

## Internal Revenue Service

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## Department of the Treasury

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CC:DOM:P&SI:4 - PLR-114454-99

Date: March 31, 2000

Re:

### LEGEND:

Donor =

State =

B =

C =

D =

Trust B =

Trust C =

Trust D =

\$p =

\$q =

\$r =

\$s =

\$t =

\$v =

\$w =

\$z =

Bank =

Dear :

This is in response to your authorized representative's letter dated August 23, 1999, requesting a ruling concerning the allocation of Generation-Skipping Transfer Tax (GSTT) exemption under § 2632 of the Internal Revenue Code.

The facts and representations submitted are summarized as follows: In 1994, Donor established three trusts, Trust B, Trust C, and Trust D, one for the benefit of each of Donor's three children, B, C, and D and their respective families. Each trust was funded with \$z in assets.

Under the terms of the trust established for B, ( the "B Trust"), until Date 1, the trustee is to accumulate the net income of Trust B. After Date 1, the trustee may in its uncontrolled discretion, pay income to or for the benefit of B, B's spouse and B's issue. Any net income that is not distributed in any fiscal year is to be added to the corpus of the trust. In addition, after Date 1, trustee may in its uncontrolled discretion, pay or apply the principal of Trust B to or for the benefit of the group comprised of B, and B's issue.

Unless Trust B is earlier terminated as a consequence of the trustee's uncontrolled discretion to distribute income and corpus, Trust B will terminate on the later to occur of (1) the death of the survivor of B and B's spouse or (2) the date on which all of the children of B have reached the age of 30 years or have previously died. Upon termination, the trustee is to distribute the remaining principal and undistributed income of the trust, per stirpes, to the then living issue of B, and in default of such issue, per stirpes, to Donor's then living issue.

Trust C, for the benefit of C, is substantially similar to Trust B, except that the trustee is authorized to distribute income and principal to C and C's issue. Trust D, for the benefit of D, is substantially similar to Trust B, except that the trustee is authorized to distribute income and principal to D, D's spouse and D's issue.

In January 1995, Donor timely filed Form 709 United States Gift (and Generation-Skipping Transfer) Tax Return with respect to the 1994 transfers. Schedule A, of the Form 709 is titled Computation of Taxable Gifts. On Schedule A, Part 1, Donor reported one-third of the value of Trusts B and C and one-half of the value of Trust D as, "Gifts Subject Only to Gift Tax". On Part 2 of Schedule A, Donor reported the balance of the transfer to each trust (two-thirds, i.e., \$w, of Trusts B and C and one-half, i.e., \$v, of Trust D) as "Gifts That are Direct Skips and are Subject to Both Gift Tax and Generation-Skipping Transfer Tax." Donor did not attach a "Notice of Allocation of Generation-Skipping Transfer Tax Exemption" to the return. Instead, on Schedule C, Computation of Generation-Skipping Transfer Tax, in Part 1, Generation-Skipping

Transfers, Donor reported the same amounts that were reported on Part 2 of Schedule A (as gifts that are direct skips and subject to both gift tax and GSTT). On Part 3, Tax Computation, of Schedule C, Donor reported an allocation of GST exemption to each of the three trusts in the same amount reported as a GSTT on Schedule C, Part 1; i.e.: \$w with respect to Trust B; \$w with respect to Trust C; and \$v with respect to Trust D. Donor also reported in Column E of Schedule C, Part 3, a “zero” inclusion ratio with respect to each transfer.

It is represented that it was Donor’s intention to allocate to Trust B, Trust C, and Trust D, a sufficient amount of Donor’s GSTT exemption, within the meaning of § 2632, to produce an inclusion ratio of zero for each of the three trusts.

It is represented that no additional assets were added to Trust B, Trust C, and Trust D, in 1995, 1996, or 1997. However, on July 22, 1998, Donor transferred \$p to each trust. These transfers were reported on a timely filed gift tax return filed on April 13, 1999. With this return, Donor filed a notice of allocation with respect to these transfers allocating \$p of GST exemption to each of Trust B, C, and D. In addition, on the return, Donor made a “protective” late allocation of GST exemption with respect to the gifts made in 1994, discussed below.

The following rulings are requested:

1) The allocation of GSTT exemption to Donor’s 1994 gifts on the federal gift tax return reporting these transfers filed in 1995, substantially complies with the requirements for making an allocation of GST exemption with respect to the amounts allocated on the return.

2) The “protective” late allocation made by Donor on the return filed on April 13, 1999 with respect to Donor’s 1994 transfers to Trusts B, C, and D substantially complies with the requirements for making a late allocation within the meaning of section 26.2632-1(b)(ii)(2) and the late allocation produces a zero inclusion ratio with respect to these transfers.

Section 2601 imposes a tax on every generation-skipping transfer. A generation-skipping transfer (GST) is defined under § 2611(a) as (1) a taxable distribution, (2) a taxable termination, and (3) a direct skip.

Section 2612(c)(1) provides that 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 a natural person assigned to a generation that is 2 or more generations below the generation assignment of the transferor, or a trust if all interests in the trust are held by skip persons.

Section 26.2612-1(d) of the Generation-Skipping Transfer Tax (GSTT) Regulations provides, in part, that a skip person is a trust if (i) all interests in the trust are held by skip persons; or (ii) no person holds an interest in the trust and no distributions, other than a distribution the probability of which occurring is so remote as to be negligible (including distributions at the termination of the trust), may be made after the transfer to a person other than a skip person.

Under § 2602, the amount of the GSTT is determined by multiplying the amount of the generation-skipping transfer by the "applicable rate." Under § 2641, the applicable rate with respect to any generation-skipping transfer is the product of the maximum federal estate tax rate and the "inclusion ratio" with respect to the transfer. Section 2642(a) defines the inclusion ratio, in the case of a transfer from a trust, as the excess of 1 over the applicable fraction with respect to the trust. The applicable fraction, with respect to trust is a fraction, the numerator of which is the amount of GST exemption allocated to the trust, and the denominator of which is the value of the property transferred to the trust (reduced as provided in the section.)

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) 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 26.2632-1(b)(2)(i) provides that an allocation of GST exemption to property transferred during the transferor's lifetime, other than in a direct skip, is made on Form 709. The allocation must clearly identify the trust to which the allocation is made, the amount of GST exemption allocated to it, and if the allocation is late or an inclusion ratio greater than zero is claimed, the value of the trust assets at the effective date of the allocation. The allocation should also state the inclusion ratio of the trust after the allocation. Generally, an allocation of GST exemption may be expressed by a formula; e.g., the allocation may be expressed in terms of the amount necessary to produce an inclusion ratio of zero. An allocation is void if the allocation is made with respect to a trust that has no GST potential with respect to the transferor making the allocation, at the time of the allocation. For this purpose, a trust has GSTT potential even if the possibility of a generation-skipping transfer is so remote as to be negligible.

Section 26.2632-1(b)(2)(ii)(A)(1)(i) provides that generally an allocation of GST exemption is effective as of the date of any transfer as to which the Form 709 on which it is made is a timely filed return (a timely allocation). With respect to a timely allocation, an allocation of GST exemption becomes irrevocable after the due date of

the return. An allocation to a trust made on a Form 709 filed after the due date for reporting a transfer to a trust (a late allocation) is effective on the date the Form 709 is filed and is deemed to precede in point of time any taxable event occurring on such date.

Under § 26.2632-1(b)(ii)(2), a late allocation to a trust may be made on a Form 709 that is timely filed with respect to another transfer. A late allocation is irrevocable when made.

Under § 2642(b)(1), if the allocation of the GST exemption is made on a timely filed gift tax return, then for purposes of determining the inclusion ratio under § 2642(a), the value of the property transferred to the trust is the value of the property for gift tax purposes. Under § 2642(b)(3), if the allocation is not made on a timely filed gift tax return, then for purposes of determining the inclusion ratio, the value of the property is the value as of the date the allocation is filed.

Under § 26.2642-4(a), the applicable fraction for a trust is redetermined whenever additional exemption is allocated to the trust. Generally, the numerator of the redetermined applicable fraction is the sum of the amount of GST exemption currently being allocated to the trust (if any) plus the value of the nontax portion of the trust, and the denominator of the redetermined applicable fraction is the value of the trust principal immediately after the event occurs. The nontax portion of a trust is determined by multiplying the value of the trust assets, determined immediately prior to the event, by the then applicable fraction.

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.

#### Ruling #1.

Under section 26.2632-1(b)(2)(i), an allocation of GST exemption to property transferred during the transferor's lifetime, other than in a direct skip, is to be made on Form 709. The allocation must clearly identify the trust to which the allocation is made and the amount of GST exemption allocated to it. The allocation should also state the inclusion ratio of the trust after the allocation.

With respect to allocations of GSTT exemption to property transferred during life, other than in a direct skip, the instructions for Form 709 that were applicable to the return filed by Donor in 1995, state:

You may wish to allocate your exemption to transfers made in trust that are not direct skips. For example, if you transferred property to a trust that has your children as its present beneficiaries and your grandchildren as future beneficiaries, the transfer was not a direct skip because the present interests in the trusts are held by non-skip persons. However, future terminations and distributions made from this trust would be subject to GST tax. You may elect to reduce the trust's inclusion ratio by allocating part or all of your exemption to the transfer. Because this transfer would be entered on Schedule A, Part I [of Form 709], it will not be shown on Schedule C (emphasis added). To allocate your exemption to such transfers, attach a statement to the Form 709 and entitle it "Notice of Allocation."

The notice should contain the following for each trust:

1. The trust's EIN, if known;
2. The item number(s) from column A, Schedule A, Part 1, of the gifts to that trust;
3. The values shown in column E, Schedule A, Part 1, for gifts (adjusted to account for split gifts, if any, reported on Schedule A, Part 3, line 2);
4. The annual exclusion claimed against each gift;
5. The net value of each gift after the reduction for the annual exclusion, if applicable; and
6. The amount of your GST exemption allocated to each gift.

In the present case, Donor did not literally comply with the instructions on Form 709. On the federal gift tax return filed in January, 1995, Donor incorrectly reported one-third of the transfers to Trusts B and C and one-half of the transfer to Trust D, on Part 1 of Schedule A, as "Gifts Subject Only to Gift Tax". On Part 2 of Schedule A, Donor improperly reported the balance of the transfer to each trust (two-thirds, or \$w, to Trusts B and C and one-half, or \$v, to Trust D) as "Gifts That are Direct Skips and are Subject to Both Gift Tax and Generation-Skipping Transfer Tax." On Schedule C, Computation of Generation-Skipping Transfer Tax, in Part 1, Generation-Skipping Transfers, Donor reported the same amounts that were reported on Part 2 of Schedule A as gifts that are direct skips and subject to both gift tax and GSTT. On Part 3, Tax Computation, of Schedule C, Donor reported an allocation of GST exemption to each of the three trusts in the same amount reported as GSTTs on Schedule C, Part 1. Donor

also reported on Schedule C, Part 3, Column E, a “zero” inclusion ratio with respect to each GSTT transfer. In addition, donor failed to attach to the gift tax return reporting the 1994 transfers, a Notice of Allocation of GST exemption, as is required by the Instructions for Form 709.

Literal compliance with the procedural instructions to make an election is not always required. Elections may be held to be effective where the taxpayer complied with the essential requirements of a regulation (or of the instructions to the applicable form) even though the taxpayer failed to comply with certain procedural directions therein. See Hewlett-Packard Company v. Commissioner, 67 T.C. 736, 748 (1977) acq. in result, 1979-1 C.B. 1. The allocation will be deemed valid if there are enough facts and circumstances to indicate that the Donor intended to allocate part of his GST exemption to the B, C, and D Trusts.

We believe that there is sufficient information provided in Donor’s gift tax return filed in January 1995 to conclude that Donor allocated part of his GST exemption to the Trusts B, C, and D. Donor reported the 1994 transfers on Schedule C, of the Form 709. On Schedule C, Part 1 (entitled: “Generation-Skipping Transfers” ) Donor reported two-thirds of Trusts B and C and one-half of Trust D as generation-skipping transfers. On Schedule C, Part 2, (“GST Exemption Reconciliation”), line 4 (Exemption claimed on this return) the Donor entered the sum of the amounts reported on Schedule C, Part 1. On Schedule C, Part 3, Column C (GST Exemption Allocated) the Donor entered \$w for Trust B, \$w for Trust C, and \$v for Trust D. In addition, the Donor attached a statement to the return that provided the trusts’ employer identification numbers and the value of the property transferred to each of the three trusts. Accordingly, we conclude that Donor substantially complied with the requirements for making an allocation of GST exemption for the transfers to Trusts B, C, and D, in the amounts stated on Schedule C, Part 3, Column C on the gift tax return filed in January 1995. Donor is, therefore, treated as having timely allocated GST exemption of \$w to Trust B, \$w to Trust C, and \$v to Trust D on the gift tax return filed in January 1995, with respect to the transfers made in 1994.

#### Ruling #2.

On a Form 709 timely filed on April 13, 1999, reporting the 1998 transfers to the trusts, Donor allocated an additional \$p of GST exemption to each trust. Also, on the return, Donor made a “protective” late allocation of GST exemption to each of Trusts B, C, and D. The Form 709 contained a Notice of Allocation that stated that, to the extent that the taxpayer failed to claim a GST Exemption allocation sufficient to produce inclusion ratios of zero for each of the transfers made in 1994, the taxpayer hereby makes a late allocation of his GST Exemption to the trusts in the total amount of \$t or such amount as is necessary to produce an inclusion ratio of zero for all three of the trusts. The statement indicated the specific amount allocated to each trust based on the formula. Donor elected to treat the late allocation as having been made as of April

1, 1999 for purposes of valuing the trust assets to determine the inclusion ratio. See, § 26.2642-2(a)(2).

Based on the representations regarding the value of the assets transferred to each trust in 1994, and the value of the assets of each trust on July 22, 1998, and April 1, 1999, and based on the formula provided in the Notice of Allocation, allocating sufficient GST exemption to each trust to produce a zero inclusion ratio for each trust, we conclude that: (1) \$q of GST exemption was allocated to Trust B; (2) \$r of GST exemption was allocated to Trust C; and (3) \$s of GST exemption was allocated to Trust D, effective on April 1, 1999. Accordingly, based on the above noted representations, as a result of the timely and late allocations made on the return filed on April 13, 1999 and the previous allocations to the three trusts made on the return filed in January 1995, the inclusion ratio with respect to Trust B, Trust C, and Trust D, is zero. Any excess amount that Donor has allocated is void. We express no opinion regarding the value of the property transferred to the trusts in 1994, or the value of the trusts on July 22, 1998 or April 1, 1999.

Except as we have specifically ruled herein, we express no opinion as to the consequences of this transaction under the cited provisions or under any other provisions of the Code.

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

Sincerely yours,  
Assistant Chief Counsel  
(Passthroughs and Special Industries)  
By George Masnik  
Chief, Branch 4

Enclosure

Copy for section 6110 purpose