

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:4 PLR-103015-00
Date:

February 07, 2001

Re:

Legend:

- Decedent =
- Spouse =
- Trust =
- Trustee =
- Date 1 =
- Date 2 =
- Date 3 =
- Date 4 =
- State =
- Court =

Dear _____ :

This letter responds to your authorized representative's letter of January 31, 2000, and subsequent correspondence, in which rulings were requested regarding the estate and generation-skipping transfer tax consequences of a division of a trust into separate trusts.

FACTS

Decedent died testate on Date 1, a resident of State. Decedent was survived by Spouse, who was appointed Executor of Decedent's estate, and two children. Pursuant to Article Three of Decedent's will, the residue of Decedent's estate passed to Trust, a revocable inter vivos trust that became irrevocable upon Decedent's death.

Article Third, Section A of the trust agreement provides that upon Decedent's death, the Trustee shall pay the entire net income, not less frequently than quarterly, to Spouse during his life. Article Third, Section B provides that the Trustee has absolute discretion to distribute so much of the Trust principal to or for the benefit of Spouse as the Trustee determines necessary for Spouse's health, support, and maintenance.

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Article Third, Section C of the trust agreement directs the Trustee to pay to or for the benefit of Spouse so much of the Trust principal (but not to exceed in any calendar year the greater of \$5,000 or 5% of the Trust principal valued as of the last day of such year) as Spouse requests in writing.

Article Third, Section D provides that upon the death of Spouse, the Trustee shall distribute such portion or portions of the remaining principal and any undistributed income to and among Decedent's issue and such issue's spouses (but in no event Spouse's creditors, Spouse's estate, or the creditors of Spouse's estate) as Spouse appoints by will. To the extent Spouse does not exercise this power of appointment, the Trustee shall distribute the remaining principal and undistributed income of Trust into trust shares, one for each living child of Decedent and one for each deceased child of Decedent with issue then living.

After Decedent's death, Trustee, without explicit authority in the trust agreement or prior court approval, divided Trust into three separate trusts, a credit shelter trust, a QTIP trust, and a reverse QTIP trust. Trust was divided on a fractional basis and each separate trust was funded with a pro rata portion of each asset of Trust. The dispositive terms of the separate trusts are identical to each other and to those of Trust.

Spouse, as Executor of Decedent's estate, timely filed the Federal Estate (and Generation-Skipping Transfer) Tax Return, Form 706, for Decedent's estate on Date 2. Trust was included in Decedent's gross estate with a reported value of \$1,509,359. Part 4, line 5 of Form 706 indicates that Trust was divided into three shares valued at \$600,000, \$400,000, and \$509,359, respectively. On Schedule M of the return, the Executor elected to treat the \$400,000 share and the \$509,359 share as qualified terminable interest property (QTIP) trusts. On Schedule R of the return, the Executor made the reverse QTIP election with respect to the \$400,000 trust and allocated \$400,000 of Decedent's generation-skipping transfer (GST) exemption to it. The Executor also allocated \$600,000 of Decedent's GST exemption to the \$600,000 trust for which a QTIP election was not made. In identifying the separate trusts on Part 4, line 5, Schedule M and Schedule R, the Executor referred to the trusts as Trust "shares" rather than as separate trusts. Decedent's return was not selected for audit, and the Executor received a closing letter from the Internal Revenue Service on Date 3.

On Date 4, Court issued a decree approving the Trustee's division of Trust. The credit shelter trust, the QTIP trust, and the reverse QTIP trust have at all times been administered as separate trusts.

You have requested the following rulings:

1. The division of Trust into separate QTIP and non-QTIP trusts will be recognized for federal transfer tax purposes; and

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2. An extension of time will be granted under § 301.9100-3 to make the transitional rule election under § 26.2652-2(c) of the Generation-Skipping Transfer Tax Regulations to divide Trust .

LAW AND ANALYSIS

Ruling Request #1

Section 2056(a) allows a marital deduction for the value of any interest in property that is included in the gross estate and that passes from the decedent to the decedent's surviving spouse. Section 2056(b)(1) disallows this deduction where, upon the occurrence of an event or contingency, or on the failure of an event or contingency to occur, an interest passing to the surviving spouse will terminate or fail.

Section 2056(b)(7) provides an exception to this general rule for "qualified terminable interest property." This is property:

- 1) which passes from the decedent,
- 2) in which the surviving spouse has a qualifying income interest for life, and
- 3) to which an election under § 2056(b)(7)(B)(v) has been made.

Section 2056(b)(7)(B)(ii) provides that the surviving spouse has a qualifying income interest for life if:

- 1) the surviving spouse is entitled to all of the income from the property payable annually or at more frequent intervals; and
- 2) no person has the power to appoint any part of the property to any person other than the surviving spouse.

Section 20.2056(b)-7(b)(2)(i) of the Estate Tax Regulations provides that a QTIP election may relate to all or any part of property for which the surviving spouse has a qualifying income interest for life, provided that any partial election must be made with respect to a fractional or percentage share of the property so that the elected portion reflects its proportionate share of the increase or decrease in value of the entire property for purposes of applying §§ 2044 or 2519. The fractional or percentage share may be defined by formula.

Section 20.2056(b)-7(b)(2)(ii) provides that a trust may be divided into separate trusts to reflect a partial election that has been made, or is to be made, if authorized under the governing instrument or otherwise permissible under local law. Any such division must be accomplished no later than the end of the period of estate

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administration. If, at the time of the filing of the estate tax return, the trust has not yet been divided, the intent to divide the trust must be unequivocally signified on the estate tax return. Although the division of the trust must be done on a fractional or percentage basis to reflect the partial election, the separate trusts do not have to be funded with a pro rata portion of each asset held by the undivided trust. A trust may be divided only if the fiduciary is required, either by applicable local law or by the express or implied provisions of the governing instrument, to divide the trust on the basis of the fair market value of the assets of the trust at the time of the division.

Section 2056(b)(7) is effective for decedents dying after December 31, 1981. Proposed QTIP regulations were issued on May 24, 1984, and had not been finalized at the time of Decedent's death. The proposed regulations generally provided that a trust with respect to which a partial QTIP election has been made may be divided into separate trusts to reflect the partial election. If a trust is severed, it must be clear, by virtue of the duties imposed on the fiduciary either by applicable state law or the express or implied provisions of the governing instrument, that the fiduciary must divide the trust according to the fair market value of the trust's assets at the time of the division.

Section 20.2056(b)-10 provides that § 20.2056(b)-7 is applicable with respect to estate of decedents dying after March 1, 1994. With respect to decedents dying on or before such date, the executor of the decedent's estate may rely on any reasonable interpretation of the statutory provisions.

In the present case, Decedent died on Date 1. Date 1 is prior to March 1, 1994. The Trustee divided Trust into three separate trusts and made a QTIP election with respect to two of the trusts. Although neither applicable state law nor the trust agreement required the Trustee to divide Trust according to the fair market value of the Trust's assets on the date of division, the Trustee divided Trust on a fractional basis and funded each separate trust with a pro rata portion of each asset held by Trust, with each separate trust receiving a proportionate share of the increase and decrease in the value of the entire Trust property. In addition, on Date 4, Court approved Trustee's division of Trust into three separate trusts.

Based on the above, we conclude that the manner in which Trust was divided constitutes a reasonable interpretation of the statutory provisions of § 2056(b)(7) and, therefore, the division of Trust into separate QTIP and non-QTIP trusts will be recognized for Federal transfer tax purposes.

Ruling Request #2

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

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Section 2631(a) provides for a generation-skipping transfer exemption of \$1,000,000 (adjusted under § 2631(c)), which may be allocated by the individual, or the individual's estate, to any property with respect to which such individual is the transferor.

Under § 2632(a), the allocation may be made at any time on or before the date prescribed for filing the individual's estate tax return (including extensions).

Section 2632(c)(1) provides that any portion of an individual's GST exemption which has not been allocated within the time prescribed by § 2632(a) shall be deemed to be allocated as follows-

(A) first, to property which is the subject of a direct skip occurring at such individual's death, and

(B) second, to trusts with respect to which such individual is the transferor and from which a taxable distribution or a taxable termination might occur at or after such individual's death.

Section 26.2652-2(a) provides that if an election is made to treat property as qualified terminable interest property (QTIP) under § 2523(f) or § 2056(b)(7), the person making the election may, for purposes of chapter 13 (the generation-skipping transfer tax), elect to treat the property as if the QTIP election had not been made (reverse QTIP election). An election under this section is irrevocable. An election under this section is not effective unless it is made with respect to all of the property in the trust to which the QTIP election applies.

Section 26.2652-2(c) provides that if a reverse QTIP election is made with respect to a trust prior to December 27, 1995, and GST exemption has been allocated to that trust, the transferor (or the transferor's executor) may elect to treat the trust as two separate trusts, one of which has a zero inclusion ratio by reason of the transferor's GST exemption previously allocated to the trust. The separate trust with the zero inclusion ratio consists of that fractional share of the value of the entire trust equal to the value of the nontax portion of the trust under § 26.2642-4(a). The reverse QTIP election is treated as applying only to the trust with the zero inclusion ratio. An election under this paragraph (c) is made by attaching a statement to a copy of the return on which the reverse QTIP election was made under § 2652(a)(3). The statement must indicate that an election is being made to treat the trust as two separate trusts and must identify the values of the two separate trusts. The statement is to be filed in the same place in which the original return was filed and must be filed before June 24, 1996. A trust subject to the election described in this paragraph is treated as a trust that was created by two transferors.

Based on the facts submitted and representations made in this case, we

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conclude that because the division of Trust is recognized for Federal transfer tax purposes as being divided prior to December 27, 1995, no relief is necessary under § 301.9100-3 to comply with the transitional rules in § 26.2652-2(c) and Decedent's reverse QTIP election will be respected for GST tax purposes.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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

Sincerely,
Katherine A. Mellody
Senior Technician Reviewer
Branch 4
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure (1)
Copy for section 6110 purposes