REPORT #559

TAX SECTION

New York State Bar Association

Summary of Responses to Survey of members
of Executive Committee of New York State Bar Association Tax Section
as to Priority Issues for Providing Taxpayer Guidance

February 21, 1987

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TAX SECTION

New York State Bar Association

February 23, 1987

The Honorable J. Roger Mentz
Assistant Secretary (Tax Policy)
Department of the Treasury
1500 Pennsylvania Ave., N.W.
Room 3120
Washington, DC 20220

Dear Roger:

In accordance with our discussion, the Executive Committee of the Tax Section was informally surveyed as to issues meriting priority consideration by the Treasury Department in providing taxpayer guidance.

Attached is a summary of the responses received to date. Roger Baneman supervised the compilation of the summary, and was assisted by Richard Alan Alayon. Since the inquiry went out only a few days ago, further responses may come in. If so, I’ll send them on.

Sincerely,

Donald Schapiro

Enclosure

REPORT #559

2/21/87

Summary of Responses to Survey of members of Executive Committee of New York State Bar Association Tax Section as to Priority Issues for Providing Taxpayer Guidance*

Section of Code	Issues as to which Guidance is Required
Section 56	Guidance generally as to operation of the AMT Book Income Preference.
Section 67(c)	Application of 2% floor on miscellaneous itemized deduction to deductions of certain pass-through entities. See further Exhibit A.
Section 129(a)(2)	Whether the $5,000 maximum annual exclusion for amounts paid by an employer for dependent care assistance provided to an employee applies to amounts paid in 1987 for dependent care assistance provided in 1986? See further Exhibit B.
Section 163(h)	Operation of the disallowance of the personal interest deduction.
Sections 168(f)(5)(A)(ii), 168(f)(5)(B)(ii)	Application of the anti-churning rules for property to which post-1986 Act ACRS provisions would otherwise apply. See Further Exhibit C.
Section 280G	Application of shareholder approval exemption, particularly with respect to tiered entities. Since the exemption is retroactive to 1984, it is important to have guidance as soon as possible for both prior and future transactions.

* Prepared under the supervision of Roger Baneman with the assistance of Richard Alan Alayon. The views summarized are of individual members of the Executive committee of the Tax Section of the New York State Bar Association, and the Exhibits attached are excerpts from responses received from the individual members.

Section of Code	Issues as to Which Guidance is Required
Section 382	Guidance generally as to the operation of the new NOL limitations.
Section 453C	Guidance generally as to operation of new installment sale provisions and, in particular, to the application of the proportionate disallowance rule to pass-through entities and prior non-recourse debt. See Further Exhibit D.
Section 469	Guidance generally as to the operation of the passive activity loss provisions.
Section 501(m)	Application of Section 501(m) to charitable gift annuities. See further Exhibit F.
Section 704(c)	Rules for accounting for the difference between basis property contributed to a partnership and its fair market value at the time of contribution. See further Exhibit F.
Section 884	Guidance generally as to operation of new branch tax provisions.
Act Section 1433(b)(2)(A)	Guidance as to: (1) What constitutes a trust that was irrevocable on September 25, 1985? (2)Will the inclusion under Section 2044 of a trust that was irrevocable on September 25, 1985 in the gross estate of a decedent who had a qualifying interest for life constitute a constructive addition to the trust? (3) Will a distribution of income be treated as a distribution “out of corpus added to trust after September 25,1986”? (4) Will property transferred from a trust that was not irrevocable on September 25, 1985 be subject to the generation-skipping transfer tax to the extent such transfer was made from property transferred to such trust after September 25, 1985 out of a trust that was irrevocable on September 25, 1985? See further Exhibit G.

Section of Code	Issues as to Which Guidance is Required
Act Section 1433(b)(3)	Guidance as to what constitutes a "transfer to a grandchild for purposes of the $2,000,000 per grandchild exclusion. Guidance as to application of generation-skipping transfer tax to distributions from a trust to a grandchild, where the trust qualifies for the $2,000,000 exclusion. See further Exhibit H.
Section 2057	Scope needs to be clarified, particularly whether the section only applies to stock owned by the decedent prior to death and what, if any, other restrictions apply with respect to stock sold to an ESOP, See further Exhibit I.
Section 2612	Whether a transfer that fits within the definition of a taxable termination and within the definition of a direct skip will be treated as taxable termination or as a direct skip? See further Exhibit J.
Section 2612(c)(2)	If a transfer to a trust is not treated as a direct skip because of the special rule applicable to transfers to a grandchild who is a child of deceased child of the transferor, will distributions to such grandchild from the trust be treated as generation-skipping transfers? See further Exhibit K.
Section 2632(b)	Guidance is needed as to: (1) if the amount of direct skip exceeds the amount of the transferor's unused generation-skipping transfer tax ("GSTT") exemption, will the deemed allocation automatically allocate more GSTT exemption to the direct skip that is needed to reduce its inclusion ratio to zero? (2) How is the unused portion of a transferor's GSTT exemption to be calculated if she had previously allocated a portion of that exemption to a transfer that was not a direct skip? (3) May the deemed allocation rule apply to a portion of a direct skip? (4) When must the allocation out of the deemed allocation rule be made? See further Exhibit L.

Section of Code	Issues as to Which Guidance is Required
Section 2642(a)	Guidance is needed as to the treatment of a situation where the denominator of the applicable fraction is zero. See Exhibit M.
Section 2652(a)(3)	Guidance is needed as to: (1) Whether the election to treat qualified terminable interest property ("QTIP") for generation-skipping transfer tax purposes as if the QTIP election had not been made (the effect of which is the continuation of the original transferor's status as transferor) may be made as to a portion of such property? (2) When must such election be made? See further Exhibit N.
Section 2652(b)(1)	Guidance is needed as to The meaning of the term "trust equivalent" for purposes of Section 2652(b)(1). See further Exhibit O.
Section 2652(c)	Whether an individual has an interest in a trust where the trust property may be used to satisfy an individual's obligation to support a trust beneficiary? See further Exhibit P.
Section 2663(2)	Guidance is needed to: (1) When does the generation-skipping transfer tax apply to transfers with respect to which the transferor is a non-resident not a citizen of the United States? (2) When does the generation-skipping tax apply to the termination of a interest held by a non-resident not a citizen of the United States or to a distribution from a trust in which a non-resident not a citizen of the United States has an interest? See further Exhibit Q.

Section of Code	Issues as to Which Guidance is Required
Section 4981A	Guidance is needed as to: (1) Whether a Section 691(c) deduction is available with respect to the 15% additional estate tax on a decedent's excess retirement accumulation imposed by Section 4981A(d)? (2) If a distribution following a death of an individual is rolled over by the surviving spouse into a spousal IRA, whether it will be excluded from further taxation under Section 4981A? (3) Whether the special rule under Section 4981A(c)(5) for Accrued Benefits as of August 1, 1986 applies to a decedent's "excess retirement accumulation"? See further Exhibit R.
Section 6655	Procedure for satisfying the safeharbor requirements of Section 6655(d), particularly Section 6655(d)(3), in the light of the new corporate alternative minimum tax of Section 55 and the environmental tax of Section 59A, both of which must be included in the estimated tax installment payments required by Section 6145.
Retroactivity of Legislative Regulations	Where possible, the Treasury should announce areas as to which it has determined that authorized additions or changes to the statute won't be made retroactively by Regulations. As to these areas, taxpayers could rely on the statute as written.

Exhibit A

Section 67(c):

Guidance is needed as to:

Application of 2% floor on miscellaneous itemized deductions of certain pass-through entities.

Brief Description of Guidance Suggested:

This issue is of particular importance to mutual funds. The limitation is already applicable, and funds must disclose the tax treatment of these items in their annual prospectuses (the filing dates for which have already passed in many cases). The suggestions described below are for mutual funds only; however, analogous provisions could be made applicable to other pass-through entities.

(a) Treatment of applicable items. Amounts otherwise deductible by the fund should be made not deductible by the fund (except as described below); deemed to have been distributed to the fund's shareholders (either in the manner provided for undistributed capital gains in section 852(b)(3)(D) or pro rata in accordance with actual dividends paid other than capital gains dividends and exempt-interest dividends); deductible, subject to the limitation, by such shareholders (pursuant to a provision similar to section 852(b)(3)(D)(ii)); and deductible by the fund under section 852(b)(2)(D). (Query whether this is fair to nonresident aliens and foreign corporations taxed on a gross basis).

(b) Applicable items. Should apply to items covered under section 67(b) only if these would have been incurred by the shareholder managing his portfolio directly (*e.g.*, should apply to investment advisory fees but not stock issuance expenses deductible by a fund under Revenue Ruling 72-13). Should not apply to that portion of items covered under section 67(b) that would be disallowed under section 265 (see also § 852(b)(5)(A)(ii)).

Exhibit B

Section. l29(a)(2):

Guidance is needed as to:

Whether the $5,000 maximum annual exclusion paid by an employer for dependent care assistance provided t o an employee impacts amounts paid in 1987 for dependent care assistance provided in 1986?

Brief Description of Guidance Suggested:

Many section 125 cafeteria plans permit employees to receive employer reimbursement up to a certain amount for dependent care expenditures under a dependent care assistance plan. Under the use-it or lose-it concept, the dependent care expenses must be incurred in the plan year for which the coverage is elected or the benefits are forfeited. Q&A – 18 of Treasury Regulations Section 1.25-1 provides that dependent care expenses are incurred when the dependent care is provided and not when the employee is billed, charged or pays for the dependent care. Thus, in many cases employees will be reimbursed in 1987 for dependent care expenses incurred in 1986. It should be made clear that for purposes of section 129(a)(2), the $5,000 limit applies to the year of Section 1.125-1 of the Regulations, and not the year the employee is reimbursed. Otherwise, many employees who in 1985 irrevocably elected 1987 dependent care coverage will find that a portion of the tax-free benefits elected by them in 1986, at a cost of foregoing other benefits, will unexpectedly be taxable in 1987 under Section 129(a)(2). This issue is important to many thousands of working parents and other workers having responsibility for dependents.

<u>Exhibit C</u>

<u>Section l68(f)(5)(A)(ii), B(ii):</u>

Guidance is needed as to:

The application of the anti-churning rules for property to which the post-1986 Act ACRS provisions would otherwise apply. (a) In the case of section 168(f)(5)(A)(ii), which applies the old anti-churning rules (pre-1986 Act Section 168(e)(4)) substituting “1987” and “1986” for “1981” and “1980”, respectively, because the language used is “[t]his section shall not apply”, literally property that is churned from old ACRS to new ACRS would be required to be depreciated under the pre-1981 depreciation rules. (b) In making the comparison between the first full taxable year depreciation under old and new ACRS, required under section 168(f)(5)(B)(ii) to determine whether the (A)(ii) anti-churning rule discussed above applies, it is unclear whether the comparison is to be made taking into account the facts particularly applicable to the taxpayer involved (<u>e.g.</u>, whether the taxpayer has a short taxable year in which the property is churned, which would affect the amount of first full year depreciation) or whether such facts should be ignored.

Brief Description of Guidance Suggested:

(a) Clarify that property churned from old ACRS to new ACRS is to be depreciated under whichever of those two methods provides the lesser first full year depreciation, <u>not</u> under the pre-1981 depreciation rules. (b) Ignore facts particuarly applicable to the taxpayer involved, <u>i.e.</u>, compare the old ACRS schedule to the particular type of property under new ACRS, using (as specified in Section 168(f)(5)(B)(ii)(II)) the half-year convention.

Exhibit D

Section 453C:

Guidance is needed as to:

Treatment of pass-through entities and nonrecourse indebtedness incurred in years prior to year of installment sale.

Brief Description of Guidance Suggested:

The 1986 Act amended the installment sale rules to add a new “proportionate disallowance rule” applicable to sales of dealer property and nondealer real property where the sales price exceeds $150,000. This new rule in effect allocates a portion of the taxpayer’s overall indebtedness to an installment note receivable and treats that as a deemed payment on the notes. Section 453C(e)(5)(A) authorizes the IRS to promulgate regulations dealing with pass-through entities. The legislative history indicates that these regulations can be retroactive to date of enactment. The potential application of these rules to situations involving pass-through entities, such as partnerships and S corporations, is extremely complex and potentially will be difficult, if not impossible, to apply. Consideration to having these regulations be prospective only and have their application limited in scope will be very helpful from both an administrative and fairness viewpoint. In addition, consideration to not applying this rule to qualified nonrecourse indebtedness that was incurred in years prior to the installment sale may also be worthwhile.

Exhibit E

Section 501(m):

Guidance is needed as to:

The application of section 501(m) to charitable gift annuities.

Brief Description of Guidance Suggested:

Regulations should be issued specifying that section 501(m), which denies tax exemption to an organization unless no substantial portion of its activities consists of providing “commercial-type insurance,” does not apply to exempt organization’s issuance of gift anuities as part of its fund raising activities.

A charitable gift annuity is a deferred giving device, similar to a transfer to a charitable remainder trust or a pooled income fund, whereby in exchange for a transfer to the charity the donor receives an annuity for the donor’s life. The gift element is the difference between the present value of the annuity payments (calculated pursuant to tables under section 72) and the amount transferred to the charity.

Before a charity organized or doing business in New York can issue gift annuities it must obtain a special permit from the New York State Insurance Department. In order to obtain such a permit, the charity must agree that its annuity rates will be calculated to return a 50% residuum to the charity; that is, the donor must make a 50% contribution to the charity. The legislative history of the New York statute states that this 50% residuum requirement is for the express purpose of avoiding having charities compete with commercial insurance companies. Accordingly, at least for gift annuities returning a significant residuum to the charity, the issuance of such annuities should not be viewed as providing “commercial-type insurance”, and, thus, section 501(m) should not apply to such annuities.

Exhibit F

Section 704(c):

Guidance is needed as to:

Accounting for the difference between basis of property contributed to the partnership and its fair market value at time of contribution (a) when one partner contributes property and another contributes cash and (b) when each of two partners contributes property.

Brief Description of Guidance Suggested:

See May 7, 1985 New York State Bar Association report. These issues have become much more important in practice as more businesses have formed joint ventures; with the repeal of the *General Utilities* doctrine; and as a result of the 704(b) Regulations' references to Section 704(c).

Exhibit G

Act Section 1433(b)(2)(A):

Guidance is needed as to:

1. What constitutes a trust that was irrevocable on September 25, 1985?

2. Whether the inclusion under Section 2044 of a trust that was irrevocable on September 25, 1985 in the gross estate of a decedent who had a qualifying income interest for life constitutes a constructive addition to the trust?

3. Whether a distribution of income will be treated as a distribution "out of corpus added to the trust after September 25, 1986"?

4. Whether property transferred from a trust that was not irrevocable on September 25, 1985 or from a trust that was irrevocable on September 25, 1985 is subject to the generation-skipping transfer tax to the extent such transfer was made from property transferred to such trust after September 25, 1985 out of a trust that was irrevocable on September 25, 1985?

Brief Description of Guidance Suggested:

1. Transfers from trusts that were irrevocable on September 25, 1985 will not be subject to the generation-skipping transfer tax except to the extent made out of corpus added to the trust after that date. A trust in existence on September 25, 1985 should be treated as irrevocable unless its transferor has retained the power to revoke it and receive back the trust property. A Regulation similar to Regulation Section 26.2601-1(c) under the repealed generation-skipping transfer tax should not be promulgated. This regulation provided that a trust in effect on June 11, 1976 would be treated as irrevocable unless "... it was subject to a power that would have caused the value of the trust to be included in a decedent's gross estate for Federal estate tax purposes by reason of section 2088." The purpose of a transitional rule of this kind is to protect dispositive patterns that were established in reliance on a particular set of tax rules unless the transferor can revoke the pattern and reestablish it with the new tax provisions in mind. A transferor who has retained control over a trust that is sufficient to require its inclusion under Section 2038 does not necessarily have the power to reestablish the dispositive pattern. For example, suppose a transferor created a trust in 1980 for

his grandchildren and retained the power to shift interests among his grandchildren. The trust would be included in his gross estate under Section 2038 but his power over the trust would be insufficient to enable him to change the trust to avoid (or postpone) imposition of the new generation-skipping transfer tax upon the lapse of his power.

2. Regulations should provide that the mere inclusion under Section 2044 of a trust that was irrevocable on September 25, 1985 in the gross estate of a decedent who had a qualifying income interest for life will not constitute a constructive addition to the trust unless the decedent had a general power of appointment over the trust property. The treatment under Regulations Section 26.2601-1(e)(8), which was promulgated under the repealed generation-skipping transfer tax prior to the enactment of Section 2044, of the release, exercise or lapse of a general power of appointment is to be treated as an addition to the trust of the property subject to the power is appropriate only because the power holder, in effect, has the opportunity to revoke the trust by the exercise of the power. This rule should not be extended to trusts over which the holder of the qualifying income interest for life does not have a general power of appointment.

3. Section 1433(b)(2)(A) subjects transfers made from trusts that were irrevocable on September 25, 1985 to the generation-skipping transfer tax only if such transfers are made out of corpus added to the trust after September 25, 1985. In order to discourage avoidance of the tax by post September 25, 1985 additions to pre-existing trusts, Regulations should provide that distributions of income attributable to such added corpus will be treated as if made out of corpus.

4. Regulations similar to Regulations Section 26.2601-1(c) promulgated under the repealed generation-skipping transfer tax should protect property transferred from a trust that was not irrevocable on September 25, 1985 or from a trust that was irrevocable on September 25, 1985 from the generation-skipping transfer tax to the extent such transfer was made from property transferred to such trust after September 25, 1985 out of a trust that was irrevocable on September 25, 1985. This conclusion is consistent with the colloquy that took place on September 27, 1986 between Senator Bentsen and Senator Packwood.[1]

[1] "As is the case of the old provision, the new provision will not apply to the exercise of a limited power of appointment under an otherwise grandfathered trust or to trusts to which the trust property is appointed provided that such exercise cannot postpone vesting of any estate or interest in the trust property for a period ascertainable without regard to the date of the creation of the original trust." 132 Cong. Rec. $13952 (daily ed. Sept. 27, 1986).

Exhibit H

Act Section 1433(b)(3):

Guidance is needed as to:

(1) What constitutes a "transfer to a grandchild" for purposes of the $2,000,000 per grandchild exclusion?

(2) If a transfer to a trust qualifies for this exclusion, will distributions to the grandchild from the trust be treated as generation-skipping transfers?

The guidance suggested for each item is, respectively:

1. A Regulation similar to Proposed Regulations Section 26.2613-4 under the repealed generation-skipping transfer tax should be promulgated. This Regulation provided, for purposes of the grandchild exemption under that law, that a transfer would be treated as made to a grandchild if the transferred property "... would be includable in the grandchild's federal gross estate if the grandchild died at any time after the generation-skipping transfer." A provision that the trust property pass to the grandchild's estate at his or her death should not be required.

2. The Section 1433(b)(3) exclusion, as written, provides only that certain transfers to a grandchild that would otherwise be direct skips, will not be direct skips. If a transfer that qualifies for the exclusion is made to a trust (or to a trust equivalent) for the benefit of a grandchild, there seems to be no mechanism to prevent distributions from that trust (or trust equivalent) from being treated as taxable distributions. If such a mechanism is not provided by Regulation or technical amendment, the grandchild exclusion, in effect, will not be available for transfers in trust. Since there seems to be no tax policy reason to discourage transfers in trust for grandchildren, such a protective mechanism-should be provided. A possible approach would be to treat a transfer to a trust (or trust equivalent) for a grandchild that qualifies for the exclusion as a generation-skipping transfer for purposes of Section 2653's multiple-skip rule. Section 2658(a) shifts the generation assignment of the transferor of property to a trust to the first generation higher than the highest generation of any beneficiary with an interest in the trust when the transfer of property to that trust was a generation-skipping transfer.

Exhibit I

Section 2057:

As Treasury is aware, the scope of this section has to be clarified. In particular, it has to be determined whether the section only applies to stock owned by the decedent prior to death and what, if any, other restrictions apply with respect to stock sold to an ESOP.

Brief Description of Guidance Suggested:

Assuming the provision is amended by way of a technical correction limiting the deduction to proceeds from the sale of stock owned by the decedent, we believe that the deduction should remain available for sales not qualifying under any amended version of the section, at least to the extent of such sales made prior to January 5, 1987, the date on which the IRS issued Notice 87-13 indicating, among other criteria, that Section 2057 only applies to stock owned by the decedent.

<u>Exhibit J</u>

<u>Section 2612:</u>

Guidance is needed as to:

Whether a transfer that fits within the definition of a taxable termination and within the definition of a direct skip will be treated as a taxable termination or as a direct skip?

Brief Description of Guidance Suggested:

If a beneficiary’s interest in a trust terminates, if after such termination only skip persons have interests in the trust, and if the termination is subject to estate or gift tax, the termination is both a taxable termination and a direct skip. Examples of such dual status include: (a) the death of the grantor of a revocable trust, the principal of which is payable to the grantor’s grandchildren; and (b) the death of a beneficiary of a qualified terminable interest property trust, the principal of which is payable to the beneficiary’s grandchildren. Regulations should indicate how such terminations should be treated. Since direct skips are generally subject to more favorable tax treatment than taxable terminations and since there seems to be no tax policy reason for discouraging the use of revocable trust as a will substitutes, it is suggested that such Regulations provide that direct skip treatment apply to the exclusion of taxable termination treatment when a transfer fits within both definitions.

Exhibit K

Section 2612(c)(2):

Guidance is needed as to:

If a transfer to a trust is not treated as a direct skip because of the special rule applicable to transfers to a grandchild is a child of a deceased child of the transferor, will distributions, to the grandchild from the trust be treated as generation-skipping transfers?

Brief Description of Guidance Suggested:

Section 2612 (o)(2) provides that for purposes of determining whether a transfer is a direct skip, a grandchild who is a child of a deceased child of the transferor or of a deceased child of the transferor’s spouse will be treated as if he or she were a child of the transferor. If a transfer that qualifies for this special rule is made to a trust (or to a trust equivalent), there seems to be no mechanism to prevent distributions from that trust (or trust equivalent) to a grandchild from being treated as taxable distributions. If such a mechanism is not provided by Regulation or technical amendment, this special rule, in effect, will not be available for transfers in trust. Since there seems to be no tax policy reason to discourage transfers in trust for grandchildren, such a protective mechanism should be provided. A possible approach would be to treat a transfer to a trust (or trust equivalent) that qualifies for the special rule as a generation-skipping transfer for purposes of Section 2653’s multiple-skip rule. Section 2653(a) shifts the generation assignment of the transferor of property to a trust to the first generation higher than the highest generation of any beneficiary with an interest in the trust when the transfer of property to that trust was a generation-skipping transfer.

Exhibit L

Section 2632(b):

Guidance is needed as to:

1. If the amount of a direct skip exceeds the amount of the transferor’s unused GST exemption, will the deemed allocation rule automatically allocate more GST exemption to the direct skip than is needed to reduce its inclusion ratio t o zero?

2. How is the unused portion of a transferor’s GST exemption to be calculated if she has previously allocated a portion of that exemption to a transfer that was not a direct skip?

3. May the election out of the deemed allocation rule apply to a portion of a direct skip?

4. When must the election out of the deemed allocation rule be made?

Brief Description of Guidance Suggested:

1. Section 2632(b)(1) provides that if the amount of a direct skip exceeds the amount of a transferor’s unused exemption, the entire unused exemption will be allocated to the transferred property. Unlike the general deemed allocation rule, there seems to be no limitation to prevent an allocation in excess of that amount required to reduce the inclusion ratio for the property to zero. In order to prevent an unintended loss of exemption by transferors who neglect to elect to have the deemed allocation rule not apply to their transfers, a Regulation should provide that transferors will be deemed to have elected not to apply more of their unused exemption than is necessary to reduce the inclusion ratio of any transfer to zero.

2. Section 2632(b)(2) defines the unused portion of a transferor’s GST exemption as that portion that has not been allocated previously to a prior direct skip. It does not provide for a reduction to reflect a prior allocation of a portion of a GST exemption to a transfer that was not a direct skip. Nor does it provide for a reduction in the amount of the exemption allocated to any such previously transferred property.

The text of the statute seems to permit a transferor to increase the amount of her GST exemption by making allocations to transfers that are not direct skips before making direct skips. Such a result would defeat Congress's intent to limit each transferor's GST exemption to $1,000,000. A technical amendment should be proposed to modify Section 2632 to prevent multiple exemptions by reducing the unused portion of a transferor's unused GST exemption by the amount of her exemption previously allocated to any transfer whether or not such transfer was a direct skip.

3. Section 2682(b)(3) permits a transferor to "elect to have this subsection not apply to a transfer." By its terms, the election out seems to be an all or nothing rule. No tax policy goal would be compromised if transferors were permitted to make partial elections out of the deemed allocation rule. Regulations should be promulgated to permit partial elections.

4. Temporary Regulations issued by Treasury on February 5, 1987 provide that the election is to be made by the later of (a) the due date (taking into account extensions) of the tax return for the first taxable year for which the election is to be effective or (b) April 15, 1987 and that the election, once made, is freely revocable. Amendments to Temporary Regulations Elections Under Various Public Laws, 52 Fed. Reg. 8624 (February 5, 1987) (to be codified at 26 C.F.R. Parts 5h).

This Temporary Regulation confuses rather than clarifies the issue. When is the election to be effective? The election, if made, would have to be effective as of the date of the transfer. If it were not effective until some time after the transfer, no generation-skipping transfer tax would apply since the transfer would have been protected by the deemed allocation of GST exemption. This analysis suggests that the tax return referred to in the Temporary Regulation must be the tax return of either the transferor or the transferee required for the year in which the transfer took place. Since transferors and transferees may use different tax years and since their tax returns for the first year in which an election is to be effective may be required on different dates, the Temporary Regulation should be clarified to identify the tax return whose filing date is to govern the election date. Alternatively, the Temporary Regulation might be revised to require the transferor to make the election on or before the due date for the filing of his gift tax return on which the direct skip is to be reported.

Exhibit M

Section 2642(a):

Guidance is needed as to:

What is the value of an applicable fraction whose denominator is zero?

Brief Description of Guidance Suggested:

If the charitable deduction allowed with respect to a transfer is equal to the amount of the transfer, the method for calculating the applicable fraction produces a denominator of zero. The value of a fraction with a zero denominator is undefined. Accordingly, it is unclear what the value of such a fraction is. Regulations are needed to provide that the value of any applicable fraction with a zero denominator is 1.

Exhibit N

Section 2652(a)(3):

Guidance is needed as to:

1. Whether the election to treat qualified terminable interest property for generation-skipping transfer tax purposes as if the qualified terminable interest property election had not been made (the effect of which is the continuation of the original transferor’s status as transferor) may be made as to a portion of such property or must be made as to all of such property?

2. When must such election be made?

Brief Description of Guidance Suggested:

1. Section 2652(a)(3) permits the original transferor (or his or her estate) of qualified terminable interest property to treat such property for generation-skipping transfer tax purposes as if the qualified terminable interest property election had not been made. Regulations should make it clear that the generation-skipping transfer tax election may apply to all or a portion of such property. This would be consistent with the provisions of Prop. Reg. Section 20.2056(b)(7) which permit the qualified terminable interest property election to be made as to all or a fraction of the property that qualifies for the election.

2. Temporary Regulations issued by Treasury on February 5, 1987 provide that the election is to be made by the later of (a) the due date (taking into account extensions) of the tax return for the first taxable year for which the election is to be effective or (b) April 15, 1987 and that the election, once made, is irrevocable. Amendments to Temporary Regulations - Elections Under Various Public Laws, 52 Fed. Reg. 3624 (February 5, 1987) (to be codified at 26 C.F.R. Parts 5h).

This Temporary Regulation confuses rather than clarifies the issue. Since the original transferor remains the transferor for generation-skipping transfer tax purposes until the death of the spouse beneficiary of the trust (or until the trust property is subject to gift tax because of a transfer made by such spouse) the election is arguably not effective until such an event has occurred. Does the Temporary Regulation permit deferral of the election until the first income tax return filed for the trust after such event has occurred? If the election must be made with the first income tax return required for the trust, does this permit, in the case of testamentary qualified terminable interest property, deferral of the election until after the trust is funded?

Exhibit O

Section 2652(b)(1):

Guidance is needed as to:

What is a trust equivalent within the meaning of Section 2652(b)(8)?

Brief Description of Guidance Suggested:

Under Section 2652(b)(1) the meaning of the term “trust” is not restricted to the term trust in its common law sense. It also includes “an arrangement (other than an estate) which has substantially the same effect as a trust,” The statute contains the following examples of the arrangements that may be deemed to be “trusts”: life estates and remainders, estates for years and insurance and annuity contracts. Regulations should specify what other arrangements, if any, are to be treated as trust equivalents.

The prior generation-skipping transfer tax contained a similar definition for the term “generation-skipping trust equivalent.” An important distinction is that under prior law the intent was to reach arrangements which had a generation-skipping effect, i.e., they permitted more than one generation to share the same property successively or simultaneously. Thus a life estate for a son followed by a remainder interest to a grandson has a generation-skipping effect because the son and the grandson each have successive temporal shares in the property and they are assigned to different younger generation levels. A life estate for a spouse followed by a remainder interest to a grandson would not have been a generation-skipping trust equivalent since it does not permit sharing between two different beneficiaries who are assigned to different younger generation levels. Similarly, under the Proposed Regulations, a custodianship under the Uniform Gifts to Minors Act for a grantor’s grandchild with a living parent who has an obligation under local law to support him was a generation-skipping trust equivalent because the funds can be used for the economic advantage of the parent as well as the child and because the parent and child are assigned to different younger generation levels. Prop. Reg. Sec. 26.2611-4.

The new law’s “arrangements” that have the same effect as trusts are not required to have any multi-generation sharing. Thus a life estate for a grandchild followed by a remainder to another grandchild is probably a trust equivalent. A custodianship under the Uniform Gifts to Minors Act may be a trust equivalent whether or not the child’s parents are living or whether under local law the custodianship funds may be used to discharge a support obligation.

Exhibit P

Section 2652(c):

Guidance is needed as to:

If trust property may be used to satisfy an individual’s obligation to support a trust beneficiary, does that individual have an interest in the trust?

Brief Description of Guidance Suggested:

Proposed Regulations Section 2613-4(d) promulgated under the prior version of the generation-skipping transfer tax an individual whose support obligations could be discharged by a trustee was deemed to have a present interest in the trust only after the trustee had exercised this power in his favor. Since Sec. 2652(c) does not treat a future interest as an interest, application of the rule of Proposed Regulations Section 2618-4(d) would mean that the individual whose support obligation could be discharged would not be treated as having an interest in a trust until the first time that the trustee exercises the power in his favor.

Exhibit Q

Section 2663(2):

Guidance is needed as to:

1. When does the generation-skipping transfer tax apply to transfers with respect to which the transferor is a non-resident not a citizen of the United States?

2. When does the generation-skipping transfer tax apply to the termination of an interest held by a non-resident not a citizen of the United States or to a distribution from a trust in which a non-resident not a citizen of the United States has an interest?

Brief Description of Guidance Suggested:

1. Section 2668(2) directs the promulgation of "... regulations (consistent with the principles of chapters 11 and 12) providing for the application of this chapter in the case of transferors who are nonresidents not citizens of the United States." These regulations are needed promptly since, in the absence of such regulations, it is impossible to determine the applicability of the generation-skipping transfer tax to transfers made by and to transfers made with respect to trusts created by nonresidents not citizens of the United States.

It is suggested that such regulations provide:

(a) that direct skips made by a nonresident not a citizen of the United States during his or her life be subject to the generation-skipping transfer tax to the same extent that they are subject to the gift tax;

(b) that direct skips made by a nonresident not a citizen of the United States at or after his or her death be subject to the generation-skipping transfer tax to the same extent that they are subject to the estate tax;

(c) that taxable terminations and taxable distributions which occur with respect to a trust created by a nonresident not a citizen of the United States be subject to the generation-skipping transfer tax in full without regard to the status of the transferor.

2. If a taxable termination or a taxable distribution occurs because of (a) the termination of an interest held by a nonresident not a citizen of the United States or (b) the distribution from a trust in which all interests held by persons assigned to generations higher than the generation assignment of the distributee are held by nonresidents not citizens of the United States, the application of the generation-skipping transfer tax should depend upon whether such nonresident is alive. If he is alive, the generation-skipping transfer tax should apply to the same extent that the gift tax would apply if the property transferred had been gifted by the nonresident during his life. If he is dead, the generation-skipping transfer tax should apply to the same extent that the estate tax would apply if the property transferred had been included in his gross estate. This result should be achieved by technical amendment. In the absence of such a rule, transferors who are able to obtain effective advice will be able to achieve this result by granting the nonresident appropriate general powers of appointment. The generation-skipping transfer tax should not result in the imposition of a higher tax than would be achieved if the property had been subject to tax under chapter 11 or 12.

Exhibit R

Section 4981A:

Guidance’ is needed as to:

(1) Whether a Section 691(c) deduction is available with respect to the 15% additional estate tax on a decedent’s excess retirement accumulation imposed by Section 4981A(d)?

(2) If a distribution following the death of an individual is rolled over by the surviving spouse into a spousal IRA, whether it will be excluded from further taxation under Section 4981A?

(3) Whether the special rule under Section 4981A(c)(5) for Accrued Benefits as of August 1, 1986 applies to a decedent’s “excess retirement accumulation.”

Brief Description of Guidance Suggested:

(1) Under Section 4981A(d), an additional 15% estate tax is imposed on a decedent’s excess retirement accumulation as that term is defined in Section 4981A(d)(3). It is not clear whether the estate or other recipient of amounts thus taxed will be entitled to an income tax deduction under Section 691(c) for such additional estate tax attributable to the amounts so received. It therefore needs to be clarified that such Section 691(c) deduction is available.

(2) If a decedent’s estate is liable for the 15% additional estate tax on an excess retirement accumulation and the accumulated amount is then rolled over into a spousal IRA, it should not be subject to another 15% tax upon distribution to such spouse or upon such spouse’s death. It is not clear whether such exclusion is available under the statute as drafted.

(3) Section 4981A(c)(5) provides a special rule for Accrued Benefits as of August 1, 1986. Although it is stated at subparagraph (A) that “no tax shall be imposed under this section” on such benefits, it needs to be clarified that the rule applies to an “excess retirement accumulation” as well as an “excess retirement distribution.”