

July 30, 2003

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Re: Safe Harbor Suggestions under Proposed Section 2642(g) Regulations

Dear Jim and Cathy:

As you mentioned at the AICPA's Trust, Estate, and Gift Tax Technical Resource Panel meeting on October 29, 2002, the IRS and Treasury Department are developing regulations under section 2642(g) to provide a means by which relief regarding allocation of Generation-Skipping Transfer Tax ("GST") exemption under section 301.9100-3 can be requested without the filing of a formal ruling request (herein referred to as "short form 9100 relief"). It is our understanding that this short form Section 9100 relief would be intended to reduce the number of ruling requests in connection with GST allocations and would provide abbreviated procedures for such relief under narrowly-defined circumstances. In an effort to assist you with this project, we submit the following suggestions for your consideration.

### **Threshold Criteria**

First, we suggest that all requests for short form 9100 relief should meet certain threshold criteria before short form 9100 relief is made available. These criteria would aim to ensure that requests for GST relief resulting from unusual fact patterns would be addressed in the ordinary ruling process.

We recommend that fact patterns meeting the following threshold criteria qualify for short form 9100 relief:

1. Taxpayer is still alive at the time that short form 9100 relief is requested. Because each spouse is treated as a separate transferor of a trust where gift-splitting has been elected, it would not seem necessary that the taxpayer's spouse also be alive at the time relief is requested;
2. Taxpayer's unused GST exemption is equal to or greater than the amount of the exemption required to achieve full allocation to the value of the transfer at issue; and
3. No taxable GST distributions or taxable terminations have occurred with respect to the transfer at issue.

Second, we recommend that in all situations taxpayers follow a series of defined procedures to obtain relief. Such procedures might include:

1. Filing an amended Form 709, U.S. Gift (and Generation-Skipping Transfer) Tax Return ("Form 709") that (a) corrects the late or incorrect allocation of GST exemption, and (b) states "Filed Pursuant to section 26.2642(g) or 9100" at the top of page one of the form;
2. Including with the amended Form 709 a statement explaining the correction and asserting the circumstances necessary to obtain relief (*i.e.*, the reasons for the amendment, the authority relied upon in seeking such relief, etc.); and
3. Providing with the amended Form 709 the taxpayer's statement (under penalties of perjury) that the failure to make the desired allocation of GST exemption was inadvertent. We do not believe it is necessary to obtain an additional affidavit by an advisor familiar with the facts underlying the taxpayer's request for relief.

### **Situations Warranting Safe Harbor Relief**

We have developed the following two lists of common situations in which short form 9100 relief might be appropriate. The first list covers situations that generally warrant safe harbor relief. The second list includes situations that frequently occur and that would merit consideration for automatic relief based on the taxpayer's intent. Our recommendations attempt to address the potential pitfalls and problems that arise under the new automatic allocation rules under section 2632(c), in addition to common situations under the pre-existing deemed allocation rules.

### **General Safe Harbor Relief**

1. Indirect Skip Treated as a Direct Skip. We believe that short form 9100 relief is warranted if GST exemption is treated as having been automatically allocated to a transfer in trust when a taxpayer mistakenly reports the gift as a transfer to a direct skip trust. For example, consider a transfer to an indirect skip trust that is mistakenly identified as a direct skip trust to which the taxpayer's GST exemption is treated as having been automatically allocated on Form 709. Although the correct method of allocating GST exemption to an indirect skip trust is by attaching a Notice of Allocation or election under section 2652(a)(3) ("allocation election"), the taxpayer impliedly expresses an intent to allocate GST exemption to transfers made to a direct skip trust because GST exemption is believed to have been automatically allocated.

We also believe that short form 9100 relief should extend to similar situations in which a transfer is incorrectly treated as a direct skip that is a nontaxable gift for GST purposes under section 2642(c) ("the GST annual exclusion"). Consider the same situation stated above except that the purported transfer to a direct skip trust resulted in the taxpayer treating all or a portion of the gift as having qualified for the GST annual exclusion. In this case, the taxpayer evidences an intent to allocate GST exemption to the whole transfer, except for the portion

that the taxpayer believed to have been a nontaxable transfer for GST purposes. In both cases, the taxpayer's intent to allocate GST exemption to the transfer is clearly established, and, therefore, we submit that short form 9100 relief should be allowed.

2. Failure to Complete GST Exemption Reconciliation. We recommend that a short form 9100 relief should be available where a taxpayer attaches a completed Notice of Allocation or allocation election with Form 709, but fails to complete (or incorrectly completes) the GST Exemption Reconciliation portion on the return itself (Schedule C, Part 2.)
3. Incorrect Allocation in Connection with Split Gifts. We suggest that short form 9100 relief should be available for spouses who incorrectly allocate their respective GST exemptions when a gift-splitting election has been made with regard to the transfer. For example, consider a situation where spouses elect to split a gift to a trust, but one spouse allocates GST exemption to the full amount of the gift via a Notice of Allocation or allocation election, even though each spouse is treated as the transferor of one-half of the gift. Alternatively, consider a situation where one spouse files an election to treat a trust as a "GST trust" under the new automatic allocation rules but the other spouse, who has consented to split the gift, failed to do so. In both cases, the failure of both spouses to treat the gift consistently for GST purposes was inadvertent. Therefore, we believe short form 9100 relief should be made available.

Another common error that we believe should be remedied through short form 9100 relief is where spouses elect to split gifts to a trust in which one of the spouses has a withdrawal right and their respective GST allocations mistakenly fail to account for the reduction in the amount of the gift passing to the other spouse. For example, assume Mom gives \$15,000 to a trust where Dad has a \$5,000 withdrawal right and Child has a \$10,000 withdrawal right. Gift splitting is elected. For gift tax purposes, Mom is treated as transferring \$10,000 of the gift (half of the child's and all of Dad's) and Dad is treated as transferring \$5,000 of the gift (half of the child's), and they allocate their GST exemptions accordingly. For GST purposes, however, Mom and Dad should each allocate \$7,500 of their GST exemption to reflect one-half of the total \$15,000 transfer to the trust. We suggest that the incorrect allocation of GST exemption in this case is the result of oversight and that the taxpayer's incorrect treatment of the transfer for GST tax purposes should be correctable through short form 9100 relief.

4. Misidentification of Spousal Donor. We recommend that short form 9100 relief should be permitted in cases where spouses incorrectly allocate their GST exemptions because the donor spouse has been inadvertently misidentified. For example, in a community property state where gifts of community property are presumed to be made one half by each spouse, a gift may be mistakenly reported as having been made entirely by one spouse who then allocates GST exemption to the total amount of the transfer. Another example is where a gift from a joint account is inadvertently reported as made one half by each spouse for gift tax purposes and each spouse allocates one half of his and her GST exemption to the transfer.

Finally, consider the situation where a gift by one spouse is inaccurately reported as being made by the other spouse, who then allocates his or her GST exemption to the transfer. In each of these cases, the taxpayer attempted to allocate GST exemption to his or her respective portion of the transfer, but the misidentification of the donor resulted in an incorrect allocation. We believe that in such cases, the taxpayer has evidenced a clear intent to allocate GST exemption to the entire transfer and that any errors in doing so should be corrected through short form 9100 relief.

5. Scrivener's Errors. When the descriptions of gifts on Form 709 and the attached Notice of Allocation or election differ due to a scrivener's error, we suggest that short form 9100 relief should be available. For example, consider situations where the Notice of Allocation or election misidentifies the trust by either (a) referring to the wrong name or EIN of the trust, a gift to which has been reported on Form 709 or (b) referring to the wrong item number of the gift described on Form 709.

In addition, if the gift identified on a Notice of Allocation or election has no obvious potential to incur a GST tax liability, but another gift does have the potential to incur a GST tax liability, we submit that short form 9100 relief should be available. It may be that, in these circumstances, additional indicia of intent to make a GST allocation to the trust would be needed. Examples of the requisite intent might include a previous, consistent allocation of GST exemption to the trust or other evidence of intent stated in the trust document.

6. Ambiguous Election to Treat Trust as a GST Trust. We recommend that short form 9100 relief should cover cases where an election was made to treat a trust as a "GST trust" under the new automatic allocation rules, but the wrong Code section was referenced in the election.
7. Unintended Partial Allocations. We suggest that unintended partial allocations of GST exemption resulting from a misinterpretation of how the GST exemption applies should qualify for short form 9100 relief. For example, assume that a trust is initially funded with \$40,000 and two children and two grandchildren are the current beneficiaries. Assume further that the children and grandchildren all have withdrawal rights so that the entire amount of the initial transfer qualified for the annual exclusion, and therefore, results in no taxable gift. The taxpayer allocates his GST exemption to the portion of the transfer treated as passing to the two grandchildren (because they are thought to be the only skip persons), but not to the children's gifts. Also, consider the same facts, except that \$100,000 is initially transferred to the trust and the gifts are split by a husband and wife, resulting in \$80,000 of the transfer qualifying for the annual exclusion and the remaining \$20,000 being treated as a taxable gift. The taxpayers allocate GST exemption to the \$20,000 taxable gift, but not to any of the annual exclusion gifts because they mistakenly believe gifts qualifying for the gift tax annual exclusion are exempt from the GST tax. In each of these cases, the failure to fully allocate GST exemption to the transfers results from an obvious inadvertence and short form 9100 relief should be available.

8. Substantial Compliance. Where a taxpayer's GST allocation gives the Service sufficient notice of the intended allocation but fails to meet the statutory or regulatory requirements for a Notice of Allocation or election due to a minor, technical error, we suggest that short form 9100 relief should be made available.

### **Intent-Based Safe Harbor Relief**

- ~~1.~~ Previous Pattern of Allocation. Consideration should be given to short form 9100 relief for a situation where a previous, consistent pattern of allocating GST exemption stops or changes. We submit that it is unlikely that a taxpayer who previously allocated GST exemption to a trust would intend to stop allocating GST exemption and cause the trust to have a partial inclusion ratio. For example, assume a taxpayer allocates GST exemption to a trust for the first eight years of the trust's existence. In year nine, the taxpayer inadvertently fails to allocate GST exemption to the transfer made to this trust. Similarly, assume the same situation but with a change in advisors in year twelve, where the new advisor reviews the prior gift tax filings for years 1-11 and discovers that the taxpayer made an isolated failure to allocate GST exemption to the trust in year 9. The taxpayer's pattern of allocation should provide enough circumstantial evidence of intent to allow safe harbor relief. We recognize that in such cases, additional indicia of intent may be necessary, such as intent indicated in the trust document. Furthermore, we recognize that the taxpayer may also need to prove that no significant change of circumstance or change of trust beneficiaries would otherwise support a deviation from prior GST allocation practices.

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- ~~3.2.~~ Voluntary Amendment of Gift Tax Return to Correct Incorrect Gift Tax Value. Incorrect GST allocations often occur as a result of mistakes in the reporting of the fair market value of a gift on Form 709. A common example is seen where a gift's adjusted basis is mistakenly reported as its fair market value or where a gift of stock is valued at its closing price, rather than the mean of its high and low prices. In such cases, the taxpayer may have allocated GST exemption in the amount of the incorrect gift tax value without making a formula allocation. If the taxpayer comes forward and voluntarily files an amended return to report the correct value for gift tax purposes, short form 9100 relief should be available to achieve a zero inclusion ratio with respect to the gift, if GST exemption was originally allocated to the total value of the incorrectly reported gift tax value.

- ~~4.3.~~ De Minimis Relief. We suggest that de minimis safe harbor relief should permit taxpayers to apply for short form 9100 relief where no gift tax return was originally required to be filed. For example, when a taxpayer makes transfers to a life insurance trust, all of which qualify for the annual exclusion without a gift-splitting election, the taxpayer may not be required to file Form 709 to report the transfers. Not filing the return, however, may result in the taxpayer having failed to allocate GST exemption in the amount of the transfer to the trust, or

alternatively, having failed to elect out of an automatic GST allocation. We would recommend that the taxpayer be granted an opportunity to apply for short form 9100 relief in such a de minimis case. Further, short form 9100 relief should be considered for an isolated, one-time, inadvertent failure, with limits on the permitted allocation amount (e.g., \$100,000 per taxpayer). Safe harbor relief may also be warranted in any situation where (a) an inclusion ratio of greater than 0.5 existed before 2002; and (b) correcting the failure does not involve amending more than two returns. Imposing limits on the amount involved, on the number of amended returns, imposing a requirement that original returns were filed, and imposing time constraints for when the failure occurred, would restrict relief to situations involving genuine failures.

5.4. Clearly Documented Intent. Taxpayers who indicate, by clear documentation, that a trust should have an inclusion ratio of zero, should be given the opportunity to treat the transfers as though sufficient GST exemption has been allocated to produce the desired result. We would suggest that the taxpayer may qualify for short form 9100 relief in this case if intent to allocate GST exemption to the trust is evidenced by (a) the fact that the taxpayer's estate plan already included a separate trust for non-skip persons, to which no GST exemption would be allocated or (b) specific language or a dispositive scheme stated in the trust document, which is inconsistent with the taxpayer's failure to allocate GST exemption to such trust.

Another situation that warrants consideration for short form 9100 relief may include contingent GST trusts. Certain trusts have separate dispositive schemes depending on whether the trust assets are exempt or non-exempt. Most often, non-exempt assets are held in a sub-trust that is designed to be included in the estate of a non-skip person (not needing protection from the GST tax), and exempt assets are held in a sub-trust that is designed to pass to skip persons (needing the protection of GST exemption). This drafting technique is intended as a protective measure for portions of a trust to maintain an inclusion ratio of zero where GST exemption is not allocated to all of the trust assets. The application of the new automatic allocation rules under section 2632(c) appears to conflict with the dispositive scheme of contingent GST trusts. Whereas the disposition of the assets of contingent GST trusts depends on the allocation of GST exemption to the trust, the allocation of GST exemption under the new rules depends upon the ultimate disposition of the assets. Because of this incongruity under the new rules, contingent GST trusts warrant short form 9100 relief if a prior history of allocation exists and an automatic allocation has not occurred under the new rules.

6.5. Transition Relief for Unintended Automatic Allocations. We believe that under the new rules, GST exemption may be automatically allocated to a significant number of indirect skip trusts to which the donors never intended to allocate. A large number of trusts receive gifts each year, and no gift tax return is required to report these gifts. However, in the past, if no gift tax return were filed, no automatic allocation of GST exemption would have occurred with respect to the unreported transfer. Under the new rules, transfers to certain trusts may

result in unintended automatic GST allocations even where no gift tax return is filed. For example, automatic allocation of GST may result in the case of a trust that provides income for life to a surviving spouse upon the grantor's death (e.g., interceding spousal lifetime interests), but where the trust otherwise falls within one of the section 2632(c) exceptions (e.g., principal to be distributed to children by age 46). This dispositive scheme is common for irrevocable life insurance trusts, which often do not result in the filing of an annual gift tax return because transfers to the trust do not rise to the level of a reportable gift, but to which GST exemption may be automatically allocated.

Trusts to which no GST allocation was made in the past, but which under the new rules would receive automatic allocations (or appear likely to receive automatic allocations if deemed to be a GST trust under the complex rules of section 2632(c)) should be able to make a retroactive election out of the new rules for a specified transitional period. This should be particularly true for trusts where an inadvertent automatic allocation occurred in tax year 2001.

7.6.Springing Allocations/Non-Allocations. Similar to the trusts outlined in the previous paragraph, certain trusts may be subject to automatic allocations in one year but not in another year. This may occur because an exception under section 2642(c) applies in one year but not in another, and in the year that the automatic allocation rules did not apply, no Notice of Allocation or election was made with respect to the transfer. As a result, only a partial GST allocation has been made to the trust. We propose that the taxpayer should be given an opportunity to make a one-time election to consistently treat all GST allocations to the trust - whether it is to continue making allocations of GST to the trust and preserve a zero inclusion ratio or to elect out of "springing" allocations altogether.

### **Other concerns**

We also see a need for relief from a failure to make an affirmative election upon the termination of an estate tax inclusion period (ETIP). We believe that, under the new automatic allocation regime, there is significant risk of an automatic allocation of the GST exemption at the end of an ETIP period even though an allocation is not intended. For example, this may occur in many terminating Grantor Retained Annuity Trusts that name skip persons as remainder beneficiaries. Therefore, we request guidance addressing whether a pre-emptive election may be made prior to the end of an ETIP period.

We also believe there is a need to clarify whether an election pursuant to section 2632(c) to treat a trust as a GST trust is revocable prospectively for future transfers to the trust, or whether the automatic allocation rules should apply with respect to any or all transfers to a particular trust.

Finally, we suggest that the short form 9100 relief procedures include a mechanism to provide certainty of result. For example, we feel that the Service should acknowledge: (a) that an amended gift tax return under the safe harbor relief has been submitted, and (b) that the Service

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will treat the allocation of GST exemption on that amended return as having been timely made. Alternatively, we would recommend that the Service could have a specified time period within which to respond to the taxpayer, after which the short form 9100 relief will be deemed granted. We also suggest that the regulations include numerous examples detailing the situations in which the short form 9100 relief applies. Additional examples could be published in IRS Notices as they are identified.

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We would be pleased to discuss these matters with you in more detail. Please contact us if you have any questions or if we can be of further assistance. I can be reached at (202) 414-0705, or [robert.zarzar@us.pwc.com](mailto:robert.zarzar@us.pwc.com); or you may contact Evelyn Capassakis, Chair, AICPA Section 2642 Task Force and Chair, AICPA Trust, Estate and Gift Tax Technical Resource Panel, at (646) 394-2363, or [evelyn.capassakis@us.pwc.com](mailto:evelyn.capassakis@us.pwc.com); or Eileen Sherr, AICPA Technical Manager, at (202) 434-9256, or [esherr@aicpa.org](mailto:esherr@aicpa.org).

Sincerely,



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Chair, Tax Executive Committee