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Department of the Treasury

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CC:DOM:P&SI:4 - PLR-120480-98

Date: February 16, 1999

Re:

LEGEND:

Taxpayer =

Date 1 =

Date 2 =

Trust A =

Trust 1 =

Trust 2 =

Partnership X =

a =

b =

c =

d =

e =

f =

g =

h =

i =

We received your authorized representative's letter, dated October 30, 1998, requesting a ruling concerning the application of § 2632 of the Internal Revenue Code and § 301.9100-1 of the Procedure and Administration Regulations. This letter responds to that request.

On Date 1, Taxpayer created Trust A. Taxpayer was the initial trustee of Trust A. The trust agreement directed Taxpayer, as trustee, to divide the trust property into two separate trusts (Trust 1 and Trust 2) for the primary benefit of Taxpayer's two daughters (each referred to as a Beneficiary).

Article 1, Section 1.2 of the trust agreement directs the trustee to keep a separate account for each of the separate trusts created under the trust agreement, but to administer such trusts as a single fund.

Article 1, Section 1.3 provides that while Taxpayer serves as trustee, she will not have any power to distribute any income or principal of any trust to any beneficiary other than the withdrawals provided for in section 1.4 (relating to certain withdrawal rights granted to individual descendants of Taxpayer). Instead, while the Taxpayer is trustee, all of the net income of each trust created under this trust agreement shall be accumulated. When the Taxpayer is not serving as trustee of a trust created by the trust agreement, the trustee shall distribute to the beneficiary of the trust such amounts of the income and principal of such trust as are necessary, when added to the funds reasonably available to such beneficiary from all other sources known to the trustee, to provide for the beneficiary's health, support, maintenance, and education, taking into consideration age, education, and station in life. In addition, the trustee has discretion to distribute to the beneficiary's descendants such amounts of the income and principal of such trust that the trustee deems necessary to provide for their health, support, maintenance, and education, taking into consideration age, education, and station in life.

Article 1, Section 1.4 provides that each living descendant of the Taxpayer is a "distributee." It further provides that notwithstanding any other provision of this trust agreement, except section 5.4, each distributee shall have the right to withdraw cash or other property from the trusts at any time during any calendar year in which a gift, as defined in § 2512(b), is made to the trusts in an amount not in excess of: (i) 100% of the maximum amount that can be excluded in calculating the taxable gifts of one donor to one donee under

§ 2503(b) as of the first day of such calendar year times the number of donors who make gifts to the trusts during such calendar year, or (ii) an amount equal to the value of such distributee's equal share of all gifts made to or for the benefit of the trusts during such calendar year, whichever amount is less. Such withdrawal rights shall be cumulative. The cumulative amount of each distributee's unexercised withdrawal rights shall lapse on December 31 of each year to the extent of the greater of \$5,000 or 5% of the value of the trusts on that date, and such lapses shall apply to unexercised withdrawal rights in the order that they arose.

Article 1, Section 1.5 provides that each trust created under this Article for a beneficiary who is a daughter, grandchild, or great grandchild of the Taxpayer shall continue for such beneficiary's lifetime and shall terminate upon such beneficiary's death. Every other trust created under the Article shall terminate when the beneficiary thereof attains age 30 or upon the death of the Taxpayer, whichever is later, and upon such termination, the trustee shall distribute all remaining unappointed property of such trust to the beneficiary thereof.

Taxpayer resigned as trustee of both Trust 1 and Trust 2 in 1996. In 1995, 1996, and 1997, Taxpayer transferred \$a, \$b, and \$c respectively to Trust 1. Also in 1995, 1996, and 1997, Taxpayer transferred \$d, \$e, and \$f respectively to Trust 2. These transfers were reported on timely filed gift tax returns.

With respect to the 1995 and 1996 transfers, Taxpayer requests a ruling that she substantially complied with the requirements for making a timely allocation of her GST tax exemption, in the amount of \$a and \$d to the transfers to Trusts 1 and 2 respectively on her 1995 gift tax return, and in the amount of \$b and \$e to the transfers to Trusts 1 and 2 respectively on her 1996 gift tax return.

With respect to the 1997 transfers, Taxpayer filed a timely gift tax return reporting the transfers on April 15, 1998. On Date 2, within 6 months of April 15, 1998, Taxpayer filed an amended gift tax return reporting total transfers of i dollars and properly allocating GST exemption with respect to the 1997 transfers. Taxpayer requests a ruling that she made a timely allocation of a portion of her GST exemption to the transfers made to Trust 1 and Trust 2 on her Amended 1997 Form 709, pursuant to the automatic relief provisions of § 301.9100 of the Procedure and Administrative Regulations.

Ruling Request #1

Section 2601 imposes a tax on every generation-skipping transfer (GST). A generation-skipping transfer 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)(1) provides that the term "skip person" means a natural person assigned to a generation that is two 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 2613(a)(2) provides, in part, that a trust is a skip person 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 § 2652(c)(1), a person has an interest in property held in trust, if (at the time the determination is made) such person has a right to receive income or corpus from the trust, or is a permissible current recipient of income or corpus and is not described in § 2055(a).

Under § 2602, the amount of the GST tax is determined by multiplying the amount of the GST 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 trust. The applicable fraction, with respect to a 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 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 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 GST potential even if the possibility of a GST 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 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.

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.

The issue is whether Taxpayer made timely allocations of her GST tax exemption to the transfers to Trusts 1 and 2 on her 1995 and 1996 gift tax returns. In the present case, the transfers to the Trusts were not direct skips. 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 and the amount of GST exemption allocated to it. The allocation should also state the inclusion ratio of the trust after the allocation.

The instructions for Form 709 applicable for the returns filed by the taxpayer during the period 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 trust 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. 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 this case, it appears that Taxpayer did not literally comply with the instructions on Form 709. Taxpayer reported the 1995 and 1996 gifts to Trust 1 and Trust 2 on Schedule A, Part 2 (Gifts Subject to Both Gift and GST Tax) and completed portions of Schedule C. In addition, Taxpayer did not attach to the 1995 or 1996 returns a Notice of Allocation of GST exemption. However, elections may be held to be effective where the taxpayer complied with the essential requirements of a regulation 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 allocations will be deemed valid if there are enough facts and circumstances to indicate that the Taxpayer intended to allocate part of her exemption to the Trusts.

We believe that there is sufficient information provided on Taxpayer's 1995 and 1996 gift tax returns to conclude that Taxpayer intended to allocate part of her exemption to Trust 1 and Trust 2. On the 1995 and 1996 gift tax returns, Taxpayer reported the transfers on Schedule C. For the 1995 gifts, Taxpayer entered a total of \$g (\$a + \$d) on Schedule C, Part 2 (GST Exemption Reconciliation), line 4 (Exemption Claimed on This Return). On Schedule C, Part 3, column C (GST Exemption Allocated), Taxpayer entered a total of \$g (\$a + \$d). For the 1996 gifts, Taxpayer entered a total of \$h (\$b + \$e) on Schedule C, Part 2 (GST Exemption Reconciliation), line 4 (Exemption Claimed on This Return). On Schedule C, Part 3, column C (GST Exemption Allocated), Taxpayer entered a total of \$h (\$b + \$e). In addition, Taxpayer attached statements to her 1995 and 1996 returns which provided the trust identification numbers and the value of the property transferred to each trust. We note that Taxpayer did not complete the GST portions of the form correctly, in view of the fact that the transfers were not direct skips. However, based on the information provided on the return, we conclude that Taxpayer substantially complied with the requirements for making an allocation of GST exemption for the transfers reported on the 1995 and 1996 gift tax returns. Taxpayer is, therefore, deemed to have allocated the exemption as described above for the 1995 and 1996 transfers to Trust 1 and Trust 2.

Ruling Request #2

Section 301.9100-1(c) of the Procedure and Administration Regulations provides that the Commissioner of Internal Revenue may grant a reasonable extension of time to make a regulatory election, or a statutory election (but not more than 6 months except in the case of a taxpayer who is abroad), under all subtitles of the Internal Revenue Code, except subtitles E, G, H, and I, if the taxpayer demonstrates to the satisfaction of the Commissioner that the taxpayer has acted reasonably and in good faith, and granting relief will not prejudice the interests of the government.

Sections 301.9100-1 through 301.9100-3 provide the standards the Commissioner will use to determine whether to grant an extension of time to make an election. § 301.9100-1(a).

Section 301.9100-2 provides automatic extensions of time for making certain elections. Section 301.9100-3 provides extensions

of time for making elections that do not meet the requirements of § 301.9100-2.

Section 301.9100-2(b) grants an automatic extension of 6 months from the due date of a return excluding extensions to make regulatory or statutory elections whose due dates are the due date of the return or the due date of the return including extensions provided the taxpayer timely filed its return for the year the election should have been made and the taxpayer takes corrective action within that 6 month extension period. Corrective action means taking the steps required to file the election in accordance with the statute or the regulation published in the Federal Register, or the revenue ruling, revenue procedure, notice, or announcement published in the Internal Revenue Bulletin. For those elections required to be filed with a return, corrective action includes filing an original or amended return for the year the regulatory or statutory election should have been made and attaching the appropriate form or statement for making the election.

In this case, based on the representations made, Taxpayer timely filed her 1997 Form 709. However, Taxpayer failed to comply with the provisions of the regulations with respect to the allocation of GST exemption. Taxpayer took corrective action by filing an amended return under § 301.9100-2 on Date 2, which was prior to the date which is 6 months from the due date of her original return excluding extensions. Accordingly, the allocation made on Date 2 is a timely allocation, effective as of the date of the transfers made in 1997 to Trusts 1 and 2, which are reported on the amended 1997 Form 709 in the amount of \$i.

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

This 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 yours,

Paul Kugler
Assistant Chief Counsel

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(Passthroughs and Special
Industries)

Enclosure

Copy for section 6110 purposes