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Person To Contact:
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Date: APRIL 12, 2010

In Re:

Legend

Decedent	=
Daughter 1	=
Daughter 2	=
Son	=
Granddaughter 1	=
Granddaughter 2	=
Grandson 1	=
Grandson 2	=
Personal Representative	=
Trust	=
Date 1	=
Accountant	=
Date 2	=
Date 3	=
V	=
W	=
X	=
Y	=
Z	=

Dear :

This letter responds to your authorized representative's letter of October 30, 2009, requesting rulings on the allocation of generation-skipping transfer (GST) exemption.

Facts

The facts and representations submitted are summarized as follows: Decedent died testate on Date 1 survived by Daughter 1, Daughter 2, Son and their descendants. Son is the father of Grandson 1, Grandson 2. Daughter 1 was the mother of Granddaughter 1 and Granddaughter 2. Daughter 1 died on Date 2.

Article V of Decedent's will provides that the residuary of her estate is to be divided among her three children. Article V, paragraph A provides that two-fifths of Decedent's residuary estate is to be placed in Trust for the benefit of Daughter 1. During Daughter 1's lifetime the trustee is to distribute $V per year for Daughter, adjusted for inflation. The trustee is also to purchase medical insurance for Daughter 1 and pay any uncovered medical care as the trustee deems feasible. The trustee is to pay $W to each of Daughter 1's children, Granddaughter 1 and Granddaughter 2 for the cost of their first weddings. At Daughter 1's death the remaining trust balance is to be distributed equally to Granddaughter 1 and Granddaughter 2 if they have reached the age of 35, otherwise the trust assets are to be held in trust for Granddaughter 1 and Granddaughter 2 and distributed when each attains the age of 35. Article V, paragraph B provides that two-fifths of the residuary estate passes to Daughter 2 outright.

Article V, paragraph C provides that one-fifth is to pass to Son outright. Son executed a qualified disclaimer within the meaning of § 2518 with respect to the interest passing to him under Decedent's will and as a result the property passed to trusts for the benefit of Grandson 1 and Grandson 2 until they attain the age of 35.

Personal Representative of Decedent's estate hired Accountant to prepare the Form 706 United States Estate (and Generation-Skipping Transfer) Tax Return for Decedent's estate. Decedent had not made any GST transfers during her lifetime and had her full GST exemption available to allocate on Form 706. The Form 706 was timely filed with an accompanying Schedule R. The Estate received an Estate Tax closing letter on Date 3.

The Schedule R correctly reported that Decedent had $X of unused GST exemption. Grandson 1 and Grandson 2 were treated as having received two-fifths of the estate as a result of Son's disclaimer, and a total of $Y of Decedent's GST exemption was allocated to the transfers on Schedule R, Part 1. Since Grandson 1 and Grandson 2 had not attained the age of 35, the transfers were to be to trusts for their benefit. The transfers should have been reported on Part 1 of Schedule R, naming the trusts and showing the allocations to those trusts.

In addition, the remaining amount of Decedent's GST exemption, $Z, was shown on line 8 of Schedule R as GST exemption available to allocate to trusts and § 2032A interests. The remaining exemption should have been allocated (either affirmatively or automatically) to Trust for the benefit of Daughter 1 and her descendants.

You have requested the following rulings:

1. The $Y of Decedent's unused GST exemption was effectively allocated to the residuary shares passing for the benefit of Grandson 1 and Grandson 2, regardless of whether they passed outright or in trust.

2. That the balance of Decedent's unused GST exemption, $Z, was effectively allocated to Daughter 1's Trust as of the date of D's death.

Law and Analysis

Section 2601 of the Internal Revenue Code 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 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.

Under § 2642(a)(1), in general, the inclusion ratio with respect to any property transferred in a generation-skipping transfer is the excess (if any) of 1 over the applicable fraction determined for the trust from which such transfer is made, or 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 under § 2631(a), and (B) the denominator of which is (i) the value of the property transferred to the trust, 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 §§ 2055 or 2522 with respect to such property.

Section 2631(a) provides that, for purposes of determining the inclusion ratio, every individual shall be allowed a GST exemption amount that 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)(1) provides that any allocation by an individual of his or her GST exemption may be made at any time on or before the date prescribed for filing the estate tax return for such individual's estate. Under § 26.2632-1(b)(4)(i) of the Generation-Skipping Transfer Tax Regulations, generally, an allocation of GST exemption to property transferred during the transferor's lifetime is made on Form 709. The allocation must clearly identify the trust to which the allocation is being made and the amount of GST exemption allocated to it. The allocation should also state the inclusion ratio of the trust after the allocation.

Under § 2632(b)(1), if an individual makes a direct skip transfer during his or her lifetime, any unused portion of such individual's GST exemption is automatically allocated to the property transferred to the extent necessary to make the inclusion ratio zero. Section 2632(b)(3) provides that an individual may elect out of this automatic allocation rule with respect to direct skips. Section 26.2632-1(b)(1) provides that if a direct skip occurs during the transferor's lifetime, the transferor's GST exemption not previously allocated is automatically allocated to the transferred property. The transferor may prevent the automatic allocation of GST exemption by describing on a timely-filed United States Gift (and Generation-Skipping Transfer) Tax Return (Form 709) the transfer and the extent to which the automatic allocation is not to apply.

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 is treated as 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.

Under § 2632(c)(3)(A), 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, as defined in § 2632(c)(3)(B). Under § 2632(c)(3)(B), a GST trust is a trust that could have GST potential with respect to the transferor unless the trust satisfies any of the exceptions listed in § 2632(c)(3)(B)(i)-(vi).

Section 2632(c)(5)(A)(i) provides that an individual may elect to have the automatic allocation rules of § 2632(c)(1) not apply to an indirect skip, or any or all transfers made by such individual to a particular trust. Section 2632(c)(5)(B)(ii) provides that the election may be made on a timely filed gift tax return for the calendar year for which the election is to become effective.

Section 26.2632-1(b)(2)(i) provides that in the case of an indirect skip made after December 31, 2000, to which § 2642(f) (relating to transfers subject to the estate tax inclusion period or ETIP) 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). This 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. An automatic allocation is irrevocable after the due date of the Form 709 for the calendar year in which the transfer is made.

Section 26.2632-1(b)(2)(ii) provides that, except as otherwise provided, the transferor may prevent the automatic allocation of GST exemption with regard to an indirect skip by making an election as provided in § 26.2632-1(b)(2)(iii). The transferor may also prevent the automatic allocation of a GST exemption with regard to an indirect skip by making an affirmative allocation of GST exemption on a Form 709 filed at any time on or before the due date for timely filing of an amount that is less than (but not equal to) the value of the property transferred as reported on that return.

Section 26.2632-1(b)(2)(iii)(A) provides 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 or to one or more separate shares that are treated as separate trusts under § 26.2654-1(a)(1). In the case of a transfer treated under § 2513 as made one-half by the transferor and one-half by the transferor's spouse, each spouse shall be treated as a separate transferor who must satisfy separately the requirements of § 26.2632-1(b)(2)(iii)(B) to elect out with respect to the transfer. Under § 26.2632-1(b)(2)(iii)(B), to elect out, the transferor must attach a statement to a Form 709 that identifies the trust and specifically provides 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)(D) provides that an election out does not affect the automatic allocation of GST exemption to any transfer not covered by the election out statement.

Section 2642(g)(2) captioned "Substantial Compliance" provides that an allocation of GST exemption under § 2632 that demonstrates an intent to have the lowest possible inclusion ratio with respect to a transfer to a trust shall be deemed to be an allocation of so much of the transferor's unused GST exemption as produces the lowest possible inclusion ratio. In determining whether there has been substantial compliance, all relevant circumstances shall be taken into account, including evidence of intent contained in the trust instrument.

In this case, Decedent's GST exemption amount was properly allocated to the transfers of the shares passing for the benefit of Grandson 1 and Grandson 2. However, the property was not identified and properly recorded on Part 1 of Schedule R as trusts for the benefit of Grandson 1 and Grandson 2. The allocation of Decedent's GST exemption to the transfers to Grandson 1 and Grandson 2 was sufficient to produce a zero inclusion ratio for both trusts. Under these circumstances, with respect to Decedent's return, the allocation is sufficient to constitute substantial compliance under § 2642(g).

Therefore, we conclude that Decedent is deemed to have made a timely allocation of Decedent's GST exemption with respect to Decedent's transfers to trusts for the benefit of Grandson 1 and Grandson 2. As a result, the trusts for the benefit of Grandson 1 and Grandson 2 will have an inclusion ratio of zero, assuming the transfers to the trusts are properly valued.

With respect to the transfers to Trust for the benefit of Daughter 1 and her descendents, the remaining amount of Decedent's GST exemption was properly reported on line 8 of Schedule R, but Trust was not listed on Part 1 of Schedule R and the remaining exemption was not allocated to Trust. Thus, we conclude that under § 2632(c)(1), Decedent's remaining GST exemption was automatically allocated to the transfer to Trust for the benefit of Daughter 1 and her descendants.

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.

The GST tax rulings in this letter apply only to the extent that the relevant sections of the Internal Revenue Code are in effect during the period at issue.

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,

Lorraine E. Gardner
Senior Counsel, Branch 4
Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures
Copy for section 6110 purposes
Copy of this letter