

§ 1.1441–2T [Removed]

■ **Par. 12.** Section 1.1441–2T is removed.

Linda E. Stiff,

Deputy Commissioner for Services and Enforcement.

Approved: June 30, 2008.

Eric Solomon,

Assistant Secretary of the Treasury (Tax Policy).

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DEPARTMENT OF THE TREASURY**Internal Revenue Service****26 CFR Part 20**

[TD 9414]

RIN 1545–BE52

**Grantor Retained Interest Trusts—
Application of Sections 2036 and 2039**

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations providing guidance on the portion of property transferred to a trust or otherwise, that is properly includible in a grantor's gross estate under Internal Revenue Code (Code) sections 2036 and 2039 if the grantor has retained the use of the property or the right to an annuity, unitrust, or other payment from such property for life, for any period not ascertainable without reference to the grantor's death, or for a period that does not in fact end before the grantor's death. The final regulations affect estates that are required to file Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return.

DATES: *Effective Date:* These regulations are effective on July 14, 2008.

Applicability Date: For dates of applicability, see § 20.2036–1(c)(3) and § 20.2039–1(f).

FOR FURTHER INFORMATION CONTACT:

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SUPPLEMENTARY INFORMATION:**Background and Explanation of Provisions**

On June 7, 2007, proposed regulations (REG–119097–05) were published in the *Federal Register* [72 FR 31487]. The proposed regulations contain proposed amendments to the Estate Tax Regulations [26 CFR part 20] providing guidance on the portion of a trust properly includible in a grantor's gross

estate under sections 2036 and 2039 if the grantor retained the use of property in the trust or the right to an annuity, unitrust, or other payment from the trust for life, for any period not ascertainable without reference to the grantor's death, or for a period that does not in fact end before the grantor's death. The trusts that were the subject of the proposed regulations include without limitation certain charitable remainder trusts (collectively CRTs) such as charitable remainder annuity trusts (CRATs) within the meaning of section 664(d)(1), charitable remainder unitrusts (CRUTs) within the meaning of section 664(d)(2) or (d)(3), and charitable remainder trusts that do not qualify under section 664, as well as other trusts established by a grantor (collectively GRTs) such as grantor retained annuity trusts (GRATs), grantor retained unitrusts (GRUTs), and various forms of grantor retained income trusts (GRITs), such as qualified personal residence trusts (QPRTs) and personal residence trusts (PRTs). A CRT was within the scope of the proposed regulations whether or not the CRT met the qualifications of section 664(d)(1), (d)(2), or (d)(3) because either the CRT was created prior to 1969, there was a defect in the drafting of the CRT, there was no intention to qualify the CRT for the charitable deduction, or for any other reason. A GRT was within the scope of the proposed regulations whether or not the grantor's retained interest was a "qualified interest" as defined in section 2702(b).

The proposed regulations incorporate the guidance provided in Rev. Rul. 76–273, 1976–2 CB 268, and Rev. Rul. 82–105, 1982–1 CB 133, by proposing to amend § 20.2036–1 to provide that the portion of the corpus of a CRT and GRT includible in the decedent's gross estate under section 2036 is that portion of the trust corpus necessary to generate a return sufficient to provide the decedent's retained annuity, unitrust, or other payment. See § 601.601(d)(2)(ii)(b). The proposed regulations provide that, in cases where both section 2036 and section 2039 could apply to a retained annuity, unitrust, or other payment in a CRT or a GRT, section 2036 (and therefore, when applicable, section 2035), rather than section 2039, will be applied. Accordingly, the proposed regulations also amend § 20.2039–1 by providing that section 2039 generally shall not be applied to an annuity, unitrust, or other payment retained by a deceased grantor in a CRT or GRT.

Written comments were received on the proposed regulations, and a public hearing was held on September 26, 2007. The proposed regulations, with

certain changes made in response to the written and oral comments received, are adopted as final regulations. Although the final regulations provide guidance as to the Code section (specifically, section 2036 or 2039) to be applied in certain circumstances when each of those sections applies to the same trust, the final regulations are not to be construed to foreclose the possibility that any applicable section of the Code (sections 2035 through 2039, or any other section) properly may be applied in the future by the IRS in appropriate circumstances beyond those described in the final regulations.

Summary of Comments and Explanation of Provisions*References to the Terms GRAT and GRUT*

A commentator recommended that the terms "GRAT" (grantor retained annuity trust) and "GRUT" (grantor retained unitrust) in the proposed regulations be replaced with references to § 25.2702–3(b) and (c) because the terms GRAT and GRUT are not statutory or regulatory terms in the Code. In response, the final regulations include both the Treasury Regulation citations and the terms GRAT and GRUT.

Application of Section 2036 to a Retained Interest in a GRAT or a GRUT

A commentator suggested that section 2036 is not applicable to a retained annuity interest in a GRAT to the extent the retained annuity interest is not payable from trust income. The commentator takes the position that the retained annuity interest is payable from principal and/or income, in kind or in cash, and the size of the annuity payment is not defined in relation to trust income. Instead, the commentator suggests that the annuity is defined as a fraction or percentage of the value of the GRAT's original principal, and accordingly, pursuant to section 2033, only the present value of any unpaid annuity payments as of a particular date or event, valued using section 7520, should be includible in the deceased grantor's gross estate. The commentator opined that section 2036 includes a portion of the trust in the gross estate only to the extent that the trust's income must be used to pay the retained annuity.

Another commentator suggested that the method in the proposed regulations for calculating the portion of GRAT or GRUT corpus includible in the deceased grantor's gross estate under section 2036 results in an overstatement of the property required to produce the retained annuity because the method

calculates the property necessary to produce the full dollar value of a fixed annuity over the actuarial life expectancy of the decedent as of the date of death, rather than for the actual term of years. Instead, the commentator stated that the method to be applied should value the retained annuity or unitrust interest, rather than the property in the trust required to produce the retained interest.

In addition, it has come to the attention of the IRS and Treasury Department that certain taxpayers have stated that section 2036 should not be applied to an annuity when the actuarial value of the present value of the remainder interest in the trust is zero, on the theory that the annuity was acquired for full and adequate consideration.

The IRS and Treasury Department have carefully considered these arguments and analyses. The IRS and Treasury Department believe, however, that these positions are not consistent with the language of section 2036(a)(1), its legislative history, and the case law interpreting this section, which require the inclusion in the gross estate of property over which a decedent has retained a "string" (the possession or enjoyment of, or the right to the income from the transferred property) for at least one of the required statutory periods (hereinafter referred to as a lifetime interest). This section was enacted in response to a concern that a donor might otherwise be able to remove property from the donor's gross estate by giving that property away before death while retaining the use or benefit of the property. Thus, section 2036 requires inclusion in the gross estate of the property subject to the "string", rather than the "string" or retained interest itself. For section 2036 purposes, if the grantor retains the possession or enjoyment of, or the right to the income from, the transferred property for life, for any period not ascertainable without reference to the grantor's death, or for a period which does not in fact end before the grantor's death, the value of the property over which the grantor retained the interest is includible in the grantor's gross estate. The interest retained by the grantor of a GRAT or GRUT who dies during the term of the GRAT or GRUT is a retained lifetime interest because the grantor is retaining the possession or enjoyment of, or the right to the income from, the transferred property for one of the statutorily required time periods. Section 2036(a)(1), accordingly, includes in the grantor's gross estate all or a portion of the corpus of the GRAT or GRUT. To conclude otherwise would

be to ignore the unambiguous statutory language and the intent of section 2036.

This conclusion is supported by the legislative history and the U.S. Supreme Court's interpretation of section 2036 and its predecessors. See *Commissioner v. Church*, 335 U.S. 632, 637-638 (1949); 64 Cong. Rec. H10729 (July 10, 1916) (statements of Messrs. Elston and Kitchin); 71 Cong. Rec. S7078-7079 (March 3, 1931) (statement of Senator Smoot); and 71 Cong. Rec. H7198-7199 (March 3, 1931) (statement of Mr. Hawley).

In *Church*, the Court interpreted the possession and enjoyment clause in section 811(c) (the predecessor to section 2036) in keeping with its historic interpretation. *Church*, 335 U.S. at 645. The Court held that the term "possession and enjoyment" in section 811(c) includes in the transferor's gross estate property passing at the transferor's death in which the transferor has retained any type of lifetime interest (for example, income, a life estate, reverter, etc., contingent or otherwise, expressly stated in the transfer document or by operation of state law) that delayed the beneficiaries' actual use of the transferred property. The Court stated, "It thus sweeps into the gross estate all property the ultimate possession or enjoyment of which is held in suspense until the moment of the decedent's death or thereafter. * * * Testamentary dispositions of an *inter vivos* nature cannot escape the force of this section by hiding behind legal niceties contained in devices and forms created by conveyancers." *Church*, 335 U.S. at 646, quoting *Goldstone v. United States*, 325 U.S. 687 (1945) and citing *Helvering v. Hallock*, 309 U.S. 106 (1940). See, also, *Spiegel's Estate v. Commissioner*, 335 U.S. 701 (1949).

In the Act of Oct. 25, 1949, ch. 720, 63 Stat. 891 (1949) (codified at 26 U.S.C. 811(c)(1949)) (1949 Act), Congress amended section 811(c) to include interests retained for a term of years. H.R. Rep. No. 81-1412 at 9 (1949) (Conf. Report). The Conference Report states, in relevant part, that the "income interests described by section 811(c)(1)(B) [the predecessor to section 2036] and by similar language elsewhere in the conference amendments include reserved rights to the income from transferred property and rights to possess or enjoy non-income-producing property [*i.e.* corpus]." *Id.* at 11.

The IRS and Treasury Department believe, based upon the broad statutory language in section 2036, as well as its legislative history and relevant case law, that under section 2036, every type of lifetime interest in property (annuity, income, use or enjoyment of the

transferred property, etc.) retained for the requisite time period constitutes the retained possession and enjoyment of the transferred property or the income therefrom, causing inclusion of the transferred property in the transferor's gross estate. This is true regardless of the extent to which the retained interest is paid from the income or the corpus of the transferred property. This interpretation is consistent with the legislative intent specifically expressed by Congress in the 1949 Act's amendment to section 811(c) as well as with the Supreme Court's decision in *Northeastern Pennsylvania National Bank & Trust Company v. United States*, 387 U.S. 213 (1967). In that case, the Court held that a bequest to the decedent's spouse of a fixed monthly stipend, payable from trust income or corpus, satisfied the requirement of section 2056(b)(5) that the spouse receive all the income from a specific portion of trust corpus. The specific portion of corpus qualifying for the marital deduction was determined by computing the amount of corpus necessary to produce the guaranteed monthly payment, assuming a fixed rate of return.

In addition, this interpretation is consistent with the regulations under section 662. For trust accounting purposes, § 1.662(a)-2(c) defines the phrase "the amount of income for the taxable year required to be distributed currently" to include any amount required to be paid out of income or corpus, limited by the amount of income received by the estate or trust for the taxable year and not paid, credited, or required to be distributed to other beneficiaries for the taxable year. Thus, an annuity required to be paid in all events (whether out of income or corpus) would qualify as income required to be distributed currently to the extent there is income (as defined in section 643(b)) not paid, credited, or required to be distributed to other beneficiaries for the taxable year. If an annuity or a portion of an annuity is deemed to be income required to be distributed currently, it is treated in all respects in the same manner as an amount of taxable income. The phrase "the amount of income for the taxable year required to be distributed currently" also includes any amount required to be paid during the taxable year in all events (whether out of income or corpus) pursuant to a court order or decree or under local law, by a decedent's estate as an allowance or award for the support of the decedent's widow or other dependent for a limited period during the administration of the

estate to the extent there is income (as defined in section 643(b)) of the estate for the taxable year not paid, credited, or required to be distributed to other beneficiaries.

With regard to the commentator's suggestion that section 2036 applies only to the extent that the trust principal alone is insufficient to fully satisfy the annuity payment, the IRS and Treasury Department believe that this would condition the estate tax treatment on the nature and performance of the investments selected by the trustee. The application of section 2036 should not be dependent on either the trustee's exercise of his or her discretion to invest in income or nonincome producing assets, or the actual performance of the trust assets.

With regard to the position of certain taxpayers that the full and adequate consideration exception under section 2036 is satisfied when the present value of the remainder interest is zero, the IRS and Treasury Department believe that this exception to section 2036 does not apply. There is a significant difference between the bona fide sale of property to a third party in exchange for an annuity, and the retention of an annuity interest in property transferred to a third party. In the bona fide sale, there is a negotiation and agreement between two parties, each of whom is the owner of a property interest before the sale; each uses his or her own property to provide consideration to the other in exchange for the property interest to be received from the other in the sale. When the transferor retains an annuity or similar interest in the transferred property (as in the case of a GRAT or GRUT), the transferor is not selling the transferred property to a third party in exchange for an annuity because there is no other owner of property negotiating or engaging in a sale transaction with the transferor. The transferor, instead, is transferring the property subject to a retained possession and enjoyment of, or right to, the income from the property. If the grantor retains the interest for life, for any period not ascertainable without reference to the grantor's death, or for a period that does not in fact end before the grantor's death, the property is subject to inclusion in the grantor's gross estate under section 2036.

The portion of the GRAT or GRUT corpus includible in the deceased grantor's gross estate is that portion, valued as of the grantor's death (or the section 2032 alternate valuation date, if applicable), necessary to yield that annual annuity, unitrust, or other payment without reducing or invading principal. This portion is determined by

using the section 7520 interest rate in effect on the decedent's date of death (or on the alternate valuation date, if applicable). The IRS has interpreted retained annuity interests under section 2036 in this manner since the enactment of this section in 1916. See Regulations 37 (revised, 1919), Article 24 at 22 (Revenue Act of 1918) or Treasury Department, Treasury Decisions under Internal Revenue Law of the United States, Vol. 21 (Jan.–Dec., 1919), TD 2910, Art. 24 at 771; Regulations 37 (revised, January, 1921), Article 24 at 20 (Revenue Act of 1918) or Treasury Department, Treasury Decisions under Internal Revenue Law of the United States, Vol. 23 (Jan.–Dec., 1921), TD 3145, Art. 24 at 299; Regulations 63 (1922 Edition), Article 20 at 21 (Revenue Act of 1921) or Treasury Department, Treasury Decisions under Internal Revenue Law of the United States, Vol. 24 (Jan.–Dec., 1922), TD 3384, Art. 20 at 1057; Regulations 68 (1924 Edition), Article 18 at 27 (Revenue Act of 1924) or Treasury Department, Treasury Decisions under Internal Revenue Law of the United States, Vol. 27 (Jan.–Dec., 1925), TD 3683, Art. 18 at 107; Regulations 70 (1926 Edition), Article 18 at 25 (Revenue Act of 1926) or Treasury Department, Treasury Decisions under Internal Revenue Law of the United States, Vol. 28 (Jan.–Dec., 1926), TD 3918, Art. 18 at 451; and Regulations 70 (1929 Edition), Article 18 at 27–28 (Revenue Act of 1926). The IRS confirmed this interpretation in Rev. Rul. 76–273 and Rev. Rul. 82–105. Although this guidance predates the advent of GRATs and GRUTs, the analysis and holdings of this guidance consistently has been applied to GRATs, GRUTs, and similar trust arrangements.

Pooled Income Funds

A commentator requested that the regulations be expanded to discuss their impact on both newer (under three years old) and more mature (over three years old) pooled income funds. The age of the fund determines the formula to be used to determine the fund's rate of return, and thus the value of the charitable gift: Funds that are at least three years old use the highest of the three last taxable years' rates of return; funds that are less than three years old generally use the highest of the three calendar-year annual averages of the section 7520 rates minus 1 percent. See § 1.642(c)–6(e)(3) and (4). This distinction based on the duration of the fund, however, is not relevant for purposes of determining the amount included in the transferor's gross estate under section 2036 because the retained

interest is the right to all of the income, thus mandating the inclusion of the entire share of the fund's corpus attributable to the transferor. A pooled income fund example has been added to the final regulations as *Example 5* in § 20.2036–1(c)(2).

Remainder Interest in Personal Residences and Farms

A commentator requested that the regulations be expanded to discuss the estate tax implications for charitable gifts of remainder interests in personal residences and farms. The calculation of the charitable deduction is beyond the scope of these final regulations. *Example 2* of § 20.2036–1(c)(1), however, has been added in the final regulations to confirm that, if the transferor transferred a personal residence to a third person while retaining the right to use the personal residence for life or for a term of years, and if the transferor died during that term, the fair market value of the residence on the date of death is includible in the transferor's gross estate under section 2036.

Alternate Valuation Date

A commentator questioned whether the proposed regulations imply that the portion of the trust includible in the grantor's gross estate when the estate has made a section 2032 election is to be determined with reference to the section 7520 rate in effect on the alternate valuation date. The commentator has requested an explanation of why the change in the section 7520 rate is not a change in value due only to the mere lapse of time under § 20.2032–1(f).

When a section 2032 election is made, the section 7520 interest rate (but not the mortality factor) on the alternate valuation date is used to determine the portion of trust corpus includible in the grantor's gross estate under section 2036. The section 7520 interest rate reflects changes due to market conditions, which is permitted under section 2032. Mortality factors are not necessary to determine the portion of trust corpus includible in the grantor's gross estate under section 2036 because under section 2036 the dispositive factor is whether the interest was retained for the requisite statutory period, not the length of the period remaining at the transferor's death. See § 20.2032–1(f) in cases where the mortality factor is applicable and the alternate valuation method under section 2032 is elected.

Alternate Valuation Date Example

A commentator requested an example that illustrates how the rules of § 20.2032-1(d) affect the trust's value and how required annuity payments made after the date of death but before the alternate valuation date affect the estate inclusion computation. Any such example, which would properly belong in the regulations under section 2032, is beyond the scope of these final regulations.

Examples of CRAT and CRUT for a Term of Years

A commentator requested that the regulation be expanded to include examples or a discussion of the estate tax implications for a donor who creates a CRAT or a CRUT for a term of years. In response to this comment, *Examples 1 and 3* of § 20.2036-1(c)(2) are amended in the final regulations to provide that, if the grantor instead had retained an interest in a CRAT or a CRUT for a term of years and had died during the term, the inclusion under section 2036 would be the same as when the grantor retained an interest for life in the CRAT or CRUT.

Graduated GRAT Example

A commentator requested that examples be provided that address a GRAT from which the grantor receives increasing annuity payments. The commentator suggested two alternative methods for valuing the annuity and requested that the IRS provide guidance on the appropriate method. The IRS and Treasury Department agree that such an example would be helpful and appropriate but believe the issue requires further consideration.

Example Illustrating Proposed § 20.2036-1(c)(1)

A commentator recommended that the example found in § 20.2036-1(c)(1)(ii) illustrating the provisions of § 20.2036-1(c)(1)(i) be changed by replacing the reference to D's spouse (E), with D's child (C), to avoid complications with section 2523. The commentator also explained that, even if D dies before E, D has a right at death to more than one-half of trust income because D has the right to the entire trust income in the event E dies before D. The IRS and Treasury Department agree that this example should be provided in the regulations under section 2036, but believe the issue requires further consideration.

Proposed Title for § 20.2036-1(c)(2)

A commentator suggested that the title of proposed regulation § 20.2036-1(c)(2) be changed to "Retained annuity,

unitrust, and other income interests in trusts." This comment is adopted because this regulation addresses retained interests in trust income and corpus.

Examples 1 and 3 of Proposed § 20.2036-1(c)(2)

A commentator recommended that *Examples 1 and 3* of proposed regulation § 20.2036-1(c)(2) state that, if D's executor elects to use the alternate valuation date and also elects to use the interest rate component for either of the two months preceding the alternate valuation date, then under § 1.664-2(c) of the Income Tax Regulations, the section 7520 rate and the mortality table for that month should be used for purposes of determining: (1) The portion of trust corpus includible in D's estate; (2) the value of C's continuing annuity interest; and (3) the charitable deduction available for the portion of the CRAT included in D's estate.

The choice as to the monthly interest rate to be used to determine the portion of trust corpus includible in D's estate and the value of C's continuing annuity interest present no issues under section 2036, and are addressed by section 7520. Mortality factors, however, generally are not necessary to determine the portion of trust corpus includible in the grantor's gross estate under section 2036. In cases where a mortality factor is applicable and the alternate valuation method under section 2032 is elected, taxpayers are directed to § 20.2032-1(f). The calculation of the charitable deduction is beyond the scope of these regulations. Accordingly, the issues raised in this comment will not be addressed in these final regulations.

Example 1 of Proposed § 20.2036-1(c)(2)

A commentator had several comments with respect to this example. The commentator pointed out that the trust in the example fails the 10 percent remainder requirement set forth in section 664(d)(1)(D). In response, *Example 1* has been modified in the final regulations so that the trust meets this requirement.

Second, the commentator concluded that the charitable deduction of \$30,024.80 arrived at in the example would be correct only if it is assumed that the annuity payments to C were paid entirely from the portion of the trust that is includible in D's gross estate. The commentator suggested that there is no basis for this assumption, and that C's annuity payments are made from the trust as a whole and should be allocated between the included and excluded portion of the trust in proportion to the relative values of each.

This approach results in a charitable deduction of \$86,683 (\$200,000 reduced by two-thirds of the value of C's annuity). In response, it has been determined that it is beyond the scope of the final regulations to address the calculation of the charitable deduction. Accordingly, the charitable deduction calculations in *Example 1* and *Example 3* of § 20.2036-1(c)(2) have been removed from the final regulations.

The commentator requested that the regulations include a statement that, if an inter vivos CRAT is properly formed and subsequently included in the grantor's gross estate, the requirements under section 664(d) for qualification as a CRAT do not need to be retested at the time of the grantor's death for purposes of determining whether the grantor's estate is entitled to a charitable deduction for the value of the remainder interest in the CRAT. This issue is governed by section 664 and is beyond the scope of the final regulations.

Finally, the commentator suggested that *Example 1* be expanded to include a right retained by D to revoke C's annuity interest or to change the identity of the charitable remainderman and to confirm the impact of these retained powers on the charitable deduction. *Example 1* in § 20.2036-1(c)(2) is expanded in the final regulations to include the scenario that D may revoke C's annuity interest or change the identity of the charitable remainderman. The example cites to section 2038 for the inclusion of property in the gross estate on account of such retained powers.

Example 2 of Proposed § 20.2036-1(c)(2)

A commentator suggested that the sentence, "No additional contributions were made to the Trust after D's transfer at the creation of the Trust" be removed or changed to reflect that no additional contributions may be made to a GRAT. In response, the final regulations adopt this comment.

A commentator suggested that the example address the amount includible in D's gross estate when the trust is payable to D's estate after D's death. In response, *Example 2* of § 20.2036-1(c)(2) is modified in the final regulations to provide that the portion of trust corpus includible in D's estate under section 2036 is that portion necessary to support D's retained interest at the moment before D's death (calculated as directed in the example). Thus, it is not material whether annuity payments are made to D's estate after D's death.

Effect on Other Documents

The following documents are obsolete as of July 14, 2008:

- Rev. Rul. 76-273 (1976-2 CB 268).
- Rev. Rul. 82-105 (1982-1 CB 133).

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations and, because these regulations do not impose on small entities a collection of information requirement, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding this regulation was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Theresa M. Melchiorre, Office of Chief Counsel, IRS.

List of Subjects in 26 CFR Part 20

Estate taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

- Accordingly, 26 CFR part 20 is amended as follows:

PART 20—ESTATE TAX; ESTATES OF DECEDENTS DYING AFTER AUGUST 16, 1954

- **Paragraph 1.** The authority citation for part 20 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

- **Par. 2.** Section 20.2036-1 is amended by:

- 1. Revising paragraph (a).
- 2. Designating the undesignated text following paragraph (a)(3)(ii) as paragraph (c)(1)(i) and adding new paragraph headings.
- 3. Adding paragraphs (c)(1)(ii), (c)(2), and (c)(3).

The revisions and additions read as follows:

§ 20.2036-1 Transfers with retained life estate.

(a) *In general.* A decedent's gross estate includes under section 2036 the value of any interest in property transferred by the decedent after March

3, 1931, whether in trust or otherwise, except to the extent that the transfer was for an adequate and full consideration in money or money's worth (see § 20.2043-1), if the decedent retained or reserved—

- (1) For his life;
- (2) For any period not ascertainable without reference to his death (if the transfer was made after June 6, 1932); or
- (3) For any period which does not in fact end before his death:

(i) The use, possession, right to income, or other enjoyment of the transferred property.

* * * * *

(c) *Retained or reserved interest—(1) Amount included in gross estate—(i) In general.* * * *

(ii) *Examples.* The application of paragraph (c)(1)(i) of this section is illustrated in the following examples:

Example 1. [Reserved].

Example 2. D transferred D's personal residence to D's child (C), but retained the right to use the residence for a term of years. D dies during the term. At D's death, the fair market value of the personal residence is includible in D's gross estate under section 2036(a)(1) because D retained the right to use the residence for a period that did not in fact end before D's death.

(2) *Retained annuity, unitrust, and other income interests in trusts—(i) In general.* This paragraph (c)(2) applies to a grantor's retained use of an asset held in trust or a retained annuity, unitrust, or other interest in any trust (other than a trust constituting an employee benefit) including without limitation the following (collectively referred to in this paragraph (c)(2) as "trusts"): Certain charitable remainder trusts (collectively CRTs) such as a charitable remainder annuity trust (CRAT) within the meaning of section 664(d)(1), a charitable remainder unitrust (CRUT) within the meaning of section 664(d)(2) or (d)(3), and any charitable remainder trust that does not qualify under section 664(d), whether because the CRT was created prior to 1969, there was a defect in the drafting of the CRT, there was no intention to qualify the CRT for the charitable deduction, or otherwise; other trusts established by a grantor (collectively GRTs) such as a grantor retained annuity trust (GRAT) paying out a qualified annuity interest within the meaning of § 25.2702-3(b) of this chapter, a grantor retained unitrust (GRUT) paying out a qualified unitrust interest within the meaning of § 25.2702-3(c) of this chapter; and various other forms of grantor retained income trusts (GRITs) whether or not the grantor's retained interest is a qualified interest as defined in section 2702(b), including without limitation a

qualified personal residence trust (QPRT) within the meaning of § 25.2702-5(c) of this chapter and a personal residence trust (PRT) within the meaning of § 25.2702-5(b) of this chapter. If a decedent transferred property into such a trust and retained or reserved the right to use such property, or the right to an annuity, unitrust, or other interest in such trust with respect to the property decedent so transferred for decedent's life, any period not ascertainable without reference to the decedent's death, or for a period that does not in fact end before the decedent's death, then the decedent's right to use the property or the retained annuity, unitrust, or other interest (whether payable from income and/or principal) constitutes the retention of the possession or enjoyment of, or the right to the income from, the property for purposes of section 2036. The portion of the trust's corpus includible in the decedent's gross estate for Federal estate tax purposes is that portion of the trust corpus necessary to provide the decedent's retained use or retained annuity, unitrust, or other payment (without reducing or invading principal) as determined in accordance with § 20.2031-7 (or § 20.2031-7A, if applicable). The portion of the trust's corpus includible in the decedent's gross estate under section 2036, however, shall not exceed the fair market value of the trust's corpus at the decedent's date of death.

(ii) *Graduated retained interests.* [Reserved].

(iii) *Examples.* The application of paragraphs (c)(2)(i) and (c)(2)(ii) of this section are illustrated in the following examples:

Example 1. (i) Decedent (D) transferred \$100,000 to an inter vivos trust that qualifies as a CRAT under section 664(d)(1). The trust agreement provides for an annuity of \$7,500 to be paid each year to D for D's life, then to D's child (C) for C's life, with the remainder to be distributed upon the survivor's death to N, a charitable organization described in sections 170(c), 2055(a), and 2522(a). The annuity is payable to D or C, as the case may be, annually on each December 31st. D dies in September 2006, survived by C who was then age 40. On D's death, the value of the trust assets was \$300,000 and the section 7520 interest rate was 6 percent. D's executor does not elect to use the alternate valuation date.

(ii) The amount of corpus with respect to which D retained the right to the income, and thus the amount includible in D's gross estate under section 2036, is that amount of corpus necessary to yield the annual annuity payment to D (without reducing or invading principal). In this case, the formula for determining the amount of corpus necessary to yield the annual annuity payment to D is: annual annuity / section 7520 interest rate =

amount includible under section 2036. The amount of corpus necessary to yield the annual annuity is $\$7,500 / .06 = \$125,000$. Therefore, $\$125,000$ is includible in D's gross estate under section 2036(a)(1). (The result would be the same if D had retained an interest in the CRAT for a term of years and had died during the term. The result also would be the same if D had irrevocably relinquished D's annuity interest less than 3 years prior to D's death because of the application of section 2035.) If, instead, the trust agreement had provided that D could revoke C's annuity interest or change the identity of the charitable remainderman, see section 2038 with regard to the portion of the trust to be included in the gross estate on account of such a retained power to revoke. Under the facts presented, section 2039 does not apply to include any amount in D's gross estate by reason of this retained annuity. See § 20.2039-1(e).

Example 2. (i) D transferred $\$100,000$ to a GRAT in which D's annuity is a qualified interest described in section 2702(b). The trust agreement provides for an annuity of $\$12,000$ per year to be paid to D for a term of ten years or until D's earlier death. The annuity amount is payable in twelve equal installments at the end of each month. At the expiration of the term of years or on D's earlier death, the remainder is to be distributed to D's child (C). D dies prior to the expiration of the ten-year term. On the date of D's death, the value of the trust assets is $\$300,000$ and the section 7520 interest rate is 6 percent. D's executor does not elect to use the alternate valuation date.

(ii) The amount of corpus with respect to which D retained the right to the income, and thus the amount includible in D's gross estate under section 2036, is that amount of corpus necessary to yield the annual annuity payment to D (without reducing or invading principal). In this case, the formula for determining the amount of corpus necessary to yield the annual annuity payment to D is: annual annuity (adjusted for monthly payments) / section 7520 interest rate = amount includible under section 2036. The Table K adjustment factor for monthly annuity payments in this case is 1.0272. Thus, the amount of corpus necessary to yield the annual annuity is $(\$12,000 \times 1.0272) / .06 = \$205,440$. Therefore, $\$205,440$ is includible in D's gross estate under section 2036(a)(1). If, instead, the trust agreement had provided that the annuity was to be paid to D during D's life and to D's estate for the balance of the 10-year term if D died during that term, then the portion of trust corpus includible in D's gross estate would still be as calculated in this paragraph. It is not material whether payments are made to D's estate after D's death. Under the facts presented, section 2039 does not apply to include any amount in D's gross estate by reason of this retained annuity. See § 20.2039-1(e).

Example 3. (i) In 2000, D created a CRUT within the meaning of section 664(d)(2). The trust instrument directs the trustee to hold, invest, and reinvest the corpus of the trust and to pay to D for D's life, and then to D's child (C) for C's life, in equal quarterly installments payable at the end of each

calendar quarter, an amount equal to 6 percent of the fair market value of the trust as valued on December 15 of the prior taxable year of the trust. At the termination of the trust, the then-remaining corpus, together with any and all accrued income, is to be distributed to N, a charitable organization described in sections 170(c), 2055(a), and 2522(a). D dies in 2006, survived by C, who was then age 55. The value of the trust assets on D's death was $\$300,000$. D's executor does not elect to use the alternate valuation date and, as a result, D's executor does not choose to use the section 7520 interest rate for either of the two months prior to D's death.

(ii) The amount of the corpus with respect to which D retained the right to the income, and thus the amount includible in D's gross estate under section 2036(a)(1), is that amount of corpus necessary to yield the unitrust payments. In this case, such amount of corpus is determined by dividing the trust's equivalent income interest rate by the section 7520 rate (which was 6 percent at the time of D's death). The equivalent income interest rate is determined by dividing the trust's adjusted payout rate by the excess of 1 over the adjusted payout rate. Based on § 1.664-4(e)(3) of this chapter, the appropriate adjusted payout rate for the trust at D's death is 5.786 percent (6 percent \times .964365). Thus, the equivalent income interest rate is 6.141 percent (5.786 percent / (1—5.786 percent)). The ratio of the equivalent interest rate to the assumed interest rate under section 7520 is 102.35 percent (6.141 percent / 6 percent). Because this exceeds 100 percent, D's retained payout interest exceeds a full income interest in the trust, and D effectively retained the income from all the assets transferred to the trust. Accordingly, because D retained for life an interest at least equal to the right to all income from all the property transferred by D to the CRUT, the entire value of the corpus of the CRUT is includible in D's gross estate under section 2036(a)(1). (The result would be the same if D had retained, instead, an interest in the CRUT for a term of years and had died during the term.) Under the facts presented, section 2039 does not apply to include any amount in D's gross estate by reason of D's retained unitrust interest. See § 20.2039-1(e).

(iii) If, instead, D had retained the right to a unitrust amount having an adjusted payout for which the corresponding equivalent interest rate would have been less than the 6 percent assumed interest rate of section 7520, then a correspondingly reduced proportion of the trust corpus would be includible in D's gross estate under section 2036(a)(1). Alternatively, if the interest retained by D was instead only one-half of the 6 percent unitrust interest, then the amount included in D's estate would be the amount needed to produce a 3 percent unitrust interest. All of the results in this **Example 3** would be the same if the trust had been a GRUT instead of a CRUT.

Example 4. During life, D established a 15-year GRIT for the benefit of individuals who are not members of D's family within the meaning of section 2704(c)(2). D retained the right to receive all of the net income from the GRIT, payable annually, during the GRIT's

term. D dies during the GRIT's term. D's executor does not elect to use the alternate valuation date. In this case, the GRIT's corpus is includible in D's gross estate under section 2036(a)(1) because D retained the right to receive all of the income from the GRIT for a period that did not in fact end before D's death. If, instead, D had retained the right to receive 60 percent of the GRIT's net income, then 60 percent of the GRIT's corpus would have been includible in D's gross estate under section 2036. Under the facts presented, section 2039 does not apply to include any amount in D's gross estate by reason of D's retained interest. See § 20.2039-1(e).

Example 5. In 2003, D transferred $\$10X$ to a pooled income fund that conforms to Rev. Proc. 88-53, 1988-2 CB 712 (1988) in exchange for 1 unit in the fund. D is to receive all of the income from that 1 unit during D's life. Upon D's death, D's child (C), is to receive D's income interest for C's life. In 2008, D dies. D's executor does not elect to use the alternate valuation date. In this case, the fair market value of D's 1 unit in the pooled income fund is includible in D's gross estate under section 2036(a)(1) because D retained the right to receive all of the income from that unit for a period that did not in fact end before D's death. See § 601.601(d)(2)(ii)(b) of this chapter.

Example 6. D transferred D's personal residence to a trust that met the requirements of a qualified personal residence trust (QPRT) as set forth in § 25.2702-5(c) of this chapter. Pursuant to the terms of the QPRT, D retained the right to use the residence for 10 years or until D's prior death. D dies before the end of the term. D's executor does not elect to use the alternate valuation date. In this case, the fair market value of the QPRT's assets on the date of D's death are includible in D's gross estate under section 2036(a)(1) because D retained the right to use the residence for a period that did not in fact end before D's death.

(3) *Effective/applicability dates.* Paragraphs (a) and (c)(1)(i) of this section are applicable to the estates of decedents dying after August 16, 1954. Paragraphs (c)(1)(ii) and (c)(2) of this section apply to the estates of decedents dying on or after July 14, 2008.

■ **Par. 3.** Section 20.2039-1 is amended by:

- 1. Revising paragraph (a).
- 2. Adding new paragraphs (e) and (f).

The revision and addition reads as follows:

§ 20.2039-1 Annuities.

(a) *In general.* A decedent's gross estate includes under section 2039(a) and (b) the value of an annuity or other payment receivable by any beneficiary by reason of surviving the decedent under certain agreements or plans to the extent that the value of the annuity or other payment is attributable to contributions made by the decedent or his employer. Sections 2039(a) and (b), however, have no application to an

amount which constitutes the proceeds of insurance under a policy on the decedent's life. Paragraph (b) of this section describes the agreements or plans to which section 2039(a) and (b) applies; paragraph (c) of this section provides rules for determining the amount includible in the decedent's gross estate; paragraph (d) of this section distinguishes proceeds of life insurance; and paragraph (e) of this section distinguishes annuity, unitrust, and other interests retained by a decedent in certain trusts.

The fact that an annuity or other payment is not includible in a decedent's gross estate under section 2039(a) and (b) does not mean that it is not includible under some other section of part III of subchapter A of chapter 11. However, see section 2039(c) and (d) and § 20.2039-2 for rules relating to the exclusion from a decedent's gross estate of annuities and other payments under certain "qualified plans." Further, the fact that an annuity or other payment may be includible under section 2039(a) will not preclude the application of another section of chapter 11 with regard to that interest. For annuity interests in trust, see paragraph (e)(1) of this section.

* * * * *

(e) *No application to certain trusts.* Section 2039 shall not be applied to include in a decedent's gross estate all or any portion of a trust (other than a trust constituting an employee benefit, but including those described in the following sentence) if the decedent retained a right to use property of the trust or retained an annuity, unitrust, or other interest in the trust, in either case as described in section 2036. Such trusts include without limitation the following (collectively referred to in this paragraph (e) as "trusts"): Certain charitable remainder trusts (collectively CRTs) such as a charitable remainder annuity trust (CRAT) within the meaning of section 664(d)(1), a charitable remainder unitrust (CRUT) within the meaning of section 664(d)(2) or (d)(3), and any other charitable remainder trust that does not qualify under section 664(d), whether because the CRT was created prior to 1969, there was a defect in the drafting of the CRT, there was no intention to qualify the CRT for the charitable deduction, or otherwise; other trusts established by a grantor (collectively GRTs) such as a grantor retained annuity trust (GRAT) paying out a qualified annuity interest within the meaning of § 25.2702-3(b) of this chapter, a grantor retained unitrust (GRUT) paying out a qualified unitrust interest within the meaning of

§ 25.2702-3(c) of this chapter; and various forms of grantor retained income trusts (GRITs) whether or not the grantor's retained interest is a qualified interest as defined in section 2702(b), including without limitation a qualified personal residence trust (QPRT) within the meaning of § 25.2702-5(c) of this chapter and a personal residence trust (PRT) within the meaning of § 25.2702-5(b) of this chapter. For purposes of determining the extent to which a retained interest causes all or a portion of a trust to be included in a decedent's gross estate, see § 20.2036-1(c)(1), (2), and (3).

(f) *Effective/applicability dates.* The first, second, and fourth sentences in paragraph (a) of this section are applicable to the estates of decedents dying after August 16, 1954. The fifth sentence of paragraph (a) of this section is applicable to the estates of decedents dying on or after October 27, 1972, and to the estates of decedents for which the period for filing a claim for credit or refund of an estate tax overpayment ends on or after October 27, 1972. The third, sixth, and seventh sentences of paragraph (a) of this section and all of paragraph (e) of this section are applicable to the estates of decedents dying on or after July 14, 2008.

Linda E. Stiff,
Deputy Commissioner for Services and Enforcement.

Approved: July 4, 2008.

Eric Solomon,
Assistant Secretary of the Treasury (Tax Policy).
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DEPARTMENT OF AGRICULTURE

Forest Service

36 CFR Part 242

DEPARTMENT OF THE INTERIOR

Fish and Wildlife Service

50 CFR Part 100

[FWS-R7-SM-2008-0021; 70101-1335-0064L6]

RIN 1018-AU71

Subsistence Management Regulations for Public Lands in Alaska, Subpart C and Subpart D—2008-09 Subsistence Taking of Fish and Shellfish Regulations

AGENCIES: Forest Service, Agriculture; Fish and Wildlife Service, Interior.

ACTION: Final rule; correcting amendment.

SUMMARY: On March 14, 2008, we published a final rule that established regulations for seasons, harvest limits, methods, and means related to taking of fish and shellfish for subsistence uses during the 2008-09 regulatory year. This rule, which became effective April 1, 2008, and remains effective through March 31, 2009, contained an error in the regulatory text. This document corrects that error.

DATES: This correction is effective July 14, 2008.

FOR FURTHER INFORMATION CONTACT: Chair, Federal Subsistence Board, c/o U.S. Fish and Wildlife Service, Attention: Peter J. Probasco, Office of Subsistence Management; (907) 786-3888. For questions specific to National Forest System lands, contact Steve Kessler, Subsistence Program Leader, USDA—Forest Service, Alaska Region, (907) 786-3592.

SUPPLEMENTARY INFORMATION: On March 14, 2008, we published a final rule (73 FR 13761) that established regulations for seasons, harvest limits, methods, and means for taking fish and shellfish for subsistence uses during the 2008-09 regulatory year. This rule became effective April 1, 2008, and remains effective through March 31, 2009. We made an error in our regulatory text. In _____.27(i)(13), there was an extra paragraph (i)(13)(xx), which inserted material about the Taku River in the middle of material pertaining to Prince of Wales/Kosciusko Islands. This correction redesignates extra paragraph (i)(13)(xx) as (xxi). The substance of the regulations remains unchanged.

Administrative Procedure Act

We find good cause to waive notice and comment on this correction, pursuant to 5 U.S.C. 533(b)(B), and the 30-day delay in effective date pursuant to 5 U.S.C. 553(d). Notice and comment are unnecessary because this correction is a minor, technical change in the numbering of the regulations. The substance of the regulations remains unchanged. Therefore, this correction is being published as a final regulation and is effective July 14, 2008.

List of Subjects

36 CFR Part 242

Administrative practice and procedure, Alaska, Fish, National forests, Public lands, Reporting and recordkeeping requirements, Wildlife.