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June 17, 2016

Legend

Husband
Wife
Trust 1
Trust 2
Trust 3
Date 1
Date 2
Year 1
Year 2
Accounting Firm
a
b
c

Dear _____ :

This letter responds to your personal representative's letter of December 14, 2015, and subsequent correspondence, requesting generation-skipping transfer (GST) tax rulings with respect to Trust 1, Trust 2, and Trust 3.

The facts and representations submitted are as follows:

On Date 1, in Year 1, Husband created Trust 1 and funded Trust 1 with \$a. Trust 1 is an irrevocable trust for the benefit of Husband's grandchildren and more remote descendants. On the same date, Wife (Husband's spouse) created Trust 2 and

funded Trust 2 with \$b. Trust 2 is an irrevocable trust for the benefit of Wife's grandchildren and more remote descendants.

On Date 2, in Year 1, Husband created Trust 3 and funded Trust 3 with \$c. Trust 3 is an irrevocable trust for the benefit of Husband's grandchildren and more remote descendants.

Husband and Wife hired Accounting Firm to prepare their Year 1 Forms 709, United States Gift (and Generation-Skipping Transfer) Tax Returns. Husband conveyed to Accounting Firm his intention to allocate GST exemption to the transfer to Trust 1 and Wife conveyed to Accounting Firm her intention to allocate GST exemption to the transfer to Trust 2. In addition, Husband conveyed his intention to not allocate GST exemption to Trust 3.

On Husband's Form 709 for Year 1, Accounting Firm correctly reported the transfer to Trust 1 as a direct skip on Schedule A, Part 2, and properly allocated GST exemption to the transfer on Schedule C, Part 3, Column C. Similarly, on Wife's Form 709 for Year 1, Accounting Firm correctly reported the transfer to Trust 2 as a direct skip on Schedule A, Part 2, and properly allocated GST exemption to the transfer on Schedule C, Part 3, Column C. However, in preparing both Husband's Year 1 Form 709 and Wife's Year 1 Form 709, Accounting Firm incorrectly checked the box in Column C of Part 2 of Schedule A, indicating an election under § 2632(b)(3) to elect out of the deemed allocation of GST exemption with respect to Husband's transfer to Trust 1 and Wife's transfer to Trust 2.

With respect to Trust 3, Accounting Firm incorrectly reported on Husband's Year 1 Form 709 the transfer to Trust 3 as an indirect skip on Schedule A, Part 3. Also on Schedule A, Part 3, Accounting Firm incorrectly checked the box to indicate Husband is making an election under § 2632(c). Accounting Firm did attach a statement to the Form 709 electing out of the automatic allocation rules under §2632(c)(5)(A)(i).

Accounting Firm should have reported the transfer to Trust 3 as a direct skip on Schedule A, Part 2, and made an election out of the automatic allocation rules under § 2632(b)(3).

In Year 2, Husband's and Wife's attorney reviewed the various trusts created by Husband and Wife and discovered the errors on the Year 1 Forms 709. In an attempt to correct the mistakes, Husband and Wife each filed a late amended Year 1 Form 709 during Year 2.

You have requested the following rulings:

- 1) Husband made an allocation of his available GST exemption to the \$a transfer to Trust 1 as of Date 1, notwithstanding the indication on Schedule A, Part 2, Column C that Husband elected under § 2632(b)(3) to have the deemed allocation rules not apply to the transfer to Trust 1.
- 2) Wife made an allocation of her available GST exemption to the \$b transfer to Trust 2 as of Date 1, notwithstanding the indication on Schedule A, Part 2, Column C that Wife elected under § 2632(b)(3) to have the deemed allocation rules not apply to the transfer to Trust 2.
- 3) Husband substantially complied with the requirements of § 2632(b)(3) for electing out of the automatic allocation rules for direct skips with respect to the Date 2 transfer of \$c to Trust 3.

LAW AND ANALYSIS

Rulings 1 - 3

Section 2601 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 imposed by § 2601 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 amount 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 2631(c) provides that, for purposes of § 2631(a), the GST exemption amount for any calendar year shall be equal to the applicable exclusion amount under § 2010(c) for such calendar year.

Section 2632(a)(1) provides that an individual's GST exemption may be allocated 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 return is required to be filed.

Section 2632(b)(1) provides that if an individual makes a direct skip during his lifetime, any unused portion of such individual's unused 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 direct skip exceeds such unused portion, the

entire unused portion shall be allocated to the property transferred.

Section 2632(b)(3) provides that an individual may elect to have § 2632(b) not apply to a transfer.

Section 26.2632-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations provides, in part, that, if a direct skip occurs during the transferor's lifetime, the transferor's GST exemption not previously allocated (unused GST exemption) is automatically allocated to the transferred property (but not in excess of the fair market value of the property on the date of the transfer). The transferor may prevent the automatic allocation of GST exemption by describing on a timely-filed Form 709 the transfer and the extent to which the automatic allocation is not to apply.

Section 26.2632-1(b)(1)(ii) provides, in part, that a Form 709 is timely filed if it is filed on or before the date required for reporting the transfer if it were a taxable gift (i.e., the date prescribed by § 6075(b), including any extensions to file actually granted (the due date)). The automatic allocation of GST exemption (or the election to prevent the allocation, if made) is irrevocable after the due date. An automatic allocation of GST exemption is effective as of the date of the transfer to which it relates. Except as provided above, a Form 709 need not be filed to report an automatic allocation.

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 for purposes of this subsection, 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) provides, in part, that the term "GST trust" means a trust that could have a generation-skipping transfer with respect to the transferor unless the exceptions enumerated in (i) through (vi) apply.

Section 2632(c)(5)(A)(i)(I) provides that an individual may elect to have § 2632(c) not apply to an indirect skip. 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 gift tax return for the calendar year in which the transfer was made.

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: (1) one or more prior-year transfers subject to § 2642(f) (regarding ETIPs) made by the transferor to a specified trust or trusts; (2) one or more (or all) current-year transfers made by the transferor to a specified trust or trusts; (3) one or more (or all) future transfers made by the transferor to a specified trust or trusts; (4) all future transfers made by the transferor

to all trusts (whether or not in existence at the time of the election out); or (5) any combination of paragraphs (b)(2)(ii)(A)(1) through (4) of this section.

Section 26.2632-1(b)(2)(iii)(B) provides that to elect out, the transferor must attach an election out statement to a Form 709 filed within the time period provided in § 26.2632-1(b)(2)(iii)(C). In general, 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. Prior-year transfers that are subject to § 2642(f), and to which the election out is to apply, must be specifically described or otherwise identified in the election out statement. Under § 26.2632-1(b)(2)(iii)(C), to elect out, the Form 709 with the attached election out statement must be filed on or before the due date for timely filing the Form 709 for the calendar year in which: (1) for a transfer subject to § 2642(f), the ETIP closes; or (2) for all other elections out, the first transfer to be covered by the election out was made.

Section 26.2632-1(b)(3)(iii) provides that a GST trust election will cause all transfers made by the electing transferor to the trust subject to the election to be deemed to be made to a GST trust as defined in § 2632(c)(3)(B). Thus, the electing transferor's unused GST exemption may be allocated automatically to such transfers. A transferor may prevent the automatic allocation of GST exemption to future transfers to the trust either by terminating the GST trust election or by electing out of the automatic allocation of GST exemption in accordance with § 26.2632-1(b)(2).

Under § 2642(a)(1), 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. The applicable fraction, as defined in § 2642(a)(2), is a fraction, the numerator of which is the amount of the GST exemption under § 2631 allocated to the trust (or to property transferred in a direct skip), and the denominator of which is the value of the property transferred to the trust or involved in the direct skip, 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 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.

In this case, the transfer by Husband to Trust 1 was correctly reported as a direct skip on Schedule A, Part 2 of Husband's Year 1 Form 709 and GST exemption was properly allocated to the transfer on Schedule C, Part 3, Column C. We conclude that the fact that the box in Column C of Part 2 of Schedule A was checked does not negate the allocation of GST exemption to the transfer to Trust 1. Accordingly, based on the facts submitted and the representations made, we conclude that Husband has allocated his available GST exemption to Trust 1.

Similarly, the transfer by Wife to Trust 2 was correctly reported as a direct skip on Schedule A, Part 2 of Wife's Year 1 Form 709 and GST exemption was properly allocated to the transfer to Trust 2 on Schedule C, Part 3, Column C. We conclude that the fact that the box in Column C of Part 2 of Schedule A was checked does not negate the allocation of GST exemption to the transfer to Trust 2. Accordingly, based on the facts submitted and the representations made, we conclude that Wife has allocated her available GST exemption to Trust 2.

With regard to Husband's § 2632(c) transfer to Trust 3, Husband incorrectly reported the transfer as an indirect skip on Schedule A, Part 3, rather than as a direct skip on Schedule A, Part 2. Husband incorrectly checked the box in Schedule A, Part 3, which indicated an election under § 2632(c), when Husband should have checked the box in Schedule A, Part 2, which would have indicated an election out of the automatic allocation of GST exemption pursuant to § 2632(b)(3). Husband did attach a statement to the Form 709 electing out of the automatic allocation rules under § 2632(c)(5)(A)(i). Husband did not literally comply with the instructions to Form 709 or the requirements in the regulations for making an election out of the automatic allocation rules under § 2632(b)(3). However, literal compliance with the procedural instructions to make an election is not always required. Elections may be treated as effective where the taxpayer complied with the essential requirements of a regulation (or the instructions to the applicable form) even though the taxpayer failed to comply with certain procedural directions therein. See *Hewlett-Packard Company v. Commissioner*, 67 T.C. 736, 748 (1977), acq. in result, 1979-1 C.B. 1.

Thus, an election that does not strictly comply with the instructions on Form 709, or the applicable regulations, will be deemed valid if the information on the return is sufficient to indicate that the personal representative intended to make the election. Based upon the facts submitted and the representations made, we conclude that the Form 709 contains sufficient information to constitute substantial compliance with the requirements of § 2632(b)(3) to elect out of the automatic allocation rules for direct skips.

In accordance with the Power of Attorney on file with this office, we have sent a copy of this letter to your authorized representatives.

Except as expressly provided herein, we neither express nor imply any opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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.

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,

Leslie H. Finlow

Leslie H. Finlow
Senior Technician Reviewer, Branch 4
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures

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Copy of this letter

cc: