

determined as of the date of the initial completed transfer to the trust, and the denominator of which is the value of the entire trust. For example, T, a NRA transferor, transfers property that has a value of \$1,000 to a generation-skipping trust. Of the property transferred to the trust, property having a value of \$200 is subject to chapter 13 and property having a value of \$800 is not subject to chapter 13. The nontax portion is .8 (\$800 (the value of the property not subject to chapter 13) over \$1,000 (the total value of the property transferred to the trust)).

(3) *Special rule with respect to the estate tax inclusion period.* For purposes of this section, the provisions of § 26.2632-1(c), providing rules applicable in the case of an estate tax inclusion period (ETIP), apply only if the property transferred by the NRA transferor is subsequently included in the transferor's gross estate. If the property is not subsequently included in the gross estate, then the nontax portion of the trust and the applicable fraction are determined as of the date of the initial transfer. If the property is subsequently included in the gross estate, then the nontax portion and the applicable fraction are determined as of the date of death.

(d) *Examples.* The following examples illustrate the provisions of this section. In each example T, a NRA, is the transferor; C is T's child; and GC is C's child and a grandchild of T:

Example 1. *Direct transfer to skip person.* T transfers property to GC in a transfer that is subject to Federal gift tax under chapter 12 within the meaning of § 26.2652-1(a)(2). At the time of the transfer, C and GC are NRAs. T's transfer is subject to chapter 13 because the transfer is subject to gift tax under chapter 12.

Example 2. *Transfers of both U.S. and foreign situs property.* (i) T's will established a testamentary trust for the benefit of C and GC. The trust was funded with stock in a publicly traded U.S. corporation having a value on the date of T's death of \$100,000, and property not situated in the United States (and therefore not subject to estate tax) having a value on the date of T's death of \$400,000.

(ii) On a timely filed estate tax return (Form 706NA), the executor of T's estate allocates \$50,000 of GST exemption under section 2632(a) to the trust. The numerator of the applicable fraction is \$450,000, the sum of \$50,000 (the amount of exemption allocated to the trust) plus \$400,000 (the value of the nontax portion of the trust ( $4/5 \times \$500,000$ )). The denominator is \$500,000. Hence, the applicable fraction with respect to the trust is .9 (\$450,000/\$500,000), and the inclusion ratio is .1 ( $1 - 9/10$ ).

Example 3. *Inter vivos transfer of U.S. and foreign situs property to a trust and a timely allocation of GST exemption.* T establishes a trust providing that trust income is payable

to T's child for life and the remainder is to be paid to T's grandchild. T transfers property to the trust that has a value of \$100,000 and is subject to chapter 13. T also transfers property to the trust that has a value of \$300,000 but is not subject to chapter 13. T allocates \$100,000 of exemption to the trust on a timely filed United States Gift (and Generation-Skipping Transfer) Tax return (Form 709). The applicable fraction with respect to the trust is 1, determined as follows: \$300,000 (the value of the nontax portion of the trust) plus \$100,000 (the exemption allocated to the trust) / \$400,000 (the total value of the property transferred to the trust).

Example 4. *Inter vivos transfer of U.S. and foreign situs property to a trust and a late allocation of GST exemption.* (i) In 1996, T transfers \$500,000 of property to an inter vivos trust the terms of which provide that income is payable to C, for life, with the remainder to GC. The property transferred to the trust consists of property subject to chapter 13 that has a value of \$400,000 on the date of the transfer and property not subject to chapter 13 that has a value of \$100,000. T does not allocate GST exemption to the trust. On the transfer date, the nontax portion of the trust is .2 (\$100,000/\$500,000) and the applicable fraction is also .2 determined as follows: \$100,000 (the value of the nontax portion of the trust) / \$500,000 (the value of the property transferred to the trust).

(ii) In 1999, when the value of the trust is \$800,000, T allocates \$100,000 of GST exemption to the trust. The applicable fraction of the trust must be recomputed. The numerator of the applicable fraction is \$260,000 (\$100,000 (the amount of GST exemption allocated to the trust) plus \$160,000 (the value of the nontax portion of the trust as of the date of allocation ( $.2 \times \$800,000$ ))). The denominator of the applicable fraction is \$800,000. Accordingly, the applicable fraction with respect to the trust after the allocation is .325 (\$260,000/\$800,000) and the inclusion ratio is .675 ( $1 - .325$ ).

Example 5. *Taxable termination.* The facts are the same as in Example 4 except that, in 2006, when the value of the property is \$1,200,000, C dies and the trust corpus is distributed to GC. The termination is a taxable termination. If no further GST exemption has been allocated to the trust, the applicable fraction remains .325 and the inclusion ratio remains .675.

Example 6. *Estate Tax Inclusion Period.* (i) T transferred property to an inter vivos trust the terms of which provided T with an annuity payable for 10 years or until T's prior death. The annuity satisfies the definition of a qualified interest under section 2702(b). The trust also provided that, at the end of the trust term, the remainder will pass to GC or GC's estate. The property transferred to the trust consisted of property subject to chapter 13 that has a value of \$100,000 and property not subject to chapter 13 that has a value of \$400,000. T allocated \$100,000 of GST exemption to the trust. If T dies within the 10 year period, the value of the trust principal will be subject to inclusion in T's gross estate to the extent provided in sections 2103 and 2104(b). Accordingly, the ETIP rule under paragraph (c)(3) of this section applies.

(ii) In year 6 of the trust term, T died. At T's death, the trust corpus had a value of \$800,000, and \$500,000 was includible in T's gross estate as provided in sections 2103 and 2104(b). Thus, \$500,000 of the trust corpus is subject to chapter 13 and \$300,000 is not subject to chapter 13. The \$100,000 GST exemption allocation is effective as of T's date of death. Also, the nontax portion of the trust and the applicable fraction are determined as of T's date of death. In this case, the nontax portion of the trust is .375, determined as follows: \$300,000 (the value of the trust not subject to chapter 13) / \$800,000 (the value of the trust). The numerator of the applicable fraction is \$400,000, determined as follows: \$100,000 (GST exemption previously allocated to the trust) plus \$300,000 (the value of the nontax portion of the trust). The denominator of the applicable fraction is \$800,000. Thus, the applicable fraction with respect to the trust is .50, unless additional exemption is allocated to the trust by T's executor or the automatic allocation rules of § 26.2632-1(d)(2) apply.

Example 7. The facts are the same as in Example 6 except that T survives the termination date of T's retained annuity and the trust corpus is distributed to GC. Since the trust was not included in T's gross estate, the ETIP rules do not apply. Accordingly, the nontax portion of the trust and the applicable fraction are determined as of the date of the transfer to the trust. The nontax portion of the trust is .80 (\$400,000/\$500,000). The numerator of the applicable fraction is \$500,000 determined as follows: \$100,000 (GST exemption allocated to the trust) plus \$400,000 (the value of the nontax portion of the trust). Accordingly, the applicable fraction is 1, and the inclusion ratio is zero.

(e) *Transitional rule for allocations for transfers made before December 27, 1995.* If an NRA made a GST (inter vivos or testamentary) after December 23, 1992, and before December 27, 1995 that is subject to chapter 13 (within the meaning of § 26.2663-2), the NRA will be treated as having made a timely allocation of GST exemption to the transfer in a calendar year in the order prescribed in section 2632(c). Thus, an NRA's unused GST exemption will initially be treated as allocated to any direct skips made during the calendar year and then to any trusts with respect to which the NRA made transfers during the same calendar year and from which a taxable distribution or a taxable termination may occur. Allocations within the above categories are made in the order in which the transfers occur. Allocations among simultaneous transfers within the same category are made pursuant to the principles of section 2632(c)(2). This transitional allocation rule will not apply if the NRA transferor, or the executor of the NRA's estate, as the case may be, elected to have an automatic allocation of GST exemption not apply by describing on a timely-filed Form 709 for the year of the