantor's estate, because of Grantor's testamentary general power of appointment that would be effective if the Grantor died prior to the expiration of the annuity term of the GRATs.

(3) If the reformation is not effective, whether the IRS position, that the revocable spousal interests provided in GRATs 1-4 prior to reformation are not qualified interests, should be applied without retroactive effect under § 7805(b).

CONCLUSIONS:

(1) The retroactive reformation of GRATs 1-4 is not effective for gift tax purposes.

(2) The value of the Grantor's retained annuity interest should not be determined based on the value of an annuity payable for a specified term to either the Grantor or the Grantor's estate.

(3) The IRS position that the revocable spousal interests provided in GRATs 1-4 prior to reformation are not qualified interests should be applied with retroactive effect under § 7805(b).

FACTS:

On Date 1, Grantor A created Grantor Retained Annuity Trusts (GRATs) 1 and 2, and Grantor B, his wife, created GRATs 3 and 4. Trustee, an independent trustee, was designated as the trustee of each GRAT. The GRATs were funded with shares of common stock in Corporation.

Paragraph II.A. of GRAT 1 (created by Grantor A) provides for the disposition of the trust, as follows:

> A. Grantor's Qualified Annuity Interest. From the date of this agreement until the day preceding the third (3rd) anniversary of this agreement or the Grantor's death, whichever is earlier ("Annuity Term"), Trustee shall pay to

> the Grantor, or, if Grantor is not then living, the Grantor's estate (the "Annuitant") an "Annuity Amount." The Annuity Amount shall be payable annually on the day preceding the anniversary of this Trust during the Annuity Term, and the last day of the Annuity Term. The Annuity Amount for each year shall be 38.3839% of the initial fair market value of the assets contributed to this trust as finally determined for federal gift tax purposes.

Paragraph II.A(7) provides that if the Grantor is living at the expiration of the Annuity Term then the Trustee is to divide the remaining trust assets into as many equal shares as Grantor has children then living and distribute one share to each child.

Paragraph II.A(1) provides that if the Grantor dies prior to the third anniversary of the agreement, then Trustee shall pay to the Grantor's estate any part of the Annuity Amount that is accrued and undistributed at the Grantor's death. The remaining trust assets shall be administered under either Paragraph II.B. or II.C.

Paragraph II.B. provides as follows:

> B. Revocable Contingent Spousal Annuity Trust**.** If, and only if, Grantor dies prior to the third ($3^{rd}$) anniversary of this Agreement, is survived by his wife [Grantor B], and has not exercised his right to revoke his wife's entire interest under this Agreement, then to the extent that Grantor has not revoked such interest, the Trustee shall hold the remaining trust assets in a marital trust for Grantor's wife. The Trustee shall administer such marital trust for the lifetime of Grantor's wife as follows:
>
> (1) Payment of Annuity. Trustee shall pay, until the first to occur of the third ($3^{rd}$) anniversary of the Grantor's death or the death of the Grantor's wife (the "Marital Trust Term"), to the Grantor's wife, or if she is deceased her estate, as an Annuitant, a Marital Trust Annuity Amount that is equal to the Annuity Amount that would have been paid to the Grantor during the Annuity Term, if it had been so extended. . . .

Paragraph II.C. provides for the disposition of the trust in the event the Grantor dies during the three year term and the Grantor's wife predeceases the Grantor, or the Grantor has otherwise revoked his wife's interest. In particular, that provision provides that if the Grantor dies prior to the expiration of the three year term and either the Grantor has revoked the marital trust and annuity provided for his wife or his wife does not survive him, then "the remaining trust assets shall be distributed to or in trust for such appointees, including his estate, as Grantor may appoint by will." In the absence of such appointment, the remaining trust assets shall be distributed to the then acting trustee of Grantor's revocable trust, and if that trust is not then in existence, then to the Grantor's estate.

Paragraph VII.D. provides:

> D. Right to Revoke Annuity to Spouse**.** Grantor may revoke in whole or in part the provisions for Grantor's wife in Paragraph II.B. of the Agreement by notice to the Trustee or by his will. To the extent the Grantor revokes his wife's interest under Paragraph II.B., this agreement shall be administered as if his wife predeceased him.

Paragraph VII.E. provides that no power, right or duty under the agreement shall be effective or exercisable to the extent to which it would cause the Grantor's retained annuity interest to fail to qualify as a "qualified annuity interest" under § 2702(b)(1).

Finally, Paragraph VIII authorizes the trustee to amend the terms of the trust as follows:

> Amendment and Revocation**.** Except as provided in paragraph VII.D., this Agreement is irrevocable and may not be amended by the Grantor. However, the Trustee acting alone shall amend the terms of this Agreement and restrict or remove any of the powers, duties, rights, and privileges of the Trustee, the beneficiaries, or any other person in any manner required for the sole purpose of ensuring that the Grantor's annuity interest qualifies and continues to qualify as a "qualified annuity interest" within the meaning of § 2702(b)(1) of the Code. . . .

The terms of GRAT 1 and GRAT 2 are identical, except that under GRAT 2 the annuity term is 5 years and the initial annual annuity payment is 24.6508 percent of the initial fair market value of the assets. The terms of GRAT 3 and GRAT 4 created by Grantor B are generally identical to those of GRATs 1 and 2, respectively, except that with respect to each trust: (1) the annuity is to be paid to Grantor B; (2) Grantor A is the beneficiary of the revocable contingent spousal annuity trust; and (3) in the absence of Grantor B's appointment by will, provided in Paragraph II.C., the remaining trust assets shall be distributed to Grantor B's revocable trust and if that trust is not then in existence, then to Grantor B's estate.

On or before Date 2, Grantors A and B each timely filed a Form 709 and reported the transfers to the GRATs. In reporting the value of each gift, the Grantors calculated the value of the retained interest with respect to each trust as the present value of an annuity for a term of years or the prior death of two individuals (Grantor A and Grantor B). Subsequent to Date 2, the Service audited the gift tax returns and determined that the revocable spousal interests provided under GRATs 1-4 were not qualified interests for purposes of § 2702 and therefore, were not to be taken into account in determining the value of the Grantors' retained interests in each trust.

On Date 3, the Trustee amended GRATs 1-4 retroactive to Date 1, to provide for a retained annuity payable for a specified term of years similar to that upheld in Walton

v. Commissioner, 115 T.C. 589 (2000). Specifically, with respect to GRAT 1, the Trustee amended Paragraph II.A. to read as follows:

> A. Grantor's Qualified Annuity Interest. From the date of this agreement until the day preceding the third (3rd) anniversary of this agreement ("Annuity Term"), Trustee shall pay to the Grantor (the "Annuitant") an "Annuity Amount." The Annuity Amount shall be payable annually on the day preceding the anniversary of this Trust during the Annuity Term, and the last day of the Annuity Term. The Annuity Amount for each year shall be 38.3839% of the initial fair market value of the assets contributed to this trust as finally determined for federal gift tax purposes.
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> Paragraph II.A.(1) was amended to read as follows:
>
> > (1) Grantor's Death**.** If the Grantor dies prior to the third (3rd) anniversary of this Agreement, Trustee shall pay to Grantor's estate any part of the Annuity Amount that is accrued and undistributed at Grantor's death based on a daily proration through the date of Grantor's death. The remaining Annuity Amounts for the balance of the Annuity Term shall be paid to the Grantor's estate. The remaining trust assets shall be administered under either Paragraph II.B. or II.C.

Finally, the first sentence of Paragraph II.B(1) was amended to read as follows:

> > (1) Payment of Annuity**.** Trustee shall pay, until the first to occur of (a) the third (3rd) anniversary of the termination of the Annuity Amounts paid under Paragraph II.A. or (b) the death of the Grantor's wife (the "Marital Trust Term"), to the Grantor's wife, or if she is deceased to her estate, as an Annuitant, a Marital Trust Annuity Amount that is equal to the Annuity Amount that would have been paid to Grantor during the Annuity Term, if it had been so extended.

Similar amendments were executed with respect to GRATs 2-4. Date 3, the date on which GRATs 1-4 were amended was after the expiration of the three year annuity term provided for in GRAT 1 and GRAT 3. On Date 4, within three years from the date the gift tax returns were filed, Grantor A and Grantor B each filed a claim for refund.

LAW AND ANALYSIS

Section 2501 provides that a tax is imposed on the transfer of property by gift. Section 25.2512-5(a)(1)(i) provides the general rule that where the donor transfers property in trust and retains an interest therein, the value of the gift is the value of the property transferred less the value of the donor's retained interest.

Section 2702 provides the method for valuing a donor's gift when the donor makes a transfer in trust to or for the benefit of a family member and the donor retains an interest in the trust. Section 2702(a)(1) provides that solely for purposes of determining whether a transfer of an interest in trust to (or for the benefit of) a family member of the transferor's family is a gift (and the value of the transfer), the value of any interest in the trust retained by the transferor or any applicable family member shall be determined as provided in § 2702(a)(2).

Section 2702(a)(2) provides, in part, that the value of any retained interest which is not a qualified interest shall be treated as being zero. The value of any retained interest which is a qualified interest shall be determined under § 7520.

Section 2702(a)(3)(i) (as amended by section 1702(f)(11)(B) of the Small Business Job Protection Act of 1996) provides that § 2702 does not apply to a transfer if the transfer is an incomplete gift. Section 2702(a)(2)(B) defines an incomplete gift as any transfer which would not be treated as a gift whether or not consideration was received for such transfer.

Section 2702(b) provides, in part, that the term "qualified interest" means:

> (1) any interest which consists of the right to receive fixed amounts payable not less frequently than annually,
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> (2) any interest which consists of the right to receive amounts which are payable not less frequently than annually and are a fixed percentage of the fair market value of the property in the trust (determined annually), and
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> (3) any noncontingent remainder interest if all of the other interests in the trust consist of interests described in paragraph (1) or (2).

Section 25.2702-1(c)(1) of the Gift Tax Regulations provides that § 2702 does not apply to a transfer, no portion of which would be treated as a completed gift without regard to any consideration received by the transferor.

Section 25.2702-2(a)(5) provides that the term "qualified interest," for purposes of § 2702( b), means a qualified annuity interest, a qualified unitrust interest, or a qualified remainder interest. Further, the retention of a power to revoke a qualified annuity interest (or unitrust interest) of the transferor's spouse is treated as the retention of a qualified annuity interest (or unitrust interest).

Section 25.2702-3(b)(1) provides, in part, that a qualified annuity interest is an irrevocable right to receive a fixed amount. The annuity amount must be payable to (or for the benefit of) the holder of the annuity interest for each taxable year of the term.

Under § 25.2702-3(d)(3), the governing instrument must fix the term of the annuity interest. The term must be for the life of the term holder, for a specified term of years, or for the shorter (but not the longer) of those periods. Section 25.2702-3(c) provides similar rules applicable to a unitrust interest (a right to receive a fixed percentage of the net fair market value of the trust assets, determined annually.)

Under § 2702(a)(3)(i) and § 25.2702-1(c)(1), a revocable interest is generally subject to the rules of § 2702 and must qualify as a qualified interest in order to avoid valuation at zero in determining the amount of any gift, unless the entire gift is incomplete. Section 25.2702-2(a)(5) provides an exception to this general rule. That is, a revocable interest is valued under § 7520, if the interest is a qualified annuity or unitrust interest of the donor's spouse. Section 25.2702-2(d)(1), Examples 6 and 7 illustrate the application of this exception. In Example 6, A transfers property to an irrevocable trust, retaining the right to receive the income for 10 years. Upon expiration of 10 years, the income of the trust is payable to A's spouse for 10 years if living. Upon expiration of the spouse's interest, the trust terminates and the trust corpus is payable to A's child. A retains the right to revoke the spouse's interest. Because the transfer of property to the trust is not incomplete as to all interests in the property (i.e., A has made a completed gift of the remainder interest), § 2702 applies. A's power to revoke the spouse's term interest is treated as a retained interest for purposes of § 2702. Because no interest retained by A (i.e., A's income interest and the spouse's revocable income interest) is a qualified interest, the amount of the gift is the fair market value of the property transferred to the trust.

In Example 7 of § 25.2702-2(d)(1), the facts are the same as in Example 6, except that both the term interest retained by A and the interest transferred to A's spouse (subject to A's right of revocation) are qualified annuity interests. The example concludes that the amount of the gift is the fair market value of the property transferred to the trust reduced by the value of both A's qualified interest and the value of the qualified interest transferred to A's spouse (subject to A's power to revoke).

Cook v. Commissioner, 269 F. 3rd 854 (7th Cir. 2001), aff'g 115 T.C. 15 (2000), considered an issue similar to that presented in the instant case. In Cook, the grantors (a husband and wife) each created trusts intended to qualify as GRATs under § 2702. Each of the GRATs provided for the payment of an annual annuity amount equal to 23.999% of the initial value of the trust corpus, to be paid to the grantor for a term of 5 years or until the grantor's earlier death. If the grantor survived the 5-year term, then the remaining trust property was to be used to establish a separate trust for the grantor's son. However, if the grantor died before the expiration of the 5-year term and was married to grantor's spouse at the time of death, all remaining trust property was to pass to a Contingent Marital Annuity Trust, pursuant to which the grantor's spouse would receive the annuity amount that would have been paid to the grantor if the grantor had survived the remainder of the 5-year term of the GRAT. Upon the earlier of the expiration of the 5-year term or the death of the grantor's spouse, the remaining trust assets were to be used to establish a separate trust for the grantor's son. In each trust, the grantor reserved the power to revoke the successor interest of the spouse.

The Seventh Circuit, in affirming the Tax Court, concluded that the revocable spousal interest (the right of the spouse to receive an annuity for the balance of the five year term of the trust provided the donor died within the five year term and was married to spouse at that time) was not a qualified interest, and therefore was not to be taken into account in reducing the value of the gift. First, the Seventh Circuit noted that the spouse's interest might never vest and allowing a reduction for tax purposes of a gift made in trust for an "ephemeral interest" would invite abuse. Cook v. Commissioner, 269 F. 3rd at 858. See also, Cook v. Commissioner, 115 T.C. at 19. The Seventh Circuit concluded that the spousal interest was contingent, and not fixed and ascertainable, because the spouse was entitled to receive the interest only if the spouse survived the grantor, and only then, if the spouse and grantor remained married.

The Court also concluded that the spouse's interest did not satisfy § 25.2702-3(d)(3), requiring that the annuity be payable for the life of the term holder, a specified term of years, or for the shorter of these periods, because the spousal interest could be paid for the life of the grantor or for a term of years, regardless of which period is shorter. The IRS also argued that the spousal interest was contingent, and did not satisfy the durational requirements of the regulations, because the spousal annuity was payable, if at all, only if the grantor died prior to the termination of the term of the trust, and if payable at all, was payable for an unspecified period dependent on the point during the term of the trust that the grantor did die. Thus, at the inception of the GRAT, the spousal interest was not fixed and ascertainable, but rather was contingent, and at the inception of the GRAT, the interest was not payable for the life of the term holder, or a specified term of years. This is in contrast to § 25.2702- 2(d)(1), Example 7, where the revocable spousal interest is payable to the spouse or the spouse's estate at the end of the grantor's term in all events. In this example, the interests of both the grantor and his or her spouse, at the creation of the trust, are fixed, ascertainable interests payable for a specified term of years, and the spousal interest is not contingent upon the grantor's death at a particular time. See Cook v. Commissioner, 115 T.C. at 23. See also, Schott v. Commissioner, T.C. Memo 2001-110, appeal docketed, No. 02-7007 (9th Cir. December 21, 2001).

In contrast, in Walton v. Commissioner, 115 T.C. 589 (2000), the grantor established a GRAT pursuant to which the grantor was to receive a specified annuity for a two year term. If the grantor died before the expiration of the two year term, the annuity was to be paid to grantor's estate for the balance of the term. Upon expiration of the two year term, the trust corpus was to be distributed to a designated remainder beneficiary. The Tax Court concluded that the grantor's retained annuity that was payable to either the grantor or the grantor's estate for a two year term, constitutes an annuity payable for a specified term of years that satisfies the § 2702(b) definition of a qualified interest. In reaching this conclusion the Court found invalid § 25.2702-3(e), Example 5. This example describes a situation where A transfers property to an irrevocable trust, retaining the right to a unitrust interest for 10 years. If A dies within the 10-year term, the unitrust amount is to be paid to A's estate for the balance of the term. The example concludes that A's retained interest is a qualified unitrust interest to the extent of the right to receive the unitrust payment for 10 years or until A's prior death. The "stub annuity" payable to the A's estate provided A dies prior to the expiration of the 10 year term, is not a qualified interest.

Issue 1

In the instant case, the revocable spousal interests provided for in GRATs 1-4, prior to reformation, are similar to those interests considered by the courts in Cook v. Commissioner, supra, and Schott v. Commissioner, supra. Accordingly, these interests are not qualified interests and are therefore not taken into account in determining the value of the Grantors' retained interests in GRATs 1-4.

Grantors argue that, assuming arguendo the revocable spousal interests provided in the original trust instruments are not qualified interests, nonetheless, the retroactive reformation revising the trusts to conform to term of years interest approved by the Court in Walton should be effective for gift tax purposes.

The Grantors assert that in formulating the GRAT transactions, they intended to maximize the value of the retained annuity interests and to minimize the gift tax consequences. To this end, they would have drafted the instruments to provide for an annuity payable for a specified term of years to the Grantor, or to the Grantor's estate if the Grantor died prior to the expiration of the term of years. However, under § 25.2702-3(e), Example 5, such an interest was not a qualified interest. Thus, the Grantors employed the revocable spousal interest technique.

Grantors assert that in view of Example 5, they drafted the instrument utilizing a different and less advantageous technique (that was later held not to produce the desired result.) However, Grantors argue that because Example 5 was held invalid in Walton v. Commissioner, the trustee had a fiduciary duty owed to each of the Grantors to adjust the terms of the GRATs due to changes and clarifications of the law. Therefore under Paragraph VIII of the GRATs, the trustee had a mandatory duty to amend GRATs 1-4, to ensure that each of the Grantors' retained annuity interests was a qualified interest, thereby carrying out the intent of the Grantors to minimize taxable gifts.

Initially, we note that under Paragraph VIII, the trustee's authority is limited to amending the GRATs to restrict or remove powers, duties, rights, etc. that might cause the retained annuity to fail to qualify as a "qualified annuity interest" within the meaning of § 2702(b)(1). We believe this provision was intended to allow amendment in order to preserve the qualification of the interest under § 2702. In this case, the Grantors' retained annuities, to the extent payable to the Grantor for a term of years or until the Grantor's earlier death, were qualified annuities. Thus, reformation was not required to ensure qualification under § 2702. Rather the reformation, which involved a complete change in the dispositive provisions of the trusts, was undertaken to enhance (and not preserve) the tax benefit available under § 2702. We do not believe this kind of reformation is within the purview of Paragraph VIII.

Even assuming Paragraph VIII authorized the modification, the courts and the IRS have generally found that savings clauses that are intended to reverse any adverse tax consequences arising after the transaction is completed, are not effective for tax purposes. For example, in Commissioner v. Procter, 142 F.2d 824 (4th Cir. 1944) the Court characterized a provision, which voided any portion of a transfer determined by a Court to be subject to gift tax, as "a device" that was contrary to public policy. The Court noted, inter alia, that the provision at issue in that case had the effect of discouraging the collection of tax by the public officials charged with its collection, since the only effect of an attempt to enforce the tax would be to defeat the gift. Further, the effect of the provision was to obstruct the administration of justice by requiring the courts to pass upon a moot case. See also, Ward v. Commissioner, 87 T.C. 78 (1986); Rev. Rul. 65-144, 1965-1 C.B. 442. Similarly, in this case, the modifications pursuant to Paragraph VIII were initiated to reverse the adverse determination by the IRS regarding the revocable spousal interests.[1] We believe that, in this case, Grantors' utilization of Paragraph VIII as a mechanism to reverse these adverse tax consequences presents the same administrative and public policy concerns as did the clause at issue in Procter.

Finally, in general, the retroactive amendment or reformation of a trust instrument is not effective to change the tax consequences of a completed transaction. For example, in Estate of La Meres v. Commissioner, 98 T.C. 294 (1992), the trustees retroactively reformed a governing instrument solely for the purpose of qualifying the bequest for the estate tax charitable deduction. The Court held that the retroactive reformation, undertaken solely for tax considerations, was not effective for tax purposes, stating as follows:

> This and other courts have generally disregarded the retroactive effect of State court decrees for Federal tax purposes. See Van Den Wymelenberg v. United States, 397 F.2d 443, 445 (7th Cir. 1968);

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[1] We note that in this case, there was no reason independent of tax considerations for the reformation. This is especially the case with respect to GRATs 1 and 3, which were reformed after the Grantors' respective terms had expired. Thus, the reformation had absolutely no substantive effect on the operation of the trusts or the dispositive provisions.

> Straight Trust v. Commissioner, 245 F.2d 327, 329-330 (8th Cir. 1957), affg. 24 T.C. 69 (1955); Estate of Nicholson v. Commissioner, 94 T.C. 666, 673 (1990); Fono v. Commissioner, 79 T.C. 680, 695 (1982), affd. without published opinion 749 F.2d 37 (9th Cir. 1984); American Nurseryman Publishing Co. v. Commissioner, 75 T.C. 271, 275 (1980), affd. without published opinion 673 F.2d 1333 (7th Cir. 1981). See Estate of Kraus v. Commissioner, T.C. Memo. 1988-154, affd. on this issue 875 F.2d 597 (7th Cir. 1989).
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> We recognize that the revocable trust authorized the trustees to take the actions which they took. . . . While we will look to local law in order to determine the nature of the interests provided under a trust document, we are not bound to give effect to a local court order which modifies the dispositive provisions of the document after respondent has acquired rights to tax revenues under its terms. [citations omitted]. As the Court of Appeals explained in Van Den Wymelenberg v. United States, supra at 445:
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>> Were the law otherwise there would exist considerable opportunity for "collusive" state court actions having the sole purpose of reducing federal tax liabilities. Furthermore, federal tax liabilities would remain unsettled for years after their assessment if state courts and private persons were empowered to retroactively affect the tax consequences of completed transactions and completed tax years.

Estate of La Meres v. Commissioner, 98 T.C. at 311-312. See also, Rev. Rul. 93-79, 1993-2 C.B. 269. The court in La Meres reached this conclusion notwithstanding that the governing instrument in that case authorized the trustees to reform the instrument, and that the trustees may have had a fiduciary duty to reform the instrument in order to reduce taxes and conserve assets, as the Grantors maintain is the situation in this case. Estate of La Meres v. Commissioner, 98 T.C. at 302, 308. We believe this case presents an even more compelling situation than La Meres for denying the efficacy of the retroactive reformation. The parties in this case are seeking to effect a retroactive change to the instrument, so that the instrument as revised produces a tax benefit that only became available after the document was executed and the transfer became complete. Further in the case of GRATs 1 and 3, the parties are seeking to effect a retroactive change to the instruments after the interests effected by the change had terminated. We do not believe the courts would uphold this use of hindsight to "retroactively affect the tax consequences of completed transactions and completed tax years."

Accordingly, we conclude that the retroactive reformation of GRATs 1-4 to provide for a retained annuity payable for a specified term of years, as described above, was not effective for gift tax purposes.

Issue 2

Grantors argue that, whether or not the amendments to GRATs 1-4 are effective for federal gift tax purposes, the Grantor's annuity interests are the economic equivalent of a term of years annuity interest that was approved by the Court in Walton v. Commissioner. Specifically, the Grantors argue that, under Article II.C. of the GRATs, if the Grantor died prior to the expiration of the term of the annuity and the Grantor was predeceased by the spouse, or the Grantor revoked the marital trust and spousal annuity, then the property was to pass pursuant to the Grantor's exercise of a general power of appointment. Accordingly, in all events, the term annuity would be payable to the Grantor, or the property from which the annuity would be paid would be subject to the Grantor's control. If the Grantor survived until the expiration of the specified term of years, the annuity payments would be received by the Grantor. If the Grantor died prior to the expiration of the specified term of years, the entire trust corpus, the value of which would include the value of the remaining annuity payments, would be distributed in accordance with Grantor's testamentary general power of appointment (to the Grantor's estate or otherwise) and included in the Grantor's gross estate for estate tax purposes. Thus, the Grantors argue that the value of the retained annuity interest should not be reduced by the mortality risk that the Grantor will die during the annuity term of the GRAT.

However, we disagree that a retained annuity payable for a term of years or until Grantor's prior death, coupled with a retained contingent reversion or contingent general power taking effect only if the Grantor dies prior to the expiration of the term, should be viewed as the equivalent of a term of years annuity that would be a qualified interest under Walton.

The Court's decision in Walton, supra, refutes this argument. In Walton, the IRS argued that the "stub annuity" payable to the grantor's estate in the event the grantor died prior to the expiration of the annuity term was the equivalent of a reversion that is valued at zero under the statute and regulations. The Court, however, rejected this argument that the "stub annuity" was the equivalent of a reversion to be valued at zero, as follows:

> As regards policy, permitting reduction to gift value for reversionary interests was resulting in arbitrary and abusive elimination of value which was intended to, and typically did, pass to the donee. Donors were subtracting the full actuarial value of a reversionary interest in the trust corpus and were not merely treating their retained interests as an annuity for a fixed term of years. Although we acknowledge that, in the case of a reversion, at least the equivalent of the term

> annuity's value would be payable to the grantor or the grantor's estate in all events, Congress was entitled to require that interests be cast in one of three specified forms to receive the favorable treatment afforded qualified interests. Accordingly, the Commissioner is equally justified in assigning a zero value to reversionary interests outside the scope of the statutory definition and refusing to consider whether such interests can have the practical effect of a different form of interest not chosen by the grantor. See sec. 25.2702-3(e), Example (1), Gift Tax Regs.

Walton v. Commissioner, 115 T.C. at 601-602 (Emphasis added).

In this case, with respect to each GRAT, the Grantors have retained a right to receive an annuity for a specified term of years, or until the Grantor's prior death, whichever occurs first. The Grantors' have also retained a general power to appoint the trust corpus, effective only in the event the Grantor dies prior to the expiration of the annuity term. As the Tax Court concluded in Walton, this contingent general power of appointment (or reversion) is not the equivalent of a "stub annuity." Rather, the contingent power/reversion is not cast in the statutorily prescribed form for a qualified interest. Therefore, the contingent power is valued at zero for purposes of § 2702, and does not have the effect of converting the Grantors' retained annuity into a term of years annuity.

Issue 3

The Grantors argue that the IRS position that the revocable spousal interests provided in Grantors' GRATs prior to reformation are not qualified interests, and the decision in Cook v Commissioner, should be applied to the Grantors without retroactive effect under § 7805(b).

Section 7805(b)(8) provides that, " the Secretary may prescribe the extent, if any, to which any ruling . . . (including any judicial decision or any administrative determination other than by regulation) relating to the internal revenue laws, shall be applied without retroactive effect." Section 301.7805-1(b) of the Procedure and Administration Regulations provides that the Commissioner may prescribe the extent, if any, to which any ruling relating to the internal revenue laws, issued by or pursuant to authorization from the Commissioner, shall be applied without retroactive effect.

The Grantors contend that, in structuring the transaction, they relied on several private letter rulings issued by the IRS that approved similar interests. In addition, the Grantors argue that, if the IRS had not "inappropriately" included Example 5 in the regulations, the Grantors would not have utilized the revocable spousal annuities in the first instant, but rather, would have utilized the term of years GRAT approved by the Court in Walton.

The taxpayers reliance on previously issued letter rulings is not a sufficient basis for relief under § 7805(b)(8). Section 6110(k)(3) provides that private letter rulings are not to be used or cited as precedent. In addition, in this case, the Grantors executed their instruments after publication of two technical advice memoranda issued after the private letter rulings cited by the Grantors, which conclude that the revocable spousal interests similar to those utilized by the Grantors were not qualified interests.

Finally, we do not believe the Walton decision changes this result. The fact that the Grantors would have utilized a Walton-type GRAT if they had been aware that Example 5 would be invalidated, is not a basis for granting relief. It is correct that the Grantors followed Example 5, and did not employ the Walton-type GRAT. However, it does not follow that because they decided to follow Example 5, and not use a Walton-type GRAT, that the Grantors could therefore employ any other technique. As noted above, § 25.2702-2(d), Example 7, illustrates a revocable spousal interest that would constitute a qualified interest. However, the Grantors did not follow this example nor did they rely on any published guidance, in structuring the transactions. Therefore, § 7805(b) relief is not appropriate.

CAVEAT:

A copy of this technical advice memorandum is to be given to the taxpayer. Section 6110(k)(3) provides that it may not be used or cited as precedent.

- END -