

## IRS EXTENDS TIME TO ELECT OUT OF AUTOMATIC ALLOCATION OF GST EXEMPTION TO GRAT

*January 9, 2007*

### **Private Letter Rulings**

In PLR 200644001, the Revenue Service permitted a late election out of the otherwise automatic allocation of GST exemption to a Grantor Retained Annuity Trust (GRAT). In the absence of this relief, the grantor's GST exemption would have been allocated automatically to the GRAT at the end of its term (the "estate tax inclusion period," or ETIP) in an amount equal to the then fair market value of the assets in the GRAT.

Section 2642(g) of the Internal Revenue Code, which was added by the Economic Growth and Tax Relief Reconciliation Act of 2001 (see our Bulletin No. 01-51), directs the Secretary to prescribe the circumstances under which extensions of time will be granted to make an allocation of generation-skipping tax (GST) exemption to a transfer or an election not to have the automatic allocation of exemption apply to certain trusts (an "election out"). Normally, this allocation, or the election out, must be made on a timely filed gift tax return.

In Notice 2001-50, 2001-2 C.B. 189, released on August 1, 2001, the Internal Revenue Service announced that taxpayers may seek an extension of time to make a late allocation of GST exemption (or an election out of the deemed allocation of that exemption in certain circumstances) under the provisions of Reg. Section 301.9100-3. Generally, relief will be granted under this regulation if the taxpayer acted reasonably and in good faith and if granting relief won't prejudice the government's interests. Taxpayers requesting relief are directed to follow the procedures for requesting a private letter ruling under reg. section 301.9100. As reported in our Bulletins Nos. 02-92, 02-124 and 03-1, the Revenue Service has been generous in granting ruling requests for Section 9100-type relief with respect to late allocations of GST exemption.

In PLR 200644001, the Service granted an extension of time to make an election out of the GST Exemption automatic allocation rules in a situation that otherwise would have resulted in the automatic allocation of exemption to the assets of a GRAT at the end of its term.

Under the facts of PLR 200644001, Taxpayer established and funded a grantor retained annuity trust ("GRAT") on Date 1 in Year 1. Taxpayer's retained interest under the GRAT terminated on Date 2.

## RA Bench

Taxpayer survived the term of his retained interest in the GRAT. Under the terms of the GRAT, there was a possibility that a generation-skipping transfer would occur.

In the case of a GRAT, an allocation of GST Exemption will not be effective until the termination of the retained interest term. In that regard, the retained interest term constitutes an estate tax inclusion period (“ETIP”). The ETIP is the period during which the value of the transferred property would be includable other than under §2035) in the gross estate of the transferor or the transferor’s spouse, if death were to occur immediately after the transfer. Since the assets of a GRAT are includable in the estate of the grantor if he or she dies during the GRAT term, the ETIP with respect to the GRAT in PLR 200644001 terminated on Date 2.

Taxpayer represented that it was his intention, based on the advice of the law firm involved in the implementation of the GRAT, to make the election out of the automatic GST exemption allocation rules with respect to all transfers by Taxpayer to the GRAT. Nevertheless, neither Accounting Firm 1 – which prepared the timely filed Federal gift-tax return reporting Taxpayer’s transfer to the GRAT -- nor Accounting Firm 2 -- which prepared and filed Taxpayer’s Federal gift tax return for Year 2, the year in which the estate tax inclusion period (“ETIP”) terminated, made the election out of the automatic GST exemption allocation rules for all transfers by Taxpayer to the GRAT. Taxpayer requested, and the Revenue Service granted, an extension of time to make the election out of the automatic GST Exemption allocation rules under the provisions of Regs. §301.9100-3 with respect to all transfers to Trust, including at the termination of the ETIP.

PLR PLR200644001 is illustrative of the complexity of the GST Exemption allocation rules since, despite the fact that both the gift tax return filed to report the initial transfer to the GRAT, as well as the gift tax returns for the year in which the ETIP terminated were prepared by accounting firms, the proper elections were not made. These types of errors can be particularly fatal in the case of a GRAT, since the automatic allocation of exemption at the end of the GRAT term likely will result in the allocation of an amount of the grantor’s exemption that is equal to the appreciated value of the assets in the trust, as opposed to their value at the beginning of the trust term.