

exemption specifically to that trust when severance occurs.

This suggestion was rejected.

Generally, the adoption of this approach would effectively allow the allocation of GST exemption to specific distributions from a GST trust, rather than to the entire trust. This result would be contrary to the clear language of the statute. See, e.g., sections 2642(a)(1)(A) and (a)(2).

#### Division of a Single Trust Into Separate Trusts

Under § 26.2654-1(c) of the proposed regulations, a testamentary trust could be severed into several parts, provided the severance was commenced prior to the filing of the estate tax return.

Further, the new trusts created pursuant to the severance had to be identical to the old trusts. For example, a testamentary trust providing for income to spouse, remainder to be divided equally between child and grandchild could only be severed into two trusts both providing income to spouse with the remainder to be divided between child and grandchild. Finally, an inter vivos trust could not be severed unless it consisted of separate shares, or different transferors had contributed to the trust.

The regulation has been clarified to specify that the division of a single trust that is included in the transferor's gross estate will be recognized if either: (1) The single trust consists of separate shares and is thus, treated as separate trusts; or (2) the single trust, although not consisting of separate shares, is severed into separate trusts pursuant to a direction in the governing instrument providing that the trust is to be divided into separate trusts on the transferor's death; or (3) the governing instrument does not require or direct severance but the trust is severed pursuant to the discretionary authority of the trustee granted under the governing instrument or local law.

The final regulations provide that the trusts resulting from the severance of a single testamentary trust need not be identical. Thus, if the trust provides income to spouse, remainder to child and grandchild, the trust may be severed to create two trusts, one with income to spouse, remainder to child and a second with income to spouse remainder to grandchild. This result could be achieved through proper estate planning in any event. However, the regulations make it clear that the resulting trusts must provide for the same succession of interests as provided for under the original trusts. Thus, a trust providing for an income interest to a child, with remainder to a grandchild,

could not be divided into one trust for the child (equal in value to the child's income interest) and another for the grandchild.

The proposed regulations provided that the new trusts must be funded with a fractional share of each and every asset held by the original single trust. The provision has been revised to provide that the new trusts may also be funded on a nonpro rata basis, based on the fair market value of the assets selected on the date of severance. Thus, the executor or trustee may select the assets with which to fund each trust, and need not fractionalize each asset.

An example has been added to illustrate that, if a revocable trust included in the transferor's gross estate is, under the terms of the trust, divided into multiple trusts on the transferor's death, then each trust established will be treated as a separate trust for GST purposes.

#### Due Date of Return

New § 26.2662-1(d)(2) has been added to provide that the due date of the return with respect to a taxable termination subject to an election under section 2624(c) (relating to alternate valuation in accordance with section 2032) is April 15th of the following year in which the taxable termination occurred or on or before the 15th day of the tenth month following the month in which the death that resulted in the taxable termination occurred, whichever is later.

#### Application of Chapter 13 to Nonresident Aliens

Section 2663(2) requires that the Commissioner prescribe regulations, consistent with the provisions of chapters 11 and 12, providing for the application of the GST tax to a nonresident alien (NRA). In general, under § 26.2663-2(b) as proposed, the GST tax applied to inter vivos and testamentary direct skip transfers by a NRA, to the extent that the transferred property was U.S. situs property such that the transfer was subject to a gift tax (in the case of inter vivos transfers) or an estate tax (in the case of testamentary transfers). Similarly, in the case of transfers in trust, chapter 13 applied to taxable terminations and distributions to the extent the initial transfer to the trust (whether inter vivos or testamentary) consisted of U.S. situs property, such that the initial transfer was subject to the gift or estate tax. This was the case regardless of the situs of the property at the time of the actual distribution or termination and regardless of the residency or

citizenship of the skip person receiving the beneficial interest or property.

Under § 26.2663-2(c) as proposed, if the property involved in a generation-skipping transfer was not situated in the U.S. at the time of the initial transfer, the generation-skipping transfer was still subject to the GST tax if: (1) At the time of the direct skip, taxable termination or distribution, the property passes to a skip person who is a U.S. resident or citizen; and (2) at the time of the initial transfer to the skip person or trust, a lineal descendant of the transferor, who is a lineal ancestor of the skip person, was a resident or citizen of the U.S. This rule applied regardless of the situs of the property at the time of the actual distribution or termination. Section 26.2663-2(f) of the proposed regulations provided for the automatic allocation of a NRA's \$1,000,000 GST exemption regardless of whether the transfer was a direct skip.

Thus, the proposed regulations subjected non-U.S. situs property to the GST tax based on the status of the skip person/recipient of the property at the time the property was received, and the status of the generation that was skipped at the time of the initial transfer to the trust or skip person.

Many comments were critical of this approach. In general, these comments emphasized that the estate and gift tax provisions subject transfers by NRAs to transfer tax based on the situs of the property, not the status of the recipient. Therefore, the proposed regulations conflict with section 2663, which provides that the regulations should be consistent with the principles of chapters 11 and 12 of the Internal Revenue Code (Code). Further, the commentators argued that treating a NRA who transfers non-U.S. situs property as a transferor for GST tax purposes would conflict with the definition of *transferor* under section 2652, since the transfer would not be subject to estate or gift tax. Under section 2652, an individual is a transferor only to the extent the transfer is subject to U.S. gift tax or estate tax.

The proposed regulations have been revised to address these concerns. Thus, the rules in the proposed regulations applying chapter 13 to transfers of property that were not subject to estate or gift tax have been eliminated. Under the final regulations, the application of the GST tax will be limited to situations where an estate or gift tax is imposed on the property. Thus, the GST tax will apply to inter vivos and testamentary direct skip transfers by a NRA transferor to the extent a gift tax is imposed on the transfer (in the case of an inter vivos transfer) or the transferred property is