

**Internal Revenue Service**

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Person To Contact:

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In Re:

Refer Reply To:

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Date: JULY 19,2004

LEGEND:

Revocable Trust -

Irrevocable Trust -

Trustee A -

Decedent -

Brother -

Sister -

Niece -

Grandniece -

Date 1 -

Date 2 -

Date 3 -

Date 4 -

M Dollars -

P Dollars -

Q Dollars -

R Dollars -

S Dollars -

T Dollars -

U Dollars -

V Dollars -

Real Property #1 -

Dear :

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This is in response to your letter dated May 19, 2004, and prior correspondence, requesting a ruling regarding the automatic allocation rules for generation-skipping transfers (GST). This letter responds to your request.

The facts and representations submitted are summarized as follows:

### Revocable Trust

On Date 1, Decedent created Revocable Trust, a revocable inter vivos trust.

Article SECOND of Revocable Trust provides that, during Decedent's life, Decedent would receive as much of the net income and principal as he requested and any undistributed income would be added to principal.

Article THIRD provides that, upon Decedent's death, the trust principal will be augmented by all property transferred to the trust as a result of Decedent's death, and the net income will be paid to Sister during her life with the principal payable, in the trustee's discretion, to or for the benefit of Sister for her medical expenses and necessities of life. Upon Sister's death, two-thirds (2/3) of the trust principal, is to be distributed outright to Niece. The remaining one-third (1/3) is to be distributed to Grandniece, who is Niece's daughter and Decedent's grandniece. However, if Niece was not living at that time, the entire principal is to be distributed to, or for the benefit of Grandniece and, likewise, if Grandniece was not then living, the entire principal is to be distributed outright to Niece. If either beneficiary is under the age of 35 at the time of distribution, the principal is to be held in trust for the benefit of that beneficiary and distributed outright when that beneficiary attains age 35. Further, if either beneficiary dies before reaching age 35, any principal and accrued income of that beneficiary's trust is to be distributed to that beneficiary's estate. If not terminated earlier, each beneficiary's trust would terminate twenty years after the last to die of the Decedent and his issue living on the date of his death.

### Irrevocable Trust

On Date 2, Decedent established Irrevocable Trust.

Article THIRD of Irrevocable Trust authorizes the trustee to make discretionary distributions of income and/or principal to specified beneficiaries during Decedent's life. The named beneficiaries of the discretionary distributions include Sister, Niece, Grandniece, and other nephews and grandnieces and grandnephews. Upon Decedent's death and after payment of certain pecuniary bequests provided for in Decedent's will that are not paid by Decedent's personal representative, the principal of Irrevocable Trust is to be divided into two equal shares. One share is to be distributed outright to Brother and the other share is to be held in a separate trust administered under the terms of Article FOURTH for the benefit of Sister and others.

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Article FOURTH sets forth the terms of a separate trust for the benefit of Sister, and upon her death, for the benefit of Niece and Grandniece. The dispositive provisions in Article FOURTH of Irrevocable Trust for the benefit of Sister, Niece, and Grandniece are identical to the dispositive provisions set forth above in Article THIRD of the Revocable Trust.

Article SEVENTH provides that the trustee may divide any trust into two or more separate trusts so that the federal generation-skipping transfer tax inclusion ratio for each trust shall be either zero or one.

You represent that prior to Decedent's death, Decedent had not allocated any GST exemption during Decedent's lifetime with respect to any transfer.

Decedent died testate on Date 3, survived by Sister, Brother, Niece, Grandniece, and other family members. Articles SECOND and THIRD of Decedent's will provide for bequests of real and personal property to Sister, Brother, and Niece. In particular, Real Property #1 is to pass to Sister for life and then, on Sister's death, to Niece, if living. If Niece is not the living, the property is to pass to Revocable Trust. Article FOURTH provides for pecuniary bequests to Niece, Decedent's nephew, and several of Decedent's grandnieces. In particular, the will provides for a pecuniary bequest of S Dollars to decedent's grandnieces. Under Article FIFTH of Decedent's will, one-half of the residue of Decedent's estate is to pass to Brother and the remaining one-half to Revocable Trust, if Sister survived Decedent by thirty days. Sister died on Date 4, more than thirty days after Decedent's date of death.

You have represented that there have been no additions, constructive or otherwise, to the Revocable Trust, the Irrevocable Trust, or to any trust created under the terms of those two trusts, since Decedent's date of death. You have also represented that, during Decedent's life, there were no transfers from Irrevocable Trust to any grandniece or any other person who was a skip person for purposes of the GST tax.

Decedent's estate filed a United States Estate (and Generation-Skipping Transfer) Tax Return (Form 706). The value of Decedent's gross estate, as reported on Decedent's estate tax return, was M Dollars. It is represented that the executor reported the Irrevocable Trust as includible in Decedent's gross estate for estate tax purposes at a date of death value of P Dollars. Real Property #1 was reported as having a date of death value of Q Dollars. Personal property to be distributed at the executor's discretion to the estate beneficiaries was valued at R Dollars. Revocable Trust was apparently unfunded at the time of death. As noted above, S dollars in pecuniary bequests passed to Decedent's grandnieces. Based on the submitted information, the residue of decedent's estate was T dollars, one-half of which passed

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outright to Brother and the remaining one-half (U Dollars) passed to Revocable Trust, which amount constituted the only contribution to the trust.

Decedent's executor did not allocate any of Decedent's available GST exemption on the Form 706. It is represented that Decedent's entire GST exemption was available for allocation at the time of his death.

You have requested that we rule that, as a result of the automatic allocation of Decedent's GST exemption as of the date of Decedent's death, and based on the value of the assets included in Decedent's gross estate as reported on Decedent's estate tax return, none of the property included in Decedent's gross estate for federal estate tax purposes, specifically the Irrevocable Trust and the Revocable Trust, is subject to the generation-skipping transfer tax.

#### Law and Analysis:

Section 2601 imposes a tax on every generation-skipping transfer. 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(a) provides that the term taxable termination means a termination (by death, lapse of time, release of a power, or otherwise) of an interest in property held in trust where the property passes to a skip person with respect to the transferor of the property. Section 2612(b) provides that the term taxable distribution means any distribution from a trust to a skip person other than a taxable termination or a direct skip. Under § 2612(c)(1), a direct skip is a transfer subject to federal estate or gift tax made by a transferor to a skip person. A skip person is defined in § 2613(a) as (1) a natural person assigned to a generation which is two or more generations below the generation assignment of the transferor, or (2) a trust if either all the interests in such trust are held by skip persons, or there is no person holding an interest in the trust, and at no time after such transfer may a distribution (including distributions on termination) be made from such trust to a non-skip person.

Section 2602 provides that the amount of the GST tax is determined by multiplying the taxable amount by the applicable rate. Section 2641(a) provides that the term "applicable rate" means, with respect to any GST transfer, the product of the maximum federal estate tax rate and the inclusion ratio with respect to the transfer.

Under § 2642(a)(1), the inclusion ratio with respect to 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 the GST exemption allocated to the trust (or to

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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), as in effect on Date 3, provided that, for purposes of determining the inclusion ratio, every individual shall be allowed a GST exemption of \$1,000,000 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 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. Section 2632(b)(2) provides that the unused portion of an individual's GST exemption is that portion of such exemption that had not previously been allocated or treated as allocated by the individual.

Section 2632(e)(1) provides that any portion of an individual's GST exemption which has not been allocated within the time prescribed by § 2632(a) shall be deemed to be allocated as follows—

- (A) first, to property which is the subject of a direct skip occurring at such individual's death, and
- (B) second, to trusts with respect to which such individual is the transferor and from which a taxable distribution or a taxable termination might occur at or after such individual's death.

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 as finally determined for estate tax purposes; 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 the death of the transferor.

Section 26.2632-1(d)(2) provides that a decedent's unused GST exemption is automatically allocated on the due date for filing Form 706 or Form 706NA to the extent

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not otherwise allocated by the decedent's executor on or before that date. Unused GST exemption is allocated pro rata (subject to the rules of § 26.2642-2(b)), on the basis of the value of the property as finally determined for estate tax purposes, first to direct skips treated as occurring at the transferor's death. The balance, if any, of unused GST exemption is allocated pro rata (subject to the rules of § 26.2642-2(b)), on the basis of the estate tax value of the nonexempt portion of the trust property (or in the case of trusts that are not included in the gross estate, on the basis of the date of death value of the trust) to trusts with respect to which a taxable termination may occur or from which a taxable distribution may be made. The automatic allocation of GST exemption is irrevocable, and an allocation made by the executor after the automatic allocation is made is ineffective.

Section 2654(b)(2) provides that, for GST purposes, substantially separate and independent shares of different beneficiaries in a trust shall be treated as separate trusts.

Section 26.2654-1(a)(1) provides that, if a single trust consists solely of substantially separate and independent shares for different beneficiaries, the share attributable to each beneficiary (or group of beneficiaries) is treated as a separate trust for GST purposes. A portion of a trust is not a separate share unless such share exists from and at all times after the creation of the trust. For purposes of this paragraph, a trust is treated as created at the date of death of the grantor if the trust is includible in its entirety in the grantor's gross estate for estate tax purposes. See § 26.2654-1(a)(5), Examples 3 and 4 regarding the treatment of trust distributions as separate shares.

Section 26.2654-1(a)(4) provides that, with respect to a separate share treated as a separate trust under § 26.2654-1(a)(1) or (2), an individual's GST exemption is allocated to the separate trust.

As discussed above, it is represented that prior to his death, Decedent did not allocate any GST exemption to any inter vivos transfers and that, at the time of Decedent's death, his available GST exemption was \$1,000,000. It is also represented that prior to Decedent's death, no distributions had been made from Irrevocable Trust to any grandniece of Decedent or any other person who was a skip person for GST tax purposes with respect to Decedent.

Based on the representations regarding the fair market value, as of the date of Decedent's death, of Irrevocable Trust and the other assets reported as includible in Decedent's gross estate for federal estate tax purposes, we conclude that, pursuant to the automatic allocation rules contained in § 2632(e)(1), GST exemption was automatically allocated as follows: S Dollars was automatically allocated to pecuniary bequests passing to Decedent's grandnieces; Q Dollars was automatically allocated to Real Property # 1; U Dollars was allocated to property passing to Revocable Trust (one-

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half the residuary estate); and finally, V Dollars (one half the date of death value of Irrevocable Trust) was automatically allocated to Irrevocable Trust, reflecting that the other one-half of the value of the Irrevocable Trust passed to Decedent's Brother on Decedent's death. Based on the representations, the aggregate of these amounts did not exceed \$1,000,000.

Accordingly, we conclude that sufficient GST exemption was allocated pursuant to the automatic allocation rules contained in § 2632(e)(1) such that Revocable Trust and Irrevocable Trust will have inclusion ratios of zero for purposes of § 2642(a)(1).

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.

Sincerely,

George Masnik  
Chief, Branch 4  
(Passthroughs and Special Industries)

Enclosures

Copy for section 6110 purposes

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CC: