Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:4/PLR-116742-99
Date:
September 29, 2000

Re:

Legend:

A =
Trust A =

Date 1 =
B =
Trust B =

Date 2 =
C =
D =
Date 3 =

Dear :

This is in response to your letter dated October 8, 1999, and subsequent correspondence submitted on behalf of the trustee of two trusts in which you requested rulings with respect to the inclusion ratios of the trusts for generation-skipping transfer tax purposes.

Facts

The facts submitted and representations made are as follows:

A, the father of C and the grandfather of D, died on Date 1. A's will provided that 50 percent of the residue of his estate was to pass outright to C and 50 percent of the residue of his estate was to pass to a trust (Trust A) for the benefit of D.

A's estate tax return was timely filed. The estate tax return shows that the value of the property which passed to Trust A was less than $300,000. On Schedule R of the estate tax return, A's executrix allocated A's available generation-skipping transfer tax exemption of $1,000,000 to Trust A.

C is the trustee of Trust A. Trust A provides that the trustee is to accumulate

income and add it to principal and use so much of the trust as in her discretion may be reasonable and necessary for the health, education, maintenance and support of D until D reaches age 22. In addition, the trustee may, in her discretion, make payments of principal as she deems reasonable and necessary for the general welfare and support of D in accordance with his accustomed mode of living and to provide amply for him in the event of accident or illness and to provide for his education and/or professional training. At age 22, D is entitled to receive all of the income of Trust A annually. D may withdraw one-third of the principal of Trust A when he reaches age 30, one-third of the remaining principal when he reaches age 35, and any portion or all of the remaining principal when he reaches age 40. D is also given a testamentary general power of appointment over any remaining assets of Trust A.

Trust A further provides the trustee with the authority to combine the trust with any other trust having equivalent provisions, whether such trust arose from an inter vivos conveyance or was created under another decedent's will. In particular, Trust A provides that if the trustee of Trust A is also the trustee of any other trust created for the same beneficiaries and under the same terms and conditions as Trust A, then the trustee in her sole discretion may combine Trust A with the other similar trusts and administer them together as one entity.

B, the grandfather of C and the great grandfather of D, died on Date 2. B's will provided that 50 percent of the residue of his estate was to pass outright to C and 50 percent of the residue of his estate was to pass to a trust (Trust B) for the benefit of D. C is the trustee of Trust B, and the terms of Trust B are identical to those of Trust A for all purposes relevant to this ruling letter.

It is represented that B's estate was valued at less than $600,000 and that a federal estate tax return was not filed. It is also represented that C and Trust B each received less than $300,000 from B's estate.

Approximately 4 years before his death, B and his wife created an irrevocable trust for the benefit of their great grandson, D, with their granddaughter, C, as trustee.The trust provides that until D attains the age of 21, the trustee shall pay income and/or principal to D in such amounts as the trustee deems reasonably necessary for his proper care, support, maintenance, or education. When D attains the age of 21, the trust will terminate, unless D desires to have the trust continue until he reaches age 30. When the trust terminates, all principal and undistributed income will be distributed to D. If D dies before the age of 21, the trust assets are to be distributed as D appoints pursuant to a testamentary general power of appointment. If he fails to exercise this power, the trust assets are to be distributed to his estate. During B's lifetime, gifts were made to the irrevocable trust by B and by B and his wife. It is represented that these gifts, after allowance for the gift tax annual exclusion, totaled less than $20,000. The irrevocable trust terminated on Date 3, when D attained age 21.

B (or B and his wife) also made a gift to D under the Uniform Gift to Minors Act. It is represented that this gift had a value of less than $3,000.

The trustee of Trust A and Trust B proposes to combine the trusts into a single trust for administrative, accounting and tax-reporting purposes.

The following rulings are requested:

1. The trustee may combine Trust A and Trust B into a single trust without triggering a generation-skipping transfer tax under § 2601.

2. Distributions from the combined trust, including the distribution at termination, will not be subject to the generation-skipping transfer tax.

Law and Analysis

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 2612(c)(1) provides that the term "direct skip" means a transfer subject to either the estate tax or the gift tax of an interest in property to a skip person.

Section 2613(a)(1) provides that the term "skip person" means a natural person assigned to a generation that is two or more generations below the generation assignment of the transferor. Section 2613(a)(2) provides that the term "skip person" means 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 (including distributions at the termination of the trust) may be made from the trust after the transfer to a person other than a skip person.

Under § 2652(c)(1), a person has an interest in property held in trust if (at the time the determination is made) such person has a right to receive income or corpus from the trust, or is a permissible current recipient of income or corpus and is not described in § 2055(a).

Under § 2652(c)(3), the fact that income or corpus of the trust may be used to satisfy an obligation of support arising under State law shall be disregarded in determining whether a person has an interest in the trust if such use is discretionary or is pursuant to the provisions of any State law substantially equivalent to the Uniform Gifts to Minors Act.

Section 2652(a)(1) provides that, in general, the term "transferor" means the decedent in the case of any property subject to the estate tax, or the donor in the case of any property subject to the gift tax. Section 2652(a)(1) further provides that an individual shall be treated as transferring any property with respect to which such individual is the transferor.

State law applicable to Trust A and Trust B provides that if the governing instrument of a trust confers upon the trustee, in his or her capacity as a trustee, the power to make discretionary distributions of either principal or income to satisfy any of the trustee's personal legal obligations for support, the trustee shall not exercise that power.

In the present case, the transfer of property from A's estate to Trust A for the benefit of A's grandson, D, is a direct skip. The transfer of property from B's estate to C, B's granddaughter, is a direct skip, and the transfer of property from B's estate to Trust B for the benefit of B's great grandson, D, is a direct skip. C's power as trustee of both trusts to make distributions of principal or income for the health, education, maintenance and support of D, her child, until he attains age 22, is discretionary. State law precludes her exercise of this power to satisfy her personal legal obligations of support. Therefore, based on the facts submitted and representations made, we conclude that C does not have an interest in the property held in either Trust A or Trust B.

Under § 2602, the amount of the GST tax is determined by multiplying the "taxable amount" by the "applicable rate." Under § 2623, the taxable amount in the case of a direct skip is the value of the property received by the transferee.

Under § 2641(a), the applicable rate with respect to any GST is the product of the "maximum federal estate tax rate" and the "inclusion ratio" with respect to the transfer.

Section 2641(b) defines the term maximum federal estate tax rate as the maximum rate imposed by § 2001 on the estates of decedents dying at the time of the taxable distribution, taxable termination, or direct skip, as the case may be.

Section 2642(a) defines the inclusion ratio as the excess of 1 over the applicable fraction. The numerator of the applicable fraction is the amount of GST exemption allocated to the trust, and the denominator of the applicable fraction is the value of the property transferred to the trust, reduced by the sum of any Federal estate tax or State death tax actually recovered from the trust attributable to such property and 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 of $1,000,000 (adjusted, after 1998, for inflation) that may be allocated by the individual (or his executor) to any property with respect to which the individual is the transferor.

Section 2631(b) provides that any allocation under § 2631(a), once made, is 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 the individual's estate (determined with regard to extensions), regardless of whether such a return is required to be filed.

In the present case, on A's federal estate tax return, A's executrix allocated A's GST exemption to the property transferred to Trust A. A's unused GST exemption amount exceeded the amount transferred to the trust. Therefore, based on the facts submitted and representations made, we conclude that Trust A has a zero inclusion ratio.

Section 2642(c) provides that, in the case of a direct skip which is a nontaxable gift, the inclusion ratio shall be zero. This provision applies to a transfer to a trust for the benefit of an individual if, during the life of such individual, no portion of the corpus or income may be distributed to (or for the benefit of) any person other than such individual and, 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. For purposes of § 2642(c), the term "nontaxable gift" includes a transfer of property to the extent such transfer is not treated as a taxable gift by reason of § 2503(b).

Section 2503(b) provides that in the case of gifts (other than gifts of future interests in property) made to any person by the donor during the calendar year, the first $10,000 (adjusted for inflation after 1998) of such gifts to such person shall not be included in the total amount of gifts made during such year. Section 2503(c) provides that no part of a gift to an individual who has not attained the age of 21 years on the date of such transfer shall be considered a gift of a future interest in property for purposes of § 2503(b) if the property and the income therefrom (1) may be expended by, or for the benefit of, the donee before his attaining the age of 21 years, and (2) will, to the extent not so expended, pass to the donee on his attaining the age of 21 years, and, in the event the donee dies before attaining the age of 21 years, be payable to the estate of the donee or as he may appoint under a general power of appointment as defined in § 2514(c).

In the present case, to the extent they did not exceed the annual gift tax exclusion amount, B's gifts to the irrevocable trust created for the benefit of D, and the gift to D under the Uniform Gifts to Minors Act, were not subject to the GSTT under the provisions of the Code cited above. To the extent the gifts exceeded the annual gift tax exclusion amount, they were subject to the GSTT. However, the provisions of § 2632(b) apply to these gifts.

Section 2632(b) provides that if any individual makes a direct skip during his 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. It is represented that the only generation-skipping transfers made by B during his lifetime are the gifts described in this letter. Based upon this representation, we conclude that B's GST exemption, in an amount of less than $20,000, was deemed to be allocated to B's lifetime gifts to D.

Section 2632(c)(1) provides that any portion of an individual's GST exemption which has not been allocated within the time prescribed by § 2632(a) shall be deemed to be allocated as follows:

(A) first, to property which is the subject of a direct skip occurring at such individual's death, and

(B) second, to trusts with respect to which such individual is the transferor and from which a taxable distribution or a taxable termination might occur at or after such individual's death.

Section 26.2632-1(d)(2) of the Generation-Skipping Transfer Tax Regulations provides that a decedent's unused GST exemption is automatically allocated on the due date for filing the decedent's estate tax return to the extent not otherwise allocated by the decedent's executor on or before that date. The automatic allocation occurs whether or not a return is actually required to be filed.

In the present case, less than $20,000 of B's GST exemption was allocated to B's lifetime gifts to D. At B's death, his unused exemption was automatically allocated to the property which passed to C in the amount of less than $300,000, and to the property which passed to Trust B in the amount of less than $300,000. Therefore, based on the facts submitted and representations made, we conclude that Trust B has a zero inclusion ratio.

Section 2642(d) provides special rules with respect to the inclusion ratio where more than one transfer is made to a trust. Generally, if a transfer of property is made to a trust in existence before such transfer, the applicable fraction for such trust is recomputed as of the time of such transfer. Under § 2642(d)(2), the recomputed applicable fraction is a fraction:

(A) the numerator of which is the sum of –
  (i) the amount of the GST exemption allocated to property involved in such transfer, plus
  (ii) the nontax portion of such trust immediately before such transfer, and

(B) the denominator of which is the sum of –
  (i) the value of the property involved in such transfer reduced by 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, and
  (ii) the value of all of the property in the trust (immediately before such transfer).

Section 2642(d)(3) defines the term nontax portion as the product of (A) the value of all of the property in the trust, and (B) the applicable fraction in effect for such trust.

Since Trust A and Trust B both have zero inclusion ratios, when they are combined into one trust, that trust will also have a zero inclusion ratio. Therefore,

based on the facts submitted and representations made, we conclude:

1. The trustee may combine Trust A and Trust B into a single trust without triggering a generation-skipping transfer tax under § 2601.

2. Distributions from the combined trust, including the distribution at termination, will not be subject to the generation-skipping transfer tax.

Except as we have specifically ruled herein, we express no opinion about the proposed transaction under the cited provisions of the Code or any other provisions of the Code.

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.

In accordance with a power of attorney on file with this office, we are sending a copy of this letter to the trustee of Trust A and Trust B.

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

Sincerely,
Associate Chief Counsel
(Passthroughs and Special Industries)
By Katherine A. Mellody
Senior Technician Reviewer
Branch 4

Enclosure: copy for § 6110 purposes