

Dear _____ :

This is in response to your letter dated January 9, 2003, and subsequent correspondence, requesting certain Generation-Skipping Transfer (GST) tax rulings.

The facts submitted and the representations made are as follows. In Year 1, Taxpayer 1 and her husband, Taxpayer 2, established a Residence Trust that was intended to qualify as a qualified personal residence trust as that term is defined in § 25.2702-5(c) of the Gift Tax Regulations. On Date 1, Taxpayer 1 transferred her personal residence to Residence Trust.

Paragraph 2 of Residence Trust provides that trustee is to hold the trust's assets for Taxpayer 1's benefit for 5 years. Paragraph 3 provides that, when Residence Trust terminates, the trust's undistributed income is to be distributed to Taxpayer 1, and the remaining assets of the trust are to be held in further trust for the benefit of the son (Son) and daughter (Daughter) of Taxpayer 1 and 2, Son's children, and Daughter's children. Paragraph 3 further provides that if the residence is sold, Residence Trust will terminate. Upon termination, Residence Trust's assets will be distributed to Son and Daughter or their respective issue.

On Date 2, Taxpayer 1 and Taxpayer 2 established an irrevocable trust (Trust) for the benefit of Daughter and her children. Paragraphs 2 and 11 of Trust provide that Daughter is to receive Trust's net income at least monthly for her lifetime, and Trust's principal to provide for her health, maintenance, support, education, or best interests. Upon Daughter's death, Trust's remaining assets are to be divided into three equal trust shares, one for the benefit of each of Daughter's three children. In the event the child for whom a trust share is created predeceases Daughter leaving living descendants, the trust share is to be distributed, free of trust, to the descendants.

A trust share held for the benefit of a child of Daughter is to be administered as follows. The child is to receive net income from his or her trust share at least monthly, and principal to provide for the child's comfortable support, maintenance, health, education, welfare, and best interests. The child is to receive the balance of his or her trust share, free of trust, when the child turns 30. Any trust not otherwise distributable on termination is to be distributed by right of representation (per capita at each generation level) to the then living descendants of the fathers of Taxpayer 1 and Taxpayer 2.

In August and September of Year 1, Taxpayer 1 made a series of transfers of stock to Trust that Taxpayer 1 valued in the aggregate at \$ A. In August of Year 1, Taxpayer 2 made a series of transfers of stock to Trust that Taxpayer 2 valued in the aggregate at \$ B.

Taxpayer 1 and Taxpayer 2 retained tax professionals to prepare their gift tax returns for Year 1. The returns reported the gifts of stock to Trust and the gift of the personal

residence to Residence Trust. On the gift tax returns, Taxpayer 1 and Taxpayer 2 consented, under § 2513, to treat the gifts made by each in Year 1 as made by both of them. In preparing the gift tax returns, however, the tax professionals inadvertently failed to allocate or advise them to allocate their GST exemptions to the gifts made to Residence Trust and Trust. In addition, Taxpayer 1 and Taxpayer 2 did not file gift tax returns for Year 2. Pursuant to the terms of Residence Trust, the estate tax inclusion period (ETIP) for this gift terminated on Date 3 in Year 2. Finally, Taxpayer 1 and Taxpayer 2's estate represent that the value of the residence as of Date 3 was \$ C.

On Date 4, Taxpayer 1 and Taxpayer 2 formed four irrevocable trusts (education trusts), one trust for the benefit of each of their four grandchildren. Each trust is intended to provide for the educational expenses of a respective grandchild. Except for the beneficiary, the terms of each trust are identical.

Article I.C of each trust provides that while both Taxpayer 1 and Taxpayer 2 are living, immediately following any contribution to the trust, the beneficiary has the right to withdrawal the proportionate amount of the contribution that does not exceed two times the amount of the federal gift tax annual exclusion in any calendar year.

Article I.D provides that until the beneficiary reaches age 28, the beneficiary is to receive net income or principal from the trust to pay for educational expenses. Article I.E provides that when the beneficiary reaches age 28 the trust will terminate and the beneficiary will receive the trust's principal and accrued interest, free of trust. In the event the beneficiary dies before reaching age 28, the trust estate is to be distributed to the beneficiary's estate.

On Date 4, Taxpayer 1 and Taxpayer 2 transferred \$ D to each trust. On Date 5, Taxpayer 1 transferred stock Taxpayer 1 valued at \$ E, in equal shares, to the four education trusts. Also on Date 5, Taxpayer 2 transferred stock Taxpayer 2 valued at \$ F, in equal shares, to the four education trusts. It has been represented that no other transfers were made to the education trusts.

Taxpayer 1 and Taxpayer 2 retained tax professionals to prepare their Year 3 gift tax returns. On the returns, each of them consented, under § 2513, to treat the gifts made by each in Year 3 as made by both of them. Taxpayer 2 died on Date 6, several years after the transfers detailed above.

Taxpayer 1 and Taxpayer 2's estate have requested:

(1) a ruling that Taxpayer 1 and Taxpayer 2 will be considered the transferors for GST tax purposes of Residence Trust and Trust;

(2) an extension of time to allocate the available GST exemptions of Taxpayer 1 and Taxpayer 2 to Residence Trust, that the extension will be effective as of Date 3, and that, as a result, Residence Trust will have a zero inclusion ratio for GST tax purposes;

(3) an extension of time to allocate the available GST exemptions of Taxpayer 1 and Taxpayer 2 to Trust, and that that the GST exemptions allocated will be effective as of the dates of transfer to Trust;

(4) a ruling that a portion of the GST exemptions of Taxpayer 1 and Taxpayer 2 were automatically allocated to the transfers Taxpayer 1 and Taxpayer 2 made in Year 3 to the four education trusts on the date the transfers were made; and

(5) a ruling that a portion of the Year 3 transfers to each education trust equal to \$10,000 is a non-taxable gift that has an inclusion ratio of zero pursuant to ' 2642(c) of the Internal Revenue Code.

Ruling 1 – Law and Analysis:

Section 2501(a)(1) provides that a tax, computed as provided in ' 2502, is imposed for each calendar year on the transfer of property by gift during such calendar year by any individual, resident, or nonresident.

Section 2511(a) provides that the tax imposed by ' 2501 shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

Section 2513(a)(1) provides, in part, that a gift made by one spouse to any person other than his spouse shall, for the purposes of this chapter, 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 ' 2513(a)(1) shall apply only if both spouses have signified (under the regulations provided for in ' 2513(b)) their consent to the application of ' 2513(a)(1) in the case of all such gifts made during the calendar year by either while married to the other.

Section 25.2513-1(b) of the Gift Tax Regulations provides, in pertinent part, that this section will apply to gifts made during a particular "calendar period" (as defined in ' 25.2502-1(c)(1)) only if both spouses signify their consent to treat all gifts made to third parties during that calendar period by both spouses while married to each other as having been made one-half by each spouse. Such consent, if signified with respect to any calendar period, is effective with respect to all gifts made to third parties during such calendar period.

Section 25.2513-2(a)(1) provides, in part, that consent to the application of the provisions of ' 2513 with respect to a "calendar period" (as defined in ' 25.2502-1(c)(1)) shall, in order to be effective, be signified by both spouses. If both spouses file gift tax returns within the time for signifying consent, it is sufficient if -- (i) the consent of the husband is signified on the wife's return, and the consent of the wife is signified on the husband's return; (ii) the consent of each spouse is signified on his own return; or (iii) the consent of both spouses is signified on one of the returns. If only one spouse files a gift tax return within the time provided for signifying consent, the consent of both spouses shall be signified on that return.

Section 26.2632-1(c)(5), Example 3, of the Generation-Skipping Transfer Tax Regulations provides as follows. T transfers \$100,000 to an irrevocable trust. The trust instrument provides that trust income is to be paid to T for 9 years or until T's prior death. The trust principal is to be paid to T's grandchild on the termination of T's income interest. T files a timely gift tax return reporting the transfer. T's spouse, S, consents to have the gift treated as made one-half by S under ' 2513. Because S is treated as transferring one-half of the property to T's grandchild, S becomes the transferor of one-half of the trust for purposes of chapter 13. Because the value of the trust would be includible in T's gross estate if T died immediately after the transfer, S's transfer is subject to an ETIP.

Section 2652(a)(1)(B) provides that, except as provided in this subsection or ' 2653(a), the term *transferor* means the donor, in the case of any property subject to the tax imposed by chapter 12. An individual shall be treated as transferring any property with respect to which such individual is the transferor.

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 the gift is treated as made by the spouse of such individual, such gift shall be so treated for purposes of the GST tax.

Section 26.2652-1(a)(1) provides, in general, that, except as otherwise provided in ' 26.2652-1(a)(3), the individual with respect to whom property was most recently subject to federal estate or gift tax is the transferor of that property for purposes of chapter 13. An individual is treated as transferring any property with respect to which the individual is the transferor. Thus, an individual may be a transferor even though there is no transfer of property under local law at the time the federal estate or gift tax applies.

Section 26.2652-1(a)(2) provides that for purposes of chapter 13, a transfer is subject to federal gift tax if a gift tax is imposed under ' 2501(a) (without regard to exemptions, exclusions, deductions, and credits). A transfer is subject to federal estate tax if the value of the property is includible in the decedent's gross estate as determined under ' 2031 or ' 2103.

In this case, Taxpayer 1 and Taxpayer 2 each made gifts to Trust and the four education trusts in Years 1 and 3. Taxpayer 1 made a gift to Residence Trust in Year 1. In addition, on their respective gift tax returns for Years 1 and 3, Taxpayer 1 and Taxpayer 2 each consented to treat gifts made by either in Years 1 and 3 as made by both pursuant to § 2513. Accordingly, based upon the facts submitted and the representations made, we conclude that, Taxpayer 1 and Taxpayer 2 are the transferors of Residence Trust, Trust, and the four education trusts for GST tax purposes.

Rulings 2 and 3 – Law and Analysis:

Section 2601 imposes a tax on every 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. Section 2642(a) provides the method for determining the inclusion ratio.

Section 2631(a), in effect at the time of the transfer, 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) 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.

Section 26.2632-1(c)(1) provides that an allocation of GST exemption (including an automatic allocation) to property subject to ETIP that is made prior to termination of the ETIP cannot be revoked, but becomes effective no earlier than the date of any termination of the ETIP with respect to the trust. Where an allocation has not been made prior to the termination of the ETIP, an allocation is effective at the termination of the ETIP during the transferor’s lifetime if made by the due date for filing a Form 709 that would apply to a taxable gift occurring at the time the ETIP terminates (timely ETIP return). An allocation is effective in the case of the termination of the ETIP on the death of the transferor as provided in § 26.2632-1(d).

Section 26.2632-1(c)(2)(i) provides that an ETIP is the period during which, should death occur, the value of transferred property would be includible (other than by reason of ' 2035) in the gross estate of -- (A) the transferor; or (B) the spouse of the transferor.

Section 26.2632-1(c)(3)(ii) provides that an ETIP terminates on the first to occur of the time at which no portion of the property is includible in the transferor's gross estate (other than by reason of ' 2035) or, in the case of an individual who is a transferor solely by reason of an election under ' 2513, the time at which no portion would be includible in the gross estate of the individual's spouse (other than by reason of ' 2035).

Section 2642(b)(1) provided 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) B (A) 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 ETIP, its value at the time of the close of the ETIP, and (B) 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 ETIP, on and after the close of such ETIP.

Section 2642(g)(1)(A) provides 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). Such regulations shall include procedures for requesting comparable relief with respect to transfers made before the date of the enactment of § 2642(g)(1)(A), which was enacted into law on June 7, 2001.

Section 2642(g)(1)(B) provides that in determining whether to grant relief, 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. Section 2642(g)(1)(B) further provides that for purposes of determining whether to grant relief, the time for making the allocation shall be treated as if not expressly prescribed by statute.

Notice 2001-50, 2001-2 C.B. 189, provides that under § 2624(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 GST 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.

Section 301.9100-1(c) provides that the Commissioner has discretion to grant a reasonable extension of time under the rules set forth in §§ 301.9100-2 and 301.9100-3 to make a regulatory election, or a statutory election (but no more than 6 months except

in the case of a taxpayer who is abroad), under all subtitles of the Code except subtitles E, G, H, and I.

Section 301.9100-3 provides the standards used to determine whether to grant an extension of time to make an election whose due date is prescribed by a regulation (and not expressly provided by statute). Under § 301.9100-1(b), a regulatory election includes an election whose due date is prescribed by a notice published in the Internal Revenue Bulletin. 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) 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.

With respect to Residence Trust, based on the facts submitted and the representations made, we conclude that the requirements of § 301.9100-3 have been satisfied. Therefore, Taxpayer 1 and Taxpayer 2's estate are granted an extension of time of sixty (60) days from the date of this letter to allocate the GST exemption of Taxpayer 1 and Taxpayer 2 to Residence Trust. The allocation will be effective as of Date 3, and will be based on the value of Resident Trust's assets on Date 3. Residence Trust will have an inclusion ratio of zero, provided the amount of GST exemption allocated to Residence Trust is equal to the value of Residence Trust's assets for federal gift tax purposes.

The allocations should be made on gift tax returns for Year 2 and filed with the Internal Revenue Service Center, Cincinnati, Ohio 45999. A copy of this letter should be attached to the returns. Copies are enclosed for this purpose.

With respect to Trust, based on the facts submitted and the representations made, we conclude that the requirements of § 301.9100-3 have been satisfied. Therefore, Taxpayer 1 and Taxpayer 2's estate are granted an extension of time of sixty (60) days from the date of this letter to allocate the GST exemption of Taxpayer 1 and Taxpayer 2 to Trust. The allocation will be effective as of the dates the transfers were made to Trust, and will be based on the value of the property transferred to Trust on the dates of transfer.

The allocations should be made on supplemental gift tax returns for Year 1 and filed with the Internal Revenue Service Center, Cincinnati, Ohio 45999. A copy of this letter should be attached to the supplemental returns. Copies are enclosed for this purpose.

Rulings 4 and 5 – Law and Analysis:

Section 2501(a)(1) provides that a tax, computed as provided in § 2502, is imposed for each calendar year on the transfer of property by gift during such calendar year by any individual, resident, or nonresident.

Section 2503(b) provides that in the case of gifts (other than gifts of future interest in property) made to any person by the donor during the calendar year, the first \$10,000 of such gifts to such person shall not, for purposes of § 2503(a), be included in the total amount of gifts made during such year.

Section 2611(a) provides that the term "generation-skipping transfers" mean - (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 26.2612-1(a)(1) provides that a direct skip is a transfer to a skip person that is subject to federal estate or gift tax. If property is transferred to a trust, the transfer is a direct skip only if the trust is a skip person. Only one direct skip occurs when a single transfer of property skips two or more generations.

Section 26.2612-1(d) provides that a skip person is – (1) an individual assigned to a generation more than one generation below that of the transferor (determined under the rules of § 2651), or (2) 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.

Section 2613(a) provides that the term "skip person" means – (1) a natural person assigned to a generation which is 2 or more generations below the generation assignment of the transferor, or (2) a trust -- (A) if all interests in such trust are held by skip persons, or (B) if -- (i) there is no person holding an interest in such trust, and (ii) at no time after such transfer may a distribution (including distributions on termination) be made from the trust to a nonskip person.

Section 26.2632-1(b)(1)(i) provides that if a direct skip occurs during the transferor's lifetime, the transferor's GST exemption not previously allocated (unused GST exemption) is automatically allocated to the transferred property (but not in excess of the fair market value of the property on the date of the transfer).

Section 26.2632-1(b)(1)(ii) provides, in pertinent part, except as provided in § 26.2632-1(b)(1)(iii), the automatic allocation of GST exemption (or the election to prevent the

allocation, if made) is irrevocable after the due date. An automatic allocation of GST exemption is effective as of the date of the transfer to which it relates. Except as provided above, a Form 709 need not be filed to report an automatic allocation.

Section 2642(c)(1) provides that in the case of a direct skip, which is a nontaxable gift, the inclusion ratio shall be zero.

Section 2642(c)(2) provides that ' 2642(c)(1) shall not apply to any transfer to a trust for the benefit of an individual unless -- (A) during the life of such individual, no portion of the corpus or income of the trust may be distributed to (or for the benefit of) any person other than such individual, and (B) if the trust does not terminate before the individual dies, the assets of such trust will be includible in the gross estate of such individual.

Section 2642(c)(3) provides that for purposes of this subsection, the term "nontaxable gift" means any transfer of property to the extent such transfer is not treated as a taxable gift by reason of -- (A) ' 2503(b) (taking into account the application of ' 2513), or (B) ' 2503(e).

Section 26.2642-1(c)(3) provides that, for purposes of chapter 13, a transfer is a nontaxable gift to the extent the transfer is excluded from taxable gifts by reason of ' 2503(b) (after application of ' 2513) or ' 2503(e). However, a transfer to a trust for the benefit of an individual is not a nontaxable gift for purposes of this section unless -- (i) trust principal or income may, during the individual's lifetime, be distributed only to or for the benefit of the individual; and (ii) the assets of the trust will be includible in the gross estate of the individual if the individual dies before the trust terminates.

Section 26.2642-1(d), Example 2, provides as follows. On December 1, 1996, T transfers \$10,000 to an irrevocable trust for the benefit of T's grandchild, GC. GC possesses a right to withdraw any contributions to the trust such that the entire transfer qualifies for the annual exclusion under ' 2503(b). Under the terms of the trust, the income is to be paid to GC for 10 years or until GC's prior death. Upon the expiration of GC's income interest, the trust principal is payable to GC or GC's estate. The transfer to the trust is a direct skip. T made no prior gifts to or for the benefit of GC during 1996. The entire \$10,000 transfer is a nontaxable transfer. For purposes of computing the tax on the direct skip, the denominator of the applicable fraction is zero, and thus, the inclusion ratio is zero.

Section 2651(b)(1) provides that an individual who is a lineal descendant of a grandparent of the transferor shall be assigned to that generation which results from comparing the number of generations between the grandparent and such individual with the number of generation between the grandparent and the transferor.

In this case, each education trust is established for a grandchild of Taxpayer 1 and Taxpayer 2. Each grandchild is a natural person assigned to a generation that is two generations below Taxpayer 1 and Taxpayer 2. Accordingly, based upon the facts

submitted and the representations made, each grandchild is a skip person within the meaning of ' 2613.

In addition, the terms of each education trust provide that during the lifetime of the grandchild for whom the trust was established, no one other than the grandchild can receive distributions of trust corpus or income, and in the event, the grandchild dies before his or her trust terminates the trust's assets are distributable to the grandchild's estate. Accordingly, based upon the facts submitted and the representations made, each education trust is a skip person within the meaning of ' 2613.

In Year 3, Taxpayer 1 and Taxpayer 2 made gifts to each education trust. The gifts to each education trust were gifts to a skip person within the meaning of ' 2613, and, thus were direct skips within the meaning of ' ' 2612(c)(1) and 26.2612-1(a)(i). Accordingly, based upon the facts submitted and the representations made, pursuant to the provisions of ' 26.2632-1(b), a portion of the GST exemptions of Taxpayer 1 and Taxpayer 2 equal to that portion of the gifts taxable under chapter 12 were automatically allocated to the gifts they made to each of the education trust in Year 3.

Further, the terms of each education trust provide that the grandchild has the right to withdrawal from his or her trust an amount not to exceed two times the gift tax annual exclusion amount in any year that Taxpayer 1 and Taxpayer 2 are alive and a transfer has been made to the trust. It has been represented that the only transfers made to each of the education trusts were made by Taxpayer 1 and Taxpayer 2 in Year 3 when both Taxpayer 1 and Taxpayer 2 were alive.

Accordingly, based upon the facts submitted and the representations made, in accordance with ' 2642(c) and Example 2 of ' 26.2642-1(d), a portion of transfers Taxpayer 1 and Taxpayer 2 each made to each education trust in Year 3 equal to \$10,000 is a non-taxable gift that has an inclusion ratio of zero, provided Taxpayer 1 and Taxpayer 2 had not made additional gifts to the beneficiaries of the education trusts in Year 3 that would qualify for the annual gift tax exclusion under ' 2503(b).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the personal representative of Taxpayer 1 and Taxpayer 2's estate.

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.

Sincerely,

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

Enclosures: Copy for ' 6110 purposes
Copies of this letter