

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

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Date:

September 29, 2000

LEGEND:

Donor:

Trust:

Trustee:

Beneficiaries:

year 1:

year 2:

date 1:

date 2:

a:

b:

c:

Dear :

We received your letter dated January 12, 2000, submitted on behalf of Trustee

requesting a ruling regarding the automatic allocation of Donor's generation-skipping transfer (GST) exemption to Trust each time Donor made a gift to Trust, pursuant to § 2632. This letter responds to your request.

On date 1, Donor created Trust to fund post-high school educational expenses for the Beneficiaries, Donor's grandchildren now living or born subsequent to the execution of the Trust agreement. Currently, Trust has b Beneficiaries.

Donor entered into the Trust Agreement with three named individuals and collectively referred to the three named individuals as Trustee. Article Ninth of Trust provides that in the event of the death, disability, resignation, failure or refusal to act of a co-trustee the remaining co-trustees shall select a successor trustee to fill the vacancy. If the co-trustee who is no longer able to serve was a non-family member, a non-family member shall be chosen to replace him. If the co-trustee who is no longer able to serve was a family member, a family member shall be chosen to replace her.

Paragraph (a) of Article Second of the trust agreement directs the Trustee to hold, manage, invest and reinvest the trust estate as follows:

The Trustee may distribute to or apply for the sole benefit of a Beneficiary so much of the net income and principal, at such time or times and in such amounts and manner, as the Trustee, in the Trustee's sole discretion, shall determine to provide for said beneficiary's post-high school educational expenses. Any amount which the Trustee shall determine not to use may be accumulated as income or may be added to the principal, as the Trustee shall deem best. However, the Trustee shall not make such distributions during the period that the trust property may be withdrawn from this Trust pursuant to the exercise of a power granted hereinafter to withdraw Trust property. The Trustee may vary the distributions of net income and/or principal to or for the benefit of such Beneficiaries as their educational needs aforesaid may respectively appear, there being no requirement that such distributions need be made equally to such Beneficiaries, either as to amounts or frequency.

Paragraph (b) of Article Second provides that each of Donor's grandchildren may, by written demand delivered to the Trustee at any time during their lives, require the Trustee to distribute to them, or as each of them may appoint to others, such amounts from additions to the principal of the Trust (other than Trust income added to Trust principal), from time to time, so that the aggregate amount that each such Beneficiary may withdraw or appoint does not exceed in any one calendar year the lesser amount of: (i) Five Thousand Dollars (\$5,000.00); or (ii) the principal so added to the Trust during the calendar year (other than income added to principal) multiplied by a fraction the numerator of which is one (1) and the denominator of which is the number of persons that are Beneficiaries of the Trust at such time and entitled to exercise this right of withdrawal or appointment.

Under paragraph (b) of Article Second, the donor of a transfer to this Trust shall have the right by a written instrument delivered to the Trustee at the time of such transfer (i) to exclude any person who would otherwise have a power of withdrawal from

exercising such power; (ii) to increase or decrease the amount subject to any power of withdrawal except that the amount subject to all withdrawal powers shall not exceed the amount of the transfer; and/or (iii) to change the period during which any power of withdrawal may be exercised. Such right to withdraw or appoint shall be exercised within 60 days of the addition to principal. Such right to withdraw or appoint shall be exercised within the calendar year of the addition to principal, if the addition is made to this Trust on or prior to October 31, and shall be exercised within sixty days of the addition if the addition is made after October 31. Subject to provisions hereinafter concerning the release of a general power of appointment, any such right not exercised within such period shall lapse. In order to facilitate the exercise of such right to withdraw or appoint the Trustee is authorized to borrow funds for such Beneficiaries to withdraw or appoint and is authorized to distribute trust assets in kind to permit the exercise of such right to withdraw or appoint.

Paragraph (b) of Article Second further provides that anything in this paragraph to the contrary notwithstanding, if upon the termination of any power of withdrawal, the Beneficiary holding the power would be deemed to have released a general power of appointment for federal gift or estate tax purposes over an amount in excess of that described in §§ 2041(b)(2) or 2514(e) of the Internal Revenue Code of 1986, as amended, or the corresponding provision in any future federal tax law, such power shall continue in existence with respect to the amount that would have been such a release except to the extent it shall thereafter terminate as provided in this paragraph and during the continuance of such power the property subject to such power shall be considered a separate trust share. Such power shall terminate as soon as and to the extent such termination shall not result in a release of a general power of appointment by the Beneficiary holding the power. For purposes of the two preceding sentences, each such power applies with respect to all of the assets out of which, or the proceeds of which, it could be satisfied without regard to any other powers which could be satisfied out of the same assets or proceeds.

Paragraph (b) of Article Second also provides that within ten days after the receipt of any contribution to this Trust, the Trustee shall give written notice of such receipt to all Beneficiaries who, at such time, shall have the right to exercise the withdrawal rights granted under this paragraph (b) or, if any such Beneficiary is then under a legal disability, to the Beneficiary's Representative then authorized to act on behalf of such Beneficiary; provided, however, if any such Beneficiary or such Beneficiary's Representative is then serving as Trustee or Co-Trustee of this Trust, such Beneficiary and/or such Beneficiary's Representative shall be deemed to have received the notice required hereunder at the time such contribution is received by this Trust. Upon receipt of the notice provided for herein, each such Beneficiary or Beneficiary's Representative shall have sixty days within which to exercise such withdrawal right.

Paragraph (c) of Article Second provides that when the youngest living Beneficiary attains age 27, the trust shall terminate, and all of the Trust property then remaining shall be paid over and distributed to the Beneficiaries then living or to then living descendants of any deceased Beneficiary in such amounts or in equal shares as

the Trustee shall determine, outright and free of trust.

For c years, including year 1 through year 2, Donor transferred assets with an aggregate value of \$a to Trust. Trustee represents that no gift tax returns have been filed and that Donor has not taken any action that would preclude the automatic allocation of Donor's GST exemption to Trust. Trustee also represents that no withdrawals have been made from the Trust since its inception and no distributions have been made to any of the Beneficiaries.

Trustee requests a ruling that (i) even though no gift tax returns have been filed for transfers over the c years, including year 1 through year 2, Donor's GST exemption was allocated automatically to the Trust each time Donor made a gift to the Trust pursuant to § 2632 and (ii) the inclusion ratio of the Trust is zero.

Section 2601 imposes a tax on every GST (within the meaning of subchapter B—generation-skipping transfer).

Section 2602 provides that the amount of the GST tax imposed by § 2601 is the taxable amount multiplied by the applicable rate.

Section 2611(a) provides that the term “generation-skipping transfer” (GST) means--(1) a taxable distribution, (2) a taxable termination, and (3) a direct skip.

Section 2612(c)(1) provides that for purposes of chapter 13 the term “direct skip” means a transfer subject to a tax imposed by chapter 11 or 12 of an interest in property to a skip person.

Section 2613(a) provides that the term “skip person” means—(1) a natural person assigned to a generation that is two or more generations below the generation assignment of the transferor, or (2) a trust—(A) if all interests in the trust are held by skip persons; or (B) if—(i) there is no person holding an interest in the trust, and (ii) at no time after the transfer may a distribution (including distributions on termination) be made from the trust to a non-skip person.

Section 2631(a) provides that, for purposes of determining the inclusion ratio, every individual shall be allowed a GST exemption of \$1,000,000 that may be allocated by the individual (or his executor) to any property with respect to which the individual is the transferor.

Section 2631(b) provides that any allocation under § 2631(a) once made, is irrevocable.

Section 2632(a)(1) provides that any allocation by an individual of his GST exemption under § 2631(a) may be made at any time on or before the date prescribed for filing the estate tax return for the individual's estate (determined with regard to extensions), regardless of whether such a return is required to be filed.

Section 2632(b)(1) provides that if any individual makes a direct skip during his lifetime, any unused portion of such individual's GST exemption shall be allocated to the property transferred to the extent necessary to make the inclusion ratio for such property zero. If the amount of the direct skip exceeds the unused portion, the entire unused portion shall be allocated to the property transferred.

Section 2632(b)(2) provides that for purposes of § 2632(b)(1), the unused portion of an individual's GST exemption is that portion of the exemption that has not previously been allocated by such individual (or treated as allocated under § 2632(b)(1) with respect to a direct skip).

Section 2632(b)(3) provides that an individual may elect to have this subsection not apply to a transfer.

Section 2641 provides that the term "applicable rate" means, with respect to any generation-skipping transfer, the product of the maximum Federal estate tax rate and the "inclusion ratio" with respect to the transfer.

Section 2642(a) provides that except as otherwise provided in this section, the inclusion ratio with respect to any property transferred in a generation-skipping transfer is the excess (if any) of 1 over— (A) except as provided in § 2642(a)(1)(B), the applicable fraction determined for the trust from which such transfer is made, or (B) in the case of a direct skip, the applicable fraction determined for such skip.

Section 2642(a)(2) provides that for purposes of § 2642(a)(1), the applicable fraction is a fraction-- (A) the numerator of which is the amount of the GST exemption allocated to the trust (or in the case of a direct skip, allocated to the property transferred in such skip), and (B) the denominator of which is-- (i) the value of the property transferred to the trust (or involved in the direct skip), reduced by (ii) the sum of-- (I) any Federal estate tax or State death tax actually recovered from the trust attributable to such property, and (II) any charitable deduction allowed under § 2055 or 2522 with respect to such property.

Section 2652(a)(1) provides that, except as provided in § 2653(a), the term "transferor" means: (A) in the case of any property subject to the tax imposed by chapter 11, the decedent, and (B) in the case of any property subject to the tax imposed by chapter 12, the donor. An individual shall be treated as transferring any property with respect to which such individual is the transferor.

Section 2652(c)(1) provides that a person has an interest in property held in trust, if (at the time the determination is made) such person has a right (other than a future right) to receive income or corpus from the trust, is a permissible current recipient of income or corpus from the trust and is not described in § 2055(a), or is described in § 2055(a) and the trust is--a charitable remainder annuity trust, a charitable remainder unitrust within the meaning of § 664, or a pooled income fund within the meaning of § 642(c)(5).

Section 26.2632-1(b)(1)(i) provides, in general, that if a direct skip occurs during the transferor's lifetime, the transferor's GST exemption not previously allocated (unused GST exemption) is automatically allocated to the transferred property (but not in excess of the fair market value of the property on the date of the transfer). The transferor may prevent the automatic allocation of GST exemption by describing on a timely-filed United States Gift (and Generation-Skipping Transfer) Tax Return (Form 709) the transfer and the extent to which the automatic allocation is not to apply. In addition, a timely filed Form 709 accompanied by payment of the GST tax (as shown on the return with respect to the direct skip) is sufficient to prevent an automatic allocation of GST exemption with respect to the transferred property.

Section 26.2632-1(b)(1)(ii) provides that a Form 709 is timely filed if it is filed on or before the date required for reporting the transfer if it were a taxable gift (i.e., the date prescribed by § 6075(b), including any extensions to file actually granted (the due date)). Except as provided in § 26.2632-1(b)(1)(iii), the automatic allocation of GST exemption (or the election to prevent the allocation, if made) is irrevocable after the due date. An automatic allocation of GST exemption is effective as of the date of the transfer to which it relates. Except as provided above, a Form 709 need not be filed to report an automatic allocation.

Based on the information submitted and the representations made, we conclude that (i) even though no gift tax returns have been filed for transfers over the c years, including year 1 through year 2, Donor's unused GST exemption was allocated automatically to the Trust each time Donor made a gift to the Trust. We also conclude that the inclusion ratio of the Trust is zero.

Except as ruled above, we express or imply no opinion concerning the federal tax consequences of this transaction under the cited provisions or any other provision of the Code. We are expressing no opinion regarding the value of the transfers to Trust or whether the transfers qualified for the annual exclusion under § 2503(b).

This letter ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,
Christine E. Ellison
Branch Chief, Branch 7
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)