Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

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September 28, 2001

Legend:

Trust -
Trustor -
Spouse -
Marital Trust -
Family Trust -
$q -
$r -
$s -
$t -
$v -
$w -
$x -
$y -
$z -
Year 1 -
Year 2 -
Year 3 -
Year 4 -
Year 5 -
Date 1 -

Dear :

This is in reference to a letter dated September 26, 2000, from your authorized representative, requesting a ruling on the federal estate and generation-skipping transfer tax consequences resulting from the establishment

of various trusts under the terms of Trust.

Trustor created Trust, a revocable trust, in Year 1 and subsequently amended it on three occasions. Trustor died in Year 2 and the full value of the Trust property was includible in Trustor's gross estate.

Article Second of Trust provides that upon Trustor's death, the trustee is to pay all expenses of Trustor's last illness, funeral, costs of administration, and allowable claims from the principal of Trust. The trustee is also to pay all estate, inheritance and generation-skipping transfer (GST) taxes that result from Trustor's death from Trust, without apportionment.

Article Fourth provides that if Spouse survives Trustor, the trustee is to establish a Marital Trust. Marital Trust is to be funded with the smallest pecuniary amount which, if allowed as a federal estate tax marital deduction, will result in the least possible federal estate tax payable by reason of Trustor's death. Article Fourth provides that in computing the pecuniary amount, the values of assets as finally determined for federal estate tax purposes are to control. For all other purposes, values determined as of the date of distribution control. The pecuniary marital bequest is to carry with it, as income and not as principal, its proportionate share of the income earned following Trustor's death.

Article Fourth authorizes Trustor's personal representative to elect any part or all the Marital Trust for the estate tax marital deduction. If a partial election is made, the trustee is to administer the separate portions as separate trusts. Article Fourth also provides that the trustee is to divide the Marital Trust into two separate funds. One fund is to be equal to the GST tax exemption available upon Trustor's death less the amount of GST exemption allocated to the Family Trust and less any additional amount of GST exemption that was previously allocated. This fund is referred to in Trust as the Generation Skipping Fund. The balance of the Marital Trust is referred to as the Regular Fund.

Under Article Fourth, Spouse is entitled to the net income from both funds, to be paid in convenient periodic payments, at least quarterly, and to so much of the principal as the trustee determines is necessarily required for Spouse's support, health, medical, dental, hospital and nursing expenses. In exercising this discretion the trustee is to consider any income or other resources available to Spouse. Any distributions of principal made to the Spouse are to be charged first to the portion of the Marital Trust for which the qualified terminable interest property ("QTIP") election had been made.

Upon Spouse's death the assets of the Generation Skipping Fund are to pass in further trust for the benefit of Trustor's children and their issue under the terms of Article Sixth of Trust. The property of the Regular Fund is to be distributed in specified amounts to various charitable organizations and the balance is to be divided into equal shares, one share for each then living child of Trustor and one share for the then living descendants collectively, of each deceased child of Trustor.

Under Article Fifth, the balance of the Trust estate is to be held as the Family Trust. Spouse is to receive the net income of the Family Trust, in convenient periodic payments, at least quarterly, during Spouse's lifetime. Spouse may also receive distributions of principal, in the discretion of the trustee, for Spouse's support, health, medical, dental, hospital, and nursing expenses. Upon Spouse's death, Spouse possesses a testamentary limited power of appointment to distribute the remaining principal of the Family Trust in such amounts, as Spouse designates, to Trustor's issue. If Spouse fails to exercise the limited testamentary power of appointment, the Family Trust property is to pass under the terms of Article Sixth.

Under Article Sixth, the balance of the Generation Skipping Fund, and the Family Trust (to the extent that Spouse fails to exercise her limited power of appointment), is to be divided into equal shares to create one share for each then living child of Trustor and one share for the then living descendants of each deceased child of Trustor. Each child is to receive the income from his or her share in at least quarterly payments. Principal may be distributed for the child's support, education, health or medical, dental, hospital, and nursing expenses.

Article Sixth, Paragraph (B)(3) provides that:

> Upon the death of such child, the balance of the trust funds shall be paid to those persons whom and in the shares which such child shall designate in his will who are my issue, and such child shall have this limited power of appointment to dispose of the remaining principal by his duly probated will. If such child fails to exercise his limited power of appointment as to all such trust property, the trust property which he shall not effectively have appointed shall be distributed to such child's issue, per stirpes, and each such share shall be held in further trust...

Article Thirteenth provides that the Trustor's personal representative, after conferring with the trustee, has the authority to allocate any portion of Trustor's

GST exemption to any property as to which Trustor is the transferor, including any property transferred by Trustor during life as to which Trustor did not make an allocation prior to death. Article Thirteenth also provides that the trustee of the successor trusts established under Trust has the authority to divide any property in any trust held under Trust with an inclusion ratio of neither one nor zero into two separate trusts representing two fractional shares of the property being divided, one to have an inclusion ratio of one and the other to have an inclusion ratio of zero.

The federal estate tax return for Trustor's estate was filed on Date 1. On Schedule M (Marital Deduction) it was indicated that the total amount allocated to the Marital Trust under the pecuniary formula described above was $q. A partial QTIP election was made with respect to 99.9% of $q, or $x. The nonelected portion was valued at $y.

On Schedule R of Trustor's Form 706, Trustor's personal representative signified the making of the "reverse QTIP" election under § 2652(a)(3). Also on Schedule R, the personal representative signified the division of the elected portion of the Marital Trust ($x) into a QTIP GST Exempt Marital Trust valued at $z and a QTIP Non-GST Exempt Marital Trust valued at $w. The Non-QTIP portion of the Marital Trust was valued at $y and the amount of property allocated to the Family Trust was valued at $v. On Schedule R, the personal representative allocated Trustor's remaining GST exemption in the amounts as follows: 1) $z to the QTIP GST-Exempt Marital Trust, 2) $y to the Non-QTIP GST Exempt Marital Trust, and 3) $v to the Family Trust.

In Year 3, prior to the completion of the funding of the Marital Trust, Spouse, individually and as personal representative of Trustor's estate and as a cotrustee of Trust, agreed to accept assets in the amount $t from Trustor's estate and to treat such assets as if they had been made as a principal distribution from the Marital Trust to Spouse. In Year 4, $s was added to the Marital Trust. In Year 5, upon examination of the Marital Trust records by the successor corporate cotrustee, it was determined that the Marital Trust had been underfunded by a small percentage, in the amount of $r. Consequently $r was transferred from Trust to the Marital Trust at that time to increase the funding of the Marital Trust to $q.

It is represented that the successor corporate trustee has severed the Marital Trust into a QTIP Non-GST Exempt Marital Trust, a QTIP GST Exempt Marital Trust and Non-QTIP GST Exempt Marital Trust, on a fractional basis, as authorized by the Trust agreement. Severance of the Marital Trust was not

accomplished prior to the filing of the Trustor's estate tax return.

The following rulings are requested:

1. The severance of the Marital Trust into the QTIP GST Exempt Marital Trust, the QTIP Non-GST Exempt Marital Trust, and the Non-QTIP GST Exempt Marital Trust was authorized by the governing instrument and complied with the requirements of § 20.2056(b)-7(b)(2)(ii) of the Estate Tax Regulations and § 26.2654-1(b)(1) of the Generation-Skipping Transfer Tax Regulations and, therefore, is recognized for purposes of Chapter 13.

2. Under § 2642, the inclusion ratios of the QTIP GST Exempt Marital Trust and the Non-QTIP GST Exempt Marital Trust are equal to zero.

3. Under § 2642, the inclusion ratio of the Family Trust is equal to zero.

4. Under § 2642, the inclusion ratio of the QTIP Non-GST Exempt Marital Trust is equal to one.

5. The power or appointment granted to each child of Trustor over the GST exempt assets of the child's trust under Article Sixth of the Trust will not be considered a general power of appointment for purposes of § 2041.

Ruling 1. Section 2056(a) provides that the value of the taxable estate is, except as limited by § 2056(b), 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.

Under § 2056(b)(1)(A) and (B), where upon the lapse of time, on 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, no deduction is allowed with respect to such interest if an interest in the property passes or has passed (for less than an adequate and full consideration in money or money's worth) from the decedent to any person other than the surviving spouse (or the estate of such spouse), and if by reason of such passing such person may possess or enjoy any part of such property after such termination or failure of the interest passing to the surviving spouse.

Section 2056(b)(7)(A) provides that qualified terminable interest property, for purposes of § 2056(a), is treated as passing to the surviving spouse, and no part of such property is treated as passing to any person other than the surviving

spouse. Under § 2056(b)(7)(B)(i), qualified terminable interest property is property: (1) which passes from the decedent; (2) in which the surviving spouse has a qualifying income interest for life; and (3) for which the election under § 2056(b)(7)(B)(v) is made.

Section 20.2056(b)-7(b)(2)(i) provides that the election may relate to all or any part of property that meets the requirements of § 2056(b)(7)(B)(i), provided that any partial election must be made with respect to a fractional or percentage share of the property so that the elective portion reflects its proportionate share of the increase or decrease in value of the entire property for purposes of applying §§ 2044 or 2519. The fraction or percentage may be defined by formula.

Section 20.2056(b)-7(b)(2)(ii) provides that, in general, 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 administration. If, at the time of the filing of the estate tax return, the trust has yet to be divided, the intent to divide must be unequivocally signified on the estate tax return. Under § 20.2056(b)-7(b)(2)(ii)(B), the division of the trust must be done on a fractional or percentage basis to reflect the partial election. However, the separate trusts do not have to be funded with a pro rata portion of each asset held by the undivided trust.

Section 2652(a)(3) provides that in the case of any trust with respect to which a deduction is allowed to the decedent under § 2056 by reason of subsection (b)(7) thereof, the estate of the decedent may elect to treat all of the property in such trust for purposes of chapter 13 as if the election to be treated as qualified terminable interest property had not been made. Under § 26.2652-2(b), an election made under § 2652(a)(3) is made on the return on which the QTIP election is made.

Section 26.2654-1(b)(1) provides 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 purposes of chapter 13 if –

(i) 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; or

(ii) The governing instrument does not require or otherwise direct severance but the trust is severed pursuant to discretionary authority granted either in the governing instrument or under local law; and

(A) The terms of the new trusts provide in the aggregate for the same succession of interests and beneficiaries as are provided in the original trust;

(B) The severance occurs (or a reformation proceeding, if required, is commenced) prior to the date prescribed for filing the Federal estate tax return (including extensions actually granted) for the estate of the transferor; and

(C) Either-

(1) The new trusts are severed on a fractional basis. If severed on a fractional basis, the separate trusts need not be funded with a pro rata portion of each asset held by the undivided trust. The trusts may be funded on a non-prorata basis provided funding is based on either the fair market value of the assets on the date of funding or in a manner that fairly reflects the net appreciation or depreciation in the value of the assets measured from the valuation date to the date of funding; or

2) If the severance is required (by the terms of the governing instrument) to be made on the basis of a pecuniary amount, the pecuniary payment is satisfied in a manner that would meet the requirements of § 26.2654-1(a)(1)(ii) if it were paid to an individual.

Section 26.2654-1(b)(2) provides that, if the governing instrument of a trust or local law authorizes the severance of the trust, a severance pursuant to that authorization is treated as meeting the requirements of § 26.2654-1(b)(1)(ii)(B) if the executor indicates on the Federal estate tax return that separate trusts will be created (or funded) and clearly sets forth the manner in which the trust is to be severed and the separate trusts funded.

Section 20.2056(b)-7(b)(2)(ii) permits the severance of the Marital Trust into an elected portion and a nonelected portion. Article Fourth of Trust authorizes Trustor's personal representative to elect any part or all the Marital Trust for the estate tax marital deduction. If a partial election is made, the trustee is to administer the separate portions as separate trusts. Trust therefore authorizes the division of the Marital Trust into a QTIP portion and a Non-QTIP portion to reflect that a partial QTIP election has been made. The intent to

divide the Marital Trust to reflect the partial election was unequivocally signified on the estate tax return.

In addition, Article Thirteenth of Trust authorizes the division of Trust property into separate trusts in order to create separate trusts having an inclusion ratio of one and an inclusion ratio of zero, in accordance with § 26.2654-1(b)(2). On Schedule R of Trustor's Form 706, the personal representative signified the division of the Trust property into four trusts (the QTIP GST Exempt Marital Trust, the Non-QTIP GST Exempt Marital Trust, the QTIP Non-GST Exempt QTIP Marital Trust, and the Family Trust) and the allocation of Trustor's remaining GST exemption to the Non-QTIP GST Exempt Marital Trust in the amount of $y, to the QTIP GST Exempt Marital Trust in the amount of $z, and to the Family Trust in the amount of $v. The severance pursuant to that authorization is treated as meeting the requirements of § 26.2654-1(b)(1)(ii)(B) since the executor indicated on the Federal estate tax return that separate trusts would be created (or funded) and clearly set forth the manner in which the trust was to be severed and the separate trusts funded.

Accordingly, we conclude that the severance of the nonelected portion of the Marital Trust and the portion of the Marital Trust for which a QTIP election was made is authorized under § 20.2056(b)-7(b)(2)(ii). The division of the elected portion of the Marital Trust into the QTIP GST Exempt Marital Trust, and the QTIP Non-GST Exempt Marital Trust is authorized by the governing instrument and complied with the requirements of § 26.2654-1(b)(2). Accordingly, the division of the Marital Trust into these three separate trusts is recognized for purposes of Chapter 13.

Rulings 2, 3, & 4. Section 2602 provides that the GST tax is computed, in general, by multiplying the taxable amount by the "applicable rate." Section 2641 provides that the applicable rate is determined by multiplying the maximum Federal estate tax rate by the "inclusion ratio."

Section 2631 provides that, for purposes of determining the inclusion ratio, every individual is allowed a GST exemption of $1,000,000 which may be allocated by the individual or his executor to any property with respect to which the individual is the transferor.

Section 2642(a) provides that the inclusion ratio with respect to any property transferred in a GST is the excess (if any) of 1 over the applicable fraction determined for the trust from which the transfer is made, or in the case of a direct skip, the applicable fraction determined for the skip. The applicable

fraction is a fraction in which the numerator is the amount of the GST exemption allocated to the trust or, in the case of a direct skip, allocated to the property transferred in the skip, and the denominator is the value of the property transferred to the trust or involved in the direct skip, reduced by any Federal estate tax or State death tax actually recovered from the trust attributable to the property and any charitable deduction allowed under §§ 2055 or 2522 with respect to the transfer.

Section 2652(a)(1)(A) provides generally that for purposes of chapter 13, the term “transferor” means in the case of any property subject to the tax imposed by chapter 11, the decedent. Section 2652(a)(3)(A) provides that in the case of any trust with respect to which a deduction is allowed to the decedent under § 2056 by reason of subsection (b)(7) thereof, the estate of the decedent may elect to treat all of the property in such trust for purposes of chapter 13 as if the election to be treated as QTIP property had not been made.

In the present case, the Trustor is the transferor with respect to the QTIP GST Exempt Marital Trust and the QTIP Non-GST Exempt Marital Trust, because a reverse QTIP election was made with respect to these trusts to treat the property in the trusts for purposes of chapter 13 as if the election to be treated as QTIP had not been made. The Trustor is also the transferor with respect to the Family Trust and the Non-QTIP GST Exempt Marital Trust because the property passing to these trusts was included in the Trustor's gross estate. The QTIP GST Exempt Marital Trust was funded with an amount equal to $z. The Non-QTIP GST Exempt Marital Trust was funded with an amount equal to $y, and the Family Trust was funded in the amount of $v. Trustor's personal representative allocated portions of Trustor’s remaining GST exemption on Schedule R of Trustor's Form 706 as follows: $z to the QTIP GST Exempt Marital Trust, $y to the Non-QTIP GST Exempt Marital Trust, and $v to the Family Trust. Thus, assuming these three trusts were properly funded as represented, each of these trusts will have an applicable fraction of one and an inclusion ratio of zero for GST purposes.

The QTIP Non-GST Exempt Marital Trust was funded with $w. No GST exemption allocation was made to this trust. Thus, the QTIP Non-GST Exempt Marital Trust will have an applicable fraction of zero and an inclusion ration of one.

Ruling 5. Section 2041(a)(2) provides, in part, for the inclusion in the gross estate the value of any property with respect to which the decedent possesses, at the time of his death, a general power of appointment created

after October 21, 1942.

Section 2041(b)(1) provides, in part, that the term "general power of appointment" means a power that is exercisable in favor of the decedent, the decedent's estate, the decedent's creditors, or the creditors of the decedent's estate, except that a power to consume, invade, or appropriate property for the benefit of the decedent that is limited by an ascertainable standard relating to health, education, support, or maintenance of the decedent is not deemed a general power of appointment.

Section 20.2041-1(c)(1)(a) provides that a power of appointment is not a general power of appointment if by its terms it is exercisable only in favor of one or more persons or classes other than the decedent or his creditors or the decedent's estate or the creditors of his estate.

As described above, upon the death of Spouse, Article Sixth provides that the balance of the QTIP GST Exempt Marital Trust and the Family Trust, is to be divided into equal shares to create one share for each then living child of Trustor, and one share for the then living descendants of each deceased child of Trustor. Each child is to receive the income from his or her share in at least quarterly payments. Principal may be distributed for the child's support, education, health or medical, dental hospital and nursing expenses. "Upon the death of such child, the balance of the trust funds shall be paid to those persons whom and in the shares which such child shall designate in his will who are my issue, and such child shall have this limited power of appointment to dispose of the remaining principal by his duly probated will. If such child fails to exercise his limited power of appointment as to all such trust property, the trust property which he shall not effectively have appointed shall be distributed to such child's issue, per stirpes, and each such share shall be held in further trust."

A child of Trustor is a member of the class of "issue of Trustor," and, therefore, could arguably appoint his or her child's share to his or her estate. However, because the Trustor has described the child's power as a limited power of appointment, we construe the power as one that would prohibit the exercise of the power on behalf of the child, the child's creditors, the child's estate, or the creditors of the child's estate. Accordingly, the power of appointment granted to each child of Trustor to appoint the child's share among individuals who are "issue of Trustor" constitutes a power of appointment that is not a general power of appointment within the meaning of § 2041(b)(1).
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Except as specifically set forth above, no opinion is expressed concerning

the Federal tax consequences of the facts described above under the cited provisions or any other provision of the Code.

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

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 certified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,
Lorraine E. Gardner
Acting Senior Technician Reviewer
Branch 4
(Passthroughs and Special Industries)

Enclosure
Copy for 6110 purposes

cc: