

§ 26.2642-3

26 CFR Ch. I (4-1-10 Edition)

paid to T's child for 10 years. At the end of the 10-year period, the trust principal is to be paid to T's grandchild. T does not allocate any GST exemption to the trust on the gift tax return reporting the transfer. On November 15, 1997, T files a Form 709 allocating \$50,000 of GST exemption to the trust. T elects to value the trust principal on the first day of the month in which the allocation is made pursuant to the election provided in paragraph (a)(2) of this section. Because the late allocation is made in November, the value of the trust is determined as of November 1, 1997.

[T.D. 8644, 60 FR 66903, Dec. 27, 1995; 61 FR 29654, June 12, 1996]

§ 26.2642-3 Special rule for charitable lead annuity trusts.

(a) In general. In determining the applicable fraction with respect to a charitable lead annuity trust—

(1) The numerator is the adjusted generation-skipping transfer tax exemption (adjusted GST exemption); and

(2) The denominator is the value of all property in the trust immediately after the termination of the charitable lead annuity.

(b) Adjusted GST exemption defined. The adjusted GST exemption is the amount of GST exemption allocated to the trust increased by an amount equal to the interest that would accrue if an amount equal to the allocated GST exemption were invested at the rate used to determine the amount of the estate or gift tax charitable deduction, compounded annually, for the actual period of the charitable lead annuity. If a late allocation is made to a charitable lead annuity trust, the adjusted GST exemption is the amount of GST exemption allocated to the trust increased by the interest that would accrue if invested at such rate for the period beginning on the date of the late allocation and extending for the balance of the actual period of the charitable lead annuity. The amount of GST exemption allocated to a charitable lead annuity trust is not reduced even though it is ultimately determined that the allocation of a lesser amount of GST exemption would have resulted in an inclusion ratio of zero. For purposes of chapter 13, a charitable lead annuity trust is any trust providing an interest in the form of a guaranteed annuity described in § 25.2522(c)-3(c)(2)(vi) of this

chapter for which the transferor is allowed a charitable deduction for Federal estate or gift tax purposes.

(c) Example. The following example illustrates the provisions of this section:

Example. T creates a charitable lead annuity trust for a 10-year term with the remainder payable to T's grandchild. T timely allocates an amount of GST exemption to the trust which T expects will ultimately result in a zero inclusion ratio. However, at the end of the charitable lead interest, because the property has not appreciated to the extent T anticipated, the numerator of the applicable fraction is greater than the denominator. The inclusion ratio for the trust is zero. No portion of the GST exemption allocated to the trust is restored to T or to T's estate.

§ 26.2642-4 Redetermination of applicable fraction.

(a) In general. The applicable fraction for a trust is redetermined whenever additional exemption is allocated to the trust or when certain changes occur with respect to the principal of the trust. Except as otherwise provided in this paragraph (a), the numerator of the redetermined applicable fraction is the sum of the amount of GST exemption currently being allocated to the trust (if any) plus the value of the nontax portion of the trust, and the denominator of the redetermined applicable fraction is the value of the trust principal immediately after the event occurs. The nontax portion of a trust is determined by multiplying the value of the trust assets, determined immediately prior to the event, by the then applicable fraction.

(1) Multiple transfers to a single trust. If property is added to an existing trust, the denominator of the redetermined applicable fraction is the value of the trust immediately after the addition reduced as provided in § 26.2642-1(c).

(2) Consolidation of separate trusts. If separate trusts created by one transferor are consolidated, a single applicable fraction for the consolidated trust is determined. The numerator of the redetermined applicable fraction is the sum of the nontax portions of each trust immediately prior to the consolidation.

(3) Property included in transferor's gross estate. If the value of property

held in a trust created by the transferor, with respect to which an allocation was made at a time that the trust was not subject to an ETIP, is included in the transferor's gross estate, the applicable fraction is redetermined if additional GST exemption is allocated to the property. The numerator of the redetermined applicable fraction is an amount equal to the nontax portion of the property immediately after the death of the transferor increased by the amount of GST exemption allocated by the executor of the transferor's estate to the trust. If additional GST exemption is not allocated to the trust, then, except as provided in this paragraph (a)(3), the applicable fraction immediately before death is not changed, if the trust was not subject to an ETIP at the time GST exemption was allocated to the trust. In any event, the denominator of the applicable fraction is reduced to reflect any federal or state, estate or inheritance taxes paid from the trust.

(4) *Imposition of recapture tax under section 2032A*—(i) If an additional estate tax is imposed under section 2032A and if the section 2032A election was effective (under § 26.2642-2(b)) for purposes of the GST tax, the applicable fraction with respect to the property is redetermined as of the date of death of the transferor. In making the redetermination, any available GST exemption not allocated at the death of the transferor (or at a prior recapture event) is automatically allocated to the property. The denominator of the applicable fraction is the fair market value of the property at the date of the transferor's death reduced as provided in § 26.2642-1(c) and further reduced by the amount of the additional GST tax actually recovered from the trust.

(ii) The GST tax imposed with respect to any taxable termination, taxable distribution, or direct skip occurring prior to the recapture event is recomputed based on the applicable fraction as redetermined. Any additional GST tax as recomputed is due and payable on the date that is six months after the event that causes the imposition of the additional estate tax under section 2032A. The additional GST tax is remitted with Form 706-A and is reported by attaching a statement to

Form 706-A showing the computation of the additional GST tax.

(iii) The applicable fraction, as redetermined under this section, is also used in determining any GST tax imposed with respect to GSTs occurring after the date of the recapture event.

(b) *Examples.* The following examples illustrate the principles of this section:

Example 1. Allocation of additional exemption. T transfers \$200,000 to an irrevocable trust under which the income is payable to T's child, C, for life. Upon the termination of the trust, the remainder is payable to T's grandchild, GC. At a time when no ETIP exists with respect to the trust property, T makes a timely allocation of \$100,000 of GST exemption, resulting in an inclusion ratio of .50. Subsequently, when the entire trust property is valued at \$500,000, T allocates an additional \$100,000 of T's unused GST exemption to the trust. The inclusion ratio of the trust is recomputed at that time. The numerator of the applicable fraction is \$350,000 (\$250,000 (the nontax portion as of the date of the allocation) plus \$100,000 (the GST exemption currently being allocated)). The denominator is \$500,000 (the date of allocation fair market value of the trust). The inclusion ratio is .30 ($1 - .70$).

Example 2. Multiple transfers to a trust, allocation both timely and late. On December 10, 1993, T transfers \$10,000 to an irrevocable trust that does not satisfy the requirements of section 2642(c)(2). T makes identical transfers to the trust on December 10, 1994, 1995, 1996, and on January 15, 1997. Immediately after the transfer on January 15, 1997, the value of the trust principal is \$40,000. On January 14, 1998, when the value of the trust principal is \$50,000, T allocates \$30,000 of GST exemption to the trust. T discloses the 1997 transfer on the Form 709 filed on January 14, 1998. Thus, T's allocation is a timely allocation with respect to the transfer in 1997, \$10,000 of the allocation is effective as of the date of that transfer, and, on and after January 15, 1997, the inclusion ratio of the trust is .75 ($1 - (\$10,000/\$40,000)$). The balance of the allocation is a late allocation with respect to prior transfers to the trust and is effective as of January 14, 1998. In redetermining the inclusion ratio as of that date, the numerator of the redetermined applicable fraction is \$32,500 ($\$12,500 (.25 \times \$50,000)$, the nontax portion of the trust on January 14, 1998) plus \$20,000 (the amount of GST exemption allocated late to the trust). The denominator of the new applicable fraction is \$50,000 (the value of the trust principal at the time of the late allocation).

Example 3. Excess allocation. (i) T creates an irrevocable trust for the benefit of T's child and grandchild in 1996 transferring \$50,000 to the trust on the date of creation. T allocates

no GST exemption to the trust on the Form 709 reporting the transfer. On July 1, 1997 (when the value of the trust property is \$60,000), T transfers an additional \$40,000 to the trust.

(ii) On April 15, 1998, when the value of the trust is \$150,000, T files a Form 709 reporting the 1997 transfer and allocating \$150,000 of GST exemption to the trust. The allocation is a timely allocation of \$40,000 with respect to the 1997 transfer and is effective as of that date. Thus, the applicable fraction for the trust as of July 1, 1997 is .40 ($\$40,000/\$100,000$ ($\$40,000 + \$60,000$)).

(iii) The allocation is also a late allocation of \$90,000, the amount necessary to attain a zero inclusion ratio on April 15, 1998, computed as follows: $\$60,000$ (the nontax portion immediately prior to the allocation ($.40 \times \$150,000$)) plus $\$90,000$ (the additional allocation necessary to produce a zero inclusion ratio based on a denominator of $\$150,000/\$150,000$ equals one and, thus, an inclusion ratio of zero. The balance of the allocation, $\$20,000$ ($\$150,000$ less the timely allocation of $\$40,000$ less the late allocation of $\$90,000$) is void.

Example 4. Undisclosed transfer. (i) The facts are the same as in Example 3, except that on February 1, 1998 (when the value of the trust is \$150,000), T transfers an additional \$50,000 to the trust and the value of the entire trust corpus on April 15, 1998 is \$220,000. The Form 709 filed on April 15, 1998 does not disclose the 1998 transfer. Under the rule in § 26.2632-1(b)(2)(ii), the allocation is effective first as a timely allocation to the 1997 transfer; second, as a late allocation to the trust as of April 15, 1998; and, finally as a timely allocation to the February 1, 1998 transfer. As of April 15, 1998, \$55,000, a pro rata portion of the trust assets, is considered to be the property transferred to the trust on February 1, 1998 ($(\$50,000/\$200,000) \times \$220,000$). The balance of the trust, \$165,000, represents prior transfers to the trust.

(ii) As in EXAMPLE 3, the allocation is a timely allocation as to the 1997 transfer (and the applicable fraction as of July 1, 1997 is .40) and a late allocation as of 1998. The amount of the late allocation is \$99,000, computed as follows: $(.40 \times \$165,000 \text{ plus } \$99,000)/\$165,000 = \text{one}$.

(iii) The balance of the allocation, \$11,000 ($\$150,000$ less the timely allocation of $\$40,000$ less the late allocation of $\$99,000$) is a timely allocation as of February 1, 1998. The applicable fraction with respect to the trust, as of February 1, 1998, is .355, computed as follows: $\$60,000$ (the nontax portion of the trust immediately prior to the February 1, 1998 transfer ($.40 \times \$150,000$)) plus $\$11,000$ (the amount of the timely allocation to the 1998 transfer)/ $\$200,000$ (the value of the trust on February 1, 1998, after the transfer on that date) = $\$71,000/\$200,000 = .355$.

(iv) The applicable fraction with respect to the trust, as of April 15, 1998, is .805 computed as follows: $\$78,100$ (the nontax portion immediately prior to the allocation ($.355 \times \$220,000$)) plus $\$99,000$ (the amount of the late allocation)/ $\$220,000 = \$177,100/\$220,000 = .805$.

Example 5. Redetermination of inclusion ratio on ETIP termination. (i) T transfers \$100,000 to an irrevocable trust. 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, GC, on the termination of T's income interest. The trustee has the power to invade trust principal for the benefit of GC during the term of T's income interest. The trust is subject to an ETIP while T holds the retained income interest. T files a timely Form 709 reporting the transfer and allocates \$100,000 of GST exemption to the trust. 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. Because of the existence of the ETIP, the inclusion ratio with respect to the taxable distribution is determined immediately prior to the occurrence of the GST. Thus, the inclusion ratio applicable to the year 4 GST is .50 ($1 - (\$100,000/\$200,000)$).

(ii) In year 5, when the value of the trust is again \$200,000, the trustee distributes another \$15,000 to GC. Because the trust is still subject to the ETIP in year 5, the inclusion ratio with respect to the year 5 GST is again computed immediately prior to the GST. In computing the new inclusion ratio, the numerator of the applicable fraction is reduced by the nontax portion of prior GSTs occurring during the ETIP. Thus, the numerator of the applicable fraction with respect to the GST in year 5 is $\$92,500$ ($\$100,000 - (.50 \times \$15,000)$) and the inclusion ratio applicable with respect to the GST in year 5 is .537 ($1 - (\$92,500/\$200,000) = .463$). Any additional GST exemption allocated on a timely ETIP return with respect to the GST in year 5 is effective immediately prior to the transfer.

[T.D. 8644, 60 FR 66903, Dec. 27, 1995; 61 FR 29654, June 12, 1996]

§ 26.2642-5 Finality of inclusion ratio.

(a) *Direct skips.* The inclusion ratio applicable to a direct skip becomes final when no additional GST tax (including additional GST tax payable as a result of a cessation, etc. of qualified use under section 2032A(c)) may be assessed with respect to the direct skip.

(b) *Other GSTs.* With respect to taxable distributions and taxable terminations, the inclusion ratio for a trust becomes final, on the later of—

(1) The expiration of the period for assessment with respect to the first