

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-116296-03
Date:
July 11, 2003

Re:

LEGEND:

Taxpayer 1 =

Taxpayer 2 =

Date 1 =

Trust I =

Trust II =

Child 1 =

Child 2 =

Child 3 =

Trust I.A =

Trust I.B =

Trust I.C =

Trust II.A =

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Trust II.B =

Trust II.C =

Date 2 =

a =b =

Year 1 =

Accounting Firm =

Date 3 =

Law Firm =

Trust I.A.1 =

Trust I.A.2 =

Date 4 =

Year 2 =

Date 5 =

Dear :

This is in response to your letter dated March 4, 2003, on behalf of Taxpayer 1 and the estate of Taxpayer 2, requesting an extension of time under § 301.9100-3 of the Procedure and Administration Regulations to make allocations of Generation-Skipping Transfer (GST) exemption.

The facts and representations submitted are summarized as follows: On Date 1, Taxpayer 1 established Trust I and Taxpayer 2 established Trust II. Trust I and Trust II are irrevocable trusts for the benefit of the children of Taxpayer 1 and Taxpayer 2.

Article I(A) of Trust I provides that immediately upon the initial transfer of property to the trustee, the trustee shall divide and set apart the trust estate into three equal shares so that there is one share for each of the settlor's children, Child 1, Child

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2, and Child 3. The share for each such child of the settlor shall constitute the initial principal of a separate trust for the primary benefit of that child.

Article I(B) of Trust I provides that any property subsequently received by the trustee as an addition to the trust estate which is not designated as an addition to a particular trust shall be divided and set apart, per stirpes, for the then living descendants of the settlor. If a share is set apart pursuant to the preceding sentence for a descendant of the settlor for whose benefit a separate trust then exists under Article II, such share shall be added to and dealt with as part of the principal of such existing trust. If a share is set apart for a descendant of the settlor for whom no separate trust then exists under Article II, or if property received by the trustee is designated for the benefit of a descendant of the settlor for whose benefit no separate trust then exists under Article II, such property shall constitute the initial principal of a separate trust for the primary benefit of that descendant and shall be dealt with as provided in Article II.

Article I(D) of Trust I provides that upon the death of the survivor of the settlor and the settlor's spouse, the trust under Article I shall terminate and the trustee shall deal with the then principal of the trust as follows: (1) If the value of all payments to any child of the settlor (including all payments to the descendants of such child) from the income and principal of the trust under Article I is less than the value of all payments to any other child of the settlor (including all payments to the descendants of such child), the trustee shall determine the amount, if any, which, if paid to each child of the settlor, would equalize the value of all payments to all of the settlor's children over the term of the trust under Article I, and shall deal with the amount so determined with respect to each child for the benefit of such child (or, if such child is not then living, per stirpes, for the descendants of such child) as provided in Article II. The amounts determined pursuant to this paragraph shall not take into account differences in the timing of payments. (2) The trustees shall divide and set apart the balance of the principal of the trust, per stirpes, for the settlor's then living descendants and shall deal with such shares as provided in Article II.

Article II(A) of Trust I provides that whenever the provisions of this agreement require that any share set apart for a descendant of the settlor be dealt with as provided in Article II, such share shall be held by the trustee as the principal of a separate trust for the primary benefit of the descendant of the settlor. The trustee may, from time to time and in his discretion: (1) pay to the beneficiary so much of the net income and principal of the trust as the trustee deems advisable for the beneficiary's health, education, maintenance and support; and (2) after the death of the survivor of the settlor and the settlor's spouse, if the beneficiary has attained the age of 35 years, pay to the beneficiary in addition to any amount or amounts distributed pursuant to the provisions of Article II(A)(1), so much of the net income and principal of the trust for any other purpose that the independent trustee deems to be worthwhile and in the best interests of the beneficiary.

Article II(C) of Trust I provides that upon the death of the beneficiary, the trust shall terminate and the trustee shall deal with the then principal of such trust as follows:

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(1) if a taxable termination or taxable distribution (within the meaning of § 2612 of the Internal Revenue Code) would otherwise occur by reason of the beneficiary's death, the trustee shall distribute the appointive share of such principal to or for the benefit of any one or more persons, including the beneficiary's estate or creditors or the creditors of his or her estate, in such proportions and on such terms and conditions, either outright or in trust, as the beneficiary appoints by will making specific reference to this power of appointment. For purposes of Article II(C)(1), the term "appointive share" shall mean the largest fraction, if any, of such principal which, if added to the beneficiary's taxable estate for federal estate tax purposes would not be taxed at the maximum federal estate tax rate in effect at the time of the beneficiary's death; provided, however, that (i) the appointive share shall be satisfied exclusively out of that portion (the non-exempt portion) of the trust which has an inclusion ratio, as defined in § 2642(a), of greater than zero and, if the appointive share exceeds the non-exempt portion, it shall be reduced by such excess, and (ii) if under any other instrument the beneficiary has one or more other general powers of appointment exercisable and measured substantially as provided by Article II(C)(1), the amount the beneficiary may appoint under Article II(C)(1) shall be reduced proportionately based on the relative fair market values at the date of death of the beneficiary of the non-exempt portion of the various properties with respect to which such powers are potentially exercisable, so that the aggregate amount appointable under this agreement and amounts so appointable pursuant to such other power or powers shall be no greater than the appointive share would be if all such properties were part of a single trust governed by Article II(C)(1).

Article II(C)(2) of Trust I provides that the trustee shall distribute the balance of such principal, including any portion of the appointive share over which the beneficiary does not effectively exercise his or her power of appointment (or all of such principal, if the provisions of Article II(C)(1) do not take effect) to or for the benefit of any one or more of the settlor's descendants (excluding the beneficiary, his or her estate, his or her creditors and the creditors of his or her estate), in such proportions and on such terms and conditions, either outright or in trust, as the beneficiary appoints by will making specific reference to this power of appointment. The trustee shall divide and set apart the balance of the principal over which the beneficiary does not effectively exercise either power of appointment, per stirpes, for the beneficiary's then living descendants or, if there is none, for the then living descendants of the beneficiary's most immediate ancestor who is the settlor or a descendant of the settlor and who has any descendant then living, and the shares so set apart shall be dealt with as provided in Article II.

Article V(G)(1) of Trust I provides that notwithstanding any provision of this agreement requiring that property be held in a single trust, the trustee of any trust created under this agreement may, at any time or times and without court approval, (i) divide any trust created under this agreement (before or after it is funded with assets) into two or more separate trusts, the terms of each such trust being identical to those of the divided trust, for any purpose, and (ii) merge or consolidate any trusts that have been so divided; any division of a trust to which a portion or all of the settlor's GST exemption (within the meaning of § 2631) will be or has been allocated shall be made solely on a fractional or percentage basis and the separate trusts created by such division shall be funded on the basis of the fair market value of the assets of the divided

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trust at the time the separate trusts are funded, or in a manner that fairly reflects the net appreciation or depreciation in the assets from the date the trust is established under this agreement to the date of funding.

Article XII of Trust I provides that notwithstanding any provision of this agreement to the contrary, at any time during the life of the settlor's spouse the trustees shall immediately distribute or otherwise deal with the principal of any trust under this agreement to or for the benefit of any one or more of the settlor's descendants, in such proportions and on such terms and conditions, outright or in trust, as the settlor's spouse appoints by written instrument signed and acknowledged by the settlor's spouse and delivered to the trustee; provided that this power of appointment may not be exercised (i) to discharge a legal obligation of the settlor's spouse, or (ii) with respect to any trust under this agreement that holds stock of an S corporation.

The terms of Trust II are virtually identical to those of Trust I.

Pursuant to the direction in Article I(A), Trust I was divided into three separate trusts; Trust I.A, Trust I.B, and Trust I.C, for the benefit of Child 1, Child 2, and Child 3, respectively. Trust II was also divided into three separate trusts; Trust II.A, Trust II.B, and Trust II.C, for the benefit of Child 1, Child 2, and Child 3, respectively. (Trust I.A, Trust I.B, Trust I.C, Trust II.A, Trust II.B, and Trust II.C are collectively referred to as the "Children's Trusts.")

On Date 2, Taxpayer 1 transferred \$a of marketable securities to each of Trust I.A, Trust I.B, and Trust I.C. Also on Date 2, Taxpayer 2 transferred \$b of marketable securities to each of Trust II.A, Trust II.B, and Trust II.C. Taxpayer 1 and Taxpayer 2 each reported the transfers on Year 1 Forms 709 United States Gift (and Generation-Skipping Transfer) Tax Return and elected under § 2513 to treat the gifts made by them to third parties during the calendar year as made one-half by each of them. Accounting Firm prepared Taxpayer 1's and Taxpayer 2's Year 1 gift tax returns but did not allocate any of Taxpayer 1's and Taxpayer 2's GST exemption to the trusts.

In Date 3, Law Firm reviewed Taxpayer 1's and Taxpayer 2's Year 1 gift tax returns and discovered that no allocation of Taxpayer 1's and Taxpayer 2's GST exemption had been made. In an attempt to mitigate further damage, the trustees of the Children's Trusts divided each trust into two separate trusts so that each taxpayer could allocate a sufficient amount of their GST exemption to fully exempt one of the divided trusts from GST tax. (For example, Trust I.A was divided into Trust I.A.1 (exempt) and Trust I.A.2 (non-exempt)). As a result of the division, Child 1, Child 2, and Child 3 were each the beneficiary of four trusts.

On Date 4, after the division of the Children's Trusts, Taxpayer 1 and Taxpayer 2 each filed Year 2 gift tax returns and made late allocations of their respective GST exemptions with respect to the divided exempt trusts. Taxpayer 2 died on Date 5.

Taxpayer 1 and the estate of Taxpayer 2 have requested the following rulings:
(1) an extension of time under § 2642(g) and §§ 301.9100-1 and 301.9100-3 to make

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allocations of Taxpayer 1's and Taxpayer 2's respective GST exemptions with respect to the transfers to the Children's Trusts in Year 1; (2) that the allocations shall be made based on the value of the property transferred to the Children's Trusts as of Date 1, the date of the original transfers; and (3) that the late allocations made by Taxpayer 1 and Taxpayer 2 on the Year 2 gift tax returns are void.

Section 2601 imposes a tax on every generation-skipping transfer (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 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)) that may be allocated by such individual (or his executor) to any property with respect to which such individual is the transferor.

Section 2632(a)(1) 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)(i) of the Generation-Skipping Transfer Tax Regulations 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. An allocation of GST exemption to a trust is void to the extent the amount allocated exceeds the amount necessary to obtain an inclusion ratio of zero with respect to the trust.

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 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) 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 estate tax inclusion period, its value at the time of the close of the estate tax inclusion period, and 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 estate tax inclusion period, on and after the close of such estate tax inclusion period.

Section 2642(g)(1)(A) provides, generally, 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) or (2), and an election under § 2632(b)(3) or (c)(5). Such regulations shall include procedures for

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requesting comparable relief with respect to transfers made before the date of the enactment of § 2642(g)(1), which was enacted into law on June 7, 2001.

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

Notice 2001-50, 2001-34 I.R.B. 189, provides that under § 2642(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 generation-skipping 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 Internal Revenue 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) or (b)(2) or an election described in § 2632(b)(3) or (c)(5) 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.

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 the estate of Taxpayer 2 are granted an extension of time of 60 days from the date of this letter to make allocations of Taxpayer 1's and Taxpayer 2's available GST exemptions,

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with respect to the transfers to the Children's Trusts. The allocations will be effective as of Date 1, the date of the transfers to the trusts, and the gift tax values of the transfers to the trusts will be used in determining the amount of GST exemption to be allocated to the trusts.

These allocations should be made on supplemental Forms 709 United States Gift (and Generation-Skipping Transfer) Tax Return and filed with the Internal Revenue Service Center, Cincinnati, OH 45999. A copy of this letter should be attached to the supplemental Form 709. Copies are enclosed for this purpose.

The Year 2 late allocations of Taxpayer 1's and Taxpayer 2's respective GST exemptions are void because if Taxpayer 1 and the estate of Taxpayer 2 make allocations of GST exemption pursuant to the relief granted above, the allocations will be deemed timely and will result in the Children's Trusts having a zero inclusion ratio immediately prior to the division. Similarly, immediately after the division of the Children's Trusts, each of the divided exempt and non-exempt trusts will have a zero inclusion ratio for GST tax purposes.

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. In addition, we express or imply no opinion regarding the value of the property transferred to the Children's Trusts.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to Taxpayer 1 and the estate of Taxpayer 2.

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

Sincerely,

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

Enclosures

Copy for section 6110 purposes
Copies of this letter (2)