

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:B09-PLR-142954-02

Date:

July 11, 2003

Legend:

Date 1 =

Grantor =

Trust =

Spouse =

A =

Date 2 =

B =

C =

D =

E =

F =

State =

G =

H =

Date 3 =

Year 1 =

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Dear _____ :

This is in response to your letter dated May 13, 2003, and prior correspondence, requesting a ruling under § 2642 of the Internal Revenue Code.

The facts submitted and representations made are as follows: On Date 1, Grantor created a trust, Trust, that was revocable during his life. Trust was funded with a nominal amount of cash, a residence, and all rights, interest and claims of Grantor in a personal injury lawsuit.

The terms of Trust provide that, upon Grantor's death, Spouse is to have the use of the residence for her life, and that she is to receive \$A per month, subject to adjustment, for her life. Upon Spouse's death, the trust estate is to be divided into separate trusts for each of Grantor's grandchildren identified in the trust document. The trustee is authorized to expend all or so much of the trust income and principal as the trustee deems necessary for the health, support, maintenance, and education of the grandchild. The grandchild is to receive the principal of his or her respective trust estate, free of trust, when the grandchild reaches age twenty-five. If the grandchild dies before reaching age twenty-five, the grandchild's share is to be distributed to his or her issue, then living, or if none, to Grantor's other grandchildren.

Trust became irrevocable upon Grantor's death on Date 2. At his death, Grantor's entire estate was held in Trust. Grantor's \$1,000,000 generation-skipping transfer (GST) tax exemption was allocated to Trust under § 2632(c)(1)(B), as in effect at the time of Grantor's death. Pursuant to a settlement agreement between the Internal Revenue Service and Grantor's estate, the gross value of Grantor's estate, and therefore Trust, was \$B. It was also determined that Grantor's estate incurred certain additional expenses that were deductible under § 2053. These expenses included attorney's fees of \$C, accountant's fees of \$D, appraiser, expert, and other professional fees totaling \$E and were related to the collection of Grantor's assets, paying debts, and distributing property. In addition, Grantor's estate paid \$F for medical expenses incurred by Grantor during his life. It was agreed that the total Federal estate tax and State death tax due was \$G and this amount was paid from assets of the Trust. Finally, the estate paid interest expense on the underpayment of Grantor's Federal estate and state death taxes in the amount of \$H.

Spouse died on Date 3. Upon Spouse's death, a taxable termination occurred for purposes of the generation-skipping transfer tax. The trustee of Trust is in the process of preparing the Form 706-GS(T), Generation-Skipping Transfer Tax Return for Termination, for Year 1.

Grantor's estate has requested a ruling that, for purposes of determining the applicable fraction under § 2642(a)(2), the denominator of the fraction is net of the expenses described above.

Section 2601 imposes a tax on every generation-skipping transfer. 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.

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.

Under section 2642(a)(1), except as otherwise provided, the inclusion ratio with respect to any property transferred in a generation-skipping transfer shall be the excess (if any) of 1 over (A) except as provided in subparagraph (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 transfer.

Section 2642(a)(2) provides that 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 sections 2055 or 2522 with respect to such property.

Section 2642(b)(2) provides that, except as provided in § 2642(f), if property is transferred as a result of the death of the transferor, the value of such property for purposes of § 2642(a) shall be its value for purposes of chapter 11; except that, if the requirements prescribed by the Secretary respecting allocation of post-death changes in value are not met, the value of such property shall be determined as of the time of the distribution concerned. Any allocation to property transferred as a result of the death of the transferor shall be effective on and after the date of transferor's death.

In this case, Trust became irrevocable upon Grantor's death on Date 2. Trust provided Spouse with the lifetime use of a residence and a monthly payment of an amount that was subject to an adjustment by the trustee. The denominator is the value of the property transferred to the trust reduced by Federal estate tax and State death tax actually recovered from the trust attributable to the property. Expenses that would not have been incurred but for the decedent's death and the resulting necessity of collecting assets, paying debts, and distributing property are excluded from the value of the property that passes to trust. The estate paid \$F for medical expenses incurred by Grantor during his life. The estate also paid other expenses relating to the collection of Grantor's assets, paying his debts and distributing his property. These expenses included attorney's fees of \$C; accountant's fees of \$D; appraiser, expert, and other professional fees totaling \$E. The amounts paid for these expenses are properly excluded from the value of the property that passes to trust for purposes of § 2642(a)(2)(B).

On the other hand, expenses of maintaining the trust after the amount that passes to the trust has been established are not excluded from the value of the

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property that passes to trust. Such expenses include the interest expense on the underpayment of Federal estate and state death taxes. These expenses are not excluded from the value of the property that passes to trust for purposes of § 2642(a)(2)(B).

Finally, the total Federal estate tax and State death tax due was \$G. Section 2642(a)(2)(B) provides that the denominator is 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. In this case, the total Federal estate tax and State death tax of \$G was paid from assets of the Trust. This amount is properly excluded from the value of the property that passes to trust for purposes of § 2642(a)(2)(B).

A copy of this letter should be attached to the Form 706-GS(T). A copy is enclosed for this purpose.

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.

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.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to the taxpayer.

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

Sincerely,

James F. Hogan
Senior Technician Reviewer, Branch 9
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures

Copy for section 6110 purposes
Copy of this letter