$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) × $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 × $165,000 plus $99,000)/ $165,000 = 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 × $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 × $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 × $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 GST tax return filed using that inclusion ratio (unless the trust is subject to an election under section 2032A in which case the applicable date under this subsection is the expiration of the period of assessment of any additional GST tax due as a result of a cessation, etc. of qualified use under section 2032A); or

(2) The expiration of the period for assessment of Federal estate tax with respect to the estate of the transferor. For purposes of this paragraph (b)(2), if an estate tax return is not required to be filed, the period for assessment is determined as if a return were required to be filed and as if the return were

timely filed within the period prescribed by section 6075(a).

[T.D. 8644, 60 FR 66903, Dec. 27, 1995, as amended at 61 FR 43656, Aug. 26, 1996]

§ 26.2642–6 Qualified severance.

(a) *In general.* If a trust is divided in a qualified severance into two or more trusts, the separate trusts resulting from the severance will be treated as separate trusts for generation-skipping transfer (GST) tax purposes and the inclusion ratio of each new resulting trust may differ from the inclusion ratio of the original trust. Because the post-severance resulting trusts are treated as separate trusts for GST tax purposes, certain actions with respect to one resulting trust will generally have no GST tax impact with respect to the other resulting trust(s). For example, GST exemption allocated to one resulting trust will not impact on the inclusion ratio of the other resulting trust(s); a GST tax election made with respect to one resulting trust will not apply to the other resulting trust(s); the occurrence of a taxable distribution or termination with regard to a particular resulting trust will not have any GST tax impact on any other trust resulting from that severance. In general, the rules in this section are applicable only for purposes of the GST tax and are not applicable in determining, for example, whether the resulting trusts may file separate income tax returns or whether the severance may result in a gift subject to gift tax, may cause any trust to be included in the gross estate of a beneficiary, or may result in a realization of gain for purposes of section 1001. See § 1.1001–1(h) of this chapter for rules relating to whether a qualified severance will constitute an exchange of property for other property differing materially either in kind or in extent.

(b) *Qualified severance defined.* A qualified severance is a division of a trust (other than a division described in § 26.2654–1(b)) into two or more separate trusts that meets each of the requirements in paragraph (d) of this section.

(c) *Effective date of qualified severance.* A qualified severance is applicable as of the date of the severance, as defined in § 26.2642–6(d)(3), and the resulting trusts are treated as separate trusts for GST tax purposes as of that date.

(d) *Requirements for a qualified severance.* For purposes of this section, a qualified severance must satisfy each of the following requirements:

(1) The single trust is severed pursuant to the terms of the governing instrument, or pursuant to applicable local law.

(2) The severance is effective under local law.

(3) The date of severance is either the date selected by the trustee as of which the trust assets are to be valued in order to determine the funding of the resulting trusts, or the court-imposed date of funding in the case of an order of the local court with jurisdiction over the trust ordering the trustee to fund the resulting trusts on or as of a specific date. For a date to satisfy the definition in the preceding sentence, however, the funding must be commenced immediately upon, and funding must occur within a reasonable time (but in no event more than 90 days) after, the selected valuation date.

(4) The single trust (original trust) is severed on a fractional basis, such that each new trust (resulting trust) is funded with a fraction or percentage of the original trust, and the sum of those fractions or percentages is one or one hundred percent, respectively. For this purpose, the fraction or percentage may be determined by means of a formula (for example, that fraction of the trust the numerator of which is equal to the transferor's unused GST tax exemption, and the denominator of which is the fair market value of the original trust's assets on the date of severance). The severance of a trust based on a pecuniary amount does not satisfy this requirement. For example, the severance of a trust is not a qualified severance if the trust is divided into two trusts, with one trust to be funded with $1,500,000 and the other trust to be funded with the balance of the original trust's assets. With respect to the particular assets to be distributed to each separate trust resulting from the severance, each such trust may be funded with the appropriate fraction or percentage (pro rata portion) of each asset held by the original trust. Alternatively, the assets may be divided