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Department of the Treasury

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Person to Contact:

Telephone Number:

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Refer Reply To:

CC: DOM: P&SI: 4 - PLR-122320-98

Date: April 8, 1999

Re:

Legend:

Taxpayers =

Decedent =

Spouse =

Date =

Trust Agreement =

Z =

This is in response to your letter of December 11, 1998, and subsequent correspondence, requesting an extension of time under § 301.9100-1 of the Procedure and Administration Regulations to make a "reverse" qualified terminable interest property (QTIP) election under section 2652(a)(3) of the Internal Revenue Code.

Decedent died testate on Date, survived by Spouse and three adult children. Under Decedent's will, his estate passed to a trust established under Trust Agreement.

Under Article III of the Trust Agreement, \$200,000 was distributed outright to each of Decedent's children.

Under Article V, the residuary trust estate passed to a Marital Trust. During her life, Spouse is to receive all of the net income from the Marital Trust, at least quarter-annually. Spouse may also receive any amount of principal the trustee (other than Spouse), in the trustee's discretion, deems necessary or advisable for Spouse's maintenance, welfare, and comfort, or for any other purpose the trustee deems to be worthwhile and in the best interests of Spouse. At Spouse's death, the trustee will pay all of the taxes attributable to the inclusion of the Marital Trust in Spouse's gross estate.

On Spouse's death, the remainder of the Marital Trust will be divided into two equal parts. Under Article V(A)(3)(a), one-half of the remainder will be distributed as Spouse appoints in

her will to persons other than herself, her creditors, her estate, or creditors of her estate; however, as long as a descendant of Decedent is living, the appointment must be made in a manner to ensure that this one-half of the remainder can only vest in a descendant of the Decedent or in a spouse of the descendant. To the extent Spouse fails to exercise this power, this one-half of the remainder of the Marital Trust will be distributed, per stirpes, to Decedent's descendants who survive Spouse. Under Article V(A)(3)(b), the other one-half of the remainder of the Marital Trust will be distributed, per stirpes, to Decedent's descendants who survive Spouse. Any distribution for an individual under age 25 must be retained in trust for the benefit of the individual.

Article VIII(H)(15) authorizes the trustees, in case of a division into shares, to make up the several shares of similar or of different property. Article VIII(H)(2) directs the trustee to divide the Marital Trust into two separate trusts, the "Exempt Trust" for which the "reverse QTIP election" under § 2652(a)(3) has been made, and the "Nonexempt Trust" for which that election has not been made. The provision further directs that any distribution of principal from the Marital Trust to Spouse under Article V as well as any payment of estate, inheritance, or succession taxes with respect to property passing from the Marital Trust at Spouse's death must be made first from the Nonexempt Trust.

On Schedule M of Form 706 (which was timely filed by the estate), the personal representatives made an election under § 2056(b)(7) with respect to the entire value of the Marital Trust. A deduction under § 2056(a) was claimed for the amount passing to the trust.

On Schedule R of Form 706, the personal representatives failed to indicate that the Marital Trust would be severed as directed under Article VIII(H)(2), failed to make an election under § 2652(a)(3) with respect to any part of the Marital Trust, and did not make an effective allocation with respect to Decedent's available GST exemption.

The Marital Trust has not yet been severed in accordance with Article VIII(H)(2). Since Decedent's death, discretionary payments of principal have been made to Spouse under Article V of Trust Agreement.

On December 11, 1998, the estate filed an amended Schedule R that signifies that a "reverse" QTIP election is being made for the "Exempt Marital Trust." On a rider to the amended Schedule R, the estate reported that pursuant to Article VIII(H)(2) of Trust Agreement, the Marital Trust will be severed into two

separate trusts, an "Exempt Marital Trust" and "Nonexempt Marital Trust."

Exempt Marital Trust will consist of an amount determined by multiplying the current fair market value of the Marital Trust corpus on the date of severance plus the amount of principal distributions made from the Marital Trust, by a fraction. The numerator of the fraction will be \$1 million, and the denominator will be \$Z, the value, as finally determined for federal estate tax purposes of the Marital Trust. The Nonexempt Marital Trust will consist of the remaining balance of the current value of the Marital Trust on the date of severance.

The Exempt Marital Trust and the Nonexempt Marital Trust will both have identical terms, except that pursuant to Article VIII(H)(2) of Trust Agreement, any payment of principal to Spouse under Article V made after the date on which the reverse QTIP election is made and any payment of estate, inheritance, or succession taxes with respect to property passing from the Marital Trust will be made first from the Nonexempt Marital Trust and next from the Exempt Marital Trust. One-half of the remainder of Exempt Marital Trust and one-half of the remainder of Nonexempt Marital Trust will pass under the provisions of Article V(A)(3)(a) pursuant to the exercise of Spouse's testamentary special power of appointment. The other one-half of the remainder of each trust will pass under the provisions in Article V(A)(3)(b).

Decedent's estate requests an extension of time under § 301.9100-1 to sever the Marital Trust and to make the reverse QTIP election under § 2652(a)(3) with respect to Exempt Marital Trust. In addition, the estate requests that we rule as follows:

1. The severance of the Marital Trust, pursuant to Article VIII(H)(2) of Trust Agreement and § 26.2654-1(b)(1), into two separate trusts, the Exempt Marital Trust and the Nonexempt Marital Trust, will be effective for GSTT purposes.

2. As a result of the reverse QTIP election, the Exempt Marital Trust will have an inclusion ratio of zero under § 2642 by operation of the automatic allocation rules under § 2632(c)(1).

Section 2056(a) provides that the value of a decedent's taxable estate shall be determined by deducting from the value of the gross estate an amount equal to the value of any interest in property that passes or has passed from the decedent to the surviving spouse.

Section 2056(b)(7)(A) provides that qualified terminable interest property shall be treated as passing to the surviving

spouse and no part of such property shall be treated as passing to any person other than the surviving spouse. Thus, the value of such property is deductible from the value of the gross estate under § 2056(a). Under § 2044, the value of the trust on the death of the surviving spouse is includible in the gross estate of the spouse.

Section 2601 imposes a tax on every generation-skipping transfer made after October 22, 1986.

Section 2631 provides for a GST exemption of \$1,000,000, which may be allocated by the individual, or the individual's executor, to any property of which the individual is the transferor for GSTT purposes under § 2652(a). Section 2632(a) states that any allocation of an individual's GST exemption may be made at any time on or before the date prescribed for filing the individual's estate tax return (including extensions).

In general, the generation-skipping transfer tax is computed by multiplying the taxable amount by the "applicable rate." The applicable rate is the highest federal estate tax rate multiplied by the inclusion ratio with respect to the transfer. Under § 2642(a), the inclusion ratio is the excess (if any) of 1 over the applicable fraction determined for the trust from which such transfer is made. The applicable fraction is a fraction - (A) the numerator of which is the amount of the GST exemption allocated to the trust and (B) the denominator of which is - (i) the value of the property transferred to the trust reduced by (ii) the sum of (I) the federal estate tax or state death tax actually recovered from the trust attributable to such property, and (II) any charitable deduction allowed under § 2055 and § 2522 with respect to the such property.

Under § 2632(c) and § 26.2632-1(d)(2), a decedent's unused GST exemption is automatically allocated on the due date for filing the federal estate tax return to the extent not otherwise allocated by the decedent's executor on or before that date. Unused GST exemption is allocated pro rata on the basis of the value of the property as finally determined for federal estate tax purposes, first to direct skips treated as occurring at the transferor's death. Any balance is allocated pro rata, on the basis of the value of the property as finally determined for federal estate tax purposes, to trusts with respect to which a taxable termination may occur or from which a taxable distribution may be made. The automatic allocation is irrevocable. No automatic allocation of GST exemption is made to a trust that will have a new transferor with respect to the entire trust prior to the occurrence of any generation skipping transfer with respect to the trust.

Section 2642(b)(2)(A) provides that if property is transferred as a result of the death of the transferor, the value of such property for purposes of determining the inclusion ratio with respect to that property shall be its value for federal estate tax purposes; except that, if the requirements in the regulations respecting allocation of post-death changes in value are not met, the value of such property shall be determined as of the time of the distribution concerned.

Under § 2652(a), the term "transferor" means, in the case of any property subject to the estate tax, the decedent. Section 2652(a)(3) states that, with respect to any trust for which a deduction is allowed under § 2056(b)(7), the estate of the decedent may elect to treat all of the property in such trust for purposes of the GSTT provisions as if the § 2056(b)(7) QTIP election had not been made. This election is referred to as the "reverse" QTIP election. The consequence of a reverse QTIP election is that the decedent remains, for GSTT purposes, the transferor of the QTIP trust for which the election is made. As a result, that decedent's GSTT exemption may be allocated to that QTIP trust.

Section 26.2654-1(b)(1)(i) and (ii) provide that the severance of a trust that is included in the transferor's gross estate (or created under the transferor's will) into two or more trusts is recognized for generation-skipping transfer tax purposes if, (1) the trust is severed pursuant to a direction in the governing instrument providing that the trust is to be divided upon the death of the transferor, (2) the trust is severed pursuant to discretionary authority granted either under the governing instrument or local law. Under §§ 26.2654-1(b)(ii)(B) and 26.2654-1(b)(2) the trust must be severed prior to the date prescribed for filing the Federal estate tax return, or in the alternative, the federal estate tax return must contain a statement that the trust will be severed. In addition, the trust must be severed either on a fractional basis, or if required to be severed on a pecuniary basis, in a manner that satisfies the requirements of § 26.2654-(1)(a)(1)(ii).

Under § 301.9100-1(c) of the Procedure and Administration Regulations, the Commissioner may grant a reasonable extension of time to make a regulatory election, or a statutory election (but no more than 6 months except in the case of a taxpayer who is abroad), under all subtitles of the Internal Revenue Code except Subtitles E, G, H, and I, if the taxpayer demonstrates to the satisfaction of the Commissioner that the taxpayer has acted reasonably and in good faith, and granting relief will not prejudice the interests of the government.

Sections 301.9100-1 through 301.9100-3 provide the standards the Commissioner will use to determine whether to grant an extension of time to make an election. § 301.9100-1(a).

Section 301.9100-2 provides automatic extensions of time for making certain elections. Section 301.9100-3 provides extensions of time for making elections that do not meet the requirements of § 301.9100-2.

Requests for relief under § 301.9100-3 will be granted when the taxpayer provides the evidence to establish that the taxpayer acted reasonably and in good faith, and granting relief will not prejudice the interests of the government. § 301.9100-3(a).

In this case, the standards of §§ 301.9100-1 and 301.9100-3 have been satisfied. Consequently, an extension of time is granted until December 11, 1998, for making a reverse QTIP election under § 2652(a)(3), and an extension of time for severing the Marital Trust is granted until 30 days after the date of this letter. However, relief under § 301.9100-1 is not available to extend the time to make an allocation of GST exemption. Accordingly, in this case, the Decedent's available GST exemption is allocated in accordance with the automatic allocation rules under § 2632(c)(1).

Based on the facts presented, we conclude, as follows:

1. The severance of the Marital Trust as proposed, pursuant to Article VIII(H)(2) of Trust Agreement and § 26.2654-1(b)(1), into two separate trusts, the Exempt Marital Trust the Nonexempt Marital Trust, will be effective for GSTT purposes.

2. As a result of the reverse QTIP election and by operation of the automatic allocation rules contained in § 2632(c)(1), the Exempt Marital Trust will have an inclusion ratio of zero under § 2642.

Except as specifically ruled herein, we express no opinion on the federal tax consequences of the transaction under the cited provisions or under any other provisions of the Code.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely yours,

Paul F. Kugler
Assistant Chief Counsel
(Passthroughs and Special
Industries)

Enclosure

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