

transfers pursuant to the trust are not subject to chapter 13.

Example 7. Amendment increasing skip person's share. Assume that A, B, and C are the grandchildren of S rather than the children (and thus are skip persons as defined in section 2613). T's amendment of the trust increasing A's share of the income subjects the trust to the provisions of chapter 13 because the amendment increases the amount of the generation-skipping transfers to be made to A.

Example 8. Amendment that adds a skip person. Assume that T amends the trust to add T's grandchild, D, as an income beneficiary. The trust will be subject to the provisions of chapter 13 because the amendment creates a generation-skipping transfer.

Example 9. Refund of tax paid during interim period when effect of amendment is not determinable. Assume that T amends the trust to provide that the issue of S are to take a one-fourth share of the principal per stirpes upon S's death. Because the distribution to be made upon S's death may involve skip persons, the amendment is considered an amendment that creates or increases the amount of a generation-skipping transfer until a determination can be made. Accordingly, any distributions from (or terminations of interests in) such trust are subject to chapter 13 until it is determined that no skip person has been added to the trust. At that time, a claim for refund may be filed within the period set forth in section 6511 with respect to any generation-skipping transfer tax that was paid.

(3) **Transition rule in the case of mental incompetency—(i) In general.** If an individual was under a mental disability to change the disposition of his or her property continuously from October 22, 1986, until the date of his or her death, the provisions of chapter 13 do not apply to any generation-skipping transfer—(A) Under a trust (as defined in section 2652(b)) to the extent such trust consists of property, or the proceeds of property, the value of which was included in the gross estate of the individual (other than property transferred by or on behalf of the individual during the individual's life after October 22, 1986); or

(B) Which is a direct skip (other than a direct skip from a trust) that occurs by reason of the death of the individual.

(ii) **Mental disability defined.** For purposes of this paragraph (b)(2), the term *mental disability* means mental incompetence to execute an instrument governing the disposition of the individual's property, whether or not there was an adjudication of incompetence and regardless of whether there has been an appointment of a guardian, fiduciary, or other person charged with either the care of the individual or the care of the individual's property.

(iii) **Decedent who has not been adjudged mentally incompetent.** If there has not been a court adjudication that the decedent was mentally incompetent on or before October 22, 1986, the executor must file, with Form 706, either—

(A) A certification from a qualified physician stating that the decedent was—

(1) mentally incompetent at all times on and after October 22, 1986; and

(2) did not regain competence to modify or revoke the terms of the trust or will prior to his or her death; or

(B) Sufficient other evidence demonstrating that the decedent was mentally incompetent at all times on and after October 22, 1986, as well as a statement explaining why no certification is available from a physician; and

(C) Any judgment or decree relating to the decedent's incompetency that was made after October 22, 1986. Such items will be considered relevant, but not determinative, in establishing the decedent's state of competency.

(iv) **Decedent who has been adjudged mentally incompetent.** If the decedent has been adjudged mentally incompetent on or before October 22, 1986, a copy of the judgment or decree, and any modification thereof, must be filed with the Form 706.

(v) **Rule applies even if another person has power to change trust terms.** In the case of a transfer from a trust, this paragraph (b)(3) applies even though a person charged with the care of the decedent or the decedent's property has the power to revoke or modify the terms of the trust, provided that the power is not exercised after October 22, 1986, in a manner that creates, or increases the amount of, a generation-skipping transfer. See paragraph (b)(2)(iv) of this section for rules concerning amendments that create or increase the amount of a generation-skipping transfer.

(vi) **Example.** The following example illustrates the application of paragraph (b)(3)(v) of this section:

Example. T was mentally incompetent on October 22, 1986, and remained so until death in 1993. Prior to becoming incompetent, T created a revocable generation-skipping trust that was includible in T's gross estate. Prior to October 22, 1986, the appropriate court issued an order under which P, who was thereby charged with the care of T's property, had the power to modify or revoke the revocable trust. Although P exercised the power after October 22, 1986, and while T was incompetent, the power was not exercised in a manner that created, or increased the amount of, a generation-skipping transfer. Thus, the existence and exercise of P's power did not cause the trust

to lose its exempt status under paragraph (b)(3) of this section. The result would be the same if the court order was issued after October 22, 1986.

(4) **Exceptions to additions rule—(i) In general.** Any addition to a trust made pursuant to an instrument or arrangement covered by the transition rules in paragraph (b) (2) or (3) of this section is not treated as an addition for purposes of this section. Moreover, any property transferred inter vivos to a trust is not treated as an addition if the same property would have been added to the trust pursuant to an instrument covered by the transition rules in paragraph (b) (2) or (3) of this section.

(ii) **Examples.** The following examples illustrate the application of paragraph (b)(4)(i) of this section:

Example 1. Addition pursuant to terms of exempt instrument. On December 31, 1980, T created an irrevocable trust having a principal of \$100,000. Under the terms of the trust, the principal was to be held for the benefit of T's grandchild, GC. Pursuant to the terms of T's will, a document entitled to relief under the transition rule of paragraph (b)(2) of this section, the residue of the estate was paid to the trust. Because the addition to the trust was paid pursuant to the terms of an instrument (T's will) that is not subject to the provisions of chapter 13 because of paragraph (b)(2) of this section, the payment to the trust is not considered an addition to the principal of the trust. Thus, distributions to or for the benefit of GC, are not subject to the provisions of chapter 13.

Example 2. Property transferred inter vivos that would have been transferred to the same trust by the transferor's will. T is the grantor of a trust that was irrevocable on September 25, 1985. T's will, which was executed before October 22, 1986, and not amended thereafter, provides that, upon T's death, the entire estate will pour over into T's trust. On October 1, 1985, T transfers \$100,000 to the trust. While T's will otherwise qualifies for relief under the transition rule in paragraph (b)(2) of this section, the transition rule is not applicable unless T dies prior to January 1, 1987. Thus, if T dies after December 31, 1986, the transfer is treated as an addition to the trust for purposes of any distribution made from the trust after the transfer to the trust on October 1, 1985. If T dies before January 1, 1987, the entire trust (as well as any distributions from or terminations of interests in the trust prior to T's death) is exempt, under paragraph (b)(2) of this section, from chapter 13 because the \$100,000 would have been added to the trust under a will that would have qualified under paragraph (b)(2) of this section. In either case, for any generation-skipping transfers made after the transfer to the trust on October 1, 1985, but before T's death, the \$100,000 is treated as an addition to the trust and a proportionate amount of the trust is subject to chapter 13.

Example 3. Pour over to a revocable trust. T and S are the settlors of separate revocable trusts with equal values. Both trusts were established for the benefit of skip persons (as