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Gift Tax Nightmares

Here are five of the most common and sometimes fatal errors

Think back to a time long, long ago, before the adequate disclosure rules of 1997, before the changes in the generation-skipping transfer (GST) tax deemed allocation rules of 2001. It was a simpler time. At tax preparation firms all across the country, veteran tax preparers looked for simple projects to assign to new staff. The gift tax return was an obvious choice: an innocuous four-page return whose calculations weren't critical, because tax was very rarely due. The fee for preparing the return was negligible and often thrown in with the client's individual return, as a courtesy.

Those days are most definitely over. Tax preparers and planners everywhere, if you're not already acutely aware, now is the time to wake up to the formidable gift tax return challenges—before they become nightmares.

After reviewing hundreds of complex gift tax returns and cleaning up countless issues brought on by improperly prepared returns or poorly planned gifts, I'm compelled to warn fellow practitioners about five potentially fatal issues I see, starting with the most obscure (therefore least likely to be spotted even by experts) and working my way toward the more common: (1) the un-splittable gift; (2) the over-allowance of the GST tax annual exclusion; (3) the chronology problem; (4) an inadvertent deemed allocation of GST tax exemption; and (5) inadequate disclosure.

I offer remedies where remedies are possible and preparation pointers that can help avoid impossible situations. This discussion is meant to aid preparers and planners alike because while some issues can be dealt with during the return preparation process, others can be prevented or at least mitigated with some forethought by planners and attorneys.

• **The un-splittable gift**—Your client executes a trust for the benefit of his wife and descendants. The trust gives a \$5,000 withdrawal right to his wife and withdrawal rights up to the annual exclusion amount (or twice that amount if gift splitting is elected) to each of their two children. Neither the husband nor his wife has ever done any gifting before and this trust is intended to be the premier trust in their estate plan. Thus, the husband and his planners decide that the husband will fund it with the maximum value possible without incurring gift tax, assuming the husband and wife consent to gift splitting. The couple also decides to allocate GST tax exemption to the trust, because they expect at least some of the assets to go to their grandchildren and foresee no better use for their exemption. The husband makes a \$2.053 million gift to the trust.¹

Then, disaster: on or around April 10 of the following year, to everyone's horror, the husband finds himself writing a check to the government for \$445,800.

How did this happen?

Internal Revenue Code Section 2513(a)(1) provides that, for gift tax purposes, a gift made by one spouse to any person other than his spouse will be considered made one-half by each spouse provided that each spouse elects gift splitting and provided certain conditions are met.² Moreover, the donor cannot split a gift made to his spouse.



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Furthermore, Treasury Regulations Section 25.2513-1(b)(4) tells us that if a donor transfers property in part to his spouse and in part to third parties, the interest transferred to third parties can be split only to the extent it is ascertainable at the time of the gift and severable from the interest transferred to his spouse. Case law has extended this regulation to allow that if the spouse's interest is ascertainable, the transfer to third parties will be deemed ascertainable.³

In our example, the planners find the terms of the trust give the trustee unlimited discretion to sprinkle income and principal among the spouse and descendants, and this sprinkle power is not limited by an ascertainable standard. There is no mention in the document that distributions are to be made for health, education, maintenance and support⁴ and no guidance is given to the trustee in making distributions. Thus, the amount of the gift to the wife is unascertainable and not severable from the gift to the descendants. The unintended result is that the entire gift, after annual exclusions,⁵ is un-splittable.⁶

If the trust document limited the spouse's interest to an ascertainable standard, only the wife's portion would have been un-splittable. This would have been a much more favorable outcome, particularly if a case could have been made that the spouse's interest was negligible.

For instance, if the client has a large estate and it could be established that in all likelihood the spouse would have adequate assets outside the trust to maintain her standard of living, the potential for distributions to the spouse would indeed be negligible. Other factors such as life expectancies and the stability of the marriage may need to be considered, as well.⁷

But what if the spouse's interest is not negligible? How is her portion valued? Only an actuary knows for sure.

You may be thinking, "So what if the wife's portion is un-splittable? It is a gift from a husband to a wife, so it must qualify for the marital deduction."

Not so. When we look back to the trust document, we see that the wife's interest terminates at her death. This is a disqualified terminable interest that does not qualify for the marital deduction.⁸

It is fairly common for a spouse to be given an interest in a family trust. It usually begins with the client saying to his attorney, "I want my wife to have an interest in the trust, just in case." Unfortunately, without careful drafting and forethought, that interest could result in a sizable, unexpected tax bite.⁹ Had the

issue been uncovered before the gift was made, the trust could have been reformed and at the very least a portion of the gift could have been split.

And what happens with respect to the GST tax exemption that the client wanted to allocate to the gift? Given that for gift tax purposes the amount of the gift in excess of the allowable annual exclusions is un-splittable, how will GST tax exemption be allocated?

Based on Treas. Regs. Sections 26.2652-1(a)(4) and 26.2652-1(a)(5) Example 9, it would be allocated equally on each spouse's return.¹⁰ Thus, the allocation would be \$1,026,500 on the husband's return and \$1,026,500 on the wife's return. This incongruous result may be surprising to some preparers, particularly those who like to believe there is more symmetry between the gift and GST tax rules than there really is, which leads us to our next nightmare that illustrates another situation in

Some preparers believe there is more symmetry between gift and GST tax rules than there really is—and this leads to nightmares.

which there is incongruence between the gift and GST tax rules.

• **Over-allowance of the GST tax annual exclusion—**Your widowed client makes a \$60,000 gift to a trust for the benefit of his five grandchildren. The trust gives each grandchild a withdrawal power for his pro rata share of the gift. The assets go into a pool from which the trustee has the discretion to make distributions to any of the five grandchildren. Your client has done quite a bit of gifting in the past and previously used his entire exemption equivalent and GST tax exemption. The gift tax return is prepared showing tax due of \$39,150. The client calls you and says there must be a mistake. He was under the impression there would be no tax due because the gift would qualify for the annual exclusion.

Is there a mistake?

Whenever I begin the GST tax portion of a training program on gift tax return preparation, I always say: "The generation-skipping transfer tax is a whole 'nother tax." The problem is, there are so many similarities between the gift and GST tax rules that people tend

to think all the same rules apply to both. A common misconception is that if a gift qualifies for the gift tax annual exclusion it also must qualify for the GST tax annual exclusion. And in many circumstances, it does.¹¹ But not always. The key is that the GST tax annual exclusion is available for transfers to only certain trusts.

By way of background, for gift tax purposes an annual exclusion of up to \$12,000 (in 2008) per donor per donee for present interest gifts is allowed.¹² To qualify as a present interest the donee must have an unrestricted right to the immediate use, possession or enjoyment of the property or the income from it.¹³ For outright transfers of cash or securities, generally, the present interest requirement is met. Gifts to trusts, on the other hand, are generally considered a future interest unless terms of the trust create a present interest.¹⁴

If it's determined that a gift to a trust qualifies for the gift tax annual exclusion, the next step is to decide if it also qualifies for the GST tax annual exclusion. The GST tax annual exclusion applies to transfers to a trust only if the trust is qualified under IRC Section 2642(c)(2). There are two requirements for a trust to qualify under Section 2642(c)(2):

- (1) The trust must be for the current benefit of one skip person¹⁵ only (or a trust that creates substantially separate shares from its onset for only skip people), and
- (2) If the trust does not terminate before the skip person dies, the assets must be includible in the skip person's gross estate.¹⁶

In our example, the return was prepared correctly. Unfortunately, the gift did not qualify for the GST tax annual exclusion because the assets went into a pool for the benefit of multiple skip people. Thus, the trust was not a qualified trust under IRC Section 2642(c)(2).

Even more unfortunately, the client was in the top marginal bracket for gift tax purposes and he had used all his GST tax exemption previously. Thus, he owed GST tax of \$27,000 on the \$60,000 (45 percent of \$60,000) plus gift tax of \$12,150 on the \$27,000 of GST tax (45 percent of \$27,000) for a total tax due of \$39,150!

Admittedly, this is a worst case scenario. The client had no GST tax exemption left and he was in the highest marginal gift tax bracket. When a taxpayer has enough GST tax exemption remaining, the annual exclusion issue won't cause him to have to write a surprise check.

GST tax exemption simply will be allocated to the trust to shelter it from GST tax.

Regardless of whether tax is due or the exemption is available, it seems like qualifying for the GST tax annual exclusion is a worthwhile goal. Why, then, aren't all grandchildren's trusts routinely drafted to meet the qualifications of IRC Section 2642(c)(2)?

One reason may be that the requirements of IRC Section 2642(c)(2) force separate shares for each grandchild. Often, clients want to leave the assets in a pool for grandchildren in case some have greater needs than others. Another reason may be that the client wants to establish a dynasty trust to benefit generations beyond the grandchildren. If the latter is the case, the goal is to avoid transfer tax at each generation and not to invite it at the death of the grandchild, as would happen with a trust that qualifies under IRC Section 2642(c)(2). For these reasons, we routinely encounter trusts that qualify for the gift tax annual exclusion but not the GST tax annual exclusion.

Occasionally, we run across returns that for years erroneously allowed the GST tax annual exclusion. If the client has adequate GST tax exemption remaining, this problem can be remedied with a simple downward adjustment to the client's remaining GST transfer exemption on the current year return.¹⁷ If the client does not have enough GST tax exemption, the returns may have to be amended and interest and possible penalties may be assessed on the overdue gift and GST tax.

• **The chronology problem**—Your client makes a \$60,000 gift to a trust with the same terms as described in our previous example. But this client has not made any gifts in the past. The trust is an insurance trust with premiums due in March. The gift to the trust is made in January. The client also makes cash gifts of \$60,000: \$12,000 to each of his five grandchildren at Christmas time. The gift tax return shows taxable gifts of \$60,000 and \$120,000 of GST tax exemption being used. Now what? Why did the client have to use so much of his GST tax exemption? Why wasn't he able to take advantage of the GST tax annual exclusion¹⁸ on the outright gifts?

We already know that a gift must first qualify for the gift tax annual exclusion before we can consider whether it qualifies for the GST tax annual exclusion. More to the point, the gift cannot simply be eligible to qualify for the gift tax annual exclusion; it must be the actual gift to which the annual exclusion was applied in any given year. Also, we cannot arbitrarily select the gift to which we would like it to apply. Treas. Regs.

Section 25.2503-2(a) says the gift tax annual exclusion is applied to the first \$10,000 (\$12,000 for 2008) of gifts. Thus, the gift tax annual exclusion is applied to the first gift of the year which, in our example, happens to be the gift to the trust. We already know that the gift to the trust does not qualify for the GST tax annual exclusion, so \$60,000 of GST tax exemption is allocated automatically to the trust on the return. Because the gift tax annual exclusion is used up on the trust gift, it's not available for the outright gift in December. The outright gift doesn't qualify for the gift tax annual exclusion, so it won't qualify for the GST tax annual exclusion either. Therefore, \$60,000 must be allocated to the outright December gifts, as well!

This is actually a common issue, because trusts often are funded early in the year and many clients like to make outright gifts during the end-of-the-year holidays. The problem can be easily avoided by advising the client to make his outright gifts before gifting to the trust. But what if the client insists on making the outright gift at holiday time? If the trust document permits it, the donor could create a written statement at the time he makes the gift articulating that the beneficiary's withdrawal rights won't apply to that particular transfer, so the gift to the trust won't qualify for the gift tax annual exclusion. Thus, the gift tax annual exclusion and the GST tax annual exclusion will be preserved for the outright gifts at year end.

• **Inadvertent deemed allocation of GST tax exemption**—It is 2008. You are reviewing some documents sent by your client to help you prepare his 2007 individual tax return. You notice that among his 1099 and partnership K-1 forms is a copy of a trust document executed back in 1995. You call your client and ask him if he's ever made a gift to the trust and he tells you, "Of course." He has been making annual premium payments of \$50,000 on a policy owned by the trust since 1995. But not to worry, he assures you, the gifts are under the annual exclusion amount and the trustee has been sending out withdrawal notices.

Is your client correct in thinking there's nothing to worry about?

No.

Some of the worst gift tax return nightmares relate to the GST tax. Why? One reason of course is the complexity of GST tax rules. The second reason is the magnitude of the tax: a flat tax rate equal to the highest marginal gift tax rate in effect at the time of the gift (currently 45 percent) and the GST tax payable on the gift tax

return is itself a taxable gift. Yet another reason GST tax is problematic is the uncertainty regarding the dollar impact of missed or incorrect allocations. They could be negligible—or they could amount to millions.

GST tax is a tax on transfers to skip people. Generally, skip people are individuals who are two or more generations below that of the transferor if related to the transferor, or 37 $\frac{1}{2}$ years younger than the transferor if unrelated to the transferor.¹⁹ In the gift tax context, direct skips are transfers directly to skip people or to trusts for the benefit of only skip people. GST tax exemption is

GST tax is problematic because of the uncertainty regarding the dollar impact of missed or incorrect allocations.

allocated automatically to direct skips unless an election is made otherwise.²⁰ If a direct skip is made and GST tax exemption is not allocated, either because the taxpayer chooses not to or because the taxpayer has no exemption left, GST tax is due immediately.

In other words, direct skips are fairly easy to understand. It's the indirect skips that seem to create confusion. Indirect skips are transfers to trusts from which there is the potential for a distribution to, or a termination in favor of one or more non-skip people.²¹

There always have been a set of automatic allocation rules in which an allocation of GST tax exemption is deemed to occur even if the taxpayer does not expressly make an allocation on a gift tax return. Before the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) of 2001, GST tax exemption was not automatically allocated to indirect skips. Thus, practitioners were mainly concerned with missed allocations of GST tax exemption: situations in which GST tax exemption should have been allocated to a trust but for whatever reason, was not. In an effort to reduce the instances of missed allocations, Congress enacted EGTRRA, which expanded the automatic allocation. EGTRRA undoubtedly succeeded in reducing the number of missed allocations but it also created a new issue—inadvertent deemed allocations—in which GST tax exemption is squandered inadvertently on less-than-ideal transfers.

IRC Section 2632 causes an automatic deemed allocation of GST tax exemption to indirect skip transfers to a GST trust.²² A GST trust is defined as a trust that could have a generation-skipping transfer. That sounds simple

enough, but the section goes on to describe six exceptions. These exceptions are difficult to interpret and the terms of trusts often fail to fit squarely within the boundaries of an exception. If it's determined the automatic allocation rules do not create the desired result, Section 2632 provides that certain elections may be made. The taxpayer can "opt-in" which will cause a trust to be treated as a GST trust so that exemption is allocated, or the taxpayer can opt-out which will prevent an automatic allocation.²³

In the beginning, practitioners struggled to apply the exceptions to trust provisions to determine if there would be an automatic allocation. After a while, many practitioners decided the best approach was to simply make the appropriate election that would accomplish the desired outcome regardless of whether the situation warranted an election. Granted, some of the elections were essentially protective and not technically necessary; but it seemed wise to be safe rather than sorry. This approach works for timely filed gift tax returns. But what about the cases in which the returns are not filed timely and the automatic allocation rules already worked their magic or mischief?

Let's look at our example. Clearly, there is cause for concern. Transfers to the trust occurred both pre- and post-EGTRRA and no returns were ever filed. Thus, we have a number of possible troubling scenarios.

Let's assume the trust is a GST trust under the post-EGTRRA rules.²⁴ For the years 2001 through 2006, there would have been automatic deemed allocations of GST tax exemption. However for the pre-EGTRRA years, 1995 through 2000, there would have been no automatic allocation of GST tax exemption. An express allocation would have had to have been made with the filing of a gift tax return and the client said he never filed a gift tax return. Thus, the trust is only partially covered by GST tax exemption—which means that distributions from it to skip people will be partially subject to GST tax. It's unlikely the client wanted this result. He probably would have preferred the gift to be either 100 percent exempt or not at all.

Now, you must help remedy the situation. If the client decides he wants the trust to be fully exempt from GST tax, he has three options: He can (1) make a late allocation;²⁵ (2) request relief under Revenue Procedure 2004-46; or (3) request a private letter ruling under IRC Section 2642(g)(1).²⁶

The first choice, a late allocation, would be contraindicated if the property appreciated significantly, because the amount allocated would be based on the current

value of the trust.

The second choice, use of the revenue procedure, would be a good choice. It gives the taxpayer an extension of time to make on amended returns. It was specifically designed to provide a low cost alternative to a request for a PLR. However, it's only available under the following circumstances:

- (1) On or before Dec. 31, 2000, the taxpayer made or was deemed to have made a transfer by gift to a trust from which a GST may be made.
- (2) At the time the taxpayer files the request for relief under the revenue procedure, no taxable distributions have been made and no taxable terminations have occurred.
- (3) The transfer qualified for the annual exclusion under IRC Section 2503(b), and the amount of the

Revenue Procedure 2004-46

gives the taxpayer an extension of time to make timely allocations on amended returns—but only under limited circumstances.

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 the transfer.

- (4) No GST exemption was allocated to the transfer, whether or not a Form 709 was filed.
- (5) At the time the taxpayer files a request for relief under this revenue procedure, the taxpayer has unused GST exemption available to allocate to the transfer.
- (6) All procedural requirements²⁷ are satisfied.

Fortunately, the taxpayer in our example can rely on the revenue procedure for relief. If he couldn't, because, for instance, there had been a distribution from the trust, his advisor would have to evaluate whether a request for a PLR would be a cost-effective alternative.

Now let's assume again that the trust is a GST trust,

but the client did not want to allocate GST tax exemption. Perhaps he feels he has a better use for his exemption. In this circumstance, presumably, the only alternative to restore the \$300,000²⁸ of GST tax exemption is to request relief in a PLR, because there is no revenue procedure to remedy inadvertent deemed allocations. Had you been aware of this back in 2001, you could have prepared a 2001 gift tax return with an opt-out election for current and future transfers to the trust. Thus, GST tax exemption would not have been allocated automatically to the trust.

• **Inadequate disclosure**—From 1998 to 2003, your client made annual exclusion gifts of family limited partnership interests to his four children. With gift splitting, the gifts amounted to \$80,000 each year from 1998 to 2001 and \$88,000 from 2002 and 2003. Each year, you urged your client to get an appraisal of the partnership.

Each year, your client balked at paying for an appraisal for such small gifts. Instead, he asked you to just prepare the return showing a 40 percent discount on the gifts. It is now 2008 and your client gets a notice from the Internal Revenue Service that his and his wife's gift tax returns are being audited. When all is said and done, the client and his wife write checks to the IRS totaling \$55,800.²⁹

There must be some mistake, the client says. Those returns were filed more than three years ago. How could the IRS assess tax? Hasn't the statute of limitations closed?

Generally, the IRS has three years after a gift tax return is filed to assess tax or if the return is filed before the due date, the return is deemed filed on the due date.³⁰ The statute is extended to six years if the taxpayer omits from the total gifts made more than 25 percent of the amount of gifts stated in the return.³¹ However, the statute won't begin to run if a gift is not adequately disclosed.³²

The Taxpayer Relief Act of 1997 and the IRS Restructuring and Reform Act of 1998 amended IRC Section 2504(c) to provide that if a gift is adequately disclosed on a gift tax return and the time lapses for assessing the gift tax, the value of the gift made in the prior calendar year cannot be adjusted, regardless of whether a gift tax was assessed or paid for that calendar year period. In other words, taxpayers now have a safe harbor of sorts to get the statute of limitations on assessment running on gifts reported on gift tax returns. All that is needed is adequate disclosure to get the clock ticking on the statute. Before that, the clock started ticking only if gift tax was paid or assessed for the calendar period. So now, with disclosure, there can be closure, even on

annual exclusion gifts where no tax is paid for the calendar year. But this does create added responsibilities for preparers to make sure gifts are disclosed properly on the gift tax return.

Treas. Regs. Section 301.6501(c)-1(f) provides the specific requirements for adequate disclosure. There are four easy requirements and one hard one. The easy ones are:

- (1) A description of the transferred property and any consideration received by the transferor;
- (2) The identity of, and relationship between, the transferor and each transferee;
- (3) If the property is transferred in trust, the trust's tax identification number and a brief description of the terms of the trust, or in lieu of a brief description of the trust terms, a copy of the trust instrument; and
- (4) If a position is taken that is contrary to any proposed, temporary or final Treasury regulations or revenue rulings, a statement describing the position taken.

And for the hard one: you can attach either:

- (1) a qualified appraisal;³³ or
 - (2) a detailed description of the method used to determine the fair market value (FMV) of property transferred, including any financial data (for example, balance sheets, etc. with explanations of any adjustments) that were used in determining the value of the interest, any restrictions on the transferred property that were considered in determining the FMV of the property, and a description of any discounts, such as discounts for blockage, minority or fractional interests, and lack of marketability, claimed in valuing the property.
- With a transfer of an interest that's actively traded on an established exchange,³⁴ all of the requirements of this paragraph will be satisfied by a recitation of the exchange where the interest is listed, the CUSIP number of the security, and the mean between the highest and lowest quoted selling prices on the applicable valuation date.
- With the transfer of an interest in an entity (for example, a corporation or partnership) that is not actively traded, a description must be provided of any discount claimed in valuing the interests in the entity or any assets owned

by such entity. In addition, if the value of the entity or of the interests in the entity is properly determined based on the net value of the assets held by the entity, a statement must be provided regarding the FMV of 100 percent of the entity (determined without regard to any discounts in valuing the entity or any assets owned by the entity), the pro rata portion of the entity subject to the transfer, and the FMV of the transferred interest as reported on the return. If 100 percent of the value of the entity is not disclosed, the taxpayer bears the burden of demonstrating that the fair market value of the entity is properly determined by a method other than a method based on the net value of the assets held by the entity. If the entity that is the subject of the transfer owns an interest in another non-actively traded entity (either directly or through ownership of an entity), the information required in this paragraph (f) (2)(iv) must be provided for each entity if the information is relevant and material in determining the value of the interest.³⁵

Which would you rather do?

The disclosure requirements under the second choice require quite a bit of effort to compile and they look suspiciously close to an actual appraisal. Because most practitioners are not trained appraisers, they may be hesitant to attempt to comply with the requirements under the second choice.

In our example, there was no qualified appraisal and the statement regarding the method used to determine the FMV did not provide enough information. The IRS agent allowed a 25 percent discount and your client agreed, wanting to put the matter behind him. In this instance, the gifts were relatively small.

Had the gift been bigger, the cost of an appraisal would be more than justified—particularly for the closure it would bring once the statute expired. It's important that advisors and preparers make clients aware of the consequences of not getting a qualified appraisal.

A Serious Matter

Clearly, the "United States Gift (and Generation Skipping Transfer) Tax Return (Form 709)" is a return to be taken

seriously. In this environment of uncertainty regarding the fate of the estate tax, clients and advisors are thinking long and hard about gifts that generate gift tax. Full repeal, a lowering of the rate, or an increase in the gift tax exemption equivalent may cause serious regrets for those who have paid large amounts of gift tax recently. This is particularly true if the payment of the tax was unplanned.

Still, even if tax is not payable, the optimal use of gift and GST tax exclusions and exemptions is a valuable objective for clients and planners.

Thus, it's important to avoid surprise gift tax events and to be able to recognize potential gifting issues—so they don't become real nightmares for you and your clients. **TE**

Endnotes

1. His exemption equivalent of \$1 million, plus his wife's exemption equivalent of \$1 million, plus a \$5,000 withdrawal amount for his wife, plus the two children's withdrawal amounts of \$24,000 each.
2. Those conditions are: (1) both spouses are either U.S. citizens or residents at the time of the gift; (2) spouses are married at the time of the gift or if subsequently divorced, neither remarries prior to the end of the year; and (3) the donor spouse does not create a general power of appointment over the gift property in the consenting spouse.
3. The transfer to third parties is calculated by subtracting the value of the spouse's interest from the value of the gift, much like the method set forth in Treasury Regulations Section 25.2511-1(e), in which the value of a gift is determined by subtracting the value of the interest retained by the donor.
4. See Treas. Regs. Section 20.2041-1(c)(2) for the full definition of a power limited by an ascertainable standard.
5. See Private Letter Rulings 8044080, 8138102 and 200130030 and GCM 38005 (issued July 10, 1979). A gift subject to a withdrawal power should be treated as a gift to the power holder and not to the trust in which the spouse has a discretionary interest. Thus, the \$24,000 withdrawal right to each of the two children is splittable.
6. This is the same situation laid out in Revenue Ruling 56-439, 1956-2 C.B. 605, in which it was determined that the gift to the wife was not susceptible of determination and could not be severed from the gift to the other beneficiaries. Thus, gift splitting was not permitted.
7. Sands G. Falk, TC Memo 1965-22, PH TCM, para. 65022.
8. Internal Revenue Code Section 2523(b).
9. See two articles that expound on the topic of gift splitting: Diana S. C. Zeydel, "Gift-Splitting—A Boondoggle or a Bad Idea? A Comprehensive Look at the Rules," *Journal of Taxation*, June 2007; and Laura Peebles, "Gift Splitting Made Easy," *Trusts & Estates*, August 2004.
10. Most practitioners probably would come to this conclusion, but there is some controversy. It begins with what some perceive as a conflict between the IRC and the Treasury Regulations related to the interface between gift

splitting and generation-skipping transfer (GST) tax. IRC Section 2652(a)(2) says that if, as a result of gift splitting, one-half of a gift is treated as made by an individual and one-half of such gift is treated as made by the spouse of such individual, such gift shall be so treated for purposes of GST tax. Whereas, Treas. Regs. Sections 26.2652-1(a)(4) and 26.2652-1(a)(5), Example 9, tell us that for GST tax purposes, the spouse is treated as the transferor of one-half of the entire value of the property transferred, regardless of the interest the spouse is deemed to have transferred for gift tax purposes. So according to the regulations, when any portion of a gift is split for gift tax purposes, the entire gift is split for GST tax purposes. Additional controversy arises from conflicting conclusions in two PLRs issued in 2001 and 2002 within months of one another (PLRs 200213013 and 200218001). Clearly, PLRs cannot be used as precedent and because the language in the regulation is clear and more specific than the language in the IRC, the safest choice might be to follow the regulation, but it would be advisable to use a formula allocation on the gift tax returns in case someone at the Internal Revenue Service disagrees!

11. IRC Section 2642(c) provides that an outright direct-skip transfer or direct-skip transfer to a qualified trust has an inclusion ratio of zero if it's not treated as a taxable gift by reason of IRC Sections 2503(b) or 2503(e).
12. IRC Section 2503(b).
13. Treas. Regs. Section 25.2503-3(b).
14. There are generally three ways for a gift to a trust to rise to the level of a present interest. They are: (1) the terms of the trust give the beneficiary a withdrawal right, often referred to as a Crummey Power (Crummey, 22 AFTR 2d 6023, 397 F.2d 82, 68-2 USTC para. 12541 (CA-9, 1968)); (2) the trust is an IRC Section 2503(c) trust; or (3) the trust is a Section 2503(b) trust in which all the income must be paid to a single beneficiary and there are no other potential beneficiaries of income or principal from the trust during that particular tax year. (See Treas. Regs. Section 25.2503-3 pertaining to future interests.)
15. A "skip person" is defined in IRC Section 2613 as an individual two or more generations younger if a family member, or a non-family member who is more than 37 1/2 years younger or a trust if all beneficiaries with a current income or principal interest are skip people (that is to say, no distributions to non-skip people) or a trust if no person holds an interest in trust and at no time after the transfer may a distribution (including a distribution on termination) be made to a non-skip person or a less than 5 percent actuarial probability that a distribution would be made to a non-skip person.
16. The skip person must have a general power of appointment. A general power of appointment is a power which is exercisable in favor of the individual possessing the power, his estate, his creditors, or the creditors of his estate. IRC Section 2514(c).
17. In lieu of amending the prior returns, this approach would contemplate the attachment of a schedule to the current year return showing the corrected use of GST tax exemption.
18. IRC Section 2642(c)(2).
19. IRC Section 2613 defines a skip person (*see supra*, note 15) and IRC Section 2651 contains the rules for generational assignment.
20. IRC Section 2632(b)(1) describes the automatic allocation to direct skips and IRC Section 2632 (b)(3) allows for an election not to have the automatic allocation apply to a transfer.
21. IRC Section 2632(c)(3)(A) defines an indirect skip as any transfer other than a direct skip made to a GST trust.
22. "GST trust" is a defined term and not simply a trust the taxpayer set up to benefit his grandchildren and more remote descendants. IRC Section 2632(c)(3)(B) contains the definition and exceptions.
23. See IRC Section 2632(c)(5) for the elections associated with indirect skip transfers. They are commonly referred to as "opt-in" and "opt-out" elections. Opting in implies that you want GST tax exemption to be allocated and opting out will prevent allocation.
24. Hopefully, we can determine with adequate certainty that the trust doesn't fall into any of the exceptions under IRC Section 2632.
25. Treas. Regs. Section 26.2632-1 describes the allocation of GST tax exemption, including the rules related to a late allocation. A detailed discussion of late allocation is beyond the scope of this article.
26. See proposed Treas. Regs. Section 26.2642-7 for guidance on the circumstances under which relief may or may not be granted.
27. Section 4 of Revenue Procedure 2004-46 sets out the procedural requirements.
28. This amount of \$300,000 consists of \$50,000 per year from 2001 to 2006.
29. The amount of \$55,800 does not include interest and penalties that may be assessed.
30. IRC Section 6501(a) and (b).
31. IRC Section 6501(e)(2).
30. Or if a gift is not shown on the return or on a statement attached to the return, the statute will not run with respect to the gift. IRC Section 6501(c)(9).
33. See Treas. Regs. Section 301.6501(c)-1(f)(3) for the requirements of a qualified appraisal.
34. An established exchange includes the New York Stock Exchange, the American Stock Exchange, the NASDAQ National Market, or a regional exchange in which quotations are published on a daily basis, including recognized foreign exchanges
35. Treas. Regs. Section 301.6501(c)-1(f)(2)(iv).

