

*Example 10. Simultaneous termination of interests of more than one beneficiary.* T establishes an irrevocable trust for the benefit of T's child, C, T's grandchild, GC, and T's great-grandchild, GGC. Under the terms of the trust, income and principal may be distributed to any or all of the living beneficiaries at the discretion of the trustee. Upon the death of C, the trust property is to be distributed to GGC if then living. If C is survived by both GC and GGC, both C's and GC's interests in the trust will terminate on C's death. However, because both interests will terminate at the same time and as a result of one event, only one taxable termination occurs.

*Example 11. Partial taxable termination.* T creates an irrevocable trust providing that trust income is to be paid to T's children, A and B, in such proportions as the trustee determines for their joint lives. On the death of the first child to die, one-half of the trust principal is to be paid to T's then living grandchildren. The balance of the trust principal is to be paid to T's grandchildren on the death of the survivor of A and B. If A predeceases B, the distribution occurring on the termination of A's interest in the trust is a taxable termination and not a taxable distribution. It is a taxable termination because the distribution is a distribution of a portion of the trust that occurs as a result of the death of A, a lineal descendant of T. It is immaterial that a portion of the trust continues and that B, a person other than a skip person, thereafter holds an interest in the trust.

*Example 12. Taxable distribution.* T establishes an irrevocable trust under which the trust income is payable to T's child, C, for life. When T's grandchild, GC, attains 35 years of age, GC is to receive one-half of the principal. The remaining one-half of the principal is to be distributed to GC on C's death. Assume that C survives until GC attains age 35. When the trustee distributes one-half of the principal to GC on GC's 35th birthday, the distribution is a taxable distribution because it is a distribution to a skip person and is neither a taxable termination nor a direct skip.

*Example 13. Exercise of withdrawal right as taxable distribution.* The facts are the same as in *Example 12*, except GC holds a continuing right to withdraw trust principal and after one year GC withdraws \$10,000. The withdrawal by GC is not a taxable termination because the withdrawal does not terminate C's interest in the trust. The withdrawal by GC is a taxable distribution to GC.

*Example 14. Interest in trust.* T establishes an irrevocable trust under which the income is to be paid to T's child, C, for life. On the death of C, the trust principal is to be paid to T's grandchild, GC. Because C has a present right to receive income from the trust, C has an interest in the trust. Because

GC cannot currently receive distributions from the trust, GC does not have an interest in the trust.

*Example 15. Support obligation.* T establishes an irrevocable trust for the benefit of T's grandchild, GC. The trustee has discretion to distribute property for GC's support without regard to the duty or ability of GC's parent, C, to support GC. Because GC is a permissible current recipient of trust property, GC has an interest in the trust. C does not have an interest in the trust because the potential use of the trust property to satisfy C's support obligation is within the discretion of a fiduciary. C would be treated as having an interest in the trust if the trustee was required to distribute trust property for GC's support.

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#### § 26.2613-1 Skip person.

For the definition of *skip person* see § 26.2612-1(d).

#### § 26.2632-1 Allocation of GST exemption.

(a) *General rule.* Except as otherwise provided in this section, an individual or the individual's executor may allocate the individual's \$1 million GST exemption at any time from the date of the transfer through the date for filing the individual's Federal estate tax return (including any extensions for filing that have been actually granted). If no estate tax return is required to be filed, the GST exemption may be allocated at any time through the date a Federal estate tax return would be due if a return were required to be filed (including any extensions actually granted). If property is held in trust, the allocation of GST exemption is made to the entire trust rather than to specific trust assets. If a transfer is a direct skip to a trust, the allocation of GST exemption to the transferred property is also treated as an allocation of GST exemption to the trust for purposes of future GSTs with respect to the trust by the same transferor.

(b) *Lifetime allocations*—(1) *Automatic allocation to direct skips*—(i) *In general.* 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 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. In addition, a timely-filed Form 709 accompanied by payment of the GST tax (as shown on the return with respect to the direct skip) is sufficient to prevent an automatic allocation of GST exemption with respect to the transferred property. See paragraph (c)(4) of this section for special rules in the case of direct skips treated as occurring at the termination of an estate tax inclusion period.

(ii) *Time for filing Form 709.* 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 section 6075(b), including any extensions to file actually granted (the due date)). Except as provided in paragraph (b)(1)(iii) of this section, 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.

(iii) *Transitional rule.* An election to prevent an automatic allocation of GST exemption filed on or before January 26, 1996, becomes irrevocable on July 24, 1996.

(2) *Allocation to other transfers—(i) In general.* An allocation of GST exemption to property transferred during the transferor's lifetime, other than in a direct skip, is made on Form 709. The allocation must clearly identify the trust to which the allocation is being made, the amount of GST exemption allocated to it, and if the allocation is late or if an inclusion ratio greater than zero is claimed, the value of the trust assets at the effective date of the allocation. See paragraph (b)(2)(ii) of this section. The allocation should also state the inclusion ratio of the trust after the allocation. Except as otherwise provided in this paragraph, an allocation of GST exemption may be made by a formula; e.g., the allocation

may be expressed in terms of the amount necessary to produce an inclusion ratio of zero. However, formula allocations made with respect to charitable lead annuity trusts are not valid except to the extent they are dependent on values as finally determined for Federal estate or gift tax purposes. With respect to a timely allocation, an allocation of GST exemption becomes irrevocable after the due date of the return. Except as provided in § 26.2642-3 (relating to charitable lead annuity trusts), 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. See § 26.2642-1 for the definition of inclusion ratio. An allocation is also void if the allocation is made with respect to a trust that has no GST potential with respect to the transferor making the allocation, at the time of the allocation. For this purpose, a trust has GST potential even if the possibility of a GST is so remote as to be negligible.

(ii) *Effective date of allocation—(A) In general. (1)* Except as otherwise provided, an allocation of GST exemption is effective as of the date of any transfer as to which the Form 709 on which it is made is a timely filed return (a timely allocation). If more than one timely allocation is made, the earlier allocation is modified only if the later allocation clearly identifies the transfer and the nature and extent of the modification. Except as provided in paragraph (d)(1) of this section, an allocation to a trust made on a Form 709 filed after the due date for reporting a transfer to the trust (a late allocation) is effective on the date the Form 709 is filed and is deemed to precede in point of time any taxable event occurring on such date. For purposes of this paragraph (b)(2)(ii), the Form 709 is deemed filed on the date it is postmarked to the Internal Revenue Service Center. See § 26.2642-2 regarding the effect of a late allocation in determining the inclusion ratio, etc. See paragraph (c)(1) of this section regarding allocation of GST exemption to property subject to an estate tax inclusion period. If it is unclear whether an allocation of GST exemption on a Form 709 is a late or a

timely allocation to a trust, the allocation is effective in the following order—

(i) To any transfer to the trust disclosed on the return as to which the return is a timely return;

(ii) As a late allocation; and

(iii) To any transfer to the trust not disclosed on the return as to which the return would be a timely return.

(2) A late allocation to a trust may be made on a Form 709 that is timely filed with respect to another transfer. A late allocation is irrevocable when made.

(B) *Amount of allocation.* If other transfers exist with respect to which GST exemption could be allocated under paragraphs (b)(2)(ii)(A)(I)(ii) and (iii), any GST exemption allocated under paragraph (b)(2)(ii)(A)(I)(i) of this section is allocated in an amount equal to the value of the transferred property as reported on the Form 709. Thus, if the GST exemption allocated on the Form 709 exceeds the value of the transfers reported on that return that have generation-skipping potential, the initial allocation under paragraph (b)(2)(ii)(A)(I)(i) of this section is in the amount of the value of those transfers as reported on that return. Any remaining amount of GST exemption allocated on that return is then allocated pursuant to paragraphs (b)(2)(ii)(A)(I)(ii) and (iii) of this section, notwithstanding any subsequent upward adjustment in value of the transfers reported on the return.

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

*Example 1. Modification of allocation of GST exemption.* T transfers \$100,000 to an irrevocable generation-skipping trust on December 1, 1996. 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, 1997. On February 10, 1997, T files a Form 709 allocating \$50,000 of GST exemption to the trust. On April 10 of the same year, T files an amended Form 709 allocating \$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 1996 transfer. The allocation made on the April 10 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, 1996. 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 10, 1997, 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 10, 1997, 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.* T transfers \$100,000 to an irrevocable generation-skipping trust on December 1, 1996. 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, 1997. On December 1, 1997, T files a Form 709 and allocates \$50,000 to the trust. The allocation is effective as of December 1, 1997.

*Example 4. Effective date of late allocation of GST exemption.* T transfers \$100,000 to a generation-skipping trust on December 1, 1996, in a transfer that is not a direct skip. T does not make an allocation of GST exemption on a timely-filed Form 709. On July 1, 1997, 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 direct skip.* On May 15, 1996, T transfers \$50,000 to a trust in a direct skip. T does not file a timely gift tax return electing out of the automatic allocation. On April 30, 1998, T and T's spouse, S, file an initial gift tax return for 1996 on which they consent, pursuant to section 2513, to have the gift treated as if one-half had been made by each. 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 direct 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.

(c) *Special rules during an estate tax inclusion period—(1) In general.* An allocation of GST exemption (including an

automatic allocation) to property subject to an estate tax inclusion period (ETIP) that is made prior to termination of the ETIP cannot be revoked, but becomes effective no earlier than the date of any termination of the ETIP with respect to the trust. Where an allocation has not been made prior to the termination of the ETIP, an allocation is effective at the termination of the ETIP during the transferor's lifetime if made by the due date for filing a Form 709 that would apply to a taxable gift occurring at the time the ETIP terminates (timely ETIP return). An allocation is effective in the case of the termination of the ETIP on the death of the transferor as provided in paragraph (d) of this section. If any part of a trust is subject to an ETIP, the entire trust is subject to the ETIP. See § 26.2642-1(b)(2) for rules determining the inclusion ratio applicable in the case of GSTs during an ETIP.

(2) *Estate tax inclusion period defined*—

(i) *In general.* An ETIP is the period during which, should death occur, the value of transferred property would be includible (other than by reason of section 2035) in the gross estate of—

(A) The transferor; or

(B) The spouse of the transferor.

(ii) *Exceptions*—(A) For purposes of paragraph (c)(2) of this section, the value of transferred property is not considered as being subject to inclusion in the gross estate of the transferor or the spouse of the transferor if the possibility that the property will be included is so remote as to be negligible. A possibility is so remote as to be negligible if it can be ascertained by actuarial standards that there is less than a 5 percent probability that the property will be included in the gross estate.

(B) For purposes of paragraph (c)(2) of this section, the value of transferred property is not considered as being subject to inclusion in the gross estate of the spouse of the transferor, if the spouse possesses with respect to any transfer to the trust, a right to withdraw no more than the greater of \$5,000 or 5 percent of the trust corpus, and such withdrawal right terminates no later than 60 days after the transfer to the trust.

(C) The rules of this paragraph (c)(2) do not apply to qualified terminable in-

terest property with respect to which the special election under § 26.2652-2 has been made.

(3) *Termination of an ETIP.* An ETIP terminates on the first to occur of—

(i) The death of the transferor;

(ii) The time at which no portion of the property is includible in the transferor's gross estate (other than by reason of section 2035) or, in the case of an individual who is a transferor solely by reason of an election under section 2513, the time at which no portion would be includible in the gross estate of the individual's spouse (other than by reason of section 2035);

(iii) The time of a GST, but only with respect to the property involved in the GST; or

(iv) In the case of an ETIP arising by reason of an interest or power held by the transferor's spouse under subsection (c)(2)(i)(B) of this section, at the first to occur of—

(A) The death of the spouse; or

(B) The time at which no portion of the property would be includible in the spouse's gross estate (other than by reason of section 2035).

(4) *Treatment of direct skips.* If property transferred to a skip person is subject to an ETIP, the direct skip is treated as occurring on the termination of the ETIP.

(5) *Examples.* The following examples illustrate the rules of this section as they apply to the termination of an ETIP during the lifetime of the transferor. In each example assume that T transfers \$100,000 to an irrevocable trust:

*Example 1. Allocation of GST exemption during ETIP.* The trust instrument provides that trust income is to be paid to T for 9 years or until T's prior death. The trust principal is to be paid to T's grandchild on the termination of T's income interest. If T dies within the 9-year period, the value of the trust principal is includible in T's gross estate under section 2036(a). Thus, the trust is subject to an ETIP. T files a timely Form 709 reporting the transfer and allocating \$100,000 of GST exemption to the trust. The allocation of GST exemption to the trust is not effective until the termination of the ETIP.

*Example 2. Effect of prior allocation on termination of ETIP.* The facts are the same as in *Example 1*, except the trustee has the power to invade trust principal on behalf of T's grandchild, GC, during the term of T's income interest. In year 4, when the value of

the trust is \$200,000, the trustee distributes \$15,000 to GC. The distribution is a taxable distribution. The ETIP with respect to the property distributed to GC terminates at the time of the taxable distribution. See paragraph (c)(3)(iii) of this section. Solely for purposes of determining the trust's inclusion ratio with respect to the taxable distribution, the prior \$100,000 allocation of GST exemption (as well as any additional allocation made on a timely ETIP return) is effective immediately prior to the taxable distribution. See § 26.2642-1(b)(2). The trust's inclusion ratio with respect to the taxable distribution is therefore .50 ( $1 - (100,000/200,000)$ ).

*Example 3. Split-gift transfers subject to ETIP.* The trust instrument provides that trust income is to be paid to T for 9 years or until T's prior death. The trust principal is to be paid to T's grandchild on the termination of T's income interest. T files a timely Form 709 reporting the transfer. T's spouse, S, consents to have the gift treated as made one-half by S under section 2513. Because S is treated as transferring one-half of the property to T's grandchild, S becomes the transferor of one-half of the trust for purposes of chapter 13. Because the value of the trust would be includible in T's gross estate if T died immediately after the transfer, S's transfer is subject to an ETIP. If S should die prior to the termination of the trust, S's executor may allocate S's GST exemption to the trust, but only to the portion of the trust for which S is treated as the transferor. However, the allocation does not become effective until the earlier of the expiration of T's income interest or T's death.

*Example 4. Transfer of retained interest as ETIP termination.* The trust instrument provides that trust income is to be paid to T for 9 years or until T's prior death. The trust principal is to be paid to T's grandchild on the termination of T's income interest. Four years after the initial transfer, T transfers the income interest to T's sibling. The ETIP with respect to the trust terminates on T's transfer of the income interest because, after the transfer, the trust property would not be includible in T's gross estate (other than by reason of section 2035) if T died at that time.

(d) *Allocations after the transferor's death*—(1) *Allocation by executor.* Except as otherwise provided in this paragraph (d), an allocation of a decedent's unused GST exemption by the executor of the decedent's estate is made on the appropriate United States Estate (and Generation-Skipping Transfer) Tax Return (Form 706 or Form 706NA) filed on or before the date prescribed for filing the return by section 6075(a) (including any extensions actually granted (the due date)). An allocation of GST ex-

emption with respect to property included in the gross estate of a decedent is effective as of the date of death. A timely allocation of GST exemption by an executor with respect to a lifetime transfer of property that is not included in the transferor's gross estate is made on a Form 709. A late allocation of GST exemption by an executor, other than an allocation that is deemed to be made under section 2632(b)(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. An allocation of GST exemption to a trust (whether or not funded at the time the Form 706 or Form 706NA is filed) is effective if the notice of allocation clearly identifies the trust and the amount of the decedent's GST exemption allocated to the trust. An executor may allocate the decedent's GST exemption by use of a formula. For purposes of this section, an allocation is void if the allocation is made for a trust that has no GST potential with respect to the transferor for whom the allocation is being made, as of the date of the transferor's death. For this purpose, a trust has GST potential even if the possibility of a GST is so remote as to be negligible.

(2) *Automatic allocation after death.* A decedent's unused GST exemption is automatically allocated on the due date for filing Form 706 or Form 706NA 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. Unused GST exemption is allocated pro rata (subject to the rules of § 26.2642-2(b)), on the basis of the value of the property as finally determined for purposes of chapter 11 (chapter 11 value), first to direct skips treated as occurring at the transferor's death. The balance, if any, of unused GST exemption is allocated pro rata (subject to the rules of § 26.2642-2(b)) on the basis of the chapter 11 value of the nonexempt portion of the trust property (or in the case of trusts that are not included in the gross estate, on the basis of the date of death

value of the trust) to trusts with respect to which a taxable termination may occur or from which a taxable distribution may be made. The automatic allocation of GST exemption is irrevocable, and an allocation made by the executor after the automatic allocation is made is ineffective. No automatic allocation of GST exemption is made to a trust that will have a new transferor with respect to the entire trust prior to the occurrence of any GST with respect to the trust. In addition, no automatic allocation of GST exemption is made to a trust if, during the nine month period ending immediately after the death of the transferor—

(i) No GST has occurred with respect to the trust; and

(ii) At the end of such period no future GST can occur with respect to the trust.

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#### § 26.2641-1 Applicable rate of tax.

The rate of tax applicable to any GST (applicable rate) is determined by multiplying the maximum Federal estate tax rate in effect at the time of the GST by the inclusion ratio (as defined in § 26.2642-1). For this purpose, the maximum Federal estate tax rate is the maximum rate set forth under section 2001(c) (without regard to section 2001(c)(2)).

#### § 26.2642-1 Inclusion ratio.

(a) *In general.* Except as otherwise provided in this section, the inclusion ratio is determined by subtracting the applicable fraction (rounded to the nearest one-thousandth (.001)) from 1. In rounding the applicable fraction to the nearest one-thousandth, any amount that is midway between one one-thousandth and another one-thousandth is rounded up to the higher of those two amounts.

(b) *Numerator of applicable fraction—*  
(1) *In general.* Except as otherwise provided in this paragraph (b), and in §§ 26.2642-3 (providing a special rule for charitable lead annuity trusts) and 26.2642-4 (providing rules for the re-determination of the applicable fraction), the numerator of the applicable fraction is the amount of GST exemption

allocated to the trust (or to the transferred property in the case of a direct skip not in trust).

(2) *GSTs occurring during an ETIP—*(i) *In general.* For purposes of determining the inclusion ratio with respect to a taxable termination or a taxable distribution that occurs during an ETIP, the numerator of the applicable fraction is the sum of—

(A) The GST exemption previously allocated to the trust (including any allocation made to the trust prior to any taxable termination or distribution) reduced (but not below zero) by the nontax amount of any prior GSTs with respect to the trust; and

(B) Any GST exemption allocated to the trust on a timely ETIP return filed after the termination of the ETIP. See § 26.2632-1(c)(5) *Example 2.*

(ii) *Nontax amount of a prior GST.* (1) The nontax amount of a prior GST with respect to the trust is the amount of the GST multiplied by the applicable fraction attributable to the trust at the time of the prior GST.

(2) For rules regarding the allocation of GST exemption to property during an ETIP, see § 26.2632-1(c).

(c) *Denominator of applicable fraction—*  
(1) *In general.* Except as otherwise provided in this paragraph (c) and in §§ 26.2642-3 and 26.2642-4, the denominator of the applicable fraction is the value of the property transferred to the trust (or transferred in a direct skip not in trust) (as determined under § 26.2642-2) reduced by the sum of—

(i) Any Federal estate tax and any State death tax incurred by reason of the transfer that is chargeable to the trust and is actually recovered from the trust;

(ii) The amount of any charitable deduction allowed under section 2055, 2106, or 2522 with respect to the transfer; and

(iii) In the case of a direct skip, the value of the portion of the transfer that is a nontaxable gift. See paragraph (c)(3) of this section for the definition of nontaxable gift.

(2) *Zero denominator.* If the denominator of the applicable fraction is zero, the inclusion ratio is zero.

(3) *Nontaxable gifts.* Generally, for purposes of chapter 13, a transfer is a