

subject to chapter 13 is the product of the allocation fraction and the value of the trust (to the extent of the terminated interest therein). In the case of a distribution described in section 2612(b) from a trust, the portion of such distribution that is subject to chapter 13 is the product of the allocation fraction and the value of the property distributed.

(C) *Allocation fraction*—(1) *In general.* The allocation fraction allocates appreciation and accumulated income between the chapter 13 and non-chapter 13 portions of a trust. The numerator of the allocation fraction is the amount of the addition (valued as of the date the addition is made), determined without regard to whether any part of the transfer is subject to tax under chapter 11 or chapter 12, but reduced by the amount of any Federal or state estate or gift tax imposed and subsequently paid by the recipient trust with respect to the addition. The denominator of the allocation fraction is the total value of the entire trust immediately after the addition. For purposes of this paragraph

(b)(1)(iv)(C), the total value of the entire trust is the fair market value of the property held in trust (determined under the rules of section 2031), reduced by any amount attributable to or paid by the trust and attributable to the transfer to the trust that is similar to an amount that would be allowable as a deduction under section 2053 if the addition had occurred at the death of the transferor, and further reduced by the same amount that the numerator was reduced to reflect Federal or state estate or gift tax incurred by and subsequently paid by the recipient trust with respect to the addition. Where there is more than one addition to principal after September 25, 1985, the portion of the trust subject to chapter 13 after each such addition is determined pursuant to a revised fraction. In each case, the numerator of the revised fraction is the sum of the value of the chapter 13 portion of the trust immediately before the latest addition, and the amount of the latest addition. The denominator of the revised fraction is the total value of the entire trust

immediately after the addition. If the transfer to the trust is a generation-skipping transfer, the numerator and denominator are reduced by the amount of the generation-skipping transfer tax, if any, that is imposed by chapter 13 on the transfer and actually recovered from the trust. The allocation fraction is rounded off to five decimal places (.00001).

(2) *Examples.* The following examples illustrate the application of paragraph (b)(1)(iv) of this section. In each of the examples, assume that the recipient trust does not pay any Federal or state transfer tax by reason of the addition.

Example 1. Post September 25, 1985, addition to trust. (i) On August 16, 1980, T established an irrevocable trust. Under the trust instrument, the trustee is required to distribute the entire income annually to T's child, C, for life, then to T's grandchild, GC, for life. Upon GC's death, the remainder is to be paid to GC's issue. On October 1, 1986, when the total value of the entire trust is \$400,000, T transfers \$100,000 to the trust. The allocation fraction is computed as follows:

$$\frac{\text{Value of addition}}{\text{Total value of trust}} = \frac{\$100,000}{\$400,000 + \$100,000} = .2$$

(ii) Thus, immediately after the transfer, 20 percent of the value of future generation-skipping transfers under the trust will be subject to chapter 13.

Example 2. Effect of expenses. Assume the same facts as in *Example 1*, except immediately prior to the transfer on October 1, 1986, the fair market value of the individual assets in the trust totaled \$400,000. Also, assume that the trust had accrued and unpaid debts, expenses, and

taxes totaling \$300,000. Assume further that the entire \$300,000 represented amounts that would be deductible under section 2053 if the trust were includible in the transferor's gross estate. The numerator of the allocation fraction is \$100,000 and the denominator of the allocation fraction is \$200,000 $((\$400,000 - \$300,000) + \$100,000)$. Thus, the allocation fraction is .5 $(\$100,000 / \$200,000)$ and 50 percent of the value of future

generation-skipping transfers will be subject to chapter 13.

Example 3. Multiple additions. (i) Assume the same facts as in *Example 1*, except on January 30, 1988, when the total value of the entire trust is \$600,000, T transfers an additional \$40,000 to the trust. Before the transfer, the value of the portion of the trust that was attributable to the prior addition was \$120,000 $(\$600,000 \times .2)$. The new allocation fraction is computed as follows:

$$\frac{\text{Total value of additions}}{\text{Total value of trust}} = \frac{\$120,000 + \$40,000}{\$600,000 + \$40,000} = \frac{\$160,000}{\$640,000} = .25$$

(ii) Thus, immediately after the transfer, 25 percent of the value of future generation-skipping transfers under the trust will be subject to chapter 13.

Example 4. Allocation fraction at time of generation-skipping transfer. Assume the same facts as in *Example 3*, except on March 1, 1989, when the value of the trust is \$800,000, C dies. A generation-skipping transfer occurs at C's death because of the termination of C's life estate. Therefore, \$200,000 $(\$800,000 \times .25)$ is subject to tax under chapter 13.

(v) *Constructive additions*—(A) *Powers of Appointment.* Except as provided in paragraph (b)(1)(v)(B) of this section, where any portion of a trust remains in the trust after the post-

September 25, 1985, release, exercise, or lapse of a power of appointment over that portion of the trust, and the release, exercise, or lapse is treated to any extent as a taxable transfer under chapter 11 or chapter 12, the value of the entire portion of the trust subject to the power that was released, exercised, or lapsed is treated as if that portion had been withdrawn and immediately retransferred to the trust at the time of the release, exercise, or lapse. The creator of the power will be considered the transferor of the addition except to the extent that the release, exercise, or lapse of the power is treated as a taxable transfer under chapter 11 or chapter 12.

See § 26.2652-1 for rules for determining the identity of the transferor of property for purposes of chapter 13.

(B) *Special rule for certain powers of appointment.* The release, exercise, or lapse of a power of appointment (other than a general power of appointment as defined in section 2041(b)) is not treated as an addition to a trust if—

(1) Such power of appointment was created in an irrevocable trust that is not subject to chapter 13 under paragraph (b)(1) of this section; and

(2) In the case of an exercise, the power of appointment is not exercised in a manner that may postpone or