

**COMMENTS OF INDIVIDUAL MEMBERS OF THE
AMERICAN BAR ASSOCIATION, SECTION OF REAL PROPERTY, PROBATE AND
TRUST LAW;**

**AMERICAN BAR ASSOCIATION, SECTION OF TAXATION; AND
AMERICAN COLLEGE OF TRUST AND ESTATE COUNSEL, ESTATE AND GIFT
TAX COMMITTEE**

CONCERNING

**PROPOSED REGULATIONS RELATING TO THE ELECTION NOT TO HAVE
AUTOMATIC ALLOCATION OF GENERATION-SKIPPING TRANSFER TAX
EXEMPTION APPLY TO CERTAIN TRANSFERS TO A GST TRUST**

REG-153841-02

The following comments were prepared by individuals who are members of the American Bar Association, Section of Real Property, Probate and Trust Law; American Bar Association, Section of Taxation; or American College of Trust and Estate Counsel, Estate and Gift Tax Committee. The comments are the individual views of the members of said Sections or Committee who prepared them and do not represent the position of the American Bar Association; the American Bar Association, Section of Real Property, Probate and Trust Law; the American Bar Association, Section of Taxation; the American College of Trust and Estate Counsel; or the American College of Trust and Estate Counsel, Estate and Gift Tax Committee.

Principal responsibility for the comments was exercised by Richard S. Franklin, Steven B. Gorin, Trent S. Kiziah, Melissa Langa, Carolyn M. Ohlsen, Mark Shiller, Lloyd Leva Plaine, David Pratt and Diana S.C. Zeydel. The comments were reviewed by Kathryn Henkel of the Section of Taxation's Committee on Government Submissions and by Lloyd Leva Plaine, as Council Director of the Section of Taxation.

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Although many of the members of the Section of Real Property, Probate and Trust Law, the Section of Taxation, and the Estate and Gift Tax Committee who participated in the preparation of these comments necessarily have clients affected by federal taxation, including the federal tax rules applied in the subject area addressed by these comments, no such members (or

the firm of such member) has been engaged by a client with respect to the specific subject matter of these comments.

Date: October 8, 2004

SUMMARY OF COMMENTS ON PROPOSED REGULATIONS,

The individuals whose names appear on the preceding page have prepared the attached comments on the Proposed Regulations concerning the election not to have automatic allocation of generation-skipping transfer tax exemption apply to certain transfers to a GST Trust, Reg-153841-02. All of us are members of the American Bar Association, Section of Real Property, Probate and Trust Law; American Bar Association, Section of Taxation, or the American College of Trust and Estate Counsel, Estate and Gift Tax Committee. Some of us are members of more than one section or committee. Nevertheless, the attached comments represent our own views and not the views or positions of the American Bar Association, the Section of Real Property, Probate and Trust Law, the Section of Taxation, the American College of Trust and Estate Counsel, the Estate and Gift Tax Committee of the American College of Trust and Estate Counsel, or the firms or companies of which we are shareholders, partners or employees.

All of us welcome the arrival of the Proposed Regulations. We recognize and commend the thought and effort expended by the individuals at Treasury and in the Internal Revenue Service who have worked on resolving the many difficult issues presented by the automatic allocation rules to indirect skips.

We believe that the Proposed Regulations are fair and helpful. In most instances, they resolve several practical issues in a reasonable manner.

It is the nature of the commenting process, and the time constraints necessarily associated with it, that we spend little time addressing those portions of the Proposed Regulations with which we are in agreement and instead focus on those portions we wish to have changed. Nonetheless, we particularly appreciate the recognition of certain taxpayer concerns and problems and the helpful resolution of these issues in several cases. For example, we believe the Proposed Regulations appropriately address transferors' requests to elect out of the automatic allocation rules for all transfers to certain trusts, such as trusts that solely own an insurance policy.

While many of our comments relate to important issues, we are particularly concerned about the decisions reached in the following six areas covered by the proposed regulations:

- (1) Additional time to elect out of the automatic allocation rules.
- (2) Specificity required to elect out or elect in to the automatic allocation rules.
- (3) Effect of partial allocation.
- (4) Election out for future transfers.
- (5) Elections with respect to trusts with an ETIP.
- (6) Blanket elections.

In addition, we have addressed a technical correction that we believe should be made to the proposed regulations.

Our specific comments on each provision of the proposed regulations follow.

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I. Additional Time to Elect Out of Automatic Allocation Rules

The Proposed Regulations provide that a transferor may prevent the automatic allocation of GST exemption to the current transfer and any or all subsequent transfers by attaching the appropriate statement to a timely filed Form 709, as defined in Treas. Reg. Sec. 26.2632-1(b)(1)(ii). Treas. Reg. Sec. 26.2632-1(b)(1)(ii) provides 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)).”

Code Section 2632(c)(5)(B)(i) provides an election under subparagraph (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 or deemed to have been made pursuant to paragraph (4) or **on such later date or dates as may be prescribed by the Secretary** (emphasis added).” The Secretary is given statutory authority to extend the time to elect out of the deemed allocation rules to indirect skips beyond the due date of the gift tax return.

In addition to the automatic allocation rules for indirect skips, P.L. 107-16 granted relief to taxpayers when an untimely death occurred (see Code Section 2632(d)), permitted the severance of trusts (see Code Section 2642(a)(3)), and provided relief for late elections including situations where the taxpayer had an intent to allocate GST exemption and the failure to allocate was inadvertent (see Code Section 2642(g)). All of these statutory changes reflect Congressional intent to provide relief to taxpayers from the exceedingly complex GST tax provisions.

It is consistent with the purpose of the amendments to Chapter 13 made by P.L. 107-16 – to simplify compliance with very complex GST tax laws – to allow taxpayers additional time to elect out of automatic allocation of GST exemption. We believe that taxpayers should be permitted time to elect out of the automatic allocation rules for indirect skips made after the effective date of P.L. 107-16 and the issuance of these Proposed Regulations. Providing relief of this nature will avoid numerous requests for relief under Section 2642(g)(1)(A)(ii). We recommend that an election out of deemed allocation of GST exemption to an indirect skip made on a gift tax return that would be timely for gifts made in the calendar year that these Proposed Regulations become final, including extensions actually granted, shall be timely for any indirect skip occurring or deemed to occur either (i) in the calendar year that, or (ii) in a calendar year prior to, the calendar year these Proposed Regulations become final. For example, if the indirect skip occurred in 2002 and these Proposed Regulations become final in 2005, the due date for electing out of automatic allocation of GST exemption would be April 15, 2006, or the extended due date.

II. Specificity Required to Elect Out or Elect In

Proposed Regulation Sec. 26.2632-1(b)(2)(ii) requires the statement electing out of the automatic allocation rules to “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).” Proposed Regulation Sec. 26.2632-1(b)(2)(iii)(A) requires similar specificity in electing out of the automatic allocation rules. Proposed Regulation Sec. 26.2632-1(b)(2)(iii)(B) requires a statement making reference to Section 26.2632-1(b)(2)(iii)(A). Similar specificity is required to elect to treat a trust as a GST

trust. The Secretary is warranted in requiring that the statement clearly indicate whether the taxpayer is electing out for the current transfer, electing out for the current transfer and all future transfers, or electing out to treat the trust as a GST trust. However, we believe the Proposed Regulations mandate specificity well beyond that required to sufficiently advise the Secretary of the taxpayer's election. This required specificity may result in inadvertent failed elections. In order to avoid this result, we recommend that the regulations not require a reference to a specific code or regulatory section.

III. Effect of Partial Allocation

The Proposed Regulations do not address the effect of a partial allocation of GST exemption to a current transfer. For example, assume on June 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. Assume T files a gift tax return by the due date, files a proper Notice of Allocation affirmatively allocating \$50,000 of GST exemption to the irrevocable GST trust that reflects that the trust has a 1/2 inclusion ratio following the allocation of GST exemption. Is T deemed to have elected out of the automatic allocation rules of Section 2632(c)(1) even though T has not attached a statement indicating T is electing out? Example 1 of Proposed Regulation Sec. 26.2632-1(b)(4)(iii) implies that both an affirmative election out of automatic allocation and an affirmative allocation of GST exemption are required to obtain a partial inclusion ratio for a transfer to a GST Trust. Instead, T's affirmative allocation of \$50,000 should be considered an election out of the deemed allocation rules to indirect skips. If T's allocation of GST exemption is not deemed an election out, then T's attempted affirmative allocation would be treated the same as if T had not made an allocation at all and \$100,000 would be automatically allocated to the transfer.

IV. Election out for Future Transfers

As described in I above, the Proposed Regulations permit the transferor to elect out of the automatic allocation rules for indirect skips for all subsequent transfers made by the transferor to the trust. Code Section 2632(c)(5)(A)(i)(II) permits the transferor to elect out for "any or all transfers made by such individual to a particular trust." In specifying the required content of a statement making an election relating to future transfers, the Proposed Regulations suggest that the election must be made for all future transfers (even though the heading of that section and the text of the Proposed Regulation indicate that an election out of automatic allocation may be made for "any" but not necessarily "all" future transfers). We would suggest that the last three sentences of Proposed Regulation Sec. 26.2632-1(b)(iii)(2)(A) be revised to read (subject to further changes if the comment in VI.b. is adopted) as follows: The statement must identify the trust (or separate share), describe the current transfer, and provide that the transferor is electing to have the automatic allocation rules not apply to the described current transfer as well as to (i) all future transfers made by the transferor to the trust (or separate share), or (ii) to such future transfers made by the transferor to the trust (or separate share) as are identified in the statement. The election, unless and until terminated, will remain in effect for all transfers made by the transferor to the trust (or separate share) or to such transfers made by the transferor to the trust (or separate share) as are identified in the statement. No future gift tax return will have to be filed by the transferor in order to prevent automatic allocation of the transferor's GST exemption either to all future transfers or to such future transfers as have been identified on the statement.

This same issue applies for electing to treat a trust as a GST trust under Code Section 2632(c)(5)(A)(ii) and Proposed Regulation Sec. 26.2632-1(b)(3)(i).

V. Elections with Respect to Trusts with an ETIP.

Code Section 2632(c)(5)(B)(ii) allows elections to be made on a timely filed gift tax return for the calendar year in which the election is to be effective. Code Sections 2632(c)(5)(A)(i)(II) and 2632(c)(5)(A)(ii) authorize elections with respect to “any or all transfers made by such individual” to a trust. Code Section 2632(c)(4) provides that for purposes of Code Section 2632(c), an indirect skip to which section 2642(f) applies shall be deemed to have been made only at the close of the estate tax inclusion period (“ETIP”). Thus, it would be at the close of the ETIP that Code Section 2632(c) may cause an automatic allocation of GST exemption to the ETIP trust. However, to give meaning to the words “any and all transfers,” we believe it should not be necessary for a transferor to have to wait until the close of the ETIP period to make the elections under Code Section 2632(c)(5). Code Section 2632(c)(5)(B)(i) provides that an election shall be deemed to be timely if filed on a timely gift tax return for the calendar year in which the transfer is made or deemed to have been made pursuant to paragraph (4). Because of the use of the disjunctive “or”, we believe the Code does not prohibit an election to be made on a timely filed gift tax return for the calendar year that the transfer is actually made to a trust (even if this is sooner than the date the transfer is deemed made under paragraph (4) for purposes of determining the timing of the deemed allocation of GST exemption to a trust with an ETIP).

Examples of typical trusts that would have an ETIP are a grantor retained annuity trust (“GRAT”) and a qualified personal residence trust (“QPRT”). Normally, the transferor would be required to file a gift tax return upon the creation of a GRAT or QPRT reporting the transfer to the trust. Therefore, if, for example, the transferor wished to elect out of deemed allocation of GST exemption to a GRAT or QPRT upon the close of the ETIP period, the most logical time to do so would be at the same time and on the same gift tax return reporting the transfer to the GRAT or QPRT rather than at the close of the ETIP period when no return might otherwise be due. In addition, the fact that a second gift tax return might be due with respect to the same transfer to the same trust solely for purposes of making the elections under Code Section 2632(c)(5) is likely to lead to taxpayer confusion and error, even if it is accurate and made clear that the Proposed Regulations authorize two returns filed in different years to be considered timely filed with respect to a single contribution to a trust.

The Proposed Regulations are unclear as to whether an election under Code Section 2632(c)(5) can be made for a transfer to a trust that precedes the occurrence of a “deemed” indirect skip under Code Section 2632(c)(4). We recommend that the Proposed Regulations be amended expressly to permit the elections under Code Section 2632(c)(5) to be made on the gift tax return that reports the transfer to the trust or on any subsequent gift tax return filed on or prior to the due date, including extensions actually granted, of the gift tax return for the year in which an indirect skip is deemed to occur under Code Section 2632(c)(4). Consistent with Example 1 of Proposed Regulation Sec. 26.2632-1(b)(4)(iii), we recommend that the Proposed Regulations also permit taxpayers to supercede any election made up until the due date for making such election as prescribed by the Code and regulations. Thus, a taxpayer would have until the due date of a timely filed gift tax return for the calendar year in which the transfer is deemed to have

been made under Code Section 2632(c)(4) to supercede any prior election with respect to a trust with an ETIP.

VI. Blanket Elections

- a) In order to elect out of the automatic allocation rules for future indirect skips, the Proposed Regulations in Proposed Regulation Sec. 26.2632-1(b)(2)(iii) require the current transfer to be described. Once the current transfer is described, the election may apply to all subsequent transfers. If the described transfer is the first transfer to the trust in that year, then the election out will apply to all subsequent transfers. If the described transfer is not the first transfer in the year, then the election out will not apply to all transfers in that year. We suggest that the Proposed Regulations permit an election out for all transfers for the current year without describing each and every transfer. For example, an election out which states the transferor is electing out for all transfers to the trust in the current year should be effective to elect out of the deemed allocation rules.
- b) The Proposed Regulations require that in order to:
 - i) elect out of the automatic allocation rules with respect to future indirect skips (Sec. 26.2632-1(b)(2)(iii)(A)),
 - ii) terminate such election (Sec. 26.2632-1(b)(2)(iii)(B)),
 - iii) elect to treat a trust as a GST trust (Sec. 26.2632-1(b)(3)(i), and
 - iv) terminate such election (Sec. 26.2632-1(b)(3)(ii))

the election must be made on a timely filed Form 709 for the calendar year in which the “current transfer” was made. It should be possible to make such an election on an earlier Form 709, i.e., in a year in which no transfer to the trust in question was made. We believe a transferor should be able to make an election with respect to the future status of the automatic allocation rules for future transfers to a certain trust even in a year in which no transfer to the trust was made — as long as the election is made on a Form 709 filed no later than a timely filed Form 709 for the calendar year in which the transfer is made to the trust to which the relevant election would first apply.

VII. Technical Corrections

Examples 1, 3, and 5 all reference a transfer to an “irrevocable GST trust.” Example 4 references a transfer to a “GST trust.” For consistency, Example 4 should state the transfer is to an “irrevocable GST trust.”