

[4830-01-p]

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 26

REG-153841-02

RIN 1545-BB54

Election Out of GST Deemed Allocations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: These proposed regulations provide guidance for making the election under section 2632(c)(5)(A)(i) of the Internal Revenue Code to not have the deemed allocation of unused generation-skipping transfer (GST) tax exemption under section 2632(c)(1) apply with regard to certain transfers to a GST trust, as defined in section 2632(c)(3)(B). The proposed regulations also provide guidance for making the election under section 2632(c)(5)(A)(ii) to treat a trust as a GST trust. The regulations primarily affect individuals.

DATES: Written and electronic comments and requests for a public hearing must be received by October 12, 2004.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-153841-02), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG-153841-02), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC, or sent electronically, via the

IRS Internet site at [www.irs.gov/regs](http://www.irs.gov/regs) or via the Federal eRulemaking Portal at [www.regulations.gov](http://www.regulations.gov) (IRS - REG-153841-02).

FOR FURTHER INFORMATION CONTACT: Mayer R. Samuels, (202) 622-3090 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

### **Paperwork Reduction Act**

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP; Washington, DC 20224. Comments on the collection of information should be received by September 13, 2004. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

The collection of information in this proposed regulation is in §26.2632-1(b)(2)(ii), (b)(2)(iii), and (b)(3). This information is required by the IRS for taxpayers who elect to have the automatic allocation rules not apply to the current transfer and/or to future transfers to the trust or to terminate such election. This information is also required by the IRS for taxpayers who elect to treat trusts described in section 2632(c)(3)(B)(i) through (vi) as GST trusts or to terminate such election. This information will be used to identify the trusts to which the election or termination of election will apply. The collection of information is required in order to have a valid election or termination of election. The likely respondents are individuals contributing to trusts that have skip persons as beneficiaries.

Estimated total annual reporting burden: 12,500 hours.

Estimated average annual burden hours per respondent: 30 minutes.

Estimated number of respondents: 25,000.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law.

Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

## **Background**

Section 2601 imposes a tax on every generation-skipping transfer (GST). Under section 2631(a), for purposes of determining the amount of GST tax imposed on a transfer, every individual is allowed a GST exemption (\$1,500,000 in 2004) that may be allocated by the individual (or his or her executor) to any property with regard to which the individual is the transferor. Generally, under section 2632(a), an allocation of an individual's GST exemption may be made at any time on or before the date prescribed for filing the estate tax return for the individual's estate (determined with regard to extensions).

Section 2632 also provides deemed allocation rules pursuant to which an individual's available GST exemption is automatically allocated to certain kinds of transfers, without any action on the part of the transferor. Under section 2632(b), an individual's unused GST exemption is automatically allocated to transfers made during that individual's lifetime that are direct skips as defined in section 2612(c), to the extent necessary to make the inclusion ratio zero for the property transferred. Under section 2632(c), in the case of a lifetime transfer made after December 31, 2000 that is an indirect skip, the transferor's available GST exemption is automatically allocated to the transfer to the extent necessary to make the inclusion ratio zero for the property transferred. Section 2632(c)(3)(A) defines an indirect skip as a transfer of property (other than a direct skip) subject to gift tax that is made to a GST trust. A GST trust is defined in section 2632(c)(3)(B), in general, as any trust that could have a generation-skipping transfer.

However, no trust described in section 2632(c)(3)(B)(i) through (vi) is treated as a GST trust, because a sufficient possibility exists (based on the statutory criteria) that the trust corpus will not be distributed to lower generations. A transfer to any trust described in section 2632(c)(3)(B)(i) through (vi) will not be subject to the automatic allocation of the GST exemption. The automatic allocation under section 2632(c) also applies to an indirect skip occurring upon the post-2000 termination of an estate tax inclusion period.

Under section 2632(c)(5)(A)(i)(I), an individual may elect out of the deemed allocation rules so that GST exemption will not be allocated automatically to a particular transfer that is an indirect skip. Under section 2632(c)(5)(B)(i), this election out with regard to a particular indirect skip shall be deemed timely if made on a timely filed gift tax return for the calendar year in which the transfer was made, or deemed to have been made under section 2632(c)(4) with regard to trusts subject to an estate tax inclusion period, or on such later dates as may be prescribed in regulations.

Under section 2632(c)(5)(A)(i)(II), an individual may elect out of the deemed allocation rules for indirect skips so that GST exemption will not be allocated automatically to any or all transfers made to the trust by that individual, regardless of when a transfer is, or may in the future be, made. Under section 2632(c)(5)(B)(ii), this election out with regard to any or all transfers to the trust by that individual may be made on a timely filed gift tax return for the calendar year for which the election is to become effective.

Alternatively, under section 2632(c)(5)(A)(ii), an individual may elect to treat any trust as a GST trust with regard to any or all transfers made by that individual to the trust. If this election is made, the rules for the automatic allocation of the GST exemption will apply

with regard to that individual's transfers to the trust, notwithstanding that the trust is described in section 2632(c)(3)(B)(i) through (vi). Under section 2632(c)(5)(B)(ii), the election to treat a trust as a GST trust may be made on a timely filed gift tax return for the calendar year for which the election is to become effective.

Notice 2001-50 (2001-2 C.B. 189), states that the Treasury Department and the IRS will issue regulations providing that the election out of the automatic allocation for indirect skips and the election to treat any trust as a GST trust must be made on a timely filed federal gift tax return (which is the same rule that applies for the election out of the automatic allocation for direct skips contained in section 2632(b)(3) and §26.2632-1(b)(1)(i)).

### **Explanation of Provisions**

Under the proposed regulations, the election out of the automatic allocation rules for indirect skips and the election to treat any trust as a GST trust are to be made on a timely filed federal gift tax return.

Under the proposed regulations, a transferor who wants to elect out of the automatic allocation rules for indirect skips has the option of electing out for the specific transfer to the GST trust, or making a single election with regard to the trust that applies to the current transfer and all subsequent transfers made by that transferor to the trust. Under the second option, once the election is made with regard to a trust, the election remains effective for all subsequent transfers to that trust by the electing transferor, until that transferor's election is terminated. Practitioners have commented that in many cases, particularly situations in which trust corpus consists of primarily insurance contracts, the transferor may not be

required to file a Federal gift tax return reporting annual transfers to a GST trust because the transfers qualify for the gift tax annual exclusion under section 2503(b). If under the terms of the trust instrument distributions to skip persons are unlikely, the transferor may choose not to allocate GST exemption to the trust. The rule in the proposed regulation is intended to alleviate the need to repeatedly file a gift tax return to elect out of the automatic allocation rules for transfers that would not otherwise require a Federal gift tax return to be filed. Thus, once the transferor “elects out” of the automatic allocation rule for indirect skips with regard to any or all transfers made by that transferor to the trust, the election out, until terminated, remains effective for all subsequent transfers made by that transferor to the trust, without any further reporting requirement on the part of the transferor. A similar rule applies with regard to the election to treat a trust as a GST trust.

Finally, the proposed regulations revise the examples illustrating the rules for allocation of GST exemption to reflect the recent statutory changes.

### **Proposed Effective Date**

The regulations are proposed to be applicable for elections made on or after the date that the proposed regulations are published in the **Federal Register**. However, any election under section 2632(c)(5)(A) made before that date will be recognized if the election was made on a timely filed gift tax return in a manner that provided adequate notice to the Commissioner that the transferor made the election.

### **Special Analyses**

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these proposed regulations, and because these proposed regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the proposed regulations will be submitted to the Small Business Administration for comment on their impact on small business.

### **Comments and Requests for Public Hearing**

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

### **Drafting Information**

The principal author of these proposed regulations is Mayer R. Samuels, Office of the Associate Chief Counsel (Passthroughs and Special Industries), IRS. If you have any questions concerning these proposed regulations, please contact Mayer R. Samuels at (202) 622-3090. Other personnel from the IRS and the Treasury Department participated in their development.

**List of Subjects in 26 CFR Part 26**

Estate taxes, Reporting and recordkeeping requirements.

**Proposed Amendments to the Regulations**

Accordingly, 26 CFR part 26 is proposed to be amended as follows:

**PART 26 -- GENERATION-SKIPPING TRANSFER TAX REGULATIONS UNDER THE TAX REFORM ACT OF 1986**

Paragraph 1. The authority citation for part 26 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Par. 2. In §26.2600-1, the table is amended under the entries for §26.2632-1 by revising the entry for paragraph (b)(2) and adding entries for paragraphs (b)(3), (b)(4) and (e) to read as follows:

§26.2600-1 Table of contents.

\* \* \* \* \*

§26.2632-1 Allocation of GST exemption.

\* \* \* \* \*

(b) \* \* \*

(2) Automatic allocation to indirect skips made after December 31, 2000.

- (3) Election to treat trust as GST trust.
- (4) Allocation to other transfers.

\* \* \* \* \*

(e) Effective date

\* \* \* \* \*

Par. 3. Section 26.2632-1 is amended as follows:

- 1. Paragraph (b)(2) is redesignated as paragraph (b)(4).
- 2. Paragraphs (b)(2) and (b)(3) are added.
- 3. In newly designated paragraph (b)(4)(i), the third sentence is revised.
- 4. In newly designated paragraph (b)(4)(ii)(A)(1), the fourth sentence is revised.
- 5. In newly designated paragraph (b)(4)(ii)(B):
  - a. All references to paragraph “(b)(2)(ii)(A)(1)(i)” are removed and “(b)(4)(ii)(A)(1)(i)” is added in its place.
  - b. All references to paragraph “(b)(2)(ii)(A)(1)(ii)” are removed and “(b)(4)(ii)(A)(1)(ii)” is added in its place.
  - c. All references to paragraph “(b)(2)(ii)(A)(1)(iii)” are removed and “(b)(4)(ii)(A)(1)(iii)” is added in its place.
- 6. Examples 1 through 5 in newly designated paragraph (b)(4)(iii) are revised.
- 7. In paragraph (c)(1), the first sentence is removed and two sentences are added in its place.
- 8. In paragraph (d)(1), the fourth sentence is revised.
- 9. Paragraph (e) is added.

The additions and revisions read as follows:

§ 26.2632-1 Allocation of GST exemption.

\* \* \* \* \*

(b) \* \* \*

(2) Automatic allocation to indirect skips made after December 31, 2000--(i) In general. An indirect skip is a transfer of property to a GST trust as defined in section 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 section 2642(f) (relating to transfers subject to an estate tax inclusion period) 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). In the case of an indirect skip to which section 2642(f) does apply, the indirect skip is deemed to be made at the close of the estate tax inclusion period and the GST exemption is deemed to be allocated at that time. The transferor may prevent the automatic allocation of GST exemption with regard to an indirect skip, as provided in paragraphs (b)(2)(ii) and (iii) of this section.

(ii) Election to have automatic allocation rules not apply to the current transfer. The transferor may prevent the automatic allocation of GST exemption with regard to the current indirect skip (and not to any other transfer) to a trust, or to one or more separate shares that are treated as separate trusts under §26.2654-1(a)(1), by attaching a statement to a timely filed Form 709 (as defined in paragraph (b)(1)(ii) of this section) for the calendar year in which the transfer was made (whether or not a Form 709 would otherwise be required for that year). The statement must identify the trust (or separate share), describe

the transfer, and specifically provide that the transferor is electing, pursuant to section 2632(c)(5)(A), to have the automatic allocation rules contained in section 2632(c)(1) not apply to the described transfer to the trust (or separate share). In the case of a transfer treated as made one-half by the transferor and one-half by the transferor's spouse under section 2513, a statement must be attached to the return filed by each transferor seeking to prevent the automatic allocation. The election will apply only with regard to the described transfer, and all subsequent transfers to the trust (or separate share) will be subject to the automatic allocation rules, unless the transferor subsequently files an election described in paragraph (b)(2)(iii) of this section, or files an election under this paragraph with regard to each transfer as additional transfers are made.

(iii) Election to have automatic allocation rules not apply to both the current transfer and any or all future transfers to the trust--(A) In general. The transferor may prevent the automatic allocation of GST exemption to both the current transfer and any or all subsequent transfers made by the transferor to the trust or to one or more separate shares that are treated as separate trusts under §26.2654-1(a)(1). The transferor must attach a statement to a timely filed Form 709 (as defined paragraph (b)(1)(ii) of this section) for the calendar year in which the current transfer was made (whether or not a Form 709 would otherwise be required for that year). The statement must identify the trust (or separate share), describe the current transfer, and specifically provide that pursuant to section 2632(c)(5)(A) the transferor is electing to have the automatic allocation rules contained in section 2632(c)(1) not apply to the described current transfer as well as all future transfers made by the transferor to the trust (or separate share). The election, unless and until

terminated, will remain in effect for all future transfers made by the transferor to the trust (or separate share). No future gift tax return will have to be filed by the transferor in order to prevent the automatic allocation of the GST exemption to such future transfers.

(B) Termination of election. The election described in paragraph (b)(2)(iii)(A) of this section may be terminated by the transferor for transfers to the trust (or separate share) in a subsequent year by attaching a statement to a timely filed Form 709 (as defined in paragraph (b)(1)(ii) of this section) for the calendar year in which the first transfer to which the election is not to apply was made (whether or not a Form 709 would otherwise be required for that year). The statement must identify the trust (or separate share), describe the transfer, and provide that the prior election out of the GST automatic allocation rule described in §26.2632-1(b)(2)(iii)(A) is terminated. Accordingly, the automatic allocation rules contained in section 2632(c)(1) are to apply to the described current transfer as well as to all future transfers made by the transferor to the trust (or separate share) unless and to the extent that another election under section 2632(c)(5)(A) is made in the future.

(iv) Subsequent allocations. Making an election under paragraph (b)(2)(ii) or (iii) of this section does not prevent the transferor from allocating the transferor-s available GST exemption to a current transfer (or, in the case of an election made under paragraph (b)(2)(iii) of this section, to any future transfer) to a trust (or separate share) either on a timely filed Form 709 (as defined in paragraph (b)(1)(ii) of this section) reporting the transfer, or at a later date in accordance with the provisions of paragraph (b)(4) of this section.

(3) Election to treat trust as GST trust--(i) In general. A transferor may elect to treat any trust as a GST trust, in which case the automatic allocation rules will apply to current and future transfers made by the electing transferor to the trust. The transferor must attach a statement to a timely filed Form 709 (as defined in paragraph (b)(1)(ii) of this section) for the calendar year in which a transfer was made by the transferor (whether or not a Form 709 would otherwise be required for that year). The statement must identify the trust, describe the current transfer, and specifically provide that, pursuant to section 2632(c)(5)(A)(ii), the transferor is electing to have the trust treated as a GST trust as defined in section 2632(c)(3)(B). As a result of this election, the current transfer and all future transfers made by the transferor to the trust will be indirect skips as defined in paragraph (b)(2)(i) of this section to which the transferor's unused GST exemption will be automatically allocated in accordance with paragraph (b)(2) of this section. The election will remain in effect for all future transfers made by the transferor to the trust unless and until terminated (as described below).

(ii) Termination of election. The election may be terminated by the transferor in a subsequent year by attaching to a timely filed Form 709 (as defined in paragraph (b)(1)(ii) of this section) for the calendar year in which the first transfer to which the election is not to apply was made (whether or not a Form 709 would otherwise be required for the year), a statement identifying the trust, describing the current transfer, and providing that the prior election to treat the trust as a GST trust as provided under §26.2632-1(b)(3)(i) is terminated. Accordingly, if the trust does not satisfy the definition of a GST trust, the automatic allocation rules contained in section 2632(c)(1) will not apply to the described

current transfer or to any future transfers made by the transferor to the trust, unless and until another election under section 2632(c)(5)(A) is made in the future.

(4) Allocation to other transfers--(i) In general. \* \* \* See paragraph (b)(4)(ii) of this section. \* \* \*

(ii) Effective date of allocation--(A) In general. (1) \* \* \* 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. \* \* \*

\* \* \* \* \*

(iii) Examples. The following examples illustrate the provisions of this paragraph (b):

Example 1. Modification of allocation of GST exemption. On December 1, 2003, T transfers \$100,000 to an irrevocable GST trust described in section 2632(c)(3)(B). The transfer to the trust is not a direct skip. The date prescribed for filing the gift tax return reporting the taxable gift is April 15, 2004. On February 10, 2004, T files a Form 709 on which T properly elects out of the automatic allocation rules contained in section 2632(c)(1) with respect to the transfer in accordance with paragraph (b)(2)(ii) of this section, and allocates \$50,000 of GST exemption to the trust. On April 13th of the same year, T files an additional Form 709 on which T confirms the election out of the automatic allocation rules contained in section 2632(c)(1) and allocates \$100,000 of GST exemption to the trust in a manner that clearly indicates the intention to modify and supersede the prior allocation with respect to the 2003 transfer. The allocation made on the April 13 return supersedes the prior allocation because it is made on a timely-filed Form 709 that clearly identifies the trust and the nature and extent of the modification of GST exemption allocation. The allocation of \$100,000 of GST exemption to the trust is effective as of December 1, 2003. The result would be the same if the amended Form 709 decreased the amount of the GST exemption allocated to the trust.

Example 2. Modification of allocation of GST exemption. The facts are the same as in Example 1, except on July 8, 2004, T files a Form 709 attempting to reduce the earlier allocation. The return is not a timely filed return. The \$100,000 GST exemption allocated to the trust, as amended on April 13, 2004, remains in effect because an

allocation, once made, is irrevocable and may not be modified after the last date on which a timely filed Form 709 can be filed.

Example 3. Effective date of late allocation of GST exemption. On December 1, 2003, T transfers \$100,000 to an irrevocable GST trust described in section 2632(c)(3)(B). The transfer to the trust is not a direct skip. The date prescribed for filing the gift tax return reporting the taxable gift is April 15, 2004. On February 10, 2004, T files a Form 709 on which T properly elects out of the automatic allocation rules contained in section 2632(c)(1) in accordance with paragraph (b)(2)(ii) of this section with respect to that transfer. On December 1, 2004, T files a Form 709 and allocates \$50,000 to the trust. The allocation is effective as of December 1, 2004.

Example 4. Effective date of late allocation of GST exemption. T transfers \$100,000 to a GST trust on December 1, 2003, in a transfer that is not a direct skip. On April 15, 2004, T files a Form 709 on which T properly elects out of the automatic allocation rules contained in section 2632(c)(1) with respect to the entire transfer in accordance with paragraph (b)(2)(ii) of this section and T does not make an allocation of any GST exemption on the Form 709. On September 1, 2004, the trustee makes a taxable distribution from the trust to T's grandchild in the amount of \$30,000. Immediately prior to the distribution, the value of the trust assets was \$150,000. On the same date, T allocates GST exemption to the trust in the amount of \$50,000. The allocation of GST exemption on the date of the transfer is treated as preceding in point of time the taxable distribution. At the time of the GST, the trust has an inclusion ratio of  $.6667 (1 - (50,000/150,000))$ .

Example 5. Automatic allocation to split-gift. On December 1, 2003, T transfers \$50,000 to an irrevocable GST Trust described in section 2632(c)(3)(B). The transfer to the trust is not a direct skip. On April 30, 2004, T and T's spouse, S, each files an initial gift tax return for 2003, on which they consent, pursuant to section 2513, to have the gift treated as if one-half had been made by each. Previously, neither T nor S filed a timely gift tax return electing out of the automatic allocation rules contained in section 2632(c)(1). As a result of the election under section 2513, which is retroactive to the date of T's transfer, T and S are each treated as the transferor of one-half of the property transferred in the indirect skip. Thus, \$25,000 of T's unused GST exemption and \$25,000 of S's unused GST exemption is automatically allocated to the trust. Both allocations are effective on and after the date that T made the transfer. The result would be the same if T's transfer constituted a direct skip subject to the automatic allocation rules contained in section 2632(b).

(c) Special rules during an estate tax inclusion period--(1) In general. An allocation of GST exemption (including an automatic allocation to a direct skip, but not an indirect skip) to property subject to an estate tax inclusion period (ETIP) cannot be revoked, but

becomes effective no earlier than the date of any termination of the ETIP with respect to the trust. See paragraph (b)(2)(i) of this section regarding the automatic allocation of GST exemption to an indirect skip subject to an ETIP. \* \* \*

\* \* \* \* \*

(d) Allocations after the transferor's death--(1) \* \* \* A late allocation of GST exemption by an executor, other than an allocation that is deemed to be made under section 2632(b)(1) or (c)(1), with respect to a lifetime transfer of property is made on Form 706, Form 706NA, or Form 709 (filed on or before the due date of the transferor's estate tax return) and is effective as of the date the allocation is filed. \* \* \*

\* \* \* \* \*

(e) Effective Date. Paragraphs (b)(2) and (b)(3), the third sentence of paragraph (b)(4)(i), the fourth sentence of paragraph (b)(4)(ii)(A), paragraph (b)(4)(iii), the first two sentences of paragraph (c)(1), and the fourth sentence of paragraph (d)(1) of this section, when published as final regulations, will apply as of July 13, 2004.

Mark E. Matthews,  
Deputy Commissioner for Services and Enforcement.