

## Internal Revenue Service

## Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

**CC:PSI:4-PLR-144567-01**

Date:

**SEPTEMBER 27, 2002**

Re:

### LEGEND:

Taxpayer	-
Spouse	-
Child 1	-
Child 2	-
Child 3	-
Trust	-
Subtrust 1	-
Subtrust 2	-
Subtrust 3	-
Year 5 Subtrust 1	-
Year 5 Subtrust 2	-
Year 5 Subtrust 3	-
Company	-
Accountants	-
Date 1	-
Date 2	-
Date 3	-
Date 4	-
Year 1	-
Year 2	-
Year 3	-
Year 4	-
Year 5	-
Year 6	-
Year 7	-
Year 8	-
a shares	-
m dollars	-

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Dear \_\_\_\_\_ :

This is in response to the letter from your authorized representative, dated May 24, 2002, and prior correspondence, requesting an extension of time under § 301.9100-3 of the Procedure and Administration Regulations to make an allocation of generation-skipping transfer (GST) tax exemption. This letter responds to your request.

The facts and representations submitted are summarized as follows: On Date 1, Taxpayer and Spouse established Trust, an irrevocable trust, for the benefit of their three children, Child 1, Child 2, and Child 3, and the children's descendants.

Section II(a) of Trust directs the trustee to divide the trust estate into 3 equal shares, one for each of the children, and hold each share in a separate subtrust for the benefit of that child and that child's descendants. The trustee has complete discretion to distribute income and/or corpus to each beneficiary to provide for that beneficiary's health, education, maintenance and support in accordance with the beneficiary's station in life. In addition, each beneficiary has a noncumulative right to withdraw annually from the applicable subtrust, an amount equal to the amount of gifts made to the subtrust limited by the annual gift tax exclusion amount on gifts made to the subtrust in that year, not to exceed the greater of \$5,000 or 5 percent of the value of that subtrust corpus.

Section III(a) provides that each of the subtrusts will terminate upon the death of the last to die of the descendants of Taxpayer and Spouse living at the date of execution of the Trust. Subsection (b) provides that in the event of the death of a designated beneficiary prior to termination of the subtrust and final distribution of the trust assets, such subtrust will continue for the use and benefit of that beneficiary's descendants by right of representation. If that beneficiary is not survived by any descendants, the subtrust will continue for the use and benefit of the living descendants of Taxpayer and Spouse by right of representation.

Upon final termination, the trust estate of each subtrust will be distributed to the beneficiaries of that subtrust. However, if the trust estate would be distributed to any beneficiary who is either under age 21 or suffering under a legal disability, the trust estate will be retained by the trustee for the benefit of the beneficiary until the beneficiary attains age 21 or recovers from the legal disability.

Section IV(v) of Trust provides that, if the trustee considers any distribution or termination of an interest or power in Trust as a distribution or termination subject to the generation-skipping transfer (GST) tax, the trustee may take certain steps to ensure payment of the tax from the share of the Trust to which the tax relates, to take into consideration deductions, exemptions, credits and other factors in the event of a termination, and to postpone final termination of any particular trust until the trustee is satisfied that no GST tax liability exists.

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Pursuant to the direction in Section II(a), Trust was divided into three subtrusts; Subtrust 1, Subtrust 2, and Subtrust 3, for the benefit of Child 1, Child 2, and Child 3, respectively. On Date 1, in Year 1, Taxpayer and Spouse funded the subtrusts with a shares of stock in Company with an approximate value of m dollars.

Prior to filing separate federal gift tax returns for the transfers made by Taxpayer and Spouse during Year 1, the trustee had Accountants, an accounting firm, review the gift tax returns for both Taxpayer and Spouse. On or before Date 2, Taxpayer and Spouse timely reported these gifts on separate Form 709 United States Gift (and Generation-Skipping Transfer) Tax Returns. On the gift tax returns, which were reviewed by Accountants, the transfers to the subtrusts were listed on Schedule A, Part 1, as gifts that were subject only to gift tax. In addition to the transfer to Subtrusts 1, 2 and 3, Taxpayer and Spouse transferred stock in Company to four separate trusts, one for the benefit of each of their four grandchildren. On the gift tax returns, the transfers to the four trusts for the benefit of the grandchildren were listed on Schedule A, Part 2 as gifts that were direct skips and subject to both the gift and GST tax. Both Taxpayer and Spouse allocated a portion of their available GST Tax exemption on Schedule C, Part 2 to the transfers to the four separate trusts for the benefit of the four grandchildren. However, no GST Tax exemption was allocated by either Taxpayer or Spouse to the transfer to Subtrusts 1, 2 and 3, and no Notice of Allocation with respect to the transfer to the subtrusts was filed with either gift tax return.

You also represent that Taxpayer and Spouse made additional transfers to Subtrust 1, Subtrust 2, and Subtrust 3, for the benefit of Child 1, Child 2, and Child 3, respectively, during Year 2, Year 3, Year 4 and Year 5. However, on the basis of the advice from Accountants given in regard to the Year 1 transfer, neither Taxpayer nor Spouse filed Federal gift tax returns for Years 2 - 4 because the value of each of the transfers to the subtrusts was below the gift tax annual exclusion amount in each year.

In Year 5, Taxpayer and Spouse engaged new attorneys who, while reviewing the gift tax returns filed by Taxpayer and Spouse reporting the transfers in Year 1, discovered that no GST exemption had been allocated to the gifts made by Taxpayer and Spouse to Subtrusts 1, 2 and 3 during that year.

You represent that, upon review of the Year 1 transfer, the determination was made in Year 5 that, if Taxpayer and Spouse had allocated their available GST exemptions on the gift tax returns for Year 1 to the transfers to the subtrusts, there would have been sufficient available GST exemption to cover the entire value of the transfers. However, due to the appreciation in the value of the assets of Subtrust 1, 2 and 3, between Year 1 and Year 5, a determination was made that a late allocation of Taxpayer's and Spouse's GST exemption would exhaust all remaining GST exemption and still leave a portion of the subtrusts subject to eventual GST tax.

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In order to mitigate further damage, the trustee of the subtrusts took curative measures on the advice of the attorneys. Pursuant to that advice, three new subtrusts (Year 5 Subtrust 1, Year 5 Subtrust 2, and Year 5 Subtrust 3) were established for the benefit of Child 1, Child 2, and Child 3, respectively, with terms and conditions that were substantially identical to Subtrust 1, Subtrust 2, and Subtrust 3 established in Year 1. The subtrusts established in Year 1 were then merged into their respective subtrusts established in Year 5; i.e., Subtrust 1 was merged into Year 5 Subtrust 1, Subtrust 2 was merged into Year 5 Subtrust 2, and Subtrust 3 was merged into Year 5 Subtrust 3. The new subtrusts; Year 5 Subtrust 1, Year 5 Subtrust 2, and Year 5 Subtrust 3; were then each divided into two separate trusts, one that would be exempt from GST tax and the other that would not be exempt from GST tax. As a result of the merger and division, each of the resulting six trusts was then funded with corpus from the respective Year 5 Subtrust, so that Child 1, Child 2, and Child 3 were each the beneficiary of two trusts.

Taxpayer and Spouse then filed amended Year 1 Federal gift tax returns. A Notice of Allocation of Generation-skipping Transfer Tax Exemption was attached to these returns pursuant to which Taxpayer and Spouse made a late allocation of GST tax exemption with respect to the three Year 5 exempt subtrusts.

In Year 6 and Year 7, Taxpayer and Spouse transferred shares of Company stock to the three Year 5 non-exempt subtrusts established for the benefit of Child 1, Child 2 and Child 3. They also made transfers either directly to or in trust for the benefit of their four grandchildren. In Year 8, Taxpayer and Spouse transferred cash to the three Year 5 non-exempt subtrusts, and Taxpayer and Spouse made gifts either directly to or in trust for the benefit of their four grandchildren. These gifts were reported on timely filed gift tax returns. Taxpayer and Spouse believed that their available GST Tax exemption had been exhausted as a result of the late allocations made in Year 5. Accordingly, no GST Tax exemption was available to be allocated to the transfers made in Year 6 and to the Year 5 non-exempt subtrusts in Years 7 - 8.

Spouse died on Date 4, in Year 8.

You have requested the following rulings:

(1) That Taxpayer and the estate of Spouse are granted an extension of time under § 2642(g) of the Internal Revenue Code and §§ 301.9100-1 and 301.9100-3 to make an allocation of Taxpayer's GST Tax exemption and Spouse's GST Tax exemption with respect to the transfers to Subtrusts 1, 2 and 3 on Date 1; and that such allocation shall be made based on the value of the property transferred to Subtrusts 1, 2 and 3, as of Date 1.

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(2) The severance of Trust is not recognized for GST purposes, including for purposes of making a late allocation of the GST Tax exemption.

(3) The late allocation made in Year 5 will be deemed void or ineffective because, pursuant to the request for an extension of time to make a timely GST allocation, Taxpayer and the estate of Spouse are treated as having made a timely allocation of the GST Tax exemption as of the date of the transfer.

(4) The automatic allocation provision under § 26.2632-1(d)(2) as it applies to Spouse's estate is suspended until after the determination of the request for an extension of time under § 2642(g) and §§ 301.9100-1 and 301.9100-3 to make an allocation of Taxpayer's GST Tax exemption and Spouse's GST Tax exemption.

Section 2501(a) imposes a tax on the transfer of property by gift during each calendar year by any individual.

Section 2513(a)(1) provides that a gift made by one spouse to any person other than his spouse shall, for purposes of chapter 12, be considered as made one-half by him and one-half by his spouse, but only if at the time of the gift each spouse is a citizen or resident of the United States. Section 2513(a)(2) provides that paragraph (1) shall apply only if both spouses have signified their consent to the application of paragraph (1) in the case of all such gifts during the calendar year by either while married to the other.

Section 2513(b)(2)(A) provides that the consent under section 2513(a)(2) may be signified at any time after the close of the calendar year in which the gift was made. The consent may not be signified after the 15th of April following the close of such year, unless before such 15th day no return has been filed for such year by either spouse, in which case the consent may not be signified after a return for such year is filed by either spouse. Thus, if a late return is filed, the consent must be made on the first return filed for such year.

Section 25.2513-2(c) of the Gift Tax Regulations provides that the executor or administrator of a deceased spouse may signify the consent under section 2513(a)(2).

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

Section 2602 provides that the amount of the tax is the taxable amount multiplied by the applicable rate. Section 2641(a) defines "applicable rate" as the product of the maximum federal estate tax rate and the inclusion ratio with respect to the transfer.

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Under § 2642(a)(1), the inclusion ratio with any property transferred in a generation-skipping transfer is generally defined as the excess of 1 over the “applicable fraction.” The applicable fraction, as defined in § 2642(a)(2), is a fraction, the numerator of which is the amount of GST exemption under § 2631 allocated to the trust (or to property transferred in a direct skip), and the denominator is the value of the property transferred to the trust or involved in the direct skip.

Section 2631(a) provides that, for purposes of determining the inclusion ratio, every individual shall be allowed a GST exemption of \$1,000,000 (adjusted for inflation under § 2631(c)) which may be allocated by such individual (or his executor) to any property with respect to which such individual is the transferor. Section 2631(b) provides that any allocation under § 2631(a), once made, shall be irrevocable.

Section 2632(a) provides that any allocation by an individual of his or her GST exemption under § 2631(a) may be made at any time on or before the date prescribed for filing the estate tax return for such 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) of the Generation-skipping Transfer Tax Regulations 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. In general, an allocation of GST Tax exemption is void to the extent the amount allocated exceeds the amount necessary to obtain a zero inclusion ratio with respect to the trust.

Under § 2632(e)(1) and § 26.2632-1(d)(2), a decedent’s unused GST exemption is automatically allocated on the due date for filing the decedent’s federal estate tax return to the extent not otherwise allocated by the decedent’s executor on or before that date. The automatic allocation of GST exemption is irrevocable and an allocation made by the executor after the automatic allocation is made is ineffective. No automatic allocation is made to a trust to the extent of the non-exempt portion of the trust (the value at the time of allocation of the trust multiplied by the inclusion ratio with respect to the trust). Section 2632(e)(2).

Section 2652(a)(2) provides that if, under § 2513, one-half of a gift is treated as made by an individual and one-half of such gift is treated as made by the individual’s spouse, then such gift shall be so treated for GST purposes.

Section 2642(b)(1) provides that, except as provided in § 2642(f), if the allocation of the GST exemption to any transfers of property is made on a gift tax return filed on or before the date prescribed by § 6075(b) for such transfer or is deemed to be made under § 2632(b)(1) or (c)(1) the value of such property for purposes of § 2642(a) shall be its value as finally determined for purposes of chapter 12 (within the meaning of § 2001(f)(2)), or, in the case of an allocation deemed to have been made at the close of an estate tax inclusion period, its value at the time of the close of the estate tax

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inclusion period. Such allocation shall be effective on and after the date of such transfer, or, in the case of an allocation deemed to have been made at the close of an estate tax inclusion period, on and after the close of such estate tax inclusion period.

Section 2642(g)(1)(A) provides, generally, that the Secretary shall by regulation prescribe such circumstances and procedures under which extensions of time will be granted to make an allocation of GST exemption described in § 2642(b)(1) or (2), and an election under § 2632(b)(3) or (c)(5). Such regulations shall include procedures for requesting comparable relief with respect to transfers made before the date of the enactment of this paragraph.

Section 2642(g)(1)(B) provides that in determining whether to grant relief under this paragraph, the Secretary shall take into account all relevant circumstances, including evidence of intent contained in the trust instrument or instrument of transfer and such other factors as the Secretary deems relevant. For purposes of determining whether to grant relief under this paragraph, the time for making the allocation (or election) shall be treated as if not expressly prescribed by statute.

Notice 2001-50, 2001-34 I.R.B. 189, provides that, under § 2642(g)(1)(B), the time for allocating the GST exemption to lifetime transfers and transfers at death, the time for electing out of the automatic allocation rules, and the time for electing to treat any trust as a generation-skipping transfer trust are to be treated as if not expressly prescribed by statute. The Notice further provides that taxpayers may seek an extension of time to make an allocation described in § 2642(b)(1) or (b)(2) or an election described in § 2632(b)(3) or (c)(5) under the provisions of § 301.9100-3.

Requests for relief under § 301.9100-3 will be granted when the taxpayer provides the evidence to establish to the satisfaction of the Commissioner that the taxpayer acted reasonably and in good faith, and that granting relief will not prejudice the interests of the government.

Section 301.9100-3(b)(1)(v) provides that a taxpayer is deemed to have acted reasonably and in good faith if the taxpayer reasonably relied on a qualified tax professional, including a tax professional employed by the taxpayer, and the tax professional failed to make, or advise the taxpayer to make, the election.

Section 301.9100-3 provides the standards used to determine whether to grant an extension of time to make an election whose date is prescribed by a regulation (and not expressly provided by statute). In accordance with § 2642(g)(1)(B) and Notice 2001-50, taxpayers may seek an extension of time to make an allocation described in § 2642(b)(1) or (b)(2) or an election described in § 2632(b)(3) or (c)(5) under the provisions of § 301.9100-3.

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Based on the facts submitted and the representations made, we conclude that the requirements of § 301.9100-3 have been satisfied. Therefore, Taxpayer and the estate of Spouse are granted an extension of time of 60 days from the date of this letter to make an allocation of Taxpayer's and Spouse's GST Tax exemption that was available at the time of the transfers on Date 1, with respect to Taxpayer's and Spouse's transfers to Subtrust 1, Subtrust 2, and Subtrust 3. The allocation will be effective as of Date 1, the date of the transfers to the subtrusts, and the gift tax value of the transfers to Subtrusts 1, 2 and 3 will be used in determining the amount of GST Tax exemption to be allocated to the subtrusts.

By separate letter, issued simultaneously with this ruling, Taxpayer and the estate of Spouse were granted an extension of time to make allocations of Taxpayer's and Spouse's available GST Tax exemption with respect to transfers made to Subtrust 1, Subtrust 2, and Subtrust 3 in Year 2, Year 3, Year 4 and Year 5, and with respect to transfers to the Year 5 non-exempt subtrusts in Years 6 - 8.

The creation, in Year 5, of the Year 5 Subtrusts and the severance of the Year 5 Subtrusts into GST Tax exempt subtrusts and GST Tax nonexempt subtrusts was valid and effective under state law.

Assuming that Taxpayer and Spouse had sufficient available GST Tax exemption and assuming sufficient GST Tax exemption is allocated with respect to the transfers made to Subtrusts 1, 2 and 3 in Years 1 - 5 pursuant to the relief granted herein and in the separate letter ruling, the allocations will be deemed timely. Therefore, immediately prior to the severance in Year 5, Subtrusts 1, 2 and 3 will be deemed to have a zero inclusion ratio for GST Tax purposes. Similarly, immediately after the severance in Year 5, each of the exempt and nonexempt subtrusts of Year 5 Subtrust 1, Year 5 Subtrust 2, and Year 5 Subtrust 3 will have a zero inclusion ratio for GST Tax purposes.

Further, because all trusts created pursuant to the Year 5 severance will have a zero inclusion ratio immediately after the severance, under § 26.2632-1(b)(2)(i), the late allocation in Year 5 of Taxpayer's and Spouse's available GST exemption is treated as ineffective.

Under the automatic allocation rules set forth in § 2632(e) and § 26.2632-1(d)(2), no automatic allocation is made to a trust if the inclusion ratio of the trust is zero. As discussed above, assuming Taxpayer and the estate of Spouse make timely allocations of their GST Tax exemption pursuant to the relief granted above and in the separate letter ruling, the allocations will be effective as of the date of the original transfers in Years 1 - 8. Consequently, each of the exempt and nonexempt subtrusts created under Year 5 Subtrust 1, Year 5 Subtrust 2, and Year 5 Subtrust 3, will be deemed to have a zero inclusion ratio prior to the date of Spouse's death. Thus, no



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portion of Spouse's available GST Tax exemption will be treated as automatically allocated to the subtrusts under § 2632.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Except as specifically ruled herein, we express or imply no opinion on the federal tax consequences of the transaction under the cited provisions or under any other provisions of the Code.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent. This election should be made on a supplemental Form 709 United States Gift (and Generation-Skipping Transfer) Tax Return and filed with the Internal Revenue Service Center, Cincinnati, Ohio 45999. A copy of this letter should be attached to the supplemental Form 709. A copy is enclosed for this purpose.

Sincerely,

Heather C. Maloy  
Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosures

Copy for section 6110 purposes

Copy of this letter

CC: