

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

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Person To Contact: \_\_\_\_\_, ID No.

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December 15, 2010

In Re

Legend:

- Taxpayer 1 =
- Taxpayer 2 =
- Son =
- Trust =
  
- Date 1 =
- Date 2 =
- Year =
- V =
- W =
- X =
- Y =
- Z =

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

This letter responds to the letter dated June 22, 2010, and subsequent correspondence, submitted by your authorized representative, requesting a ruling determining the amount of generation-skipping transfer (GST) exemption, as defined by § 2631(a) of the Internal Revenue Code, that was allocated to amounts Taxpayer 1 and Taxpayer 2 transferred to Trust in Year, a year after December 31, 2000.

The facts and representations submitted are as follows. In Year, on Date 1, Taxpayer 1 formed Trust. Article I, paragraph 1 of Trust provides that during Son's lifetime, the trustee may distribute net income and corpus of Trust to provide for the health, support, maintenance, and/or education of Son, Son's wife, and/or Son's then living issue. The trustee is authorized to make payments in such proportions as the trustee deems advisable; the trustee is not required to equalize distributions among beneficiaries. Income not distributed in any year is to be added to corpus.

Article I, paragraph 2 provides that after the youngest of Son's then living children attains age 22 and Son's issue have either withdrawn or received a certain portion of Trust's assets, Son may exercise an *intervivos* limited power to appoint Trust corpus to any one or more of Taxpayer 1's issue and/or their spouses. Son may not exercise this power in favor of his estate, his creditors, or the creditors of his estate or in a manner that would discharge any of his support, contractual, or other obligations.

Article I, paragraph 3 provides that Son has a testamentary limited power to appoint Trust corpus to beneficiaries of his choosing. These beneficiaries, however, cannot include his estate, his creditors, or the creditors of his estate.

Article I, paragraph 4 provides that upon Son's death, Trust corpus not otherwise appointed is to be divided *per stirpes* into shares for Son's then living issue. These shares are to be held as separate trusts. The terms of these trusts provide that until the beneficiary of the trust attains age 35, the trustee may distribute net income and corpus to provide for the beneficiary's health, support, maintenance, and education. Income not distributed in any year is to be added to principal. When the beneficiary attains age 35, trust corpus is distributed free of trust to the beneficiary. If the beneficiary dies before attaining age 35, the beneficiary has a testamentary limited power to appoint Trust corpus to any one or more of Taxpayer 1's issue. The beneficiary may not exercise this power in favor of his or her estate, his or her creditors, or the creditors of his or her estate. Assets not appointed are to be distributed free of trust: (1) to the beneficiary's then living issue, if any, *per stirpes*; but if no living issue, then (2) in equal shares to each of the beneficiary's then living siblings who are Son's issue and the then living issue, collectively, of each of the beneficiary's deceased siblings who are Son's issue, if any, *per stirpes*; but if none, then (3) to Son's then living issue, if any, *per stirpes*; but if none, then (4) to Son's wife if she is living and married to Son at Son's death; but, if not, then (5) to Taxpayer 1's then living issue, *per stirpes*.

Article II provides that when a person makes an *intervivos* transfer of assets to Trust, Son and each of his then living issue have the right to withdraw a fraction of the transferred assets. The numerator of this fraction is one and the denominator of the fraction is one plus the number of Son's then living issue who have not been excluded pursuant to Article II, paragraph 3 from withdrawing a portion of the transferred assets.

Article II, paragraph 3 provides that a person transferring assets to Trust may: (a) exclude any person who would otherwise have a withdrawal right from exercising that right as to such transferred assets; (b) increase or decrease the amount or fraction of the transferred assets that would otherwise be subject to a withdrawal right; and (c) change the period during which any person would otherwise be entitled to exercise his or her withdrawal right.

On Date 1, Taxpayers 1 and 2 each transferred \$V to Trust. In the same year, on Date 2, Taxpayers 1 and 2 each transferred \$W to Trust. With respect to the total amount of these transfers (\$V plus \$W), Taxpayers 1 and 2 authorized Son to withdraw \$Y (Son's \$Y withdrawal right) and each of Son's three children to withdraw \$Z (Children's \$Z withdrawal right). Son and his three children did not exercise their withdrawal rights.

Taxpayers 1 and 2 retained tax professionals to prepare their Year Forms 709, United States Gift (and Generation-Skipping Transfer) Tax Returns. The Forms 709 were timely filed. On these forms, each taxpayer consented, under § 2513, to treat the gifts made by each in Year as made by both of them. The Forms 709 did not report a portion equal to \$X of the transfer of \$W that Taxpayers 1 and 2 made to Trust on Date 2.

On the forms, no GST exemption was allocated to the portion of the taxpayers' transfers represented by Son's \$Y withdrawal right. In addition, because the forms did not report \$X of the \$W the taxpayers transferred to Trust on Date 2, no GST exemption was allocated to the \$X transfers.

With respect to the portion of the taxpayers' transfers represented by Children's \$Z withdrawal rights, the forms reflected: (1) an election under § 2632(c)(5)(A)(i)(II) to have the § 2632(c)(1) automatic allocation rules not apply to these transfers; (2) an allocation of their respective GST exemption equal to the amount of these transfers; and (3) a formula allocation of their respective GST exemption in an amount necessary to produce an inclusion ratio which was closest to or equal to zero.

Taxpayers 1 and 2 are requesting rulings: (1) that § 2632(c) automatically allocated their respective GST exemption to the portion of their transfers represented by Son's \$Y withdrawal right as well as their transfers of \$X that they did not report on their respective Forms 709; and (2) that their respective GST exemption was timely allocated to the portion of their transfers represented by Children's \$Z withdrawal rights.

#### 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 transfers, 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(c)(1) provides that if any individual makes an indirect skip during such individual's 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. If the amount of the indirect skip exceeds such unused portion, the entire unused portion shall be allocated to the property transferred.

Section 2632(c)(3)(A) provides that the term "indirect skip" means any transfer of property (other than a direct skip) subject to the tax imposed by chapter 12 made to a GST trust.

Section 2632(c)(3)(B) generally provides that the term "GST trust" means a trust that could have a GST with respect to the transferor except in certain circumstances.

Section 2632(c)(3)(B) further provides that for purposes of § 2632(c)(3)(B), the value of transferred property shall not be considered to be includible in the gross estate of a non-skip person or subject to a right of withdrawal by reason of such person holding a right to withdraw so much of such property as does not exceed the amount referred to in § 2503(b) with respect to any transferor, and it shall be assumed that powers of appointment held by non-skip persons will not be exercised.

Sections 2632(c)(5)(A)(i)(I) and (II) provide that an individual may elect to have the automatic allocation rule contained in § 2632(c)(1) not apply to an indirect skip or to any or all transfers made by such individual to a particular trust.

Section 2632(c)(5)(B)(i) provides that an election under § 2632(c)(5)(A)(i)(I) shall be deemed to be timely if filed on a timely filed Form 709 for the calendar year in which the transfer was made or deemed to have been made pursuant to § 2032(c)(4) or on such later date or dates as may be prescribed by the Secretary.

Section 2632(c)(5)(B)(ii) provides that an election under § 2632(c)(5)(A)(i)(II) may be made on a timely filed Form 709 for the calendar year for which the election is to become effective.

Section 26.2632-1(b)(2)(i) of the Generation-Skipping Transfer Tax Regulations provides, in part, that an indirect skip is a transfer of property to a GST trust as defined in § 2632(c)(3)(B) provided that the transfer is subject to gift tax and does not qualify as a direct skip. In the case of an indirect skip made after December 31, 2000, to which § 2642(f) does not apply, the transferor's unused GST exemption is automatically allocated to the property transferred (but not in excess of the fair market value of the

property on the date of the transfer). The automatic allocation is effective whether or not a Form 709 is filed reporting the transfer, and is effective as of the date of the transfer to which it relates.

Section 26.2632-1(b)(2)(iii)(A)(2) provides, in part, that a transferor may prevent the automatic allocation of GST exemption (elect out) with respect to any transfer or transfers constituting an indirect skip made to a trust. A transferor may elect out with respect to one or more (or all) current-year transfers made by the transferor to a specified trust or trusts.

Section 26.2632-1(b)(2)(iii)(B) provides, in part, that to elect out, the transferor must attach a statement (election out statement) to a Form 709 filed within the time period provided in paragraph (b)(2)(iii)(C) of this section. The election out statement must identify the trust, and specifically must provide that the transferor is electing out of the automatic allocation of GST exemption with respect to the described transfer or transfers.

Section 26.2632-1(b)(2)(iii)(C)(2) provides, in part, that to elect out, the Form 709 with the attached election out statement must be filed on or before the due date for timely filing of the Form 709 for the calendar year in which the first transfer to be covered by the election out was made.

Section 26.2632-1(b)(2)(iii)(D) provides, in part, that an election out does not affect the automatic allocation of GST exemption to any transfer not covered by the election out statement. An election out does not prevent the transferor from allocating the transferor's available GST exemption to any transfer covered by the election out, either on a timely filed Form 709 reporting the transfer or at a later date in accordance with the provisions of paragraph (b)(4) of this section.

Section 26.2632-1(b)(4)(i) provides, in part, 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 being made, the amount of GST exemption allocated to it, and if the allocation is late or if 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. Except as otherwise provided in this paragraph, an allocation of GST exemption may be made by a formula; e.g., the allocation may be expressed in terms of the amount necessary to produce an inclusion ratio of zero. With respect to a timely allocation, an allocation of GST exemption becomes irrevocable after the due date of the return.

Section 26.2632-1(b)(4)(ii)(A)(1) provides, in part, that an allocation of GST exemption is effective as of the date of any transfer if the Form 709 on which it is made is timely filed (a timely allocation). If more than one timely allocation is made, the earlier

allocation is modified only if the later allocation clearly identifies the transfer and the nature and extent of the modification. For purposes of this paragraph (b)(4)(ii), the Form 709 is deemed filed on the date it is postmarked to the Internal Revenue Service address as directed in forms or other guidance published by the Service.

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 Form 709 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)), and (B) such allocation shall be effective on and after the date of such transfer.

Based upon the facts submitted and the representations made, Trust's terms satisfy the definition of a GST trust under § 2632(c)(3)(B). Therefore, the transfers Taxpayers 1 and 2 made to Trust in Year satisfy the definition of indirect skips under § 2632(c)(3)(A) and § 26.2632-1(b)(2)(i). Accordingly, pursuant to § 2632(c)(1), the GST exemption of Taxpayers 1 and 2 was automatically allocated to the portion of their transfers represented by Son's \$Y withdrawal right, effective as of the dates of transfer. Further, their GST exemption was automatically allocated to the \$X transfers effective as of the dates of transfer, pursuant to § 26.2632-1(b)(2)(i) (providing that the automatic allocation is effective whether or not a Form 709 is filed reporting the transfer, and is effective as of the date of the transfer to which it relates).

With respect to the portion of the taxpayers' transfers represented by Children's \$Z withdrawal rights, Taxpayers 1 and 2 elected under § 2632(c)(5)(A)(i)(II) to have the § 2632(c)(1) automatic allocation rules not apply to these transfers on their respective Forms 709. Taxpayers, however, timely allocated their GST exemption to these transfers under § 26.2632-1(b)(4)(i). The timely allocation was effectuated when Taxpayers 1 and 2 provided on their Forms 709 that their respective GST exemption was to be allocated in an amount equal to the amount of these transfers and by a formula designed to allocate as much GST exemption to these transfers as was necessary to produce an inclusion ratio which was closest to or equal to zero. These timely allocations were effective as of the dates of transfer pursuant to § 26.2632-1(b)(4)(ii)(A)(1).

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. The ruling(s) in this letter pertaining to the federal estate and/or generation-skipping transfer tax apply only to the extent that the relevant sections of the Internal Revenue Code are in effect during the period at issue.

This ruling is directed only to Taxpayers 1 and 2. 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 your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by Taxpayers 1 and 2 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,

Leslie H. Finlow

Leslie H. Finlow  
Senior Technician Reviewer, Branch 4  
(Passthroughs & Special Industries)