Reporting GRATS, GRUTS, ILITS and IDGTs on Form 709:

GST Exemption Allocation Calculations and Strategies

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Note: This presentation is designed per the request of the sponsor for practitioners with significant or advanced experience. It is not an entry level presentation. The author teaches a full-day course for the California CPA Education Foundation entitled *GST Tax from A-Z,* which goes into greater depth and provides enhanced coverage of GST basics.

1. TO FILE OR NOT TO FILE, THAT IS THE QUESTION.

> *"To file or not to file: that is the question:*
> *Whether 'tis wiser to save the cost of professional compliance or*
> *The risk run of more tax and pains of outrageous audit fortune,*
> *Or to shut the door on later challenge,*
> *And by disclosing end them?..."*
>
> *This outline,* Act. I, Sc. 1, by someone who shares the birthday of William Shakespeare

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1.1 Audit Percentages

Table 9a of the 2014 IRS Data Book (October 1, 2013- September 30, 2014) reveals that gift tax returns are infrequently audited. Gift tax returns are infrequently audited:

Type of Tax	Number of returns	Audits	Audited %
Gift Tax	371,747	3,098	.8 (under 1%)
Estate Tax	9,945 ($5M or more)	1,389 ($5M -$10M gross estate) 906 ($10M+ gross estate)	21.1% 27%

Many gift tax returns are filed with little revenue potential for the IRS (e.g., Code §529 elections, little or no use of the gift tax annual exclusion, gifts of readily-valued assets or to allocate GST exemption on gifts in trust for skip persons that are not "vested" gifts under Code §2642 though the gift is an annual exclusion gift.)

1.2 Was There a Gift?

A gift tax return is not required unless a gift is made, in whole or part.

The gift tax regulations define the term "gift" to mean, "[A]ny transaction in which an interest in property is gratuitously passed or conferred upon another, regardless of the means or device employed." Reg. §25.2511-1(c). Accordingly, a gift may be made, directly or indirectly. It is NOT necessary that there be no consideration (i.e., there can be a gift even if the donor receives some consideration of monetary value. Code §2512(b) provides that, if property is transferred for less than adequate and full consideration in money or money's worth, the excess of the value of the transferred property over the value of consideration received is a gift for federal gift-tax purposes. As a result, a gift can include sales, exchanges, and other dispositions of property for a consideration to the extent that the value of the property transferred by the donor exceeds the value in money or money's worth of the consideration given to the transferor. Reg. §25.2512-8.

1.2.1 Donative Intent Is Not Required

Donative intent is not required on the part of the donor to create a gift transfer. Instead, the characterization of a transfer as a gift will depend on whether or not the transfer was for *full and adequate* consideration. *Comr v. Wemyss* 324 U.S. 303, 306 (1945). Transfers within the "ordinary course of business" are excluded from consideration of whether or not there was full and adequate consideration. Reg. §25.2512-8; *Estate of E. Redstone v. Comr*., 145 T.C. 11 (Oct. 26, 2015) and contrast with *S. Redstone v. Comr*., T.C. Memo 2015- 325 (ordinary course of business test not met).Even though the intent of the donor is normally irrelevant to the characterization of the transfer as a gift, the existence of donative intent is relevant in determining whether the transfer was made in the ordinary course of business. Reg. §25.2512-8. For example, the sale of goods in an arm's length purchase and sale is not a gift, even if less than full and adequate consideration was paid, if the transaction is characterized as a commercial event based on the objective analysis of the facts and relationship of the parties. *Fehrs v. U.S*., 620 F.2d 255, 260 (Ct. Cl. 1980).

Estate of Redstone, *supra,* arises from a dispute regarding the succession and management of a successful family business. So typical of family disputes, personal stress and dynamics led to controversy and litigation. One son, the plaintiff, felt disrespected and shut out. The father was aligned with the other son, the mother wanted peace and finally after exacerbated litigation a settlement was reached. At issue was whether the payments to the son in 1972 constituted a gift. The court also rejected the main position of the IRS, namely, that the consideration in the settlement had to flow from the transferees to the transferor. The court concluded that the consideration to the transferors was sufficient even if it did not come from the transferees.

Although donative intent is not required for a gift, the transfer must be donative in nature. The ordinary course of business exception applies not only to transactions with recurring customers, but also to business related transactions and transfers that are bona fide, arms' length, and free from donative intent. As a result, in *Weller v. Comr*., 38 T.C. 790 (1962), acq. 1968-2 C.B. 3, there was no gift on the sale of a partnership interest to an unrelated party for one-half its value because of the arms' length character of the transaction and the seller's business reasons for making the transfer.

Transactions among family members are far more difficult to characterize within the ordinary course of business exclusion, although they may qualify on a sufficient showing of proof. That was the case in *Estate of Redstone*, *supra*. See also, *Ellis Sarasota Bank & Trust Co. v. U.S*., 77-2 USTC ¶13,204 (M.D. Fla. 1977) and *Galluzzo v. Comr*., T.C. Memo 1981-733.

As discussed above, the treatment of a transfer as a gift or bona fide sale is not determined by intent, per se. The most important factor on transfers between family members is exchange of value. Was it full and adequate? However, intent is not irrelevant. It may help determine whether or not there was a business purpose (which may be income and not a gift) and the practical perspective that the IRS or courts may bring to bear. A written agreement can help define the framework of why the transaction occurred, but objective factors will be more important.

1.3 General Rule for Assessment of Gift Tax

As a general rule, the IRS has three years after the gift tax return was filed (whether or not such return was filed on or after the date prescribed) to assess gift tax. Code §6501(a). The statute remains open in the event of a failure to file a gift tax return or in the event of fraud. A return filed timely prior to April 15 will be deemed filed on April 15. In a rule similar to income taxation, the statute of limitations is extended to six years in the event the gift tax return omits items that are properly includible as gifts during the year, of a value in excess of 25 percent of the total amount of the gifts reported on the return for that year. Code §6501(e)(2).

The author encourages the filing of gift tax returns when there might be a benefit from filing. The word "might" is given expansive meaning because of concern with unintended consequences if a Form 709 is not filed. From a purely practical matter, very few gift tax returns are audited (about 0.8 percent). While valuation issues are the most evident benefit for disclosure, other areas of filing can be beneficial, including but not limited to the measure of the return on a GRAT or GRIT; providing a copy of the trust which might preclude a later challenge to the effectiveness of the trust (recognizing that the regulations want disclosure of a non-compliance with the regulations of public rulings); that a sale is not a gift due to the adequacy of the consideration; annual exclusion treatment for Crummey gifts; and the basic benefit of reporting the transfer for compliance with the law, making a record, and running the statute.

2. ADEQUATE DISCLOSURE

2.1 Finality of Valuation

After the assessment period runs for gift tax, neither the taxpayer nor the IRS may revalue gifts. However, either the IRS or the taxpayer, on gifts made prior to August 6, 1997, can revalue gifts for estate tax purposes in the determination of adjusted taxable gifts. The IRS was successful in several instances of death prior to 1997 to increase adjusted taxable gifts (line 4 on page 1 of the estate tax return), thereby achieving increased estate tax, even though the gift tax assessment period had run. *Smith Est. v. Comr.*, 94 T.C. 872 (1990), *acq.*, 1990-2 C.B. 1.

☺ Similarly, the IRS acknowledged the right of the taxpayer to lower the value of the gifts in the determination of adjusted taxable gifts. TAM 9718004.

> **Example:** D made a gift of a 50 percent interest in a condo in 1985, for which a 100 percent interest was valued for $500,000. No fractional interest discount was asserted on the return (not an uncommon event before fractional interest discounts became more recognized), as a result of which a $250,000 value was reported. CPA notices this fact in 2005, following the death of D. The adjusted taxable gifts reported on D's estate tax return can be reduced for a fractional interest discount on the gift (let's assume 10 percent of $250,000, or $25,000, in this illustration).

The *Smith* decision and its progeny were overruled by the 1997 Taxpayer Relief Act, §506(b), which amended §6501(c) to provide that adequately disclosed gifts cannot be revalued, even on an audit of the estate tax return, after the gift tax statute of limitations has run. As a transitional rule under the 1976 Act, completed lifetime transfers taken into account in determining cumulative transfers at death for purposes of imposing the estate tax include only taxable gifts made after Dec. 31, 1976. Correspondingly, the gift tax paid with respect to gifts made before Jan. 1, 1977, is not to be included as part of the offset in computing the estate tax. It is, however, available as a credit under §2012.

If the time has expired within which gift tax may be assessed on (1) the transfer of property by gift made during a prior year, or (2) an increase in taxable gifts required under §2701(d), the value thereof shall, for purposes of computing gift tax, be final for determination of the value of adjusted taxable gifts. Code §2504(c).

2.2 Introduction to Adequate Disclosure

Adequate disclosure requirements are encountered with gifts to which Code §§2701 or 2702 may apply and to gifts generally. Although the words "adequate disclosure" are used in each of these contexts, the words do not have the same meaning under Regulations issued by the IRS.

Compliance with adequate disclosure requirements is very important. The statute of limitations under Code §6501 does not commence to run unless adequate disclosure rules are met. Prior to 1997, the filing of a gift tax return commenced the statute on undisclosed gifts (absent fraud). After 1996, the statute commences only as to those transfers with respect to which adequate disclosure has been provided.

Adequate disclosure is made on a gift tax return.

The regulations take a tough reporting stand regarding the commencement of the statute of limitations and reporting requirements of transfers that may not be completed gifts. Reg. §301.6501(c)-1(f)(5) provides:

> "(5) Adequate disclosure of incomplete transfers.
> Adequate disclosure of a transfer that is reported as a completed gift on the gift tax return will commence the running of the period of limitations for assessment of gift tax on the transfer, even if the transfer is ultimately determined to be an incomplete gift for purposes of Section 25.2511-2 of this chapter. For example, if an incomplete gift is reported as a completed gift on the gift tax return and is adequately disclosed, the period for assessment of the gift tax will begin to run when the return is filed, as determined under section 6501(b). Further, once the period of assessment for gift tax expires, the transfer will be subject to inclusion in the donor's gross estate for estate tax purposes only to the extent that a completed gift would be so included. On the other hand, if the transfer is reported as an incomplete gift whether or not adequately disclosed, the period for assessing a gift tax with respect to the transfer will not commence to run even if the transfer is ultimately determined to be a completed gift. In that situation, the gift tax with respect to the transfer may be assessed at any time, up until three years after the donor files a return reporting the transfer as a completed gift with adequate disclosure."

Accordingly, a taxpayer who is in doubt as to whether or not the statute of limitations runs on a transfer that may not be a completed transfer can benefit under the regulations if the incomplete transfer is treated as complete (and pays whatever gift tax that may be associated with that incomplete transfer). However, that taxpayer runs the risk that by reporting an incomplete transfer as an incomplete transfer the statute of limitations will not have commenced should it later be determined that the transfer was complete.

> **Corrective Action:** In the event that the donor made a gift after 1996 with respect to which the donor filed a gift tax return but did not make adequate disclosure as required by Code §6501(c)(9) and Reg. §301.6501(c)-1(f)(2), the donor may file a supplemental gift tax return in accordance with Rev. Proc. 2000-34 to meet the adequate disclosure requirement. This Revenue Procedure directs the following steps:
>
> (1) File an amended Form 709 making adequate disclosure.
> (2) The amended return is to be filed at the same Service Center at which the original return was filed.[2]
> (3) The top of the first page of the return must have the words, "Amended Form 709 for gift(s) made in [insert the calendar year that the gift was made] — In Accordance with Rev. Proc. 2000-34, 2000-34 I.R.B. 186."

[2] Announcement 2001-74: Beginning with returns filed on or after January 1, 2001, file estate and gift tax returns at the Cincinnati/Covington Center. However, Rev. Proc. 2000-34 was not updated to reflect mailing to Cincinnati for returns that preceded January 1, 2001. Unless Rev. Proc. 2000-34 is amended, file amendments to pre-2001 Form 709s under this procedure at the Service Center of original filing.

The following are highlights from cases or announcements regarding adequate disclosure:

1. PLR 200510026: The IRS considered the disclosures to a gift tax return as effectively allocating GST exemption even though Schedule C was not completed to allocate the exemption. The trust provided that GST exemption would be allocated and the trust included reference to an exempt share. The IRS concluded that strict compliance with the procedural instructions was not required as long as the information provided on the return was sufficient to indicate that the taxpayer intended to make an allocation of GST exemption. The attachment of a copy of the trust was important, in this situation, in allowing the allocation to be treated as timely made on the gift tax return (timely filed) because of the terms of the trust.

2. CCA 200221010: The IRS Chief Counsel's Office advised that the following should be shown on the return to avoid the closing of the statute under §6501(c)(9): (1) the value of the gift was required to be shown on a gift tax return; and (2) the gift was not disclosed on the return or on any statement attached to the return in a manner sufficient to apprise the IRS of the nature of the gift.

> **Comment**: This announcement reminds the author of his grandmother's lesson, whoever keeps score wins the game. In the background of this announcement, the IRS commenced its audit of the Form 709 within the 3-year period and spotted whatever was of concern to it within that time. However, they were late in getting around to issuing a Notice of Deficiency, or they encountered some other delay. IRS Counsel then concluded that the Notice was inadequate. Duh … how did the IRS figure out how to select this return in the first place?

3. CCA 200916022: This advisory leaves unknown the facts upon which IRS Chief Counsel made a determination that disclosure was not adequate in connection with the determination of mortality with an annuity. The estate tax audit arose out of southern California and appears to reflect extensive estate planning. The actual disclosures in the gift tax return are not indicated, and it appears that the issue pertains to the improper application of mortality and explanation of the method used. Given the paucity of analysis, the advisory appears to be result-oriented. In the least skeptical light, the ruling provides a reminder to disclose the method of analysis used.

4. CCA 201024059: Adequate disclosure lacking. The examiner indicated:

> "…that a donor of stock of a closely-held business failed to disclose on the gift tax return: (1) any information with respect to the method used to determine the FMV of the stock; and (2) any description of discounts used to value the stock when discounts were in fact used to value the stock."

5. *Estate of Sanders v. Comr.*, T.C. Memo 2014-100: Tax Court declined to grant taxpayer's motion for summary judgment on issue of adequate disclosure. Valuation information pertaining to a subsidiary (which contributed less than 10% of the value of the parent entity) was not disclosed. Substantial discounts were reported on the gift tax return.

6. Legal Advice by Field Attorneys (LAFA) 20172810F: This advisory concludes that the statute of limitations remained open when the donor failed to file gift tax

returns and for those years even when filed because under Code Sec. 6501(c)(9) because the Form 709 that was filed neither described the transferred property nor provided a description of the method used to determine its value. (As an aside, the limitations period will start to run when the amended return is filed. See, Rev Proc 2000-34, 200-2 CB 186. In this LAFA, the donor made gifts over 6 years and filed no gift tax returns. For year 7, a gift tax return was filed, but the donor neither described any of the property transferred nor provided a description of the method used to determine the value of that property. As a result, the donor did not file Forms 709 and did not otherwise report the gifts made in Years 1 through 6 (thus, the limitations period on assessing tax on these gifts did not expire), and as a result of the failure to make adequate disclosure, the period of limitations on assessing tax on the Year 7 gifts did not expire. Per Rev Proc 2000-34, the donor may begin the running of the statute of limitations by filing complete and accurate Forms 709 for Years 1-7.

2.3 Adequate Disclosure with Sales and Other Closely-held Business Transactions

Potential gifts can arise from sales and a variety of transactions with family businesses. Sales, of course, need not be totally independent of family-business transactions or circumstances. Reg. §301.6501(c)-1(f)(4) encourages the reporting on Form 709 of sales, including sales that are not believed to be gifts. At the same time, the regulation distinguishes between ordinary course events and other transactions. Transactions "made in the ordinary course of operating a business" are considered to be adequately disclosed when reported on income tax returns. Accordingly, gift tax returns are not required for those family-business events. However, an issue of interpretation of the law may exist with respect to ordinary course events. Is the exception the same that excludes "ordinary course of business" from the definition of a gift? (See, §1.2.1, *supra*.) Or, is the test one that excludes sales or other normal acts in the course of business (such as salaries, inventory sales and the like)?

> **Comment:** If a transaction is in the ordinary course of business, no gift arises. The Tax Court in *E. Redstone,* supra, recited the following test under Reg. §25.2512-8 for the determination that a transfer was in the ordinary course of business: (1) the transfer must have been bona fide, (2) transacted at arm's length, and (3) free of donative intent. If the transaction meets the ordinary course test, then the value of the consideration exchanged is not relevant since the transaction is outside of the scope intended for gift tax law. However, for the purpose of adequate disclosure, an ordinary course of business test would add nothing since there is no gift tax return required, and therefore no gift to disclose. Therefore, a statement that reporting an ordinary course of business transaction on an income tax return satisfies the gift tax adequate disclosure test presumes the conclusion that the transaction is not a gift per se. On the other hand, if ordinary course business transactions (which might be a gift if, for example, inventory is sold to a family member below market price) are adequately disclosed on an income tax return, then the income tax disclosure is more than implementing a tautology.

> **Comment Example**: The *E. Redstone* case was concluded to not be a gift because the ordinary course test was satisfied. The safer approach under post 1997 law would be to report the transaction as a completed non-gift event to start the statute of limitations. That same approach could be followed had the facts of *S. Redstone* arisen under current law. In either case the IRS would have three years to audit and no issue of late filing, payment or other penalties would have arisen.

Capital gain events are not, of course, sales in the ordinary course of business. If sales are ordinary course events (e.g., the sales of inventory), gain would not be of a capital asset or asset held for the production of income. Reg. §301.6501(c)-1(f)(4), which is entitled, “Adequate Disclosure Of Non-Gift Completed Transfers Or Transactions” provides:

> “Completed transfers to members of the transferor's family, as defined in §2032A(e)(2), that are made in the ordinary course of operating a business are deemed to be adequately disclosed under paragraph (f)(2)of this section, even if the transfer is not reported on a gift tax return, provided the transfer is properly reported by all parties for income tax purposes. For example, in the case of salary paid to a family member employed in a family owned business, the transfer will be treated as adequately disclosed for gift tax purposes if the item is properly reported by the business and the family member on their income tax returns. For purposes of this paragraph (f)(4), *any other completed transfer that is reported, in its entirety, as not constituting a transfer by gift* will be considered adequately disclosed under paragraph (f)(2) of this section only if the following information is provided on, or attached to, the return —
>
> (i) The information required for adequate disclosure under paragraphs (f)(2)(i), (ii), (iii) and (v) of this section; and
>
> (ii) An explanation as to why the transfer is not a transfer by gift under chapter 12 of the Internal Revenue Code.”

Reporting sales to family members on Form 709 that are outside of the ordinary course of business transactions commences the statute of limitations. This can be a big deal. The IRS may be later precluded from arguing that the value of the economic return to the transferor was financially less than equal (or what is reported to be the value) for purposes of asserting that a gift arose or to aid a taxpayer’s defense against a Code §2036 (retained interest) or Code §2519 (transfer of QTIP) attack. Defense against a Code §2036 challenge is not purely one of economic parity (equal value received) since the IRS can raise the “bona fides” of the transfer to the donee, removing the valuation issue as of the date of the gift can aid the taxpayer in achieving a final result… or make less expensive the cost to litigate the point.

The following attachments, subject to the particulars of a given transaction, are illustrative of the types of exhibits to attach to the Form 709 as part of adequate disclosure with sales:

1. The purchase and sale agreement.
2. Promissory note.
3. Security agreement/deed of trust, if any.
4. Trust (if a buyer or seller).
5. Appraisal(s) of the property/interest sold.
6. Transfer documents (assignments or deeds) if not otherwise described in the disclosures on the gift tax return.

2.4 Adequate Disclosure under Code §§2701 and 2702

Adequate disclosure requirements were first introduced with gifts subject to Code §§2701 or 2702. As a result of the 1997 Tax Act, these disclosure requirements were extended to gifts generally.

2.5 Adequate Disclosure on Annual Exclusion Gift or Gifts of "Modest" Amount

Clients should be encouraged to file gift tax returns when valuation issues or questions of the interpretation may exist that bear on valuation or gift tax treatment. Gifts limited to the annual exclusion amount (aggregating all gifts from a given donor to a given donee) that are made outright and in cash do not present, in of themselves, an issue of dispute to necessitate the filing of a gift tax return. However, an annual exclusion gift that is made in trust or transfers value other than case-present issues that should be disclosed on a gift tax return. Consider the following as a non-inclusive list:

1. Valuation of interests in real estate, partnerships, corporations, LLCs, or hard-to value assets: Are the values correct?

2. Gifts to Crummey trusts: Is the gift of property a gift of a present interest?

   (See, *Hackl v. Comr.* 335 F.3rd 664 (7th Cir. 2003); *Fisher v. U.S.*, 2010-1 U.S.T.C. ¶60,588 (S.D. IN); *Price v. Comr.*, T.C. Memo 2010-2. See, *Estate of Wimmer v. Comr.* T.C. Memo 2012-157 for a favorable result. This issue is discussed in *706 Art*, chapter 6, §6.7.3.)

   Comment: The author would rather see challenges made to annual exclusion treatment of a Crummey gift on a gift tax return than to give the IRS a free challenge to go back to the commencement of the trust when the estate tax audit is conducted. Adequate disclosure commences the three-year statute of limitations under Code §6501. That section focuses on the "amount of tax" reported not merely valuation.

3. Does the gift create an indirect skip to which GST exemption should be allocated (or elected out of deemed allocation)?

4. Is the gift to a direct skip trust one that does not meet the special vested-trust rule for GST purposes to allow the annual exclusion gift to be treated as a non-taxable transfer under Code §2642(c)?

5. Is the gift in any way connected to a more sensitive matter including but not limited to a family entity, installment sale, possible Code §2036 retained interest, existence of a completed gift in a year in which the gift tax exemption is high, or property that has appreciated significantly?

6. Is the taxpayer's estate likely to be one to which estate tax will be relevant, regardless of changes in the applicable exclusion amount?

7. If the taxpayer has fairly recent appraisals, but not an appraisal as of the date of the gift, attach a copy of the more recent appraisal, and, include the following: (1) a copy of financial statements and balance sheets since the most recent appraisal; and, (2) include a description of significant events. The foregoing recommendation is *not* open-ended in time. For example, an appraisal of a real estate property in a constant market may be helpful for a few months or years, but its use beyond that for annual exclusion gift use is suspect. Also, what has been the general market inflation or deflation? In any event, attach financial information and explain what is being done, how value

is determined and the discounts applied. **Keep in mind that the IRS is going after penalties more.** The qualified appraisal is the best protection for the client and the practitioner. Thus, urge the clients to have appraisals done. Also, bunch annual exclusion gifts … such as in December of one year and January of the next.

3. TAKING POSITIONS CONTRARY TO THE REGULATIONS

3.1 Regulations May Be Invalid and Consideration of *Mayo Foundation*.

At times the taxpayer may feel justified to take a position contrary to the regulations. Regulations are from time to time held invalid. See, *Walton v. Comr.*, 115 T.C. 589 (2000) ("Zeroed-out" GRATs); *Finfrock v. U.S.*, 2012-1 U.S.T.C. Par. 60,641 (C.D. Ill.) (special-use qualification); *Miller v. U.S.*, 680 F. Supp. 1269 (C.D. Ill. 1988) (similar to *Finfrock)*; *Estate of Boeshore v. Comr*., 78 T.C. 523 (1982), acq. in result only, 1987-1 C.B. 1. (charitable annuity or unitrust interest in which excessive restrictions imposed by regulation not found in statute); *Stephenson Trust v. Comr*., 81 T.C. 283 (1983) (use of multiple trusts); *Northeastern Pennsylvania Nat'l Bank and Trust Co. v. U.S.*, 387 U.S. 213 (1967) (specific portion marital deduction test); *Estate of Pullin v. Comr.*, 84 T.C. 789 (1985), acq., 1988-2 C.B. 1 (special-use election signing).

The Supreme Court decisions in *Chevron U.S.A., Inc.*, v. *National Resources Defense Council, Inc*., 467 U.S. 837 (1984) and *Mayo Foundation for Medical Education and Research, et. al., v. U.S.*, 131 S. Ct. (2011) reflect the deference given to regulations. *Mayo Foundation* arises from the issue of employment taxes (FICA) with medical students. *Mayo* narrows, if not wholly eliminates, the distraction between interpretive and administrative regulations when applying the *Chevron* standard. *Mayo* frames the issue and analysis as follows:

- The first step of the two-part framework is to ask whether Congress has "directly addressed the precise question at issue."
- In the event that ambiguity is determined, the court will not disturb an agency rule unless it is "arbitrary or capricious in substance, or manifestly contrary to the statute." In this regard, the Supreme Court follows *Chevron*, *supra*, stating: "The sole question for the Court at step two under the *Chevron* analysis is 'whether the agency's answer is based on a permissible construction of the statute.'"
- *Mayo Foundation*, *supra*, also rejected the principle that the courts owe the Treasury's interpretative regulations less deference when they are contained in a rule adopted under that "general authority" (so-called "administrative" regulations) than when they are issued under a specific grant of authority to define a statutory term or prescribe a method of executing a statutory provision (so-called "legislative" regulations). Although *Mayo Foundation* provided additional ammunition for the IRS, decisions from two courts of appeal considered *Mayo Foundation* held regulations invalid. The Fourth (*Home Concrete & Supply, Inc., et. al., v. U.S.,* 634 F.3d 249 (4th Cir. 2011), *rev'g* and *rem'g* 2009 U.S. Dist. LEXIS 127250 (E.D.N.C. 2009)). and Fifth Circuits (*Burks v. U.S.*, 633 F.3d 347 (5th Cir. 2011), *rev'g* and *rem'g* 2008-2 U.S.T.C. ¶50,702 (N.D. Tex. 2008)) rejected the application of the exception to the Treasury's regulation-promulgated definition of "an omission of income" for the purpose of applying the six-year, rather than

the three-year, statute of limitations.[3] The circuit courts rejected granting these regulations *Chevron*-deference because Code §6501(e)(1)(A) was not ambiguous. The Fifth Circuit in *Burks v. U.S.*, stated that the regulations "attempt to 'trump' what is established precedent …" The *Burks* court went on to state that even if the statute was ambiguous, it is unclear that *Chevron*-deference under *Mayo Foundation*, should be extended. The following quotation from *Burks*, may have application in view of the fact that Treasury's Code §2053 regulations reflect an effort to change the law, and thus establish a litigation position contrary to interpretation of that law announced in several circuits, and of which the IRS has every expectation that taxpayers in relevant circuits would continue to follow that precedent with respect to Code §2053:

> "Significantly, in *Mayo* the Supreme Court was not faced with a situation where, during the pendency of the suit, the treasury promulgated determinative, retroactive regulations following prior adverse judicial decisions on the identical legal issue. 'Deference to what appears to be nothing more than an agency's convenient litigating position' is 'entirely inappropriate.'" (Citation). The Commissioner 'may not take advantage of his power to promulgate retroactive regulations during the course of a litigation for the purpose of providing himself with a defense based on the presumption of validity accorded to such regulations.'

3.1 Penalties for Negligence or Disregard

Code §6662(b)(1) imposes an accuracy-related penalty to any portion of an underpayment attributable to negligence or disregard of rules or regulations. Code §6662(c). Reg. §1.6662-3(b)(1) provides that the term "negligence" includes any failure to make a reasonable attempt to comply with the provisions of the internal revenue laws or to exercise ordinary and reasonable care in the preparation of a tax return. Negligence also includes any failure by the taxpayer to keep adequate books and records or to substantiate items properly. A return position that has a reasonable basis as defined in paragraph (b)(3) of the foregoing regulation is not attributable to negligence.

Paragraph (b)(3) of this regulation directs that "reasonable basis" is a relatively high standard of tax reporting, that is, significantly higher than not frivolous or not patently improper. The reasonable basis standard is not satisfied by a return position that is merely arguable or that is merely a colorable claim. If a return position is reasonably based on one or more of the authorities set forth in §1.662-4(d)(3)(iii) (taking into account the relevance and persuasiveness of the authorities, and subsequent developments), the return position will generally satisfy the reasonable basis standard even though it may not satisfy the substantial authority standard as defined in §1.6662-4(d)(2). (See §1.6662-4(d)(3)(ii) for rules with respect to relevance, persuasiveness, subsequent developments, and use of a well-reasoned construction of an applicable statutory provision for purposes of the substantial understatement penalty.) In addition, the reasonable cause and good faith exception in §1.6664-4 may provide relief from the penalty for negligence or disregard of rules or regulations, even if a return position does not satisfy the reasonable basis standard.

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[3] Code §6501(e)(1)(A) and its application to "Son of BOSS" — Bond and Option Sales Strategy. The IRS alleged that these transactions were undertaken to inflate basis to achieve artificial losses.

Exception for adequate disclosure:

The penalty for disregard of the rules under Code § 6662(b)(1) can be avoided for any portion of an underpayment that is attributable to a position contrary to a rule or regulation if: (i) the position is disclosed in accordance with the method of disclosure rules described below, and (ii) in case of a position contrary to a regulation, the position represents a good faith challenge to the validity of the regulation.[4] The disclosure exception does not apply, however, in the case of a position that does not have a reasonable basis or where the taxpayer fails to keep adequate books and records or to substantiate items properly.

The negligence penalty cannot be avoided though adequate disclosure of a return position. Reg. §1.6662-7(b).

Under the *method of disclosure* requirement, the return should include a properly completed and filed Form 8275 or 8275-R, as appropriate. The following requirements apply under Reg. §1.6662-4(f):

(1) Disclosure is adequate with respect to an item (or group of similar items, such as amounts paid or incurred for supplies by a taxpayer engaged in business) or a position on a return if the disclosure is made on a properly completed form attached to the return or to a qualified amended return for the taxable year. In the case of an item or position other than one that is contrary to a regulation, disclosure must be made on Form 8275 (Disclosure Statement); in the case of a position contrary to a regulation, disclosure must be made on Form 8275-R (Regulation Disclosure Statement).

(2) The Commissioner may by annual revenue procedure (or otherwise) prescribe the circumstances under which disclosure of information on a return (or qualified amended return) in accordance with applicable forms and instructions is adequate. If the revenue procedure does not include an item, disclosure is adequate with respect to that item only if made on a properly completed Form 8275 or 8275-R, as appropriate, attached to the return for the year or to a qualified amended return.

(3) Disclosure with respect to a recurring item, such as the basis of recovery property, must be made for each taxable year in which the item is taken into account. (Item 4 omitted.)

(4) Disclosure in the case of items attributable to a pass-through entity (pass-through items) is made with respect to the return of the entity, except as provided in this paragraph (f)(5). Thus, disclosure in the case of pass-through items must be made on a Form 8275 or 8275-R, as appropriate, attached to the return (or qualified amended return) of the entity, or on the entity's return in accordance with the revenue procedure described in paragraph (f)(2) of this section, if applicable. A taxpayer (i.e., partner, shareholder, beneficiary, or holder of a residual interest in a REMIC) also may make adequate disclosure with respect to a pass- through item, however, if the taxpayer files a properly completed Form 8275 or 8275-R, as appropriate, in duplicate, one copy attached to the taxpayer's return (or qualified amended return) and the other copy filed with the Internal Revenue Service Center with which the return of the entity is required to be filed. Each Form 8275 or 8275- R, as appropriate, filed by the taxpayer should relate to the pass- through items of only one entity. For purposes of this paragraph (f)(5), a pass-through entity is a partnership, S corporation (as defined in section

[4] Additional requirements apply with reportable transactions.

1361(a)(1)), estate, trust, regulated investment company (as defined in section 851(a)), real estate investment trust (as defined in section 856(a)), or real estate mortgage investment conduit ("REMIC").

3.2 Added Caution with Adequate Disclosure on Form 709

The regulation governing adequate disclosure for gift tax return requires that the return disclose any position that is taken contrary to any proposed, temporary or final regulation or revenue ruling published at the time of the transfer. Reg. § 301.6501(c)-1(f)

Comment: This requirement for disclosure of a contrary position is distinct from the disclosure requirements for penalties, though they can overlap. Also, the gift tax adequate disclosure rule than the exception for penalty defense. If a position contrary to a regulation is being asserted, disclosure under Code § 6662(b)(2) should be made to provide a defense for penalties under that distinct rule.

4. PRACTICE HINTS TO REDUCE AUDITS OF GIFT TAX RETURNS

The following are some practice tips to reduce gift tax audit exposure:

(i) Hire quality appraisers with experience with the type of property and interest gifted.

(ii) Ditto on point #1.

(iii) File the gift tax return with extensive disclosures and attachments for purposes of adequate disclosure and to reflect competency. See adequate disclosure discussion, *supra.*

(iv) Avoid a sloppy return or one with mistakes.

(v) Verify prior gifts by taxpayer. Request a transcript from the IRS if uncertainty exists.

(vi) Remind clients to include all gifts during the year to a given donee.

(vii) QTIP election for gift tax purposes can only be made on a timely filed gift tax return.

(viii) Consider gift splitting with separate property. (Election applies to all gifts during the year, each spouse is jointly and severally liable.) The election is gift-tax effective only. The primary donor remains donor for grantor-trust purposes. Gift splitting enables more exclusion amount to be used if that result is desired before gift tax is paid.

(ix) Carefully review return for unique rules under GST law. Is deemed allocation of GST exemption applicable? Is it desirable? Consider election out of deemed allocation rules. Should GST exemption be allocated timely, or would a late allocation of GST exemption be preferable? The denominator in the applicable fraction for GST exemption allocation purposes is the date of gift value with a timely filed gift tax return or the date of late filing (or first day of the month of late filing) when the GST exemption is allocated after the due date of the gift tax return.

Example #1: Donor gifted $400,000 of stock to a trust reportable under Schedule A, part 3 (indirect skip) on the Form 709 on 11/1/16. The donor plans to file a timely gift tax return on April 15, 2017. However, the value of the stock in the trust has declined to $350,000 as of 4/1/17.

Q: What should be done?
A: File the 709 timely, elect out of the allocation of GST exemption to this trust, then file a gift tax return at a later date (such as in May, 2017) and use the May 1, 2015 value (which presumably is less than $400K). If the stock went back up this approach would be unhelpful. It is the client's call. Thus, if the stock has a value of $360K on May 1, 2017 and the late GST exemption is allocated in May, 2017 while the donor remains alive, only $360K of GST exemption needs to be allocated to achieve an applicable fraction of one ($360K/$360K) and an inclusion ratio of zero (0) for GST purpose.

Example #2: Gifts to an irrevocable life insurance trust (if included on Schedule A, part 3). The trust commonly declines in value after the gift is made since premiums paid administrative costs and mortality expense to significant degree even with investment-type life insurance. Opting out of the deemed allocation of GST exemption can save GST exemption. Beware if the decedent becomes terminally ill before GST exemption is allocated, or worse, dies before GST exemption is allocated. In each of these instances the policy is valued based on fair market value principles.

5. GIFT TAX REPORTING OF GRANTOR RETAINED ANNUITY TRUSTS (GRATS)

GRATs offer the opportunity to freeze the estate value to the value of the gift plus a return to the donor equal to the Code §7520 rate at the time of the gift (let's call it the "hurdle rate"). Provided the technical requirements of the GRAT are satisfied, the growth in value plus the return apart from growth (e.g., distributions, net rents, actual income, etc.) passes to the remainder beneficiaries free of gift tax.

In a nutshell, GRATs add a time-value discount on top of all other discounts applicable to the gifted interest. The purpose of the GRAT is to minimize the value of the taxable gift. As will be seen, the taxable value may be near zero, yet vast wealth can transfer free of gift tax (and free of later estate tax when the donor dies) if the grantor survives the retained term.

5.1 <u>Leveraging Discounts: The Statutory GRAT</u>

In addition to discounts for lack of marketability and minority interest, the wealthy business owner can take further advantage of discounts through the use of a GRAT. The GRAT is blessed by statute. Code §2702. Its discount is based on **present value**, with the Code §7520 rate (120 percent of the mid-term applicable federal rate) serving as the discount rate. If the desired remainder beneficiary of the trust is not a "family" member, a GRAT does not have to be used; and, the more flexible grantor retained income trust (GRIT) can be used.

Because the GRAT is bless by statute, the client does not have to expose himself to potentially adverse tax risks that may attend strategies based on case law or rulings (such as "defective trusts"). However, a defective trust offers greater discount potential because the discount rate is the applicable federal rate ("AFR", not the §7520 rate. The §7520 rate is 20 percent greater than the AFR, causing increased value to be attributed to the remainder interest based all the same other factors.

During the retained annuity payment period, the income from a GRAT is taxed to the grantor. Whether grantor-trust status continues after the retained period is a matter of gift and estate planning for the particular client. Thus, a GRAT can be coupled with an intentionally defective grantor trust (IDGT) if so desired and defective trusts are income taxed as grantor trusts (depending as to the nature of the defect). Some defects apply to income only, others apply to the entire trust.

Basically, the GRAT rules apply when the grantor retains income or benefits from a trust or asset. The purpose of Code §2702 is to value the remainder — i.e., the gifted interest — for **gift tax** purposes. The IRS wants to value the remainder interest as high as possible. If the remainder beneficiary is a family member and the GRAT rules are not followed, the deemed value of the gift is the total gift without regard for any time-value discount. If the GRAT rules are followed, the donor will retain a "**qualified interest**," which is subtracted from the total value of the gifted interest to arrive at the present-value gift amount. This is called the "**subtraction method**"... the value of the gift figure net the qualified interest.

5.2 Background

GRATS and GRITS reduce gift and estate taxes through the value allocated to the retained interest. These tactics create a **time-value discount**, which is in addition to all other traditional valuation discounts. Before the 1990 Tax Act, these split-interest trusts often took the form of a GRIT. Except in the case of a qualified personal residence trust (QPRT), the GRIT is no longer permitted with family members.[5]

Think of a split interest trust as a "trust time-share." The split-interest trust divides a trust into three component parts, usually measured by time or by the occurrence of an event: (1) the **retained interest** (what the grantor keeps); (2) the **remainder interest** (what others receive when the grantor's retained term ends); and, possibly, (3) a **reversionary interest** (what comes back to the grantor if the grantor dies during the retained term). The remainder interest is the gifted interest. If the donor retains a long-term interest, the value of the gifted remainder declines.

If the donor outlives the retained term, then the remainder would pass to the beneficiary at no additional transfer tax. The trust can also be created so that the retained interest *reverts*

[5]Grantor Retained Income Trusts (GRITs) can be used when the remainder beneficiary is not an applicable family member. The benefit of a GRIT over a GRAT is the fact that the grantor does not have to retain a fixed return. The grantor need only retain an income interest. If there is little or no income, the value of the gifted remainder is still reduced by a present-value factor using the Code §7520 rate. With family members as remainder beneficiary, a GRIT can only be used in the context of the residence, and then under the rules applicable to a Qualified Personal Residence Trust (QPRT). The present-value discount that applies to a GRIT is the same as applies to a QPRT.

back to the grantor in the event the grantor dies within the retained term. The retention of the reversion right is often done in order to reduce the value of the gifted interest — the remainder. With the gift having been valued at the time the retained interest trust was established, the growth is removed from the donor's estate.

Code §2702 imposes special gift tax valuation rules for most retained interest trusts **among** "**family members**" — transferor's spouse, descendants of the transferor or of the spouse and the spouses of descendants. Code §2701(e)(2). It does not apply to the transferor's brothers, sisters, nieces, nephews or non-family members. Gifts of an interest in a trust to these excluded people are valued under general rules. A gift of an interest in a trust to a family member which does not meet the **qualified interest** rules of Code §2702 will be deemed to be the entire value of the trust under the so-called "**subtraction method**." In other words, the value retained by the grantor will be deemed to be zero (i.e., the entire value of the trust therefore gifted) unless the qualified interest rules are met.

GRATs are designed to meet the qualified interest rules of Code §2702. GRATS can save substantial estate taxes when funded with growth assets or assets that produce yields in excess of the IRS interest assumptions (Code §7520 rate). Consider funding these trusts with assets that are not the core of the client's net worth because the client will "lose" the assets by outliving the benefit term that the client retains.

5.3 GRAT Statutory Requirements

The "qualified interest" must satisfy the GRAT rules. A qualified annuity trust must satisfy the regulations in Reg. §25.2702-3(b):

a. It must be payable to or for the benefit of the holder of the annuity interest for each taxable year of the term.

b. There must be an irrevocable right to receive a fixed amount.

c. A fixed amount means either:

(i) A stated dollar amount payable periodically, but not less frequently than annually, but only to the extent that the amount does not exceed 120 percent of the stated dollar amount payable in the preceding year, or

(ii) A fixed fraction or percentage of the *initial* fair market value of the property transferred to the trust as finally determined for federal tax purposes, payable periodically, but not less frequently than annually, but only to the extent that the fraction or percentage does not exceed 120 percent of the fixed fraction or percentage payable in the prior year.

Planning Note: Practitioners may want to create a GRAT with increased payments in later years in the hope that the investments will outperform the Code §7520 rate and leave something for the remainder beneficiaries — at least more than the transfer tax value upon creating the GRAT. Increasing payments tend to allow for greater value to be transferred to the remainder beneficiaries at the end of the GRAT term.

d. Proration rules apply for short taxable years. Reg. §25.2702-3(b). In the alternative, the GRAT can elect to have a fiscal year, which avoids pro-rated years and can lead to the need for fewer appraisals.

e. Augmentation to the trust after the initial transfers must be prohibited.

f. The annuity term must be fixed with distributions made only to the annuitant.

g. The term must be for the life of the holder or for a shorter specified period, but no longer than these periods.

h. There can be no right of commutation (prepayment).

i. GRAT payments must be made when due, or within 105 days of the end of the fiscal year of the GRAT when an anniversary payment date is selected under the GRAT.

Alert: Practitioners need to monitor with the client the required payment from the GRAT. If the annuity payment is being made in kind to any extent, appraisals of the interest returned will be needed. Appraisals may take a few weeks. In addition, the client may need to consider whether to make required payments in cash to the fullest extent possible (and keep more of the underlying assets in the GRAT) or receive greater underlying assets (and keep more cash in the GRAT). Some GRATs can be so successful that the grantor may not want the donee to receive too large a percentage in the entity or property. Each situation is fact specific. The grantor will want to consider the variables … and that may take time.

Elements c (i) and (ii) above permit flexibility by allowing the annuity amount or unitrust percentage to increase by 120 percent of the amount/percentage paid the preceding year (i.e., the increase can go from 10 percent the first year to 12 percent the second year, to 14.4 percent the third year, etc). Excess payment increases are disregarded in determining the value of the annuity or unitrust.

The annuity interest is computed using the Code §7520 rate. (The Code §7520 is 2.0 percent for the month of December, 2015.)

In the event that the GRAT is not able to meet its required payments from income, it will need to distribute trust corpus to the donor. The Service has ruled that a trust, which distributes appreciated assets to the grantor to satisfy the required payments, does not cause a recognition of income by virtue of the grantor-trust rules. See PLRs 9441031, 9415012, 9352004 and 9525032. Because net income is not discounted (even if the underlying asset is discounted), the effective capitalization rate when compared to the discounted value of the underlying asset (the denominator in the capitalization rate fraction) the effective yield when compared to the discounted value increases and provides a larger gap (differential) when compared to the §7520 rate.

Example: An interest in rental property (RP) has no debt and its $1 million value is based upon a capitalization rate of 8% ($80,000 per year). Assuming that the rental property is part of an LLC to which a combined 40 percent discount applies, the $80,000 of income will have 13.33 percent return when based on the $600,000 discounted value. The 13.33 percent rate can be used when planning the effectiveness of the GRAT, assuming the values are correct.

In structuring the GRAT, borrowing should not be the anticipated means of raising funds for meeting required payments; and, use of borrowing should be expressly prohibited by the terms of the GRAT. Reg. §25.2702-3.

The annuity can be structured based on one life, or two lives. In *Schott v. Comr*., 2002-1 USTC ¶60,457 (9th Cir.) *rev'g* 81 T.C.M. 1600, the Appellate Court overruled the Tax Court and permitted a two-life annuity retained by the husband and wife in each of their GRATs. These GRATs were similar in term, each with a 15-year retained period. If the grantor died before the expiration of that 15-year term, the spouse would receive the balance of the annuity for that period, and the grantor retained the right, during life, to revoke the designation to the spouse. The Ninth Circuit determined that Example (7) of the Reg. §25.2702-2(d)(1) was indistinguishable from the facts before the court. The Court distinguished *W. Cook v. Comr*., 2001-2 USTC ¶60,422, on the grounds that the *Cook* case involved the additional contingency that the husband and wife be married at the time of the grantor's death. Reg. §25.2702-3(d)(3), Example 8: grantor makes a completed gift to the spouse when the revocation right lapses on the expiration of the grantor's retained term.

5.4 Zeroed Out GRAT

In pursuit of the smallest gift possible, attention is given to a GRAT with no remainder value — a zeroed out GRAT. Planners can come close.

In *Walton v. Comr*., 115 T.C. 41 (2000), *acq*. Notice 2003-72, the Tax Court considered whether the valuation of the retained interest was the annuity term specified, or the shorter of the term certain or the period ending on the donor's death. The donor established two GRATS, each for a 2-year term, funded with Wal-Mart stock, valued for approximately $100 million. The donor retained a 49.3 percent annuity payment the first year and a 59.22 percent the second year, and valued the gift at near zero ($6,195). The *Walton* decision held invalid Reg. §25.2702-3(e), example (5) As a result of the *Walton* decision, the Service revised examples 5 and 6 of Reg. §25.2702-3(e) on March 7, 2005. Under these final regulations, a unitrust or annuity interest payable for a specified term of years to the grantor, or the grantor's spouse if the grantor dies before the term expires, is a qualified interest for the specified term. ***Walton GRATs are not age sensitive.*** Unlike GRITS, QPRTs and non-*Walton* GRATs the annuity payment is sensitive only to its length and the Code §7520 rate than in effect.

Under Rev Proc 2015-3, the IRS will not rule on whether annuity interests are qualified annuity interests under Code §2702 if the amount of the annuity payable annually is more than 50 percent of the initial net fair market value of the property transferred to the trust, or if the value of the remainder interest is less than 10 percent the initial net fair market value of the property transferred to the trust.

BNA in the *Estates, Gifts and Trusts Folios* suggests a .1% residual value though it recognizes that an attack on a zeroed out GRAT likely would not succeed. PLR 9631021, on the other hand, upheld a zeroed out charitable lead annuity trust.

5.5 Modeling for Clients

Sofware programs, such as *Numbercruncher*™ provides excellent illustrations of projected tax benefits with the use of a GRAT. These variables can be adjusted easily with a client in the office to enable the client to determine the desired retained period and features of the GRAT.

6. GIFT TAX REPORT OF QUALIFIED PERSONAL RESIDENCE TRUSTS ("QPRTs")

QPRTS provide a time-value discount in addition to any fractional interest discount that applies to the interest gifted. The time-value discount is based on the Code §7520 rate. If the grantor retains a reversionary interest in the event of death during the retained term, the value of the gift will be reduced. The IRS has published sample QPRT language for a one-donor QPRT. See, Rev. Proc. 2003-42 for sample terms for a QPRT established by one grantor. The QPRT provides a more attractive alternative to a personal residence trust.[6]

QPRTs become significantly more complicated when debt is on the property. QPRTs can be used with the primary or other residence (within the meaning of Code §280A(d)(1)[7] — without regard to §280A(d)(2) — relating to property that is used in part as a residence); or (3) an undivided fractional interest in either of such properties. Various private letter rulings have considered whether farm use, multi-residence, rental with the grantor personally using the property detached units, and other factors may disqualify a particular property from either of these tests.

6.1 Strategic Use

The time-value discount enables QPRTS to save estate tax even if the residence does not increase in value. If the property appreciates in value, the gift-tax savings increases. The following are significant planning considerations:

1. Consider whether the transfer of the property will have a property tax impact. In California, use of a principal residence or to a lesser extent a secondary residence (subject to the $1 million exemption under Proposition 58 [parent-child] or Proposition 193 [grandparent to grandchild, whose parents are a deceased child and deceased child-in-law [or divorced in-law with the child deceased] of the grandparent) should be considered. Also, structure the trust so that beneficiary interests satisfy Proposition 58 requirements.

2. A gift in trust, of a small fractional interest will avoid loss of the estate tax savings if the donor is the sole owner and does not outlive the retained term on any QPRT.

[6] QPRTS are allowed to own certain types of assets in addition to the personal residence. Most significant are limited amounts of cash that may be needed to pay debt or maintain the property or purchase replacement property. See, Regs. §25.2702-5(c)(5)(ii)(A)(1).

[7] Code §280A(d)(1)Taxpayer uses a dwelling unit during the taxable year as a residence if he uses such unit (or portion thereof) for personal purposes for a number of days which exceeds the greater of 14 days, or 10 percent of the number of days during such year for which such unit is rented at a fair rental. For purposes of the 10 percent test, a unit shall not be treated as rented at a fair rental for any day for which it is used for personal purposes.

3. Consider the establishment of two or three QPRTs, each with different duration in order to spread the risk of death during the retained term. The amount of the taxable gift is reduced the longer the retained term. On the other hand, the risk of mortality increases.

4. Establish the post-retained term as a grantor-defective trust (IDGT). The grantor may want to retain occupancy of the residence after the retained term. To avoid a retained interest under Code §2036, fair rental value should be paid. To avoid the rent payment to the trust constituting income to the trust, grantor-trust status should be established. The rent payment provides a non-gift enhancement to the value of the QPRT after the retained period.

5. No GST exemption can be allocated until the retained period concludes.

6. QPRTs are the only form of grantor retained income trust in which an applicable family member can be a beneficiary.

7. Cash may be held in a QPRT for specified purposes under the regulations. See, Reg. §25.2702-5(c)(5)(ii): (i) for the payment of trust expenses, including the debt on the property already incurred or reasonably expected by the trust within six months from the making of the contribution to the trust; (i) payment for improvements to the residence to be paid within six months of contributing the funds; (iii) for the purchase of a trust within three months of creation of the trust under certain conditions; and, (iv) for purchase of a replacement residence within three months of when the addition funds are given to the trust. See, PLR 9315010.

   Note: The trust must require that the trustee determine, at least quarterly if the amount of funds held in the trust exceed the requirements of the allowed purposes, and to immediately refund any excess to the grantor. Each additional cash contribution for at least improvements (or benefits allocable to trust corpus) is another gift, based on the date made, the §7520 rate at the time, retained term (reduced since creation of the QPRT) and the grantor's age at the time of each addition. PLR 9249014 determined that a gift did not arise for contributions to a grantor trust allocable to trust accounting income (such as maintenance, interest on debt and utilities.)

6.2 A sample QPRT gift is reported in the illustrated return. (See gift made December 23, 2015).

7. INTENTIONALLY DEFECTIVE GRANTOR TRUSTS (GRATS)

GRATs offer the opportunity to freeze the estate value to the value of the gift plus a return to the donor equal to the Code §7520 rate at the time of the gift (let's call it the "hurdle rate"). Provided the technical requirements of the GRAT are satisfied, the growth in value plus the return apart from growth (e.g., distributions, net rents, actual income, etc.) passes to the remainder beneficiaries free of gift tax.

In a nutshell, GRATs add a time-value discount on top of all other discounts applicable to the gifted interest. The purpose of the GRAT is to minimize the value of the taxable gift. As will be seen, the taxable value may be near zero, yet vast wealth can transfer free of gift tax (and free of later estate tax when the donor dies) if the grantor survives the retained term.

7.1 GRATs Versus Sales to an IDGT

Clients who desire to freeze growth and transfer substantial value to other family members may find their most significant choice between a gift to a GRAT or sale to an IDGT. The IDGT is the most tax-efficient choice, offers the greatest flexibility, and is generally, but not universally preferable.

Issue/Consideration	**GRAT**	**IDGT**	**Notes**
Grantor Receives	Grantor receives more	Grantor receives less	IRC §7520 "hurdle" rate is 20% greater with the GRAT than mid-term AFR (result may differ if long term AFR used)
Present value discount?	Yes	No	Discount at the §7520 rate. However, this rate is higher than mid-term rate on IDGT sale.
Potential discount on value of interest transferred when donor dies.	Possible	Possible	For a GRAT, a discount can apply, but valuation includes post-gift appreciation. For an IDGT, the promissory note balance may be discounted in the gross estate if the fair market value of the note is less than the face amount. This is likely with rising interest rates, differences inherent with market rates versus AFR, and other business factors.
Payments to the Grantor are flexible	Yes	No	For a GRAT, payments can increase payments, but only by 20% prior year. For an IDGT, the promissory note sets terms, including interest only or extended amortization with balloon.
Seed gift Required?	No	Yes	For an IDGT, generally a down payment of at least 10% of the sales price. Not firm law, but a standard common to practice based on old annuity ruling. IF IDGT has other assets, the equity can support the 10% other property guideline.
Grandchildren or other skip persons as beneficiaries?	No	Yes-.	For a GRAT, no GST exemption allocation until retained period ends. This is a significant benefit for an INDT when compared to a GRAT.
IRS audit risk?	Less Risk	More risk	For a GRAT, valuation changes

Issue/Consideration	**GRAT**	**IDGT**	**Notes**
			increase annuity, but have little impact on the amount of the tax gift. If the donor has little gift tax exemption remaining or is concerned about audit challenge to cause too much exemption to be used. For an IDGT, there is a greater audit potential for IRS. This is less of a factor with substantial increase in the gift tax exemption. May reduce risk to increased taxable gift with formula gift. See, *Wandry*.
Annual appraisals needed	Maybe	Rarely	For a GRAT, generally principal is returned to grantor to make annual payments, unless cash or marketable securities are sufficient. If principal returned, then updated appraisals are needed each year. For an IDGT, payments generally made in cash, though in-kind may be made if approved in the promissory note. If income is sufficient to make annual payments, no appraisals needed on periodic payments.
Gross estate recaptures all, or a substantially all, of the post-growth appreciation in the event the grantor dies during the retained term (or while the promissory note is outstanding)	Yes	Unlikely	For a GRAT, it is not always the case that 100% of the GRAT is automatically included in the gross estate in the event of premature death. Determine amount necessary to pay annuity amount at §7520 rate in month of death. Loss of grantor-trust status. Acceleration of the liability likely does not occur, but issue has not been formally resolved. For and IDGT, with loss of grantor-trust status Acceleration of the liability likely does not occur, but issue has not been formally resolved.
Penalty for failure to timely make a payment when due	Yes	Yes	GRATs can have 105 days after fiscal year anniversary to make required payment. Outside of that is not within regulatory safe harbor. Contract right of acceleration, which holder may exercise. Brings

Issue/Consideration	GRAT	IDGT	Notes
			into question bona fides of the deal. Want to set good track record of respecting the deal.
Grantor trust status	Yes and maybe	Yes	For a GRAT, during the retained period, yes. Common but not required after the retained period. Trust protector or independent trustee can turn off grantor trust status. For and IDGT, a trust protector or independent trustee can turn off grantor trust status
Grantor can purchase or sell assets in/with the trust	Yes	Yes.	For both a GRAT and IDGT, this is permitted if Rev. Rul. 2004-64 is followed.
Basis increase on death of donor.	No	No	For a GRAT, no increase if the grantor outlives retained period. For both a GRAT and IDGT, a “Planning Action” is for the Donor to buy back appreciated assets after retained period.
Prepayment	No	Yes	GRAT cannot be prepaid. IDGT can be prepaid… and often is in order to avoid balance remaining at death.
Impact of Death	☹	KBO with issues	Grantor status lost, though it has been informally argued to the contrary. Dispute regarding whether death is a recognition event. Promissory note may be subject to discount on death if presumption of Reg. §20.2031-4 can be overcome.

IDGTs have several significant benefits over a GRAT:

(1) Flexibility of payments. The IDGT note can be interest only, or amortized; and, in any event can be prepaid. Full amortization is not required.

(2) GST exemption can be allocated when the gift to the IDGT is made rather than waiting until some post-transfer date. With a GRAT, no GST exemption can be allocated until the retained period terminates.

(3) The increase in the gift tax exclusion has reduced the risk that gift tax will have to be paid if the IRS can successfully challenge value. Moreover, *Wandry,*

supra, in particular, as well as other formula gift cases approved in recent court decisions have reduced the risk of additional gift tax. *However, the IRS may want to argue that a Wandry formula may not be respected and even if the IRS does not choose to fully litigate the issue, they may assert the potential risk of rejection as a negotiating tool to increase valuation.*

(4) Unless a GRAT of a sufficiently long retained term is established, equity will need to be returned to the grantor to make the annual payments. This will add expense for later appraisals. However, if entity interests are returned to the grantor with an IDGT in payment of annual sums due, appraisals will be needed in that context.

(5) GRATs do not work unless the grantor survives.

(6) Probably the most significant benefit of the GRAT arises because the risk of valuation change on audit is low. The IRS does not receive more gift tax or use additional exemption. Instead, the annuity payment increases. The formula clause cases have reduced this risk. However, the IRS is looking for formula clause cases to challenge … let's call them "piggy" cases or with some defect that the Tax Court does not want to tolerate. This may open the door to further debate … ala the evolution of FLP challenges from the mid-90s and the next two decades thereafter.

8. GST TAXABLE TRANSFERS

8.1 <u>Ten Summary Points… Moses Only Had Ten on a More Significant Subject</u>

1. You need to obtain age differences on transfers to non-family members for possible GST effect. An age difference of more than 37 ½ years is a skip person in the non-family rules.

2. Do not substantially modify a pre-1986 GST exempt trust.

3. Annual exclusion gifts in trust to a grandchild or other skip person are taxable gifts under GST rules unless the skip person's annual exclusion gift will be included in the skip person's estate on death (i.e., payable to the skip person's estate or under a general power of appointment of the skip person).

4. Annual exclusion gifts, in trust, for a non-skip beneficiary (such as a child) are not GST exempt unless the non-skip person holds a general power of appointment or estate tax inclusion. (Then it is out of the GST system). Therefore, you should consider whether or not you want GST exemption allocated or if your recommendation is to elect out of automatic allocation, if the trust is a GST Trust.) **Make an affirmative election to state what you want (whether or allocate GST exemption or not.)**

5. Identify whether or not the separate share rules apply to each trust. Get help if needed. When separate shares exist, respect them for all purposes (title to assets [although pooled liquid investments are possible with a proper set of books], EIN, income tax filing, accounting and books).

6. On gifts to non-skip persons, in trust, report the transfers on Schedule A, Part 3 of the Form 709 for gift tax purposes and determine whether or not you want current or late allocation rules to apply to the gift. Communication with the client is important and different decisions may be made under a different set of facts. For examples, trusts that declined in value since the time of the gift or ILITs may be excellent candidates for election out of automatic allocation of GST exemption and use of late allocation rules. However, you must communicate issues and risk of death before allocation is made, particularly with an ILIT.

7. When completing Schedule A of the Form 709, be certain to place gifts in the Correct part, 1, 2 or 3 so that you will be mindful of then correctly considering the GST effect, if any, of the transfer.

8. Crummey trusts create complex GST allocation issues, may change the identity of the transferor, and involve intricate planning in an area of law that lacks full clarity. Crummey trusts can cause duplicate transfer value when lapse exceeds $5,000 or 5% of the trust. Possible GST exemption savings with late allocation (avoiding deemed exemption on indirect skip). Include a flexibility provision to achieve a zero inclusion ratio with minimum GST exemption allocation if that is what you want.

9. Avoid mixed GST exemption ratios (i.e., anything other than a zero inclusion ratio for an exempt trust or an inclusion ratio of one for a non-exempt trust). Otherwise, GST exemption will either be wasted or GST tax needlessly paid. Also, inclusion ratios of 0 or 1 assist long-term planning, distribution sourcing and asset allocation.

10. IF GST exemption is not fully used on death after considering all transfers other than a marital QTIP trust, consider making a reverse QTIP election on Schedule R to use the otherwise unused balance of the decedent's GST exemption, if any, and divide the QTIP trust between GST exempt and non-exempt shares.

8.2 Chronological Exemptions:

The GST tax law enacted in 1976 was repealed with the passage of the "new" GST tax law on October 22, 1986. As a general rule, the GST tax (Chapter 13 of the Internal Revenue Code ["Code]) applies to all transfers made after October 22, 1986. In addition, the GST tax law applies to lifetime transfers made after September 25, 1985, but prior to October 23, 1986. However, Chapter 13 does not apply to[8]:

(1) transfers from trusts irrevocable on September 25, 1985, to the extent not made from principal added after that date or out of income attributable to principal added after that date;

(2) transfers under revocable trusts and Wills in existence on October 22, 1986, if the decedent died before January 1, 1987;

(3) transfers from a person under a mental disability to change the

[8] Technical and Miscellaneous Revenue Act of 1988, §1014(h)(2)-(4).

disposition of his or her property on October 22, 1986, if he or she does not regain competence before death; and

(4) direct skip transfers to a grandchild of the transferor made before January 1, 1990, of up to $2,000,000 per grandchild. (Transfers under this rule follow the so-called "Gallo Amendment" which was supported by the winery family and the many grandchildren of its founders.)

8.3 Additions, Actual or Constructive, to a Chronologically Exempt Trust.

Additions to a chronologically exempt trust can arise from a direct addition or a constructive addition.

If an addition is made after September 25, 1985, to a chronologically exempt irrevocable trust, a pro rata portion of subsequent distributions from (and terminations of interests in property held in) the trust will be subject to GST tax. If an addition is made, the trust will be thereafter deemed to consist of two portions, a portion not subject to GST tax (the exempt portion) and a portion subject to GST tax (non-exempt 13 portion), each with a separate inclusion ratio (as defined in §2642(a)). The exempt portion represents the value of the assets of the trust as it existed on September 25, 1985. The non-exempt portion represents the value of all assets added to the trust after September 25, 1986. The applicable fraction (as defined in §2642(a)(2), and detailed in Chapter 5, infra) for the exempt portion is deemed to be 1 and the inclusion ratio for such portion is 0. The inclusion ratio for the GST-taxed portion is determined under §2642.

A constructive addition arises after any release, exercise or lapse of any power of appointment, if the release, exercise, or lapse is taxable to any extent. Reg. §26.2601-1(b)(1)(v). The release of a power above that allowance makes the entire portion subject to the general power treated as an addition.

8.4. Avoid Substantial Modifications

☹ **A substantial modification to a chronologically exempt trust causes complete loss of the GST exemption with respect to the trust so modified.**

Regulations proposed in 1999 were made final in 2000 with respect to chronologically exempt trusts (Reg. §26.2601-1(b)(4)). These regulations provide assistance as to whether or not changes to a GST exempt trust will cause loss of grandfathered status. These rules largely apply to positions taken in prior letter rulings. Four categories of modifications are stated which do not cause loss of the chronological exemption:

1. Trustee's exercise of discretion (without court approval or the consent of a beneficiary) under power granted in the trust document or state law, to transfer to a new trust or make distributions from an ongoing exempt trust, provided that the action of the trustee does not extend the time for vesting any beneficiary interest beyond the Rule Against Perpetuities (using the 90-year rule under the Uniform Act). The decision on distribution is not controlled by the beneficiary.

2. Court-approved settlement of a bona fide controversy relating to the construction of the trust. Recognizing that court orders may result more from a tax-savings motive than a true dispute, the regulations provide that the settlement result from "arm's length negotiations" and the result is reasonable. See PLRs 200507002 and 200543015.

3. Court orders that construe an ambiguity in a trust, if the result is consistent with the law applied by the highest court of the state (a standard adopted from *Comr. v. Bosch,* 387 U.S. 456 [1967]).

4. Other changes, not within the above categories, which do not "shift a beneficial interest in the trust to any beneficiary who occupies a lower generation ...than the person or persons who held the beneficial interest prior to the modification"... and the modification does not extend vesting beyond the perpetuities period. If the effect of the modification cannot be determined, it will be deemed to shift the beneficial enjoyment to the lower generation. PLR 200314003.

8.5 <u>GST Taxable Events</u>.

Three events can trigger GST tax: DIRECT SKIP, TAXABLE DISTRIBUTION, and TAXABLE TERMINATION. GST tax can arises when property passes to a so-called "skip person," an individual assigned to a generation which is two or more generations below that of the transferor.

(i) Direct Skip: Property passing to a skip person or a trust only for the benefit of a skip person.

(ii) Taxable distribution: When a skip person receives income or principal from a trust when there are both skip and non-skip beneficiaries – with the exception of <u>qualified educational or qualified medical</u> expenses.

(iii) Taxable termination: Once a trust no longer has any non-skip beneficiaries and property passes to a skip person, such GST event is a taxable termination, unless gift tax or estate tax applies on that terminating event.

8.6 <u>Skip Persons and Non-Skip Persons</u>.

8.6.1 <u>Skip Persons</u>: All transferees are classified as either "skip person" or "non-skip person." An individual assigned to a generation which is two or more generations below that of the transferor is a skip person. The generations are assigned by lineal descent under the family rule or non-family rule. The family lineal descent rule applies to (1) individuals who are lineal descendants of the grandparent of the transferor, (2) lineal descendants of the grandparent of the present or former spouse, with legal adoptions and half-blood relationships, and (3) marital relationships. A present or former spouse of the transferor is assigned to the transferor's generation. Code Sec. 2651(c)(1). This family-assignment rule applies to descendants of a grandparent, spouse or former spouse as well. As a result, step children are treated under the family rule when considering transfers made to a descendant of the transferor.

As a general rule, in the event that an individual is assigned to more than one generation, the youngest generational assignment shall apply. Reg. §26.2651-2(a). Exceptions to this general rule include: (1) adopted individuals who satisfy the four-art test under Reg.

§26.2651-2(b) (see below); and (2) an adjustment is made to the generational assignment of the following with respect to the adopted individual: (i) spouse or former spouse of that individual; (ii) descendant of that individual; or (iii) spouse or former spouse of each descendant of that individual. Reg. §26.2651-2(c).

Generally, step relations fall within the family rule. Both current and ex-spouses are assigned to the transferor's generation. A present or former spouse of the transferor is assigned to the transferor's generation. Code §2651(c)(1).

Non-family members are assigned generations based upon an age comparison to the transferor. A non-family member is a "skip person" if he/she is 37 1/2 years younger than the transferor.

> Example: W is 75 years old, married to H who is age 40. W and H are treated as of the same generation as to any transfer made by either of them during the marriage. Code '2651(c)(1).

> **Practice Tip: When gifts and bequests are made to non-family members, find out the date of birth of the transferor and transferee to determine whether or not the donee is a skip person.**

8.6.2 Predeceased Ancestor Exception (Code Sec. 2651(e)).

An exception to the generation assignment rule exists under the family attribution rule when an individual is a grandchild of the transferor, or of the transferor's spouse or former spouse, and at the time of the transfer the parent of the individual who is a lineal descendant of the transferor, or of his spouse or former spouse, is deceased, the individual is treated as if he were a child of the transferor and all of that grandchild's lineal descendants are stepped up one generation. Code Sec. 2651(e). This exception is called the "**predeceased ancestor exception**" or the "move-up rule." The result is that the gift to the grandchild is not taxed as a GST transfer.

The move-up rule does not apply to disclaimers. Reg. Sec. 26.2612-1(a)(2).

The move-up rule can also apply to collateral relatives (grand-nieces, for example) when the transferor has no issue and the transferor has collateral relatives (such as a sibling or issue of a sibling) for which there has been a death in a generation equal to, or younger than, that of the transferor.

The move-up rule also applies to taxable terminations and taxable distributions if the parent of a particular beneficiary is deceased at the earliest time that the transfer (from which the beneficiary's interest in the property was established) was subject to estate or gift tax, the transfer qualifies for the exception (as modified by the change described above in connection with collateral heirs).

8.6.3 Non-skip Persons. Anyone who is not a skip person.

8.6.4 Interests Through Entities.

The term "skip persons" refers not only to real people, but can include a trust as well. If an estate, trust, partnership, corporation or other entity (except charitable and governmental organizations) has an interest in property, each individual having a beneficial interest in such entity shall be treated as assigned to a generation under the family or non-family rules above discussed. Code Sec. 2652(f)(2).

However, a trust (itself) is classified a skip or non-skip person depending upon its terms and the generation assignment made to beneficiaries. Code Sec. 2613(a)(2). A trust is considered a skip person if (1) all interests in the trust are held by skip persons; or, (2) no person holds an interest in the trust and no distributions, other than a distribution the probability of which occurring is so remote as to be negligible (including distributions at the termination of the trust) may be made after the transfer to a person other than a skip person.

The interest of a charity in a charitable remainder or charitable lead trust is that of a non-skip person. Code Sec. 2652(d)(3). A GST transfer occurs with a charitable remainder trust (or pooled income fund) when distributions are made to the skip person because the interest of the charity is considered that of a non-skip person under this rule. Charities referenced in Code §§511(a)(2) and 511(b)(2) and governmental entities are non-skip persons, assigned to the transferor's generation under this rule.

Similarly, the lead interest for the charity in a charitable lead trust is considered held by a non-skip person under this rule.

8.6.5 GST Trusts (The "Cure"… But Does It Help?)

The pre-2001 ailment: GST exemption automatically applied only to direct skip transfers, not among other things to trusts for non-skip beneficiaries (such as children) with remainder to skip persons (such as grandchildren). Result: Large non-exempt trusts, particularly irrevocable life insurance trusts (ILITs) after donor's death since GST exemption had not been allocated at modest amounts.

Cure: Expand the type of trusts (called *GST* Trusts) to which GST exemption automatically applies.

Question: Are there times when the cure is detrimental?

The term "GST Trust" became effective with the 2001 Tax Act as part of the relief granted to practitioners who were neglecting to consider the differences between annual exclusion gifts for gift tax purposes and the fact that such gift-tax free transfers to a trust could still be taxable transfers under GST law. **The current key issue is whether or not the relief provision to deem allocation of GST exemption (to a GST Trust) helps or hurts**. The term *GST Trust* (Code Sec. 2632(c)) means all trusts in which a GST event may later arise <u>except</u> for certain limited exceptions to which a GST event is considered sufficiently unlikely. The following trusts are **excluded** from the definition of a GST Trust under Sec. 2632(c)(3):

1. Any trust in which more than 25% of the trust corpus must be distributed or may be withdrawn by one or more individuals who are non-skip persons:

    a. before the date that the individual attains the age of 46 years;

    b. on or before one or more dates specified in the trust instrument that will occur before the date that such individual attains age 46 years,

c. upon the occurrence of any event that, in accordance with regulations issued by the Secretary, may reasonably be expected to occur before the date that such individual attains age 46 years.

2. Any trust in which more than 25% of the trust corpus may be paid to a non-skip person living on the date of death of another person identified in the instrument (by name or class) who is more than 10 years older than such individuals.

   Example: T is married to young second wife (W), when T dies. W is within 10 years the age of D, the child of T. If T leaves a life interest, in trust, for W the trust would not be a GST Trust because W is less than 10 years older than D.

3. Any trust which provides that, if one or more individuals who are non-skip persons die on or before a date or event described in exceptions 1 or 2, above, more than 25% of the trust corpus must be distributed to the estate or estates of one or more of such individuals or is subject to a general power of appointment exercisable by one or more of such individuals.

4. Any portion of the trust would be included in the gross estate of a non-skip person (other than the transferor) if such person died immediately after the transfer.

5. The trust is a charitable lead annuity trust, a charitable remainder annuity trust, or a charitable remainder unitrust.

6. The trust is a trust with respect to which a charitable deduction was allowed for the amount of an interest in the form of the right to receive annual payments of a fixed percentage of the net fair market value of the trust property (determined yearly) and which is required to pay principal to a non-skip person if such person is alive when the payments for which the deduction was allowed terminate.

In addition, the taxpayer may elect, on a timely filed gift tax return, to cause <u>any trust</u> to be considered a GST Trust. Code Sec. 2632(c)(5). This election is made by an attached notice to the Gift Tax Return.

Planning Hint: To eliminate doubt expressly state whether you want a trust to be classified as a GST trust or not (currently and/or in the future.) This is accomplished by including a statement on the Notice of Allocation as an attachment or on a continuation page to the Form 709. The sample return with these materials includes several examples of this technique.

A special rule exists with respect to Crummey powers, which by their nature may cause a portion of the trust to be included in the estate of the non-skip Crummey power holder (i.e., that portion of the trust which lapses in excess of the 5/5 exception under the general power of appointment rule under Code Sec. 2514 and 2041). Since most Crummey powers are not exercised, the GST Trust definition has adopted a special exception to the general rule to exception 4 in the above list. Crummey powers, limited to the annual exclusion amount, are not considered in the issue of whether or not a non-skip person holds a power within the exceptions to the GST Trust definition. Code Sec. 2632(c)(3)(B). In other words, a Crummey Trust will normally be a GST Trust if the Crummey powers lapse solely within the annual exclusion amount.

- **Query:** If the donee's withdrawal power exceeds the annual exclusion amount in any year (for example a hanging power in which 5% of the trust equals more than the annual exclusion), is the trust then no longer a GST Trust? It would appear that it is no longer a GST Trust. Regulatory guidance is needed on this point.

8.6.6 Crummey Trusts after March 31, 1988

Crummey trusts have a special exemption rule that applies in a narrow but significant arena. As with any lifetime trust, an addition made to a Crummey Trust after September 25, 1985, is subject to the general rule (i.e., not chronologically exempt). However, after the effective date of the GST law and before March 31, 1988, a Crummey Trust that met the annual gift tax exclusion rule as a non-taxable gift was also GST exempt. However, after March 31, 1988, a gift to a Crummey Trust that is desired by the donor to be within the annual exclusion under GST law, must meet the additional requirement that the trust be included in the gross estate of the skip person donee in the event the donee dies during the term of the trust. IRC Sec. 2642(c).

8.7 Direct Skips.

A direct skip is a transfer subject to estate or gift tax of an interest in property to a skip person. Code Sec. 2612(c)(1).

8.7.1 Survivorship Condition.

An individual who dies no later than 90 days after a transfer occurring by reason of the death of the transferor is treated as having predeceased the transferor. Reg. Sec. 26.2651-1(a)(2)(iii). A qualified disclaimer does not change the generation assignment or create a direct skip when the disclaimer is made by a non-skip person.

8.7.2 Multiple-Skips.

A direct skip transfer to a great-grandchild (GGC), or more remote person, counts as only one direct skip, which occurs when a single transfer of property skips two or more generations. Reg Sec. 26.2612-1(a)(1).

Example: T gifts $ to T's GGC. The transfer is a direct skip. Only one generation-skipping transfer (GST) tax is imposed on the direct skip although two generations, or more, are skipped by the transfer.

8.8 Taxable Distribution.

A **taxable distribution** is any distribution (income or principal) from a trust to a skip person other than a taxable termination or a direct skip. Code Sec. 2612(b). Thus, distribution of income or principal to a grandchild from a sprinkling trust benefiting a child and grandchild is a taxable distribution giving rise to possible GST tax. An income tax deduction is available for GST tax paid. Code Secs. 2612(b), 164(a)(4), (b)(4).

The payment of any GST tax (including interest and penalties) by the trust which is imposed on the skip beneficiary will be treated as an additional taxable distribution to the beneficiary from the distributing trust. If federal estate or gift tax is imposed on any individual with respect to an interest in property held by a trust, the interest in property is treated as having been distributed to the individual to the extent that the value of the interest is subject to federal estate or gift tax. Reg. Sec. 26.2612-1(c)(1).

> ☺ Distributions from a trust for the education or medical care of the skip beneficiary are excluded from GST taxable distributions if the payment would qualify for the exclusion under Code Sec. 2503(e) if made by an individual. Code Sec. 2611(b)(1).

8.9 Taxable Terminations.

Code Sec. 2612(a) defines a **taxable termination** as the termination of an interest in property held in trust unless immediately thereafter a non-skip person has an interest in property or unless no distributions may be made thereafter to a skip person. In other words, a taxable termination arises once the trust passes to a skip person and non-skip persons have an interest in the trust. For example, a taxable termination will arise in a trust, for the benefit of a child of transferor with the remainder to a grandchild, upon the child=s death or conclusion of the child=s interest in the trust. However, a taxable termination does not arise if the termination is a transfer subject to estate tax or gift tax. Reg. Sec. 26.2612-1(b)(1)(i), Reg. Sec. 26.2612-1(f), ex. 5.

> **Example:** P leaves trust to C and C holds general power of appointment. If C does not exercise power, the trust goes to C’s issue. There is no taxable termination because the trust is included in C’s gross estate under federal estate tax (FET) law.

> **Example:** Same as above example except C has no general power of appointment. On C’s death a taxable termination will then occur.

8.10 Trusts

The term “trust” for purposes of GST law includes any arrangement (other than an estate) which, although not a trust, has substantially the same effect as a trust. Code Sec. 2652(b)(1). Such an arrangement may involve Uniform Transfers to Minors Act events, life estates and remainders, estates for years, and insurance and annuity contracts. Therefore, the term “trust” under GST law has a more expansive definition than normally applies to that term. The GST law calls trust-type arrangements “explicit trusts” ... such as estates for years, life estates with remainders, insurance contracts and annuities. ode Sec. 2652(b)(1)(3). The trustee is the person with actual or constructive possession of the property subject to the arrangement. Code Sec. 2652(b)(2). However, a testamentary transfer contingent on a 6-month survivorship period does not create a trust by virtue of that contingency. Reg. Sec. 26.2652-1(b)(1).

When someone other than the executor is the trustee of a trust with greater than $250,000 passing on the transferor's death, the third-party trustee pays the GST tax. The executor provides a Schedule R-1 to inform the third party trustee of the GST liability and GST exemption allocated to that transfer.

8.11. SEPARATE SHARE RULE

The separate share rule creates a major opportunity to maximize the benefit of the GST exemption and avoid tax traps that arise when trusts concurrently have both skip and non-skip beneficiaries.

A single trust is treated as one trust for GST purposes. However, the law treats a single trust as two or more trusts in either of the following circumstances: (i) when there is more than one transferor to the trust (then each transferor=s portion is considered a separate trust); (ii) when there are substantially separate and independent shares in a trust for different beneficiaries. IRC Sec. 2654(a)(2) and Sec. 2654(b)(1). The Regulations provide that except as otherwise stated, a separate share under GST law is governed by the same rules as those that apply for separate shares under Income Tax Regulations Sec. 1.663(c)-3. Reg. Sec. 26.2654-1(a).

The determination of whether or not separate shares or separate trusts exist for GST purposes can depend upon the application of several rules, the terms and powers granted in the trust or Will document, and powers conferred by state law.

The separate share must exist under GST law as a separate share at the time of its creation. Reg. Sec. 26.2654-1(a)(1)(i). Therefore, a gift in trust for the benefit of several children and grandchildren of T with sprinkling powers until the youngest child attains age 21 years which then divides into separate trusts, one for each beneficiary, is not a separate share (either at its creation or at any later time) because it was not established as a separate share at the outset of the trust. See Reg. Sec. 26.2654-1(a)(5), ex. 8. requirements of this section.

8.11.1 <u>Separate Share Rule and Qualified Severances</u>

The 2001 Tax Act enacted Sec. 2642(a)(3), which establishes a procedure for the division of trusts into separate trusts, called a *qualified severance*. The division is to be made on a fractional basis, one trust with an inclusion ratio of zero and the other with an inclusion ratio of one. The same succession of interests needs to apply to both trusts. This rule is not limited to any particular trust. It may provide an effective planning tool in situations where the division of a trust may be beneficial.

Under Sec. 2642(a)(3)(B), the division of a single trust into two or more trusts is treated as a qualified severance if (1) the single trust is divided on a fractional basis and (2) the terms of the new trusts, in the aggregate, provide for the same succession of interests of beneficiaries as are provided in the original trust.

The final regulations provide guidance regarding the qualified severance of a trust for GST tax purposes under Code Sec. 2642(a)(3). The final regulations apply to severances occurring on or after August 2, 2007. Reg. Sec. 26.2642-6(k)(1). For qualified severances occurring after December 31, 2000, and before August 2, 2007, taxpayers may rely on any reasonable interpretation of Code 2642(a)(3), as long as reasonable notice concerning the qualified severance and identification of the trusts involved has been given to the IRS. Reg.

Reg. Sec. 26.2642-6(k)(2). The final regulations under Reg. Sec. 26.2642-6 generally provide rules for the qualified severance of a trust (whether or not includible in the transferor's gross estate) if the severance will be effective only prospectively from the date of severance. A qualified severance is to be reported by filling Form 706-GS(T), with the words "Qualified Severance" appearing at the top of the form, and attaching a Notice of Qualified Severance to the return. Reg. Sec. 26.2642-6(e)(1).

A trust may be severed in a qualified severance at any time prior to the termination of the trust. Thus, provided that the separate trusts resulting from the severance continue in existence after the severance, a trust may be severed in a qualified severance either before or after: (I) GST tax exemption has been allocated to the trust; (II) a taxable event has occurred with respect to the trust; or (III) an addition has been made to the trust. A qualified severance is effective at the time the trust is divided into two or more separate trusts. Thus, a qualified severance has no effect on a taxable termination or a taxable distribution that occurred prior to the effective date of the qualified severance.

Under Reg. Sec. 26.2642-6(d), each new trust must receive assets with a value equal to the fractional share of the total value of the trust assets. A pecuniary division may <u>not</u> be used. However, a non-pro rata division may be used, provided it is done on a fractional basis, and if such non-pro rata approach is used, it must be based on the total fair market value of the assets on the date of funding. The terms of the new trusts must provide, in the aggregate, for the same succession of interests of beneficiaries as are provided in the original trust, which requirement will be satisfied if the beneficiaries of the separate trusts and the interests of the beneficiaries with respect to the separate trusts, when the separate trusts are viewed collectively, are identical to the beneficiaries and their respective beneficial interests with respect to the original trust before severance. This requirement B with respect to trusts from which discretionary distributions may be made to any one or more beneficiaries on a non-pro rata basis B will be satisfied if the terms of each of the separate trusts are the same as the terms of the original trust (even though each permissible distributee of the original trust might be a beneficiary of only one of the separate trusts), the severance does not shift a beneficial interest in the trust to any beneficiary in a lower generation than the person or persons who held the beneficial interest in the original trust, and the severance does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust.

On August 2, 2007, the IRS also issued Proposed Regulations to provide guidance regarding: 1) GST tax consequences of the severance of trusts in a manner that is effective under state law, but that does not meet the requirements of a qualified severance under Code 2642(a)(3); 2) GST tax consequences of a qualified severance of a trust with any inclusion ratio between zero and one into more than two resulting trusts; and 3) special funding rules applicable to the non-pro rata division of certain assets between or among resulting trusts. The regulations will affect trusts that are subject to the GST tax.

8.11.2 <u>Pecuniary Trusts and Bequests</u>

A pecuniary transfer will be treated as a separate share if (1) it carries "appropriate interest" or (2) if valued other than at the date of distribution and in accordance with "fairly representative" allocation rules. Reg. Sec. 26.2654-1(a)(1)(ii). "Appropriate interest" is defined by Reg. Sec. 26.2642-2(b)(4)(i) to mean that interest must be payable from the date of death of the transferor (or from the date specified under applicable State law requiring the payment of interest) to the date of payment, at a rate at least equal to (1) (i) the statutory interest rate, if any, applicable to pecuniary gifts under applicable state law; or, (ii) if no such state-law rate applies, then 80% of the Sec. 7520 rate at the time of the transferor=s death; and, (2) not in excess of (i) the greater of the statutory rate of interest, if any, applicable to pecuniary gifts under the state's law or applicable state law, or (ii) 120% of the Sec. 7520 rate applicable at the time of the transferor's death.

If a pecuniary payment does not carry ***appropriate interest***, the pecuniary payment is deemed to carry appropriate interest to the extent that (i) the entire payment is made or property is irrevocably set aside to satisfy the entire pecuniary payment within 15 months of the transferor=s death; or (ii) the governing instrument or applicable state law specifically requires the executor or trustee to allocate to the pecuniary payment a pro rata share of the income earned by the fund from which the pecuniary payment is made between the transferor=s date of death and the date of the payment.

8.12 Multiple Transferors With Respect To Single Trust

If a trust has more than one transferor, the portions of the trust attributable to the different transferors are treated as separate trusts for GST purposes. Reg. '26.2654-1(a)(2). Treatment of a single trust as separate trusts under this rule does not apply for purposes of filing returns and payment of tax or for purposes of computing any other tax. Also, additions to, and distributions from, such trusts are allocated pro rata among the separate trusts unless otherwise expressly provided in the governing instrument.

If an individual makes an addition to a trust of which the individual is not the sole transferor, the portion of the single trust attributable to each separate trust is determined as follows: multiply the fair market value of the single trust immediately after the contribution by a fraction (Reg. Sec. 26.2654-1(a)(2)(ii)), the numerator of the fraction is the value of the separate trust immediately after the contribution; and, the denominator of the fraction is the fair market value of all the property in the single trust immediately after the transfer.

8.13 GST Exclusions and Exemptions

8.13.1 Annual Exclusion Gifts under Gift Tax System

Outright Annual Exclusion Gifts are non-taxable under GST law. Code §2642(c)(3).

Annual exclusion gifts to a skip trust are non taxable if the gift is both an annual exclusion gift under gift tax law and a *vested* gift under GST law. A transfer to a skip person or a trust solely for the benefit of skip persons (i.e., a skip trust) AND within the gift tax annual exclusion rule is GST non-taxable, to the extent that there will be estate tax inclusion in the skip person's gross estate (i.e., payable to the estate of the skip person or under which the skip person holds a general power of appointment) when the interest of the skip person concludes. Code Sec. 2642(c). Annual exclusion Uniform Transfer to Minors Act gifts meet this vested rule.

8.13.2 Transfers to Trusts Non-Skip Persons to Which a GST Event May Later Arise:

These transfers are TAXABLE, not excluded.[9]

[9] Before March 31, 1988, gifts in trust were GST-tax free (i.e., they had a "zero inclusion ratio") as long as the gift was excluded from gift tax (e.g. a Crummey withdrawal gift).

The 2001 Tax Act does not change this rule. In other words, a transfer to a GST Trust is a taxable transfer, not an excluded or non-taxable transfer. A transfer to a GST Trust receives automatic allocation of GST exemption unless there is a timely election out. However, GST exemption has to be used to avoid GST tax.

8.13.3 Lifetime GST Exemption

While it has varied through the years, since 2004 it has equally the allowable estate tax exemption equivalent (currently $5,490,000 for 2017). The GST exemption is the same amount as the basic exclusion amount.

8.13.4 Lifetime Exemption (Useable During Life or on Death)

The author calls the GST exemption the *next exemption* because it applies to benefits received by the younger (or “downstream”) generations with the same tax-saving strategy that donors and decedents use with the unified gift and estate tax exemption (or equivalent exclusion amount). The allocation of the GST exemption can be made by the transferor (or executor of the transferor) or it will be made under statutory allocation rules. Code §§2631(a), 2632. Once made, the allocation is irrevocable. Code §2631(b). The statutory automatic allocation rules were significantly changed under the 2001 Tax Act for GST transfers made after December 31, 2000, with the creation of the new *GST Trust* (Code §2632(c)).

GST- exempt property, including its appreciation, remains GST tax-free, <u>including all appreciation on that property</u>.

The GST exemption may be allocated any time before the due date of the transferor’s estate tax return, including extensions, regardless of whether or not a refund is due. Code §2632(a)(1). The allocation is made on Schedule R of the return, and is reconciled with lifetime exempt transfers reported on the Form 709, trust transfers on death and direct skips.

8.13.5 No Credit for Payment of Prior GST Tax

There is no credit for prior transfer under GST law as there is with federal estate tax law. The absence of a credit for prior GST tax makes the GST system far harsher than payment of estate tax.

8.14 GST Exemption Allocation: Applicable Fraction and Inclusion Ratio

The GST exemption is allocated either as a result of an affirmative election by the donor or executor, or under the automatic (aka “deemed”) allocation rules.

The allocation of GST exemption and the **valuation rules** that apply to the allocation of exemption are key to imposition or avoidance of GST tax. The GST law excludes very few transfers to skip persons from GST tax. Exceptions are outright transfers to skip persons if within annual exclusion rules (including the $14,000 annual exclusion adjusted for inflation, the qualified medical and qualified education for tuition that apply under Gift Tax rules) and qualified medical and qualified educations distributions that would otherwise be taxable distributions.

Other than these exclusions, the avoidance of GST tax requires the allocation, except that a taxable termination can be avoided by rendering the trust subject to Estate Tax or Gift Tax on the conclusion of the interest of the last non-skip beneficiary in what would otherwise be a taxable termination.

In view of the significance of the GST exemption to the avoidance of this tax, estate planners and return preparers seek to minimize the amount of GST exemption necessary to achieve the desired goal… no GST tax. A transfer that has a zero (0) inclusion ratio bears no GST tax. A transfer that has an inclusion ratio of more than zero bears some GST tax, with full GST tax (i.e., at 100% the GST tax) arising when the inclusion ratio is one (1).

GST transfers are taxed at the maximum rate (excluding the pre-2002 Estate Tax surcharge) that applies to Estate Tax. The effective rate of GST tax is the result of multiplying the inclusion ratio by the flat tax rate. For example, the GST Tax rate for transfers in 2017 is 40%. If the inclusion ratio is 1, the effective rate is 40%. If the inclusion ratio is zero (0), there is no GST tax. Thus, the effect of the GST exemption is to reduce the tax rate.

Code §2642(a)(2) defines the applicable fraction to be that fraction – the numerator of which is the amount of the GST exemption allocated to the trust (or in the case of a direct skip, allocated to the property transferred in such skip), and the denominator of which is— the value of the property transferred to the trust (or involved in the direct skip), reduced by the sum of— any Federal estate tax or State death tax actually recovered from the trust attributable to such property, and any charitable deduction allowed.

For gift tax reporting a direct skip transfer, the numerator of the applicable fraction is shown in Column C in Part 3 (page 5) of the Form 709 while the inclusion ratio is shown in Column E. In the event that the gift is an indirect skip (i.e., one reported on Schedule A, part 3 of the Form 709), the amount of GST exemption being allocated to each transfer would be shown on an attachment to the return with the inclusion ratio indicated.

For purposes of completing Schedule R on an estate tax return, the allocation of GST exemption for transfers other than direct skip transfers is the total of columns C and D under line 9 with that sum then divided by the value of the transfer to determine the inclusion ratio (column E). The allocation of GST exemption to direct skip transfers in a Form 706 is made on either part 2 or part 3 of Schedule R, depending upon whether or not GST tax is charged to that transfer or paid from another source.

8.14.1 Lifetime Transfers

The 2001 Tax Act changed the rules for automatic allocation of GST exemption, effective for transfers made after December 30, 2000. As a result, discussion of these automatic allocation rules will be divided between the pre-2001 rules, the post-2000 rules, and common requirements.

8.14.1.1 Pre-1/1/01 Rules

If an individual makes a direct skip transfer during his lifetime, any unused portion of the transferor's exemption is deemed allocated to the **direct skip transfer** to make the inclusion ratio zero, or as small as possible if zero is not possible. Code §2632(b)(1). The transferor can irrevocably opt out of this allocation on a timely filed Form 709. Reg. §26.2632-1(b)(1)(i). Of course, electing out will necessitate a GST tax payment.

COMMENT: GST tax on direct skips is based on what the skip person receives, and does not include the tax paid on that amount (tax exclusive). Code §2603(b); TAM 98220001. If GST tax or maximum gift or estate tax payments are viewed as inevitable, the client may want to opt out of the automatic allocation rules with direct skips and allow GST tax to be paid.

If the lifetime gift is made in trust to both skip and non-skip persons, the transferor would need to allocate GST exemption on Form 709 (by reporting the transfer for gift tax purposes on Schedule A, part 3 on page 2 and indicating the GST exemption being allocated to all indirect skips on line 5 of part 4 of Schedule C on page 4 of the gift tax return). In addition, the author suggests that an attachment be included to explain the allocation and include a formula or statement to preserve the exclusion ratio (such as zero or as close to zero as possible).

8.14.1.2 Post 12/31/00 Rules

If an individual makes a direct skip transfer after 12/31/00 during his lifetime, any unused portion of the transferor's exemption is deemed to the first allocated to the **direct skip transfer** to make the inclusion ratio zero, or as small as possible if zero is not possible. Code §2632(b)(1). The remaining unused portion of the transferor's GST exemption is next deemed allocated to "indirect transfers" to a **GST Trust**. Code §2632(b)(2) and (c). The transferor can irrevocably opt out of this allocation on a timely filed Form 709. Reg. §26.2632-1(b)(1)(i).

In addition, the taxpayer may elect, on a timely filed gift tax return, to cause any trust to be considered a GST Trust. Code §2632(c)(5). This election is made by an attached notice to the Gift Tax Return.

Electing out of the automatic allocation on a direct skip transfer causes GST tax to immediately arise.

Regulation §26.2632-1(b)(2)(ii) allows the transferor to prevent the automatic allocation of GST exemption with regard to the current indirect skip (and not to any other transfer) to a trust, or to one or more separate shares that are treated as separate trusts under §26.2654-1(a)(1) by attaching a statement to a timely filed Form 709 for the calendar year in which the transfer was made (whether or not a Form 709 would otherwise be required for that year). The statement must: (1) identify the trust (or separate share), (2) describe the transfer, and (3) specifically provide that the transferor is electing, pursuant to §2632(c)(5)(A), to have the automatic allocation rules contained in §2632(c)(1) not apply to the described transfer to the trust (or separate share). In the case of a gift-split transfer, a similar statement must be attached to the timely filed gift tax return of the consenting spouse.

The regulations approve the taxpayer making a current election out of the automatic allocation rules to a trust, as well as electing out for future gifts to that trust. Reg. §26.2632-1(b)(2)(iii)(A).

If the lifetime gift is made, in trust, to both skip and non-skip persons, the transferor would need to **affirmatively** allocate GST exemption on Form 709 **unless** the trust is a GST Trust. If the trust is a GST Trust, the automatic allocation rules apply, and no affirmative election is required to allocate GST exemption on transfers made after December 31, 2000. However, an affirmative election is required to opt out of the automatic allocation of GST exemption to a GST Trust.

The automatic allocation of GST exemption to a GST Trust to which the estate tax inclusion period (ETIP) rules under Code §2642(f) applies is delayed until the close of the ETIP. The fair market value of the trust property shall be its value as of the conclusion of the ETIP. Code §2032(c)(4).

As with the pre-2000 rules, an affirmative allocation of GST exemption to a transfer in trust is made by creating and attaching a Notice of Allocation. (See instructions for line 5, part 2 of Schedule C in the Form 709 Instructions. The Regulations do not require that the current value of the trust assets be set forth unless the allocation is late or less than 100% is exempt.

8.14.1.3 Timely Allocations of GST Exemption and Valuation

The value used in determining the applicable fraction and inclusion ratio is the date of the transfer provided the allocation is made on a gift tax return timely filed or is deemed made under Code §2632(b)(1) (pre-2001 rule) or under Code §2632(b)(1) or Code §2632(b)(2) (post-2000 rule). Code §2642(b)(1).

The date of death applies for direct skip transfers consistent with Estate Tax law. Code §2642. Alternate valuation may also be elected when a taxable termination arises on death, which election may be made regardless of whether or not it applies for Estate Tax purposes. Code §2624(c).

In the event that the Estate Tax Inclusion Period (ETIP) applies, the allocation of GST exemption and the value of the transferred property is postponed until the conclusion of the ETIP. Code §2642(f).

8.14.1.4 Late Allocations

Late allocations of GST exemption may save GST exemption or waste it. The outcome is all in the facts. Late allocations arise in one of two ways: (1) under normal rules, or (2) as a result of the IRS allowing relief.

A late return is effective on the date the return is postmarked. A late allocation occurring on the same day as the GST event is deemed to precede the GST event. Reg. §26.2632-1(b)(ii)(A), (b)(iii). However, if the donor dies before the late GST exemption allocation is filed, then the date of death value applies. That can be a horrific result if the trust greatly appreciates or a life insurance death benefit is paid to the trust.

A late allocation is effective on the date of allocation. An executor makes a late allocation on Form 706. This rule theoretically (and technically) can create problems because the Form 706 would ordinarily not be filed for several months after death, yet the allocation would not be effective until then.

The potential benefit of a late election arises from the fact that the value as of the filing of the late return. For example, if $80,000 was gifted to a trust and the trust has a $35,000 current value, then only $35,000 of GST exemption need be allocated to achieve a zero inclusion ratio on that gift. In that instance, filing late was a benefit. The late allocation strategy is often employed with ILITs. After all, most trusts decline in value once the premium is paid. The bulk of the premium is often allocated to death benefits and administration expenses. (That is why life insurance companies own tall buildings.) If the insured cooperates and lives long enough so that the late filed gift tax return allocates GST exemption before the death of the insured, then GST exemption will be saved most likely, rather than allowing the automatic allocation rules to apply.

For a caution, however, with the value of life insurance, see *Pritchard v. Comr*., 4 T.C. 204 (1944) wherein the replacement value of a life insurance policy was determined in view of the insured's terminal condition at the time of the gift.

If the transferor or executor desires to elect out of the automatic allocation rules, that election must be made on a timely filed gift tax return to be effective for the prior gift. Reg. §26.2632-1(b)(2). Election out of the automatic allocation rules can also be made prospectively with respect to either a particular trust or any future gift to which the automatic allocation rules would apply. Reg. §26.2632-1. The IRS has granted various private letter ruling requests under Reg. §301.9100-3 to correct inadvertent automatic GST exemption allocations or to make an otherwise last allocation.

8.14.1.4 Use of Exemption Increase for Late Allocations

Query: Can the increase in GST exemption be applied currently to lifetime gifts made in prior years?

Although Code §2631(c) is not altogether clear, the legislative history reflects the intention that the increase in the GST exemption can be used in later years throughout the lifetime for gifts made in prior years. However, a technical reading of the statute would appear to limit the allowance to the amount available in the year of death. For an article criticizing this narrow application, see Schiller, *Determining Increase in the Late GST Exemption Allocation*, Estate Tax Planning *Advisor* (Aspen Publishers Jan. 2003).[10]

8.14.2 Allocation of GST Exemption Under Relief Provisions

The 2001 Tax Act provides two additional relief provisions for valuation, which may affect the allocation of GST exemption, namely:

(1) Retroactive allocation of GST exemption (Code §2632(d)); and

(2) Relief to make late allocation of GST exemption under rules to be prescribed by the Service. Code §2642(g). See, Reg. §301.9100-3.

8.14.2.1 Retroactive Allocation of GST Exemption.

[10] The author's approach to this issue is to apply the increase, notify the client of this issue, and insert a statement in the Gift Tax return that the application raised in the Senate Finance Committee Report is being applied. The author has also discussed this issue informally with the author of the GST Regulations, who indicated agreement with this interpretation.

Retroactive allocations permit values less than would apply under the late allocation rules to apply when there has been an *unnatural order of death* in a trust that has both skip and non-skip beneficiaries. Code §2632(d). It applies to deaths of non-skip persons occurring after December 31, 2000. Under this rule, the retroactive allocation of GST exemption is permitted IF: (1) a non-skip person has an interest[11] or future interest in a trust to which any transfer has been made; (2) such non-skip person is a lineal descendant of a grandparent of the transferor or a grandparent of the transferor's spouse or former spouse; (3) is assigned to a generation below that of the transferor; and, (4) such non-skip person predeceases the transferor. If each of these conditions are met, then the transferor may allocate any remaining GST exemption to any previous transfer or transfers to that trust on a chronological basis.

If a retroactive allocation of GST exemption is made on a **timely filed** gift tax return for gifts made in the year in which the non-skip beneficiary dies, the value of the transfer or transfers shall be determined as though the GST exemption was timely made for each calendar year in which a transfer was made, and said allocation shall be effective as though made immediately prior to the death of the non-skip person.

If the trust is worth less on the date of the death of the non-skip person than the value of gifts made to the trust, relief is not needed because the late allocation rules could allow less GST exemption to be used yet achieve a zero inclusion ratio.

8.14.3 GST Exemption Allocation on Death

In the absence of an allocation by the transferor or his executor, any portion of a decedent's GST exemption that has not been allocated during life or with the timely filing of an estate tax return on death, will be allocated at the decedent's death as follows:

(i) First, to property that is subject to a direct skip occurring at a decedent's death, and

(ii) Second, to trusts with respect to which the decedent is the transferor and from which a taxable distribution or termination might occur at or after his death.

Within each of these categories, the deemed allocation is made proportionally to each transfer within that respective category. Code §2632(e)(2). The automatic allocation to trusts for which a taxable termination or taxable distribution may occur is made pro-rata based on the estate tax value for property that is included in the gross estate and as to property that is not included in the gross estate (such as a life insurance trust), at the date of death value of the trust. Reg. §26.2632-1(d)(2).

Automatic allocations are effective on the due date for the federal estate tax return, including extensions. Reg. §26.2632-1(d)(2). The automatic allocations are irrevocable and cannot be amended once effective.

The primary disadvantage of the automatic allocation rules arises from the allocation, pro-rata, among all transfers within a group (such as all indirect transfers).

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[11] The right of a person to receive income or principal from a trust constitutes an **"interest"**. Code § 2652(c)(1)(A).

Example: T dies in 2008 with her $2 million GST exemption intact. She leaves an estate with a net value of $4 million, allocated equally, in trust, for S (age 39 with no children and no desire to have children) and D (age 28 with two children). The trust for each child terminates at age 40 years with remainder to issue of the deceased child if the child dies before age 40 years. Under the deemed allocation rules, $1 million of GST exemption is allocated to each child's trust even though the share to S will be wasted. If D dies before age 40 years, the inclusion ratio is .5 and GST tax is payable at the rate equal to one-half the GST rate then in effect. The Trustee of the trust could make a qualified severance of D's trust into a one-half share with an inclusion ratio of 0 and a one-half share with an inclusion ratio of 1. However, GST tax will still likely occur, which could have been avoided.

8.15 Estate Tax Inclusion Period (ETIP) Exception (Code §2642(f))

GST exemption cannot be allocated during the ETIP. Reg. §26.2632-1(c). An ETIP is the period during which, should death occur, the value of transferred property would be included (other than by reason of section 2035) in the gross estate of the transferor, or, the spouse of the transferor. Reg. §26.2632-1(c)(2). The following are exceptions to the ETIP: (1) if the possibility that the property will be included in the gross estate is ascertainably less than 5%; (2) if the spouse of the transferor possesses a right of withdrawal not greater than the 5/5 power and such withdrawal right terminates no later than 60 days after the transfer to the trust; or, (3) QTIP property to which a reverse QTIP election has been made. CAUTION: A hanging power should not be granted to the spouse of the transferor if it is desired to avoid the ETIP trust. Limit the spouse's Crummey power to the 5/5 rule. See, PLR 200513006.

An ETIP terminates on the first to occur of: (1) the death of the transferor; (2) the time at which no portion of the property is includible in the transferor's gross estate (other than by virtue of §2035; (3) in the case of an individual who is a transferor solely by reason of an election under Code §2513 [gift splitting], the time at which no portion would be includible in the gross estate of the individual's spouse (other than by reason of §2035); or (4) the time of a GST, but only with respect to the property involved in the GST, or 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 Code §2632, at the first to occur of: the death of the spouse, or the time at which no portion of the property would be includible in the spouse's gross estate (other than by reason of Code §2035).

The ETIP rules make skip persons bad beneficiaries of GRATs and QPRTs because GST exemption cannot be allocated during the retained period.

8.16 Excessive Exemption Allocations

Allocation of the GST exemption in excess of the amount necessary to achieve a zero inclusion ratio is void (Reg. §26.2632-1(b)(4), with the exception of excess allocations to charitable lead trusts.

In the context of a reverse QTIP election, the Service ruled that an allocation of GST exemption to a by-pass (credit shelter) trust in excess of the amount needed to obtain a zero inclusion ratio is void. PLR 200028012.

PRACTICE POINT: When filing Gift Tax Returns, or as a last resort the Estate Tax Return, review prior Gift Tax Returns to determine whether or not excessive GST exemption allocations have been made, which would be void under the above rule. If so determined, supplement/amend the prior returns, or provide a statement with the current return or Estate Tax Return correcting previously void exemption allocations.

8.17 Relief Provisions for Late Allocation of GST Exemption ☺☺

Code §2642(g) (effective after 12/30/00) authorizes Treasury to prescribe by regulation such circumstances and procedures under which extensions of time will be granted to make the following:

1. Code §2642(b)(1): allocations on timely filed gift tax returns;

2. Code §2642(b)(2): allocations on the transferor's estate tax return;

3. Code §2632(b)(3): election out of automatic allocation of gifts; and

4. Code §2632(c)(5): election out of automatic allocation of exemption on *GST Trusts*.

All relevant factors may be considered. A common theme, however, is the admission by a practitioner of having not properly advised the taxpayer. See PLR 200443010 (extension granted with grantor's spouse relied on a CPA who failed to advise of need for allocation and reliance was in good faith, and interests of IRS would not be prejudiced), PLR 200512006 (good faith reliance on tax advice), and PLR 200513006; and, PLR 200815011 (ruling granted relief on decade-past transfer).

Code §2642(g)(2) provides a "substantial compliance" rule. An allocation of GST exemption under §2632 that demonstrates an intent to have the lowest possible inclusion ratio with respect to a transfer or a trust shall be deemed to be an allocation of so much of the transferor's unused GST exemption as produces the lowest possible inclusion ratio. **This rule strongly encourages the making of formula stated GST exemption allocations.**

Note: In addition to stating the numbers that apply to an election, include language along the line of the following, if the intention is a zero inclusion ratio:

"Notwithstanding the foregoing, the taxpayer elects to allocate the minimum value necessary to achieve a zero inclusion ratio or a ratio as close to zero as possible if there is insufficient GST exemption available to achieve a zero inclusion ratio.

8.17.1 Reduced-Cost Relief on Pre-2001 Annual Exclusion Indirect Skip Gifts

Rev. Proc. 2004-46 makes it easier and less expensive (i.e. no user fee) to make a late GST exemption allocation within the limitations granted by this procedure and in lieu of §301-9100 relief. Normally, late allocation is as of the date of late filing gift tax return (unless death occurred). Relief may be sought to treat GST exemption allocation as though timely made. This ruling greatly simplifies relief procedure applicable to (1) pre 1/1/01 transfers by gift to a trust in which GST allocation could be made, (2) at time relief requested there have been no taxable distributions or terminations; (3) the transfer qualified for annual gift tax exclusion and the amount of the transfer does not exceed annual exclusion allowance; (4) no GST exemption allocated; (5) there is available GST exemption and (6) procedural requirement met. Under this procedure, it is necessary to file a gift tax return for the year of the transfer and include Notice of Allocation and indicate "FILED PURSUANT TO REV. PROC. 2004-46" at the top of the form.

8.18 Crummey Trusts and Lapsing Powers

There may be no more inconsistent and frustrating area of GST law than the effect of the lapse of a Crummey power. Regrettably, the GST law which was desired to break up dynastic wealth devolved on the arena of Crummey trusts and lapsing Crummey powers into mess, contrary to the Gift Tax law, or apparently inconsistent in its application.

8.18.1 Direct Skip Crummey Trusts

Unless the post-March 31, 1988 transfer to a skip trust for ONE beneficiary creates a vested interest (i.e., eventual estate or gift tax inclusion when the interest of the skip beneficiary dies), the transfer is a taxable transfer under GST law irrespective of the trust meeting annual exclusion rules for gift tax purposes or the existence of a valid Crummey power. Code §2642(c).

8.18.2 Change of the Transferor

The right of the beneficiary to withdraw from the trust is a power of appointment. To the extent that the right of withdrawal exceeds the 5/5 limitation under Code §2514, a general power of appointment exists. See Reg. §26.2612-1(c)(1). The beneficiary who holds a lapsing withdrawal right in excess of the 5/5 ceiling is deemed the transferor with respect to the excess. Reg. §26.2652-1(a)(5), example 5. This example states:

> "Example 5. Effect of lapse of withdrawal right on identity of transferor.
> T transfers $10,000 to a new trust providing that the trust income is to be paid to T's child, C, for C's life and, on the death of C, the trust principal is to be paid to T's grandchild, GC. The trustee has discretion to distribute principal for GC's benefit during C's lifetime. C has a right to withdraw $10,000 from the trust for a 60-day period following the transfer. Thereafter, the power lapses. C does not exercise the withdrawal right. The transfer by T is subject to Federal gift tax because a gift tax is imposed under section 2501(a) (without regard to exemptions, exclusions, deductions, and credits) and, thus, T is treated as having transferred the entire $10,000 to the trust. On the lapse of the withdrawal right, C becomes a transferor to the extent C is treated as having made a completed transfer for purposes of chapter 12. Therefore, except to the extent that the amount with respect to which the power of withdrawal lapses exceeds the greater of $5,000 or 5% of the value of the trust property, T remains the transferor of the trust property for purposes of chapter 13." (Emphasis added.)

The donee also becomes the transferor with respect to the value of the lapse in excess of the 5/5 amount. Therefore, the donee may have a gift tax return to file and his or her own GST planning to consider when the lapse exceeds the 5/5 amount. In that instance, a transfer to the grandchild arising from a lapse in excess of the 5/5 amount would be a non-skip transfer to the extent that the lapse is treated as a taxable transfer by the child, but a taxable termination as to the lapse relative to the initial donor.

8.18.3 Allocation of GST Exemption

What effect does the lapse of the withdrawal right by the donee in excess of the 5/5 amount change the amount needed to allocate to a trust to achieve a zero inclusion ratio? If an annual exclusion gift of $14,000 is made with a lapsing Crummey withdrawal power over that amount, it appears the case that T would have to allocate $14K of GST exemption and C (the non-skip beneficiary) is treated as a transfer of $9,000 ($14K-$5K). That interpretation would follow if Code §2642(b)(1)(B) is construed to follow since the value of a transfer for GST purposes under the timely filed (or deemed filed) rule is the value as of the date of the "allocation shall be effective on and after the date of such transfer." On the other hand, when the deemed allocation rules do not apply and the allocation of GST exemption is made on a late-filed Form 709, the allocation of the GST exemption on lifetime gifts not made on a timely filed gift tax return filed and not deemed to be made: (i) the value of such property for GST purposes is the value of the late filing (or first day of the month of permitted), and "such allocation shall be effective on and after the date on which such allocation is filed with the Secretary." Code §2642(b)(3)(B). Thus, an issue exists as to whether, with a late allocation of GST exemption, the donor must still allocate GST exemption based on the full amount of the transfer even if at that time the non-skip donee has become a transferor.

The more common approach is for T to allocate GST exemption to the entire gift if there is a lapse over the 5/5 amount regardless of when the allocation is made. If it is desired to avoid having two transferors over the same dollar (i.e., to avoid the donor being treated as the donor of 100% of the gift and the donee as an additional transferor as to the amount of the lapse over the 5/5 allowance), then either a hanging power or so-called "cascading power" can be used.

8.18.4 Hanging Powers.

With the hanging power, lapses are limited to the greater of $5,000 or 5% of the value of the trust each year. If the amount of the annual exclusion gift exceeds that amount, the withdrawal right continues subject to the 5/5 limitation to the next year (and potentially beyond). In view of the issues created by Crummey powers, both to the donee who becomes a transferor and the original donor, if treated as the transferor for GST purposes over more value that he or she is considered to have transferred for gift tax purposes, planners have developed alternative approaches for crafting Crummey trusts:

(1) The donor's gift is limited in an amount that is within the 5/5 lapse rule (i.e., give only $5,000 per donee in a smaller trust, or if the trust has $280,000 of value at the time of the gift, then $14,000 (2017 annual exclusion amount) would equal 5% of that trust, and the full $14,000 would be within the 5/5 lapse allowance.

Comments:

(i) This is an effective technique if the trust is substantial in amount since the 5% rule could shield the annual exclusion treatment and create the lapse within the 5/5 allowance.

(ii) If a skip person is the powerholder, establish the portion to which annual exclusion treatment is desired as a separate share, which meets the "vested" rule for non-taxable transfer for direct skip purposes.

(iii) If the trust is not substantial, the amount of the gift in excess of the 5/5 amount will not receive annual exclusion treatment (except to the extent that of the present value of a net-income interest to which trustee discretion on distributions does not apply).

A so-called "Hanging Power" may be used (and hope that by the time the grantor or child dies the hanging powers have been used up). With a hanging power, the right of withdrawal in excess of the 5/5 allowance continues over to the next year (or succeeding years), until lapses of the power can arise within the 5/5 allowance. If the power holder dies before the withdrawal right lapses, the remainder is included in the estate of the power holder. (To avoid a GST transfer by the power holder, the balance could be subject to a general power of appointment as the power holder directs, paid to the estate of the power holder, or paid to a non-skip person if the power holder dies before the lapse fully occurs.)

8.18.6 Cascading powers

Cascading powers (a term developed by Jonathan Blattmachr) may eliminate the donee being treated as a transferor. Upon the non-skip beneficiary allowing a 5/5 power to lapse, a skip person (to the original transferor) is allowed a withdrawal right. That skip person need not be the issue of the donee who allowed the lapse. It may be a niece or nephew or friend of the donee. The donee can be a remote possible beneficiary, but there cannot be an agreement that the power holder will not exercise their withdrawal right.[12] (This requirement applies to annual exclusion treatment for Crummey powers generally.)

> Example: T makes a gift of $13K to C, who holds a withdrawal right that lapses to the greater of 5/5. As a result of the lapse, Grandniece (GC 1) and Grandnephew (GC 2) each has a withdrawal power for one-half of the lapse, not to exceed the 5/5. T also makes a gift of $13K in trust to GC under which G/C has a separate and vested share for annual exclusion treatment, including estate tax inclusion on the death of G/C.
>
> Result: T allocates $13K of GST exemption if allocating on a timely basis. No allocation is needed on the annual exclusion gift to GC that meets the requirements of Code §2642(c) – vested interest.

8.19 Reverse QTIP Elections

The reverse QTIP election changes the identity of the transferor for GST PURPOSES but does not change the ESTATE TAXATION of a QTIP marital trust.

[12] *Christofani v. Comr*. 97 T.C. 74 (1991); *Estate of Kohlsaat v. Comr*. 73 T.C. Memo. 2732 (1997) and *Estate of Holland v. Comr*. 73 T.C.M. 3236 (1997). See, TAM 9731004 and Action on Decision 1996-010 for contrary IRS view, although a private ruling is not authority. The court cases have been favorable generally to the taxpayer.

GST exemptions exist because a QTIP election under Code Sec. 2056(b)(7) makes the surviving spouse the owner (taxpayer) under Code Sec. 2044. However, treating the surviving spouse as the owner/transferor for GST purposes may waste some of the GST exemption of the first spouse to die. Thus, the reverse QTIP election exists to preserve more of the GST exemption of the first spouse to die. It arose in the law because the GST exemption for many years was greater in amount than the estate tax exemption equivalent. In normal credit shelter trust/QTIP trust planning, the GST exemption is allocated to the credit shelter trust (after lifetime and direct skip transfers) are considered. Of course, a given plan may have been places to allocate exemption. Thus, the normal approach is not a fixed rule.

Thus, if there is a QTIP trust and all other uses of GST exemption have been considered, the reverse QTIP election may be made.

With the uniting of the GST exemption and Estate Tax exemption equivalent, the reverse QTIP election most likely will be relevant when the decedent made lifetime taxable gifts to non-skip persons greater in value than the taxable gifts to skip persons, either during life or upon death.

The following is done to make a reverse QTIP election:

1. Identify the marital trust to which the election is being made on Schedule R beneath line 9.

2. The reverse QTIP election is an all-or-nothing election. Therefore, divide the marital trust between a GST exempt trust (with its own EIN and tax reporting, title, etc.) and the Nonexempt share.

3. The reverse QTIP election can only be made on a QTIP trust, not an outright share or a general power of appointment trust.

4. The author suggests that you attach language expressing the intention to allocate GST exemption to the QTIP trust as a reverse QTIP election to achieve a zero inclusion ratio after considering all direct skip transfers and other transfers identified by the preparer made by the decedent, during life or upon death, to which priority of the allocation is desired.

Relief for failure to timely elect the reverse QTIP election is made under Reg. §9100 (§301.9100-3), or by a less expensive procedure under Reg. Proc. 2004-47. The taxpayer must have acted reasonably and in good faith to obtain relief.

Rev Proc. 2004-47 provides relief to make a late reverse QTIP election where it was not made in the initial estate tax return. The ruling was effective as of August 9, 2004. Relief may be granted under this procedure if, on the date of the filing of the request described in 4.03 of this revenue procedure, the following requirements are met: (1) A valid QTIP election under section 2056(b)(7) was made for the property or trust on the federal estate tax return filed for the decedent's estate; (2) The reverse QTIP election was not made on the estate tax return as filed because the taxpayer relied on the advice and counsel of a qualified tax professional and that qualified tax professional failed to advise the taxpayer of the need, advisability, or proper method to make a reverse QTIP election; (3) The decedent has a sufficient amount of unused GST exemption, after the automatic allocation of the GST exemption under section 2632(e) and section 26.2632-1(d)(2), to result in a zero-inclusion ratio for the reverse QTIP trust or property;

(4) The estate is not eligible under section 301.9100-2(b) for an automatic 6-month extension; (5) The surviving spouse has not made a lifetime disposition of all or any part of the qualifying income interest for life in the QTIP trust or property; (6) The surviving spouse is alive or no more than 6 months have passed since the death of the surviving spouse; and (7) Relief is requested by the executor in accordance with section 4.03 of the revenue procedure.

Added Assistance: The author's book, *706 Art,* published by Bloomberg BNA Books (chapter 25) includes further explanation and examples of reverse QTIP elections. In addition, the author discusses this topic, and all other GST topics presented in these materials, in greater depth in the full-day webinar course, *GST Tax from A-Z*, offered by the CalCPA education foundation (Go to https://www.slg4law.com/speaking-events for more information about speaking events and a link to the GST course on October 31, 2017).

8.20. GIFT TAX RETURNS

Form 709 has three purposes under GST law: (1) to pay GST tax on direct skip transfers that are not fully exempt transfers; (2) to allocate GST exemption; or (3) to elect out of the automatic allocation of GST exemption.

Allocation of GST exemptions are of four types: **current**, **late**, **retroactive**, and **protective.**

Form 709 reports GST transfers that are direct skip gifts. A non-taxable gift (which is a direct skip) to a trust for the benefit of an individual is also subject to GST tax unless: (1) during the lifetime of the beneficiary no corpus or income may be distributed to anyone other than that beneficiary; and (2) if the beneficiary dies before the trust terminates, the trust is included in the beneficiary=s gross estate. Code §2642(c).

The automatic allocation rule can be elected to NOT apply on a timely filed gift tax return for the year of the gift, or on a gift tax return for prospective years. An election to opt out of the automatic allocation of GST exemption can be made: (1) for the gift reported timely that was made in the prior year (i.e., the current reporting year); (2) for future gifts (either particular ones or all gifts) made to a GST Trust in future years; or (3) for the timely reversal of a prior election out on a gift made in the current reporting period or in the future. Thus, an election to opt out of the automatic allocation of GST exemption that is prospectively made can be reversed (so as to allow the automatic allocation of GST exemption) for gifts made in years after the opt-out is reversed.

9.1 Overview to Schedule A

The **gift tax** reporting of transfers is made on Schedule A (page 2 of the Form 709). Schedule A is divided into three parts in order to facilitate GST reporting.

*Part 1 is completed for transfers that have NO GST impact. (An example would be an outright gift to a non-skip person or an outright gift to a charity).

*Part 2 is completed for direct skip gifts. These transfers have both a current gift tax reporting element and would give rise to immediate payment of GST tax unless exempt.

*Part 3 is completed for indirect skip transfers, in other words on transfers made to a trust that has both a non-skip and a skip beneficiary.

It is possible that a trust will establish separate shares at the time of its creation. If that is the case, a determination must be made as to each transfer as to whether it falls into Part 1, Part 2 or Part 3.

9.2. Schedule C and GST Exemption Reporting

GST exemption is allocated on Schedule C of the Gift Tax Return. The post-2003 edition of Form 709 also allows all current allocations of GST exemption to be reported on Parts 1 and 3 to Schedule C, rather than with a Notice of Allocation.

The Notice of Allocation is used, however, with late allocations, retroactive allocations of GST exemption (unnatural order of death rule), protective elections, and elections out of the automatic allocation rules. The total of GST exemption allocations made on a Notice of Allocation is shown on line 6 of Part 2 of Schedule C of the Form 709. The instructions direct that any election out of the automatic allocation rules for GST exemption (i.e., to elect out of the allocation to a direct skip, or to a post-2000 transfer to a GST Trust) shall be made on an attachment to the Form 709. Reg. §26.2632-1 sets forth the requirements to elect out of automatic allocation of GST exemption on gifts made to a trust.

The instructions to Line 6 of Schedule C, part 2 (i.e., regarding the Notice of Allocation) state that the purpose of the notice is to allocate GST exemption with the return to transfers not reported on the return.

> **Practice Comment:** A Notice of Allocation (as opposed to a general attachment to the Form 709) is made: (i) to elect out of timely allocations of GST exemption; (ii) to make late elections or retroactive elections; (iii) to indicate that a trust will be deemed to be a GST trust even though it is not (i.e., to have GST exemption apply currently or in the future to that trust); or (iv) to elect out of the deemed allocation rules. In addition, a protective election can be included in the Notice of Allocation. While a Notice of Allocation is not expressly required for deemed allocations or timely allocations, including an explanation of the transfer and formula for the allocation is a good safeguard if the numbers alone are not sufficient.

To allocate exemptions to such transfers, the instructions direct that a statement called a "**Notice of Allocation"** be affixed and contain the following:

* Clearly identify the trust, including the trust's EIN, if known
* If this is a late allocation, the year the transfer was reported on Form 709.
* The value of the trust assets at the effective date of the allocation.
* The value of the trust assets at the effective date of the election.
* The date of the transfer.
* The amount of the GST exemption allocated to each gift (or a statement that you are allocating exemption by means of a formula, such as an "an amount necessary to produce and inclusion ratio of zero").
* The inclusion ratio of the trust after the allocation.

As noted previously, the author recommends including a protective formula GST exemption notice as an attachment to the Gift Tax Return, even with direct skips (transfers to GST Trusts). This is done to protect desired zero inclusion ratios, and keep the transfer GST-tax free. Also, life creates unintended consequences, so include a formula in the event that you missed something or results do not turn out as you might expect. The author recommends including the protective elections in a Notice of Allocation.

See the illustrated gift tax return and underlying facts at Appendix 1.

9. ILLUSTRATED GIFT TAX RETURN

See Appendix 1 for the facts underlying the illustrated gift tax return that concludes these materials.

TAX ADVICE DISCLAIMER:

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APPENDIX 1

Strafford Webinar: Illustrated Gift Tax Return (2015 Sample.)

Note: The facts that follow are hypothetical and any connection between these made-up facts and any real person or transfer is unintended. The illustrated gift tax return attached is based on these facts and assumptions. The terms and presentation of any gift tax return depends upon the facts, timing and law applicable to that transfer. These materials do not express an opinion in a particular matter, in whole or part.

The following facts and assumptions for this gift tax return by Jordan D. Taylor, an unmarried person, are below stated. In 2001, Jordan made a $2 million taxable gift to outright to his son. In 2001, the applicable exclusion amount was $675,000 and the maximum gift tax rate was 55%. The 41% rate commenced at $1 million of taxable value, the 43% rate at $1.5 million of taxable value and the 45% rate commenced at $2 million of taxable value. The gift tax on $2 million was $780,800 less the equivalent credit on $675,000 (i.e., $220,550) for a gift tax paid of $560,250 at rates in effect in 2001. However, based on 2015 rates, gift tax for the prior gift is $745,800 before reduction for the gift tax credit. (See, line 5 of the Form 709.) The gift tax payable on this prior gift is only $525,250 based on 2015 rates as reflected on the Numbercruncher® "Prior Gifts" workpaper at the final page of the attachments to the sample return.)

In 2015, Jordan made the following gifts and transfers:

1. On February 1, 2015, Jordan made a gift to City National Bank, as Trustee of the Kenneth Dean Taylor Irrevocable Trust, which trust constitutes a completed gift yet is an intentionally defective grantor trust (IDGT) for income tax purposes. The trust lasts for the lifetime of Kenneth, a child, paying all net income and principal for need. The Trust is divided between GST exempt and non-exempt shares. On death, Kenneth has a limited power of appointment as to GST exempt share and a general power of appointment as to the non-GST exempt share. If the power is not exercised, the trust is allocated to the living issue of Settlor by right of representation. At the onset of the trust, Jordan gifted $900,000 to the trust. The trust then purchased a 30% interest in ABC, LLC, a Nevada LLC, which owns real estate in several states and a 4% limited partnership in XYZ Limited Partners, a California limited partnership. The limited partnership owns commercial rental property in Georgia. The general partner is reluctant to release financial information regarding the Georgia rental properties and these properties have not been appraised by an outside appraiser for several years. The Nevada LLC purchased the limited partnership interest in 2003. The partnership has gross rental income of $700,000 and net operating income of $600,000 with mostly NNN leases. There is no debt on the property. When the LLC purchased the 4% interest, gross rental income was $400,000 and the net rental income was $300,000, the LLC paid $100,000. The limited partnership agreement includes a fair market value purchase option on sales/transfers of limited partnership interests, including applicable discounts. The LLC agreement includes a similar restrictive provision. The LLC is among family members. The limited partnership is among outside investors. Jordan obtained an appraisal for the fair market value of the 30% interest in the LLC, which value is $9 million including an aggregate 35% discount for lack of marketability and minority interest. (*See, A-3-1)*

2. On March 1, 2015, Jordan made a gift in LLC interests in Brittany Farms, LLC equal to a $2.5 million value. Based on an initial valuation good faith estimate of value from a qualified appraiser, this sum equated to a 25% LLC interest. The appraiser then conclude his/her work several weeks later, at which time it was determined that a 24% LLC interest equated to the $2.5 million defined value. The donee of the gift is Winston Taylor, a grandchild of Jordan's. The gift was made outright to Winston. *(See, A-2-1)*

3. A 10% membership interest in the Taylor Family Limited Liability Company. Jordan had a $70,000 basis in the interest, which had a fair market value of $200,000 as of the date of the April 1, 2015 gift. The donee is Adam, a child of Jordan. (*See, A-1-1)*

4. A gift of a 10% limited partnership interest in the Taylor Family Limited Partnership is given to Jessica, a grandchild, on May 1, 2015. The donor's basis is $800,000 and the fair market value of the gift is $500,000. *(See, A-2-2)*

5. $100,000 is placed into a Crummey Trust on June 1, 2015. There are two beneficiaries, Barry, a son (non-skip person) and Jessica (a skip person). Each beneficiary has a separate share under the trust. Each beneficiary receives income and principal for need from the trust. Upon the beneficiary attaining the age of 50 years (many years from now), distribution goes outright to that beneficiary. In the event of death, distribution goes to the estate of the deceased beneficiary although no beneficiary has a general power of appointment over any part of the trust. Each beneficiary has an annual withdrawal right up to the full annual exclusion gift and there is no hanging power. *(See, A-1-2; A-2-3)*

6. $10,000 is gifted on July 1, 2015 to the Taylor Irrevocable Life Insurance Trust. The beneficiary of the trust is Danelle, a grand-daughter, who has the power to withdraw the gift up to the annual exclusion amount. The grandchild holds no general power of appointment or estate tax inclusion with regard to the trust, or any part thereof, on her death. *(See, A-2-4)*

7. On July 15, 2015, Jordan created Crummey Trust #2 for the benefit of his daughter, Andrea, under which $14,000 is gifted and to which Andrea has a Crummey withdrawal power up to the annual exclusion amount. The child holds no general power of appointment or estate tax inclusion with regard to the trust, or any part thereof. On her death, the trust goes to her issue. *(See A-3-2)*

8. On August 1, 2015, taxpayer establishes a Sprinkling Trust for the benefit of Barry (a child) and Tiffany (a grandchild), funded with $60,000. Under the terms of the trust, the trustee may pay income or principal for need to either beneficiary. The beneficiaries are adults. The trust will last for 30 years. Upon the death of either beneficiary, the other becomes the sole beneficiary. Upon the death of the survivor, the balance of the trust will be distributed equally to the surviving issue then living of each of these beneficiaries. The trust has no Crummey powers. (*See A-3-3)*

9. On September 1, 2015, taxpayer establishes a Health and Education Trust for the benefit of Charlie (a child, age 45) and Ashley (a grandchild, age 15 with great grades), funded with $50,000. Under the trust, the trustee may pay income or principal for need (health, education, support and maintenance) to or for the benefit of either beneficiary. The trust will last for 30 years. Upon the death of either

beneficiary, the other becomes the sole beneficiary. Upon the death of the survivor, the balance of the trust will be distributed equally to the surviving issue then living of each of these beneficiaries. There are no Crummey withdrawal powers. *(See A-3-4)*

10. On October 1, 2015, the taxpayer makes a gift of $14,000 to Suzie Smith, a friend, who is 40 years younger than the taxpayer. *(See A-2-5)*

11. On November 1, 2015, Jordan makes a gift of $40,000 to a GST Trust for the benefit of his son, Nick. Nick is to receive principal and income for need with outright distribution at the age of 60 years. There is no Crummey withdrawal power. If Nick dies, the remainder goes to Nick's issue. Jordan does not want GST exemption to apply to this gift, now or in the future.(*See A-3-5)*

12. On December 1, 2015, Jordan creates the GRAT #1, retaining a 2-year annuity under GRAT rules, remainder to his grand-daughter, Eleanor Riley, in trust for life remainder to her issue. A stock portfolio with $1 million in value is placed in the GRAT. The present value of the remainder interest under the GRAT rules is $1,003. (*See A-3-6)*

13. On December 21, 2015, Jordan gifted $70,000 to the California TIAA-CREF Educational Fund (529 Plan) for his grandchild, Julie Jordan, which he wishes to be treated as equally gifted over a 5-year period. (*See, 2-6)*

14. On December 23, 2015, Jordan gifted an undivided 40% interest in the residential property commonly known as 1000 Ocean Ave., Unit 5B, Santa Monica, CA 85555 (APN 546-099) to the Taylor 2015 Qualified Personal Residence Trust. The 40% interest gifted has a fair market value of $800,000 after a 28% fractional interest discount. Jordan retained a 4-year period and holds the revision in the event of his death before the end of the retained term. The remainder beneficiaries are two children, namely Barry and Adam, who were donees of earlier gifts in 2015. (*See A-1-3)*

15. On January 1, 1993, Jordan gifted $20,000 to the Taylor Non-Skip Trust. The gift is one of a present interest for gift tax purposes and to which annual exclusion fully applies. No GST allocation was made on any gift tax return. There have been no taxable terminations or taxable distributions with respect to this trust. CPA now realizes that there was no automatic allocation of the GST exemption when the gift was made because of the presence of both skip and non-skip beneficiaries in the same trust. The GST exemption is being allocated on the 2015 Form 709 when the gifted property has a value of $45,000. The funds are invested with City National Bank. (*See Notice of Allocation II)*

16. On January 1, 1994, Jordan gifted $10,000 to the Taylor Non-Skip Trust. The gift is one of a present interest for gift tax purposes and to which annual exclusion fully applies. No GST allocation was made on any gift tax return. There have been no taxable terminations or taxable distributions with respect to this trust. CPA now realizes that there was no automatic allocation of the GST exemption when the gift was made because of the presence of both skip and non-skip beneficiaries in the same trust. The GST exemption is being allocated on the 2015 Form 709 when the value of the gifted property is $25,000. (*See Notice of Allocation III)*

17. Jordan filed a gift tax return in 2002 in which he elected into the automatic allocation of GST Exemption to the Goofy GST Trust, for the benefit of his nephew, Donald. Jordan would like to have GST exemption no longer automatically apply to future gifts. He made no gift to this trust in 2015. (*See Notice of Allocation IV)*

18. On December 6, 1991, Jordan made a gift of $70,000 in trust for the benefit of his son, Herman, with remainder to the issue of Herman. Herman would receive income and principal for need. No GST exemption was allocated (and to make matters worse there was no Crummey power). Herman died on May 8, 2015, when the trust had a value of $500,000. (*See Notice of Allocation V)*

Filed Pursuant to Rev. Proc. 2004-46

Form **709**

Department of the Treasury
Internal Revenue Service

United States Gift (and Generation-Skipping Transfer) Tax Return

▶ Information about Form 709 and its separate instructions is at *www.irs.gov/form709*.

(For gifts made during calendar year 2015)

▶ See instructions.

OMB No. 1545-0020

2015

Part 1—General Information

1 Donor's first name and middle initial	2 Donor's last name	3 Donor's social security number
Jordan D.	Taylor	555-66-7777

4 Address (number, street, and apartment number)	5 Legal residence (domicile)
1000 Ocean Ave., Unit 5B	Los Angeles County, CA
6 City or town, state or province, country, and ZIP or foreign postal code	**7** Citizenship (see instructions)
Santa Monica, CA 85555	USA

		Yes	No
8	If the donor died during the year, check here ▶ ☐ and enter date of death ______ , ______.		
9	If you extended the time to file this Form 709, check here ▶ ☐		
10	Enter the total number of donees listed on Schedule A. Count each person only once ▶ fourteen (14)		
11a	Have you (the donor) previously filed a Form 709 (or 709-A) for any other year? If "No," skip line 11b	✔	
b	Has your address changed since you last filed Form 709 (or 709-A)?		✔
12	**Gifts by husband or wife to third parties.** Do you consent to have the gifts (including generation-skipping transfers) made by you and by your spouse to third parties during the calendar year considered as made one-half by each of you? (see instructions.) (If the answer is "Yes," the following information must be furnished and your spouse must sign the consent shown below. **If the answer is "No," skip lines 13–18.**)		
13	Name of consenting spouse — **14** SSN		
15	Were you married to one another during the entire calendar year? (see instructions)		
16	If 15 is "No," check whether ☐ married ☐ divorced or ☐ widowed/deceased, and give date (see instructions) ▶		
17	Will a gift tax return for this year be filed by your spouse? (If "Yes," mail both returns in the same envelope.)		

18 **Consent of Spouse.** I consent to have the gifts (and generation-skipping transfers) made by me and by my spouse to third parties during the calendar year considered as made one-half by each of us. We are both aware of the joint and several liability for tax created by the execution of this consent.

Consenting spouse's signature ▶ **Date** ▶

19	Have you applied a DSUE amount received from a predeceased spouse to a gift or gifts reported on this or a previous Form 709? If "Yes," complete Schedule C		

Part 2—Tax Computation

1	Enter the amount from Schedule A, Part 4, line 11	1	4,885,907
2	Enter the amount from Schedule B, line 3	2	2,000,000
3	Total taxable gifts. Add lines 1 and 2	3	6,895,907
4	Tax computed on amount on line 3 (see *Table for Computing Gift Tax* in instructions)	4	2,700,163
5	Tax computed on amount on line 2 (see *Table for Computing Gift Tax* in instructions)	5	745,800
6	Balance. Subtract line 5 from line 4	6	1,954,363
7	Applicable credit amount. If donor has DSUE amount from predeceased spouse(s), enter amount from Schedule C, line 4; otherwise, see instructions	7	2,117,800
8	Enter the applicable credit against tax allowable for all prior periods (from Sch. B, line 1, col. C)	8	220,550
9	Balance. Subtract line 8 from line 7. Do not enter less than zero	9	1,897,250
10	Enter 20% (.20) of the amount allowed as a specific exemption for gifts made after September 8, 1976, and before January 1, 1977 (see instructions)	10	0
11	Balance. Subtract line 10 from line 9. Do not enter less than zero	11	1,897,250
12	Applicable credit. Enter the smaller of line 6 or line 11	12	1,897,250
13	Credit for foreign gift taxes (see instructions)	13	0
14	Total credits. Add lines 12 and 13	14	1,897,250
15	Balance. Subtract line 14 from line 6. Do not enter less than zero	15	57,113
16	Generation-skipping transfer taxes (from Schedule D, Part 3, col. H, Total)	16	0
17	Total tax. Add lines 15 and 16	17	57,113
18	Gift and generation-skipping transfer taxes prepaid with extension of time to file	18	0
19	If line 18 is less than line 17, enter **balance due** (see instructions)	19	57,113
20	If line 18 is greater than line 17, enter **amount to be refunded**	20	0

Attach check or money order here.

Sign Here

Under penalties of perjury, I declare that I have examined this return, including any accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than donor) is based on all information of which preparer has any knowledge.

May the IRS discuss this return with the preparer shown below (see instructions)? ☐ **Yes** ☐ **No**

▶ Signature of donor — Date

Paid Preparer Use Only

Print/Type preparer's name	Preparer's signature	Date	Check ☐ if self-employed	PTIN
Firm's name ▶			Firm's EIN ▶	
Firm's address ▶			Phone no.	

SCHEDULE A **Computation of Taxable Gifts** (Including transfers in trust) (see instructions)

A Does the value of any item listed on Schedule A reflect any valuation discount? If "Yes," attach explanation . . . . Yes ☑ No ☐

B ☑ ◄ Check here if you elect under section 529(c)(2)(B) to treat any transfers made this year to a qualified tuition program as made ratably over a 5-year period beginning this year. See instructions. Attach explanation.

Part 1—Gifts Subject Only to Gift Tax. Gifts less political organization, medical, and educational exclusions. (see instructions)

A Item number	B • Donee's name and address • Relationship to donor (if any) • Description of gift • If the gift was of securities, give CUSIP no. • If closely held entity, give EIN	C	D Donor's adjusted basis of gift	E Date of gift	F Value at date of gift	G For split gifts, enter 1/2 of column F	H Net transfer (subtract col. G from col. F)
1	See Attachment A-1						854,904
Gifts made by spouse —*complete **only** if you are splitting gifts with your spouse and he/she also made gifts.*							
Total of Part 1. Add amounts from Part 1, column H . . . . ►							854,904

Part 2—Direct Skips. Gifts that are direct skips and are subject to both gift tax and generation-skipping transfer tax. You must list the gifts in chronological order.

A Item number	B • Donee's name and address • Relationship to donor (if any) • Description of gift • If the gift was of securities, give CUSIP no. • If closely held entity, give EIN	C 2632(b) election out	D Donor's adjusted basis of gift	E Date of gift	F Value at date of gift	G For split gifts, enter 1/2 of column F	H Net transfer (subtract col. G from col. F)
1	See Attachment A-2						$3,088,000
Gifts made by spouse —*complete **only** if you are splitting gifts with your spouse and he/she also made gifts.*							
Total of Part 2. Add amounts from Part 2, column H . . . . ►							$3,088,000

Part 3—Indirect Skips. Gifts to trusts that are currently subject to gift tax and may later be subject to generation-skipping transfer tax. You must list these gifts in chronological order.

A Item number	B • Donee's name and address • Relationship to donor (if any) • Description of gift • If the gift was of securities, give CUSIP no. • If closely held entity, give EIN	C 2632(c) election	D Donor's adjusted basis of gift	E Date of gift	F Value at date of gift	G For split gifts, enter 1/2 of column F	H Net transfer (subtract col. G from col. F)
1	See Attachment A-3	✔					$1,065,003
Gifts made by spouse —*complete **only** if you are splitting gifts with your spouse and he/she also made gifts.*							
Total of Part 3. Add amounts from Part 3, column H . . . . ►							$1,065,003

(If more space is needed, attach additional statements.)

Part 4—Taxable Gift Reconciliation

1	Total value of gifts of donor. Add totals from column H of Parts 1, 2, and 3			1	5,007,907
2	Total annual exclusions for gifts listed on line 1 (see instructions)			2	122,000
3	Total included amount of gifts. Subtract line 2 from line 1			3	4,885,907
Deductions (see instructions)					
4	Gifts of interests to spouse for which a marital deduction will be claimed, based on item numbers ______ of Schedule A	4	0		
5	Exclusions attributable to gifts on line 4	5	0		
6	Marital deduction. Subtract line 5 from line 4	6	0		
7	Charitable deduction, based on item nos. ______ less exclusions	7	0		
8	Total deductions. Add lines 6 and 7			8	0
9	Subtract line 8 from line 3			9	4,885,907
10	Generation-skipping transfer taxes payable with this Form 709 (from Schedule D, Part 3, col. H, Total)			10	0
11	**Taxable gifts.** Add lines 9 and 10. Enter here and on page 1, Part 2—Tax Computation, line 1			11	4,885,907

Terminable Interest (QTIP) Marital Deduction. (see instructions for Schedule A, Part 4, line 4)

If a trust (or other property) meets the requirements of qualified terminable interest property under section 2523(f), and:

a. The trust (or other property) is listed on Schedule A, and

b. The value of the trust (or other property) is entered in whole or in part as a deduction on Schedule A, Part 4, line 4, then the donor shall be deemed to have made an election to have such trust (or other property) treated as qualified terminable interest property under section 2523(f).

If less than the entire value of the trust (or other property) that the donor has included in Parts 1 and 3 of Schedule A is entered as a deduction on line 4, the donor shall be considered to have made an election only as to a fraction of the trust (or other property). The numerator of this fraction is equal to the amount of the trust (or other property) deducted on Schedule A, Part 4, line 6. The denominator is equal to the total value of the trust (or other property) listed in Parts 1 and 3 of Schedule A.

If you make the QTIP election, the terminable interest property involved will be included in your spouse's gross estate upon his or her death (section 2044). See instructions for line 4 of Schedule A. If your spouse disposes (by gift or otherwise) of all or part of the qualifying life income interest, he or she will be considered to have made a transfer of the entire property that is subject to the gift tax. See *Transfer of Certain Life Estates Received From Spouse* in the instructions.

12 Election Out of QTIP Treatment of Annuities

☐ ◀ Check here if you elect under section 2523(f)(6) **not** to treat as qualified terminable interest property any joint and survivor annuities that are reported on Schedule A and would otherwise be treated as qualified terminable interest property under section 2523(f). See instructions. Enter the item numbers from Schedule A for the annuities for which you are making this election ▶ ______

SCHEDULE B Gifts From Prior Periods

If you answered "Yes," on line 11a of page 1, Part 1, see the instructions for completing Schedule B. If you answered "No," skip to the Tax Computation on page 1 (or Schedules C or D, if applicable). Complete Schedule A before beginning Schedule B. See instructions for recalculation of the column C amounts. Attach calculations.

A Calendar year or calendar quarter (see instructions)	B Internal Revenue office where prior return was filed	C Amount of applicable credit (unified credit) against gift tax for periods after December 31, 1976	D Amount of specific exemption for prior periods ending before January 1, 1977	E Amount of taxable gifts
2001	Fresno, CA	220,550	0	$2,000,000
1 Totals for prior periods	1	220,550		

2	Amount, if any, by which total specific exemption, line 1, column D is more than $30,000	2	0
3	Total amount of taxable gifts for prior periods. Add amount on line 1, column E and amount, if any, on line 2. Enter here and on page 1, Part 2—Tax Computation, line 2	3	$2,000,000

(If more space is needed, attach additional statements.)

SCHEDULE C Deceased Spousal Unused Exclusion (DSUE) Amount

Provide the following information to determine the DSUE amount and applicable credit received from prior spouses. Complete Schedule A before beginning Schedule C.

A Name of Deceased Spouse (dates of death after December 31, 2010 only)	B Date of Death	C Portability Election Made?		D If "Yes," DSUE Amount Received from Spouse	E DSUE Amount Applied by Donor to Lifetime Gifts (list current and prior gifts)	F Date of Gift(s) (enter as mm/dd/yy for Part 1 and as yyyy for Part 2)
		Yes	No			
Part 1—DSUE RECEIVED FROM LAST DECEASED SPOUSE						
Part 2—DSUE RECEIVED FROM PREDECEASED SPOUSE(S)						
TOTAL (for all DSUE amounts applied from column E for Part 1 and Part 2)						

1	Donor's basic exclusion amount (see instructions)	1	
2	Total from column E, Parts 1 and 2	2	
3	Add lines 1 and 2	3	
4	Applicable credit on amount in line 3 (See *Table for Computing Gift Tax* in the instructions). Enter here and on line 7, Part 2—Tax Computation	4	

SCHEDULE D Computation of Generation-Skipping Transfer Tax

Note. Inter vivos direct skips that are completely excluded by the GST exemption must still be fully reported (including value and exemptions claimed) on Schedule D.

Part 1—Generation-Skipping Transfers

A Item No. (from Schedule A, Part 2, col. A)	B Value (from Schedule A, Part 2, col. H)	C Nontaxable Portion of Transfer	D Net Transfer (subtract col. C from col. B)
1	$2,500,000	$14,000	$2,486,000
2	800,000	$14,000	$786,000
3	$50,000	0	$50,000
4	$10,000	$10,000	0
5	14,000	14,000	0
6	14,000	14,000	0
Gifts made by spouse (for gift splitting only)			

(If more space is needed, attach additional statements.)

Part 2—GST Exemption Reconciliation (Section 2631) and Section 2652(a)(3) Election

Check here ▶ ☐ if you are making a section 2652(a)(3) (special QTIP) election (see instructions)

Enter the item numbers from Schedule A of the gifts for which you are making this election ▶

1	Maximum allowable exemption (see instructions)	1	5,430,000
2	Total exemption used for periods before filing this return	2	0
3	Exemption available for this return. Subtract line 2 from line 1	3	5,430,000
4	Exemption claimed on this return from Part 3, column C total, below	4	3,322,000
5	Automatic allocation of exemption to transfers reported on Schedule A, Part 3. To opt out of the automatic allocation rules, you must attach an "**Election Out**" statement. (see instructions)	5	960,000
6	Exemption allocated to transfers not shown on line 4 or 5, above. **You must attach a "Notice of Allocation."** (see instructions)	6	125,000
7	Add lines 4, 5, and 6	7	4,407,000
8	Exemption available for future transfers. Subtract line 7 from line 3	8	1,023,000

Part 3—Tax Computation

A Item No. (from Schedule D, Part 1)	B Net Transfer (from Schedule D, Part 1, col. D)	C GST Exemption Allocated	D Divide col. C by col. B	E Inclusion Ratio (Subtract col. D from 1.000)	F Maximum Estate Tax Rate	G Applicable Rate (multiply col. E by col. F)	H Generation-Skipping Transfer Tax (multiply col. B by col. G)
1	$2,486,000	$2,486,000	1	0	40% (.40)	0	0
2	$786,000	$786,000	1	0	40% (.40)	0	0
3	$50,000	$50,000	1	0	40% (.40)	0	0
4	0	0	1	0	40% (.40)	0	0
5	0	0	1	0	40% (.40)	0	0
6	0	0	1	0	40% (.40)	0	0
Gifts made by spouse (for gift splitting only)							
					40% (.40)		
					40% (.40)		
					40% (.40)		
					40% (.40)		
					40% (.40)		
					40% (.40)		
Total exemption claimed. Enter here and on Part 2, line 4, above. May not exceed Part 2, line 3, above		3,322,000	**Total generation-skipping transfer tax.** Enter here; on page 3, Schedule A, Part 4, line 10; and on page 1, Part 2—Tax Computation, line 16				0

(If more space is needed, attach additional statements.)

Form 709
Taxpayer: Jordan Dean Taylor
Year: 2015
Statement of Annual Exclusions

1.	Adam Taylor	Schedule A, part 1, item 1	$14,000
2.	Barry Taylor	Schedule A, part 1, item 2	$14,000
3.	Winston Taylor	Schedule A, part 2, item 1	$14,000
4.	Jessica Player	Schedule A, part 2, item 2	$14,000
5.	Danelle Player	Schedule A, part 2, item 4	$10,000
6.	Suzie Smith	Schedule A, part 2, item 5	$14,000
7.	Julie Jordan	Schedule A, part 2, item 6	$14,000
8.	Kenneth D. Taylor	Schedule A, part 3, item 1	$14,000
9.	Andrea Pandra	Schedule A, part 3, item 2	$14,000
		Total	$122,000

Form 709
Taxpayer: Jordan Dean Taylor
Year: 2015
Attachment A-1

Item	Description	Adjusted Basis	Date of Gift	Value of Gift
1	Adam Taylor, a child, 100 H Street, Tucson, CA 29374 Gift of 10% membership interest in the Taylor Family Limited Liability. See, Attachment A-1 for a copy of the Taylor Family Limited Liability Company Agreement dated 1/1/2000, and a copy of the appraisal by ABC, Inc. dated as of 4/1/2015	$70,000	4/1/2015	$200,000
2[1]	Barry Taylor, a child, 1 Bruin Walk, Los Angeles, CA 90025 Gift of $50,000 cash to the separate share under the Crummey Trust, (TIN: 12-1256777), to which Michael Smith, whose address is 5321 Pine Street, Chico, CA is the trustee. A copy of the trust is attached at Attachment A-1-2, together with a copy of the Crummey Notice to the donee, which notice is also affixed as “Attachment A-1-2.*	$50,000	6/1/2015	$50,000
3	An undivided 40% interest in the residential property commonly known as 1000 Ocean Ave., Unit 5B, Santa Monica, CA 85555 (APN 546-099) to the Taylor 2015 Qualified Personal Residence Trust dated December 23, 2015 (the QPRT). The current taxpayer is the trustee of the QPRT and the trust uses the social security number of the taxpayer. The address of the taxpayer is stated on the first page of this gift tax return. There is no debt on the subject property. Attached as “Attachment A-1-3-1” is a copy of the QPRT . Attached as “Attachment A-1-3-2” is a copy of the appraisal of 1000 Ocean Ave., Unit 5B, Santa Monica. CA conducted by HM Appraisers on January 18, 2015, as of December 23, 2015. Attached as “Attachment A-1-3-3” is a copy of the appraisal by VMF Appraisers, Inc. as of the December 23, 2015 valuation date concluding that a 28% fractional interest discount applies to	$650,000	12/23/2015	$604,904

[1] **Aside comment to class regarding this item. The gift to Barry provided that upon his death the share of the trust remaining would go to Barry’s estate. During Barry’s life, he is the sole beneficiary. As a result, there is no possibility of a taxable termination or taxable distribution occurring.*

	the gift of the undivided 40% interest in the subject property. Before application of a fractional interest discount, the pro-rata value of the 40% interest is $1,111,111, which results in a partial interest valuation of $800,000 $1,111,111 times 72% (1-.28) after the application of the 28% fractional interest discount. The following are the computations of the present value of the remainder interest in the 40% interest in the foregoing residential property determined under Reg. §25.2702-5(c) with respect to this QPRT: Date of the gift: 12/23/2015 Date of birth of the donor: 04/23/1939 Age of the donor: 76 Value of nontaxable retained interest by the taxpayer: $195,096 Taxable gift (present value of the remainder interest: $604,904 Term retained by the taxpayer: 4 years The taxpayer retained a reversion interest in the event of death before the conclusion of the retained term. Fair market value before application determination of the value of the remainder interest gifted. $800,000 The value of the remainder interest applying the factors in accordance with the regulations and using the Numbercuncher software program reflects 0.75613 of the value of the gift as being attributable to the retained interest as the nontaxable portion retained by the taxpayer. Attached as Attachment 1-3-4 is a copy of the workpaper from Numbercruncher on the computation of the taxable gift. The beneficiaries of remainder interest in the QPRT are Barry Taylor and Adam Taylor, whose identities, relationships and addresses are recited in items 1 and 2 to this Attachment A-1. If either of them is not living at the time of the death of the taxpayer following the retained term (if the taxpayer survives the retained term), the balance of the trust goes to the issue of the deceased child. No GST exemption can yet be allocated in view of the Estate Tax Inclusion Period (ETIP) that applies while the taxpayer is living during the retained term.			
	Total Gifts Schedule A, Part 1			**$854,904**

Form 709
Taxpayer: Jordan Dean Taylor
Year: 2015
Attachment A-2

Basis Date Value

Item	Description	Adjusted Basis	Date of Gift	Value of Gift
1	A defined-value gift of interests in Brittany Farms, LLC, a California limited liability company, ("the Company"), which has an EIN of the Company is 444-55-6666, equal to a fair market value of $2,500,000. The taxpayer gave a sufficient percentage of membership interests in the Company which represent a membership interest so that the aggregate fair market value of such gifted interests for federal gift tax purposes shall be Two Million Five Hundred Thousand Dollars ($2,500,000). The gift is intended to be exactly Two Million Five Hundred Thousand Dollars ($2,500,000) ("Defined Value Gift Amount") to Winston Taylor, a grandchild of the taxpayer. The address of Winston Taylor is 5 Chartwall Lane, Surrey, PA 51040. Although the number of members interests gifted is fixed on the date of the gift, that number is based on the fair market value of the gifted shares, which cannot be known on the date of the gift but must be determined after such date based on all relevant information as of that date. Furthermore, the value determined is subject to challenge by the Internal Revenue Service ("IRS"). Prior to the date of this gift, the taxpayer obtained a preliminary good faith estimate of the quantity of membership interests in the Company necessary to equal said $2,500,000 Defined Value Gift Amount. This initial preliminary estimate of the quantity of membership interests equal to said Defined Value Gift Amount is twenty-five percent (25%) with a value of One Hundred Thousand Dollars ($100,000) for each one percent membership interest. On July 6, 2015, the taxpayer obtained an appraisal by Abraham Appraisal Co. opining to the number of membership interests in the Company equal to said Defined Value Gift Amount. Said appraisal company determined that a twenty-four percent (24%) membership interest equates to said Defined Value Gift Amount, of One Hundred Four Thousand One Hundred Sixty-Six Dollars ($104,166) per each one percent interest. Accordingly, the donee returned a one-percent (1%) membership interest in the Company to the taxpayer to equal said Defined Value Gift Amount. Abraham Appraisal Co. is an independent third-	$1,750,000	3/1/2015	$2,500,000

	party professional experienced in such matters. Nevertheless, if, after the number of gifted membership interests in the Company is determined based on such date of gift valuation, the IRS challenges such valuation and a final determination of a different value is made by the IRS or a court of law, the number of gifted membership interests in the Company shall be adjusted accordingly so that the value of the membership interests gifted to DONEE equals the amount set forth above, in the same manner as a federal estate tax formula marital deduction amount would be adjusted for a valuation redetermination by the IRS and/or a court of law. Attached as “Attachment A-2-1” is a copy of the initial good faith estimate of value provided by Abraham Appraisal Co. dated February 20,2015. Attached as “Attachment A-2-2” is a copy of the appraisal report of Abraham Appraisal Co. dated July 6,2015 reflecting the number of membership interests in the Company as of March 1, 2015 equal to the Defined Value Gift Amount. In the event that any adjustment arises in the actual quantity of membership interets gifted or the value of membership interests gifted, adjustments will be made to the allocable capital accounts, allocations, interest in profits and losses, distributions, and all other distributive shares/rights and other tax incidents otherwise allocated to ownership of membership interests in the Company that that equate to the foregoing defined-value gift as finally determined, and income tax returns shall be amended accordingly. The foregoing Defined Value Gift was evidenced by a Deed of Gift (a copy of which is attached as “Attachment A-2-3”) and Assignment of Membership Interests with Agreement to Be Bound by the Operating Agreement of the Company (a copy of which is attached as “Attachment A-2-4”). Attached as “Attachment A-2-5” is a copy of the Operating Agreement of Brittany Farms, LLC, dated November 30, 2004. In the event that it is finally determined that of value of the memberhip interests gifted equalling the Defined Value Gift Amount to a aforseid donee is greater, foregoing adjustments hereunder, than the value of the membership interests in the Company indicated on this Deed of Gift, the donee is obligated to donee repays to the taxpayer the amount of each excess			

	distributions received by donee plus interest from the date of the distribution at the applicable federal rate then in effect for the period of time between the date of the overpayment and the date of repayment, with such interest being payable from the date of the distribution until repaid. The reciprocal shall apply if the value of membership interests is less than indictated in the Deed of Gift (and as above described).			
2	Jessica Player, Grandchild 88 Rutgers Rd. Santa Rosa, CA 83456 Gift of a 10% limited partnership interest in the Taylor Family Limited Partnership (EIN 888-77-3456) Date of Gift: May 1, 2015. See Attachment A-2-2 for a copy of the Agreement of Limited Partnership dated June 8, 2010, and the Appraisal by Higgins Appraisal dated August 1, 2015, of the fair market value of the gifted interest.	$800,000	5/1/2015	$500,000
3	Jessica Player, Grandchild See identification information above Gift of $50,000 in cash to the separate share under the Crummey Trust (TIN: 12-1256777), to which Michael Smith, whose address is 5321 Pine Street, Chico, CA , is the trustee. A copy of said trust is attached at Attachment A-2-3, together with a copy of the Crummey Notice to the donee.[2]	$50,000	6/1/2015	$ 50,000
4	Danelle Player, Grandchild, 321 Half Dome Rd. Alamo, Ca 94509. Gift of $10,000 cash to the Taylor Irrevocable Life Insurance Trust. (TIN 21-1234568) to which the Trustee is George Jones,	$10,000	7/1/2015	$ 10,000

[2] *NOTE TO CLASS: This gift is a nontaxable annual exclusion gift because the annual exclusion was presumably used on the Jessica on May 1, 2015, gift to Jessica. Therefore, the gift is not a non-taxable transfer even though the gift is a vested gift under §2642(c). (This gift is vested even though there is no general power of appointment because there is estate tax inclusion if the beneficiary dies during the term of the trust).* Application of annual exclusion for the gift of the limited partnership interest in May, 2015 might be challenged by the IRS if the limited partnership agreement includes excessive “strings.” Giving the Crummey notice on the June 1, 2015 gift provides back-up for an annual exclusion gift if that prior one did not qualify for that treatment. In that instance, $14,000 of the June 1, 2015 gift would be a non-taxable gift for GST purposes.

[3] *NOTE TO CLASS: This gift is not within the nontaxable annual exclusion rule for GST purposes, per Code §2642(c) because the skip beneficiary’s share is not a vested share (i.e., no general power of appointment or estate tax inclusion if the skip beneficiary dies during the term of the trust).*

	whose address is XXX, Newport Beach, CA. 98765. [3] See Attachment A-2-4 for a copy of the Trust and Crummey Notice.			
5	Suzie N. Smith, of 77 Bimbo Blvd, San Diego, CA. 80000, friend. Gift of cash.	$14,000	10/1/2015	$ 14,000
6	Gift of $70,000 to the California TIAA-CREF 529 plan. The beneficiary is Julie Jordan, a grandchild, whose address is 85 Carousel Place, Hamerstein, Maine, 98645. The 529 election indicated on Schedule A to this return is made with respect to the entire gift, so that $14,000 is applied as annual exclusion treatment for the year of the gift and each of the next four years.	$14,000	12/21/2015	$ 14,000
	Total Gifts Schedule A, Part 2			**$3,088,000**

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Form 709
Taxpayer: Jordan Dean Taylor
Year: 2015
Attachment A-3

Item	Description	Adjusted Basis	Date of Gift	Value of Gift
1	City National Bank, Trustee of the Kenneth Dean Taylor Irrevocable Trust dated February 1, 2015, for the benefit of Kenneth Taylor, a child of the taxpayer. A copy of said trust is attached hereto as Attachment A-3-1-1. On February 1, 2015, the taxpayer made a cash gift of $900,000 to the trustee. The address of the Trustee is 1234 Roxbury, Beverly Hills, CA 83456 and the taxpayer identification number for the trust is the social security number of the taxpayer. The address of Kenneth Dean Taylor is 3214 Tiverton Ave., Danville, CA 85299. Attached as Attachment A-3-1-2 is a copy of the Crummey Withdrawal Notice issued by the Trustee and mailed to Kenneth Taylor on February 12, 2015. <u>NOTICE OF ELECTION OF GST TRUST STATUS WITH AUTOMATIC ALLOCATION OF GST EXEMPTION</u>: In accordance with IRC §2632 and Reg. §26.2632(b)(3)(ii), the taxpayer elects to have the automatic GST exemption allocation rule apply to the foregoing trust and to make the election to declare such trust a GST trust. GST Trust status with respect to the foregoing trust shall apply to the above-described transfer and to all subsequent transfers made to this trust until such time that an effective termination of this election is filed. Accordingly, the taxpayer elects to have the foregoing treated as a GST trust under IRC §2632(c) with respect to the covered transfers. Available GST exemption is allocated to this gift in the sum of $900,000. In the event, however that a different amount of GST exemption is required to achieve a zero inclusion ratio, then GST exemption is allocated to the minimum extent necessary to achieve a zero inclusion ratio. In view of the fact that the annual exclusion amount subject to the foregoing Crummey withdrawal notice is less than 5% the value of the Kenneth Taylor Irrevocable Trust, the taxpayer is the sole transferor to said trust.	$900,000	2/1/2015	$900,000

1A	Adequate Disclosure of a Non-Gift Completed Transfer or Transactions under Reg. Sec. § 301.6501(c)-1 (f)(4): The disclosures, and each of them referenced in the foregoing item 1 to this Appendix A-3 are incorporated in full herein together with the exhibits therein referenced and attached are incorporated in full in this item 1A. On February 22, 2015, Trustee purchased a 30% membership interest in ABC, LLC, a Nevada Limited Liability Company, from the taxpayer for $8.9 million. The terms of payment were $900,000 down payment and a promissory note secured by the 30% interest in ABC, LLC. Attached hereto are the following documents with respect to the purchase and sale: The foregoing purchase and sale was not a gift since the consideration received by the taxpayer full and equal in money or money's worth to the value of the property transferred. Reg. §25.2511-1(g)(1); The statements with respect to this purchase and sale and the exhibits and information identified in this description or attached hereto are for the purpose of providing adequate disclosure of a non-gift completed transfers or transactions under Reg. Sec. § 301.6501(c)-1 (f)(4). In addition to the foregoing, the following additional statements and attachments are part of this adequate disclosure: 1. The Operating Agreement of ABC, LLC dated April 25, 2000 and the First Amendment dated August 7, 2001. See Attachment A-3-1A-1 2. The Appraisal dated May 3, 2015 as of February 22, 2015, conducted by FV Appraisal, with respect to the 30% membership interest in ABC, LLC is attached as Attachment A-3-1A-2. The EIN of ABC, LLC is 95-3451212. Said appraisal includes in addition among its content the fair market value of the 4% limited partnership interest in XYZ Limited Partners, a California limited partnership, EIN 94-5673456. The valuation of XYZ Limited Partners includes both the 100% entity interest and the 4% limited partnership interest owned by ABC, LLC. 3. Attached as Attachment A-3-1A-3 is a copy of the promissory note in the sum $8 million, and as to which promissory note payment is guaranteed on the face thereof by Kenneth Taylor. The promissory note is at the mid-term applicable federal rate, due and payable in full on January 1,	$2,250,000	02/22/2015	No gift.

	2024, with the other terms and conditions therein stated. . 4. Attached as Attachment A-1A-4 is a copy of the Assignment of Membership Interest with respect to the purchase and sale of the 30% membership interest in ABC, LLC. 5. Attached as Attachment A-3-1A-5 is a copy of the Security Agreement dated February 22, 2015, collateralizing the aforesaid promissory note 6. Attached as Attachment A-3-1A-6 is a copy of the UCC Financing Statement dated February 22, 2015, which was filed with the California Secretary of State on March 10, 2015, as indicated on said exhibit. Because there was no gift with respect to this purchase and sale, no generation-skipping transfer (GST) tax exemption is being allocated to this transfer. GST exemption has been allocated to the gift reported in Appendix A-3, item 1 disclosed above. In the event that the non-gift transaction referenced in this item 1-A of Attachment A-3 did result in a gift, then GST exemption available is allocated to the minimum extent available to achieve a zero inclusion ratio.			
2	Andrea Pandrea, a child, 75894 Runway Lane El Segundo, CA 89456 Gift under Crummey Trust #2, a copy of which is attached hereto as Attachment A-3-2. The Trustee is Troy Taylor, 99 Beer Ct., Boulder, CO. 90923. A copy of the Crummey notice is also attached with Attachment A-3-2 <u>NOTICE OF ELECTION OF GST TRUST STATUS WITH AUTOMATIC ALLOCATION OF GST EXEMPTION</u>: In accordance with IRC §2632 and Reg. §26.2632(b)(3)(ii), the taxpayer elects to have the automatic GST exemption allocation rule apply to the foregoing trust and to make the election to declare such trust a GST trust. GST Trust status with respect to the foregoing trust shall apply to the above-described transfer and to all subsequent transfers made to this trust until such time that an effective termination of this election is filed. Accordingly, the taxpayer elects to have the foregoing treated as a GST trust under IRC §2632(c) with respect to the covered transfers.	$14,000	7/15/2015	$14,000

3	Gift of $60,000 cash to the Sprinkling Trust for the benefit of Barry, a child (who has been earlier identified) and Tiffany Taylor, a grandchild, whose address is 68 Beach Front Rd., Santa Monica, CA 95555. For gift tax purposes, each beneficiary's gift is separately listed. This is not, however, a separate share trust. The TIN for this trust is 92-1278777, and the trustee is Michael Smith, whose address is 5321 Pine Street, Chico, CA. A copy of the trust is attached at Attachment A-3-3. <u>NOTICE OF ELECTION OF GST TRUST STATUS WITH AUTOMATIC ALLOCATION OF GST EXEMPTION</u>: In accordance with IRC §2632 and Reg. §26.2632(b)(3)(ii), the taxpayer elects to have the automatic GST exemption allocation rule apply to the foregoing trust and to make the election to declare such trust a GST trust. GST Trust status with respect to the foregoing trust shall apply to the above-described transfer and to all subsequent transfers made to this trust until such time that an effective termination of this election is filed. Accordingly, the taxpayer elects to have the foregoing treated as a GST trust under IRC §2632(c) with respect to the covered transfers.	$60,000	8/1/2015	$60,000
4	Gift of $50,000 cash to the Health and Education Trust for the benefit of Charlie, a child, whose address is 10 Mott Lane, San Ramon, Ca 93874, and Ashley Taylor, a grandchild, of 505 Lakeland Village, South Lake Tahoe, CA 91313. The TIN for this trust is 92-1278777. The is Michael Smith, whose address is 5321 Pine Street, Chico, CA. A copy of the trust is attached at Attachment A-3-4. The trust allows for the sprinkling of benefits between or among the beneficiaries. <u>NOTICE OF ELECTION OUT OF AUTOMATIC ALLOCATION OF GST EXEMPTION</u>: In accordance with IRC §2632 and Reg. §26.2632(b)(2)(ii), the taxpayer elects to not have the automatic GST exemption allocation rule to either of these gifts. Accordingly, "pursuant to §2632(c)(5)(A) the transferor is electing to have the automatic allocation rules contained in §2632(c)(1) not apply to the described current transfer.	$50,000	9/1/2015	$50,000

5	Gift of $40,000 to Nick Morgan, of 406 Battery Lane, Boston, Ma 80456, under the GST Trust dated 11/1/2015. The Trustee is Michael Smith, whose address is 5321 Pine Street, Chico, CA. A copy of the trust is attached at Attachment A-3-5. <u>NOTICE OF ELECTION OUT OF AUTOMATIC ALLOCATION OF GST EXEMPTION</u>: In accordance with IRC §2632 and Reg. §26.2632(b)(2)(ii), the taxpayer elects to not have the automatic GST exemption allocation rule to this gift nor to any future gift that may be made to this trust. Accordingly, "pursuant to §2632(c)(5)(A) the transferor is electing to have the automatic allocation rules contained in §2632(c)(1) not apply to the described current transfer as well as all future transfers made by the transferor to the trust (or separate share)."	$40,000	11/1/2015	$40,000
6[4]	A gift of 10000 shares of Intel (CUSIP NO. Z45464) with a fair market value of $500,000 and a gift of 20,000 shares of Southwest Airlines (CUSIP FL875659) with a value of $500,000, or a total value of $1 million contributed by the taxpayer to GRAT #1 dated 12/1/2015. The TIN of the trust is the 95-3457887, though the trust is a grantor trust. Eleanor Riley, grandchild, is the remainder beneficiary of said trust. Her address is 30 Curry Lane, Davidson, North Carolina, 75015. Attached as Attachment A-6 is a copy of said GRAT. The donor's basis in the contributed assets is $400,000 for the Intel shares and $300,000 for the Southwest Airlines shares. Date of the Gift: December 1, 2015 Value of the GiftValue prior to GRAT: $1,000,000 The date of birth of the donor is April 23, 1939. The value of the remainder interest in the GRAT has been calculated in accordance with the requirements of Code §§2702 and 7520. The taxpayer calculated the value of the remainder interest using the NumberCruncher software program, which taxpayer is informed and believes and therein contents, has been updated to the change in mortality tables published by the IRS.	$700,000	12/1/2015	$1,003

[4] No GST exemption can be allocated as of yet tot this gift because of the retained interest of the taxpayer. The ETIP rules are in effect. Also, there would normally be two GRATS, one for each stock gifted so that a decline in value in one would not wipe out, or reduce the estate tax savings that the other assets gifted could generate.

	Property value $1,000,000 Retained term 3 years Times Payment Percentage 34.6405% Base Term/Life Annuity Factor 2.8839 Frequency Adjustment Factor 1.0000 Equals Annuity Payment $346,405 Equals Value of Return to Donor $998,997.38 Remainder (Gift) $1,002.62 Taxable Gift Value $1,003			
	Total gifts Schedule A, Part 3			**$1,065,003**

GST Exemption Allocation from Part 3 (See reconciliation below): $960,000

Summary of GST exemption being allocated from this Appendix A-3:

Date	Gift Value	GST Annual Exclusion	Opt Out	GST Exemption Allocated	Inclusion ratio
	$900,000	$14,000		$886,000	0
7/15/15	$ 14,000	$0	$0	$14,000	0
8/1/15	$ 60,000	$0	$0	$60,000	0
9/1/15	$ 50,000	$0	$50,000	$0	1.0
11/1/15	$ 40,000	$0	$40,000	$0	1.0
12/1/15	$ 1,003	$0		Estate Tax Inclusion Period	In suspense
Total	$1,065,003			$960,000	

Form 709
NOTICE OF ALLOCATION
Donor/Taxpayer: Jordan D. Taylor
Social Security Number: 555-66-7777
Year: 2015

I. **Protective Election with Respect to Each Transfer Reported in Schedule A, Part 2 and Part 3 of this Return**

The taxpayer elects as to each transfer reported in Schedule A, Part 2, the minimum amount of GST exemption necessary to achieve a zero inclusion ratio. As indicated in Schedule D, Parts 1 and 3, a total of $3,322,000 of GST exemption is being allocated to these transfers. In the event that excessive GST exemption has been allocated in the past or as a result of this return to any such gift or trust, or any part thereof, than is necessary to achieve a zero inclusion ratio, then in accordance with the Regulations, all prior and current GST exemption allocations shall be adjusted downward to achieve the minimum allocation necessary to result in a zero inclusion ratio.

With respect to Schedule A, Part 3, and except in those instances in which the taxpayer has elected that GST exemption not apply to a transfer and/or trust, the taxpayer elects to have the minimum amount of GST exemption apply as may be necessary to achieve a zero inclusion ratio.

II. **Late Allocation to Taylor Non-Skip Trust**

1. Taxpayer made a gift of $20,000 on January 1, 1993, to the Taylor Non-Skip Trust, a copy of which is attached hereto ("Non-Skip Trust"). The names, addresses and social security numbers of the beneficiaries of said trust are as follows: Dana Rocks, a daughter, whose address is 862 North Ave., Santa Ana, Texas, and Louis Richards, a cousin, whose address is 99 Jump Street, Universal, Nevada 38445. The taxpayer identification number of the Non-Skip Trust is 99-5544354. The name and address of the Trustee of the Trust are Cepia Ace, 77 Sunset Strip, Los Angeles, CA.

2. The taxpayer elects to allocate to the Non-Skip Trust the smallest amount of the taxpayer's GST exemption necessary to achieve a zero inclusion ratio under IRC §2642(a), or if that zero inclusion ratio cannot be obtained, then the election is made so as to produce the lowest inclusion ratio that is possible. In the event of any change in the values, method of determination, or other factors that may affect the GST exemption and/or the inclusion ratio, the allocation is hereby adjusted to achieve a zero inclusion ratio (or if that is not possible the lowest inclusion ratio that is closest to zero). This is a formula election, which shall be adjusted in the event of any audit changes or other factors that would alter the values necessary to establish the zero inclusion ratio. In accordance with Reg. §26.2642-a(a)(2), the taxpayer elects to have the GST exemption allocation made effective as of the first day of the month on which this election is made, to wit, on April 1, 2015. No part of this gift was an annual exclusion gift for gift tax purposes.

   As of April 1, 2015, the Non-Skip Trust had a value of $45,000. This value consists of brokerage account number KW-384957843 at City National Bank. A copy of the account statement is attached hereto. Based on values as returned this allocation will result in $45,000 of GST exemption allocated to this trust and an inclusion ratio of zero (0).

3. In the event that excessive GST exemption has been allocated in the past or as a result of this Notice to any gift or to the Non-Skip Trust, or any part thereof, than is necessary to achieve a zero inclusion ratio, then in accordance with the Regulations all prior GST exemption allocations shall be adjusted downward to achieve the minimum allocation necessary to result in a zero inclusion ratio.

GST Exemption Allocation (Entered on Schedule D, part 2, line 6) $45,000

III. Late Allocation of GST Exemption to the Non-Skip Trust (REV. PROC. 2004-46) **FILED PURSUANT TO REV. PROC. 2004-46**

1. Taxpayer made a gift of $10,000 on January 1, 1994, to the Taylor Non-Skip Trust, a copy of which is attached hereto ("Non-Skip Trust"), which gift for gift tax purposes was an annual exclusion gift. The names, addresses and social security numbers of the beneficiaries of said trust are identified in section II of this notice. The taxpayer identification number of the Non-Skip Trust is 99-5544354. The name and address of the Trustee of the Trust are Cepia Ace, 77 Sunset Strip, Los Angeles, CA.

2. In lieu of the normal rules that would apply to the late allocation of a gift, or the taxpayer seeking relief under Reg. Sec. 3001.9100-3, the taxpayer requests relief from the late allocation of GST exemption rule and be allowed to allocate GST exemption as though exemption was currently and timely allocated to this gift with respect to the year in which the gift was made, and that this relief be granted under Rev. Proc. 2004-46.

   The inclusion ratio of the trust after the allocation of GST exemption is zero (0).

   See, Schedule D for the amount of the taxpayer's unused GST exemption.

   All requirements of Section 3.01 of Rev. Proc. 2004-46 have been met.

   As of the time of filing this request for relief under Rev. Proc. 2004-46 there have been not taxable distributions and no taxable terminations.

   No GST exemption has been previously allocated to this transfer

   The transfer qualified for the annual exclusion under Section 2503(b), and the amount of the transfer, when added to the value of all other gifts by the transferor to that donee in the same year, was equal to or less than the amount of the applicable annual exclusion for the year of transfer.

   As of April 1, 2015, the Non-Skip Trust had a value of $25,000. This value consists of brokerage account number IH-86756 at Mechanics Bank. A copy of the account statement is attached hereto. Based on values as returned and in accordance with the relief allowable under Rev. Proc. 2004-46, this allocation will result in $10,000 of GST exemption being allocated to this gift, and this gift and an inclusion ratio of zero (0).

3. In the event that excessive GST exemption has been allocated in the past or as a result of this Notice to any gift or to the Non-Skip Trust, or any part thereof, than is necessary to achieve a zero inclusion ratio, then in accordance with the Regulations all prior GST exemption allocations shall be adjusted downward to achieve the minimum allocation necessary to result in a zero inclusion ratio.

4. In any event, the taxpayer elects to allocate to the Non-Skip Trust the smallest amount of the taxpayer's GST exemption necessary to achieve a zero inclusion ratio under IRC §2642(a), or if that zero inclusion ratio cannot be obtained, then the election is made so as to produce the lowest inclusion ratio that is possible. In the event of any change in the values, method of determination, or other factors that may affect the GST exemption and/or the inclusion ratio, the allocation is hereby adjusted to achieve a zero inclusion ratio (or if that is not possible the lowest inclusion ratio that is closest to zero). This is a formula election, which shall be adjusted in the event of any audit changes or other factors that would alter the values necessary to establish the zero inclusion ratio.

GST Exemption Allocation (Entered on Schedule D, part 2, line 6 $10,000)

IV. ELECTION OUT OF GST TRUST STATUS

The taxpayer established the Goofy Trust on April 1, 2001, which trust the taxpayer elected to be treated as and deemed to be a GST Trust under Code §2632. Said election was made on the 2002 gift tax return of the taxpayer. The Trustee of the Goofy Trust is Amarosa Sybil, whose address is 3 Nutty Lane, Hollywood, CA 80796. The taxpayer identification number for the trust is 99-4583214. In accordance with Regulation §26.2632-1(b)(3)(ii), the taxpayer states that no current transfer has been made to this trust. The taxpayer further provides that the prior election to treat this trust as a GST trust as provided under §26.2632-1(b)(3)(i) is terminated.

V. RETROACTIVE ALLOCATION OF GST EXEMPTION

A retroactive allocation of GST exemption is hereby made in accordance with IRC §2632(d) with respect to the Herman Monster Trust dated December 6, 1991, established by the taxpayer for the benefit of his son, Herman Monster. Herman died on May 8, 2015, a copy of his death certificate of which is attached. As a result of his having predeceased the transferor on a death that occurred after December 30, 2000, a retroactive allocation is made to the minimum extent necessary to achieve a zero inclusion ratio for this trust.

The following are further particulars with respect the gift, the trustee and this trust:

Gift of $70,000 to Winston Coventry, of 77 Mel Brooks Drive, Revengeville, CA 88908, under the Trust dated December 6, 1991, for the benefit of Herman Monster, son. Herman died on May 8, 2015, survived by the transferor taxpayer, when the trust had a value of $500,000. That $500,000 value consisted of cash in the sum of $60,000 at City National Bank, Account Number 567889, $40,000 at Wells Fargo Bank, Beverly Hills, CA, and $400,000 of common stock in Levi Strauss (CUSIP 181818). In view of the unnatural	$70,000	5/8/15	**$70,000**

order of death the allocation of $70,000 is made to fully exempt
this transfer under IRC §2632(d) whereby the value of
the transfer is determined as of the date of the transfer
with the allocation effective immediately prior to the
death of the non-skip beneficiary. On December 6, 1991,
the transferor gifted $70,000 in cash to the trust.

GST Exemption Allocation (Entered on Schedule D, part 2, line 6) $125,000
See, Items II, III and V above referenced

Note: The foregoing are forms. Adapt any form to the particular client's case. This form is not drafted with any particular case in mind nor for a particular client. This limitation applies to all forms in this text, whether stated in the form or not. Also, the author recommends that you have a Table of Contents as a part of each return when several documents or exhibits are to be attached.

All references in this return are to fictional people. Any resemblance to a real person, living or dead is coincidental.