

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:B04-PLR-144049-01
Date:

APRIL 04, 2002

Re:

Legend:

- Decedent =
- Family Trust =

- Child 1 =
- Child 2 =
- Child 3 =
- Grandchild 1 =
- First Spouse =
- Second Spouse =
- Second Spouse's share =

- Law Firm =
- Attorney =
- Date 1 =
- Date 2 =
- Date 3 =
- Date 4 =
- Date 5 =
- Date 6 =
- Date 7 =
- X =
- State Statute =

Dear :

This is in response to your letter dated August 16, 2001, requesting an extension of time under section 301.9100-1 of the Procedure and Administration Regulations to sever Second Spouse's share into Trust X and Trust Y under section 26.2654-1(b)(1) of

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the Generation-Skipping Transfer (GST) Tax Regulations and to make a “reverse” qualified terminable interest property (QTIP) election for Trust X under section 2652(a)(3) of the Internal Revenue Code. The letter also requests a ruling that the automatic allocation rules of section 2632(e) will apply to Trust X with the result that Trust X will have an inclusion ratio of zero for purposes of the GST tax.

The facts and representations submitted are as follows:

Decedent and First Spouse, the trustors, executed Family Trust on Date 1 and amended Family Trust on Date 2. First Spouse died on Date 3. Decedent later married Second Spouse and further amended the trust on Date 4, Date 5, and Date 6.

Article IV of the Family Trust provides that upon the death of the first trustor to die, the Family Trust is to be divided into two trusts. The surviving trustor’s share shall consist of fifty percent of the assets of the trust estate plus any assets allocable to surviving trustor’s share under the terms of the will of the first deceased trustor, and the other share shall be set aside and designated as the deceased trustor’s share which will consist of that portion of trust estate not allocated to the surviving trustor’s share plus all assets allocable to the deceased trustor’s share under the terms of the deceased trustor’s will.

Article V provides that the trustees shall pay the income of the surviving trustor’s share to the surviving trustor during his lifetime. The surviving trustor has the right to direct the trustees to distribute principal of the surviving trustor’s share to the surviving trustor up to the whole thereof as the surviving trustor designates. At surviving trustor’s death, after paying any inheritance, estate, or other death taxes, the trustees shall allocate the remaining balance of the surviving trustor’s share to the Second Spouse’s share, if Second Spouse is married to and living with the surviving trustor at the time of his death. The trustees shall pay all of the net income from Second Spouse’s share to Second Spouse during her lifetime. Upon the death of Second Spouse, the trustees shall distribute the remaining corpus equally to the trustor’s grandchildren outright.

Article VI provides that the deceased trustor’s share shall be allocated into two separate and distinct trusts known as Trust A and Trust B. Trust A shall be a fraction of the trust’s qualified property that will produce minimum total estate taxes upon the death of the deceased trustor. The remaining property in the trust shall be allocated to Trust B. The trustors intend that Trust A be eligible for the marital deduction. The trustees shall pay all the income of Trust A and Trust B to the surviving trustor while he or she is alive. In the trustee’s discretion, the trustee may distribute principal to the surviving trustor for care, support, and maintenance. Upon surviving trustor’s death, the principal of Trust A will be added to Trust B and distributed in accordance with Article VII.

Article VII provides that upon the death of the surviving Trustor, after payment of

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expenses and taxes, the trustees shall divide the remaining assets in the trust pro rata into three shares as follows: one share outright to Child 1; one share outright to Child 2; and one share to Grandchild 1, to be held in trust until Grandchild 1 attains the age of thirty. If the beneficiary is not living, then the beneficiary's share shall be distributed to that beneficiary's children equally, and held in trust for each child of beneficiary until such child is thirty years old. The trustees have discretion to expend for the child's care, support, and maintenance until the child is 18 years old, and then the trustees will pay out all net income to that child, until the child is thirty years old. When the child attains thirty years of age, the trust will terminate and the corpus will be distributed to the child outright. Grandchild 1 is the only surviving issue of Child 3, a predeceased child of the trustors.

Article X provides that the trustors acting jointly, while both are alive and competent, shall have the right to amend and/or revoke any or all of the provisions of the trust agreement. Following the death of the first trustor, the surviving trustor shall have the right to amend or revoke the trust with respect to his interest in the community or separate property. Following the death of the surviving trustor, the trust shall be irrevocable. Decedent, the surviving trustor, died on Date 7. The trust became irrevocable on that date.

The trustees represent that Decedent's federal estate tax return (Form 706) was timely filed. On Schedule M of the Form 706, the trustees of the Family Trust made a QTIP election under section 2056(b)(7) for \$x, the amount of Second Spouse's share. However, the trustees did not make a "reverse" QTIP election with respect to Second Spouse's share nor did they allocate Decedent's GST exemption to Second Spouse's share.

The trustees, who had no prior experience with estate tax matters, hired Law Firm to prepare the Form 706 and to advise the trustees on estate tax matters. The trustees declare that they provided Law Firm with all documents relevant to the Family Trust. Law Firm had years of experience in the law of federal estate and gift taxation. However, at the time of Decedent's death, Law Firm failed to advise the trustees to make the "reverse" QTIP election nor did Law Firm make the election on the Form 706. The failure to make the "reverse" QTIP election was recently discovered upon current discussions between the children of Decedent and Attorney regarding the estate plans of Decedent's children.

The trustees represent that Decedent made no direct skips to any skip person and that no trusts, other than Second Spouse's share, created by Decedent have any GST potential. There have been no distributions of principal from Second Spouse's share.

The estate proposes to sever Second Spouse's share into two separate trusts, Trust X and Trust Y and make a "reverse" QTIP election under section 2652(a)(3) with

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respect to Trust X. Trust X will consist of a fraction of the current value on the date of severance of the Second Spouse's share. The numerator of the fraction will be the amount of Decedent's GST exemption available at his death, and the denominator will be the value of Second Spouse's share as finally determined for federal estate tax purposes in Decedent's estate. Trust Y will consist of the balance of Second Spouse's share.

State Statute provides that on petition by a trustee or beneficiary, the court, for good cause shown, may divide a trust into two or more separate trusts, if the court determines that dividing the trust will not defeat or substantially impair the accomplishment of the trust purposes or interests of the beneficiaries.

You have requested the following rulings:

1. An extension of time under sections 301.9100-1 and 301.9100-3 to sever Second Spouse's share into Trust X and Trust Y under section 26.2654-1(b)(1) and to make a "reverse" QTIP election under section 2652(a)(3) with respect to Trust X; and
2. The automatic allocation rules under section 2632(e) will apply to Trust X with the result that Trust X will have an inclusion ratio of zero for GST tax purposes.

LEGAL ANALYSIS

Section 2001(a) imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

Section 2056(a) provides that, for purposes of the tax imposed by section 2001, the value of the taxable estate is to 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)(1) provides the general rule that no deduction is allowed under section 2056(a) for an interest passing to the surviving spouse if, on the lapse of time, on the occurrence of an event or contingency, or on the failure of an event or contingency to occur, the interest will terminate or fail.

Section 2056(b)(7)(A) provides that, in the case of qualified terminable interest property, the entire property is treated as passing to the surviving spouse for purposes of section 2056(a) and no part of the property is treated as passing to any person other than the surviving spouse for purposes of section 2056(b)(1)(A).

Section 2056(b)(7)(B)(i) defines "qualified terminable interest property" as property: (1) that passes from the decedent, (2) in which the surviving spouse has a

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qualifying income interest for life, and (3) to which an election under section 2056(b)(7)(B)(v) applies.

Section 2056(b)(7)(B)(v) provides that an election under section 2056(b)(7) with respect to any property shall be made by the executor on the return of tax imposed by section 2001. Such an election, once made, is irrevocable.

Section 2601 imposes a tax on every generation-skipping transfer which, under section 2611(a), is defined as a taxable distribution, a taxable termination, and a direct skip.

Section 2602 provides that the amount of tax imposed by section 2601 is the “taxable amount” multiplied by the “applicable rate.”

Section 2641(a) provides that for purposes of chapter 13, the term “applicable rate” means, with respect to any generation-skipping transfer, the product of the maximum federal estate tax rate and the inclusion ratio with respect to the transfer.

Section 2631(a) provides that, for purposes of determining the inclusion ratio, every individual shall be allowed a GST exemption of \$1,000,000 (adjusted for inflation under section 2631(c)) which may be allocated by such individual (or by his or her executor) to any property with respect to which such individual is the transferor. Section 2631(b) provides that any allocation under section 2631(a), once made, is irrevocable.

Section 2632(a) provides that any allocation by an individual of his or her GST exemption under section 2631(a) may be made at any time on or before the date prescribed for filing the estate tax return for such individual’s estate (determined with regard to extensions), regardless of whether such a return is required to be filed.

Section 2632(e)(1) provides that, in general, any portion of an individual’s GST exemption which has not been allocated within the time prescribed by section 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 26.2632-1(d)(2) provides that a decedent’s unused GST exemption is automatically allocated on the due date for filing Form 706 to the extent not otherwise allocated by the decedent’s executor on or before that date. Unused GST exemption is allocated pro rata (subject to the rules of section 26.2642-2(b)), on the basis of the value of the property as finally determined for purposes of chapter 11 (chapter 11 value), first to direct skips treated as occurring at the transferor’s death. The balance, if any, of unused GST exemption is allocated pro rata on the basis of the chapter 11

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value of the nonexempt portion of the trust property to trusts with respect to which a taxable termination may occur or from which a taxable distribution may be made.

Section 2642(b)(2) provides that, except as provided in section 2642(f), if property is transferred as a result of the death of the transferor, the value of such property for purposes of section 2642(a) shall be its value for purposes of chapter 11; except that, if the requirements prescribed by the Secretary 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. Any allocation to property transferred as a result of the death of the transferor shall be effective on and after the date of transferor's death.

Section 2652(a)(3) provides that in the case of any trust with respect to which a deduction is allowed to the decedent's estate under section 2056(b)(7), the estate of the decedent may elect to treat all of the property in the trust, for purposes of chapter 13, as if the election to be treated as QTIP 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 GST purposes, the transferor of the QTIP trust for which the election is made. As a result, the decedent's GST exemption may be allocated to the QTIP trust.

Section 26.2652-2(b) provides that a "reverse" QTIP election is made on the return on which the QTIP election is made.

Section 26.2654-1(b)(1) provides rules pursuant to which the severance of a trust that is included in the transferor's gross estate into two or more trusts is recognized for purposes of chapter 13. For a trust whose governing instrument does not require severance, the requirements are: (i) the trust is severed pursuant to discretionary authority granted either under the governing instrument or under local law; (ii) 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; (iii) the trust is severed prior to the date prescribed for filing the federal estate tax return (including extensions actually granted) for the estate of the transferor; and (iv) the trust is severed on a fractional basis (either on a pro rata basis of each asset held in the undivided trust or on a non-pro rata basis under certain circumstances).

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. Under section 301.9100-1(c), 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.

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Section 301.9100-2 provides automatic extensions of time for making certain elections. Section 301.9100-3(a) provides that, in general, requests for extensions of time for regulatory elections that do not meet the requirements of section 301.9100-2 must be made under the rules of section 301.9100-3. Requests for relief subject to this section will be granted when the taxpayer provides the evidence to establish to the satisfaction of the Commissioner that the taxpayer acted reasonably and in good faith, and the grant of relief will not prejudice the interests of the Government.

Section 301.9100-3(b)(1)(v) provides in part that a taxpayer is deemed to have acted reasonably and in good faith if the taxpayer reasonably relied on a qualified tax professional, including a tax professional employed by the taxpayer, and the tax professional failed to make, or advise the taxpayer to make, the election.

Section 301.9100-3(b)(2) provides that a taxpayer will not be considered to have reasonably relied on a qualified tax professional if the taxpayer knew or should have known that the professional was not (i) competent to render advice on the regulatory election; or (ii) aware of all relevant facts.

Section 301.9100-3(c)(1)(i) provides, in part, that the interests of the Government are prejudiced if granting relief would result in a taxpayer having a lower tax liability in the aggregate for all taxable years affected by the election than the taxpayer would have had if the election had been timely made (taking into account the time value of money).

Based on the facts submitted and representations made, we conclude that the requirements of section 301.9100-3 have been met in this case. An extension of time to sever Second Spouse's share into Trust X and Trust Y and to make a "reverse" QTIP election for Trust X is granted until 60 days after the date of this letter. This election should be made on a supplemental Form 706 (United States Estate (and Generation-Skipping Transfer) Tax Return) and filed with the Cincinnati Service Center.

Under the facts presented, the automatic allocation rules of section 2632(e) apply with the result that Decedent's unused GST exemption will be automatically allocated to Trust X. The allocation will be effective as of Date 7, the date of Decedent's death. The estate tax value of the transfers to Trust X will be used in determining the amount of GST exemption allocated to Trust X. Provided the severance meets the requirements of section 26.2654-1(b) and provided the estate tax value of the transfers to Trust X equals Decedent's unused GST exemption, Trust X will have an inclusion ratio of zero.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to each taxpayer.

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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.

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.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent. A copy of this letter should be attached to the supplemental Form 706.

Sincerely yours,

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

Enclosures:

Copy of letter for section 6110 purposes
Copy of this letter