

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:B09-PLR-168959-02
Date:
April 21, 2003

Re:

LEGEND:

Decedent =

Spouse =

Estate =
Trust =

Trustors =
Tax Practitioner =
Date 1 =
Date 2 =
Date 3 =
State =

Dear :

This letter responds to your request, dated March 31, 2003, and prior correspondence, requesting an extension of time under § 301.9100-3 of the Procedure and Administration Regulations to sever a trust into an exempt and nonexempt trust for purposes of the Generation-Skipping Transfer (“GST”) Tax and to make a “reverse” qualified terminable interest property (“QTIP”) election under § 2652(a)(3) of the Internal Revenue Code with respect to the exempt trust.

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The facts and representations submitted are summarized as follows: Decedent and Spouse created Trust, a revocable trust, on Date 1. Trust provides for the administration, use and disposal of Decedent's and Spouse's assets during life and at death.

Article Four of Trust provides that, upon the termination of the administrative period following the death of the first Trustor, the trustee shall divide the Trust estate into three shares, designated the Survivor's Trust, the Marital Trust, and the Decedent's Trust. The Survivor's Trust shall consist of: (i) the surviving Trustor's share of the community property included in the trust estate; (ii) the surviving Trustor's separate property included in the trust estate; and, (iii) all jewelry, clothing, household furniture, automobiles and other tangible articles of a personal nature of the predeceased Trustor not otherwise specifically bequeathed. The Marital Trust shall consist of the minimum pecuniary amount necessary to entirely eliminate (or to reduce to the maximum extent possible) the federal estate tax that may be due upon the predeceased Trustor's death. The Decedent's Trust shall consist of the balance of the trust estate.

Article Four further provides that, during the lifetime of the surviving Trustor, the trustee shall pay to or apply for the benefit of only the surviving Trustor, not less frequently than annually, the entire net income of the Marital Trust. If the trustee deems such income payments to be insufficient, the trustee shall from time to time pay to or apply for the benefit of the surviving Trustor such sums out of the principal of the Marital Trust, as the trustee in the trustee's discretion deems necessary for the surviving Trustor's proper support, care and maintenance. Upon the death of the surviving Trustor, the trustee shall pay and distribute the then accrued and undistributed income of the Marital Trust to the Survivor's Trust (in the absence of appointment by the surviving Trustor) and the trustee shall pay the then remaining balance of the principal of the Marital Trust to the Decedent's Trust.

Article Five provides generally that the trustee is authorized, in the event of any generation skipping transfer which would result in a generation skipping tax at any time, to make such elections either alone or in conjunction with a surviving spouse, for the use and/or allocation of any exemption permitted under §§ 2631 and 2632.

Decedent died on Date 2, survived by Spouse, three children and six grandchildren. Tax Practitioner was engaged to prepare Decedent's Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return. The Form 706 was timely filed. On Schedule M of Form 706, an election was made under § 2056(b)(7) to treat the property of the Marital Trust as QTIP property. However, the Schedule M did not evidence an intent to sever the Marital Trust into a GST-exempt QTIP trust and a GST-nonexempt QTIP trust. Tax Practitioner did not attach a Schedule R to the return. Thus, the Estate did not make a reverse QTIP election under § 2652(a)(3) and did not allocate any of Decedent's available GST tax exemption to a GST-exempt QTIP trust.

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Spouse died on Date 3. While preparing Spouse's Form 706, it was discovered that a reverse QTIP election had not been made in Decedent's estate tax return.

Decedent's Estate requests an extension of time under § 301.9100 of the Procedure and Administration Regulations in which (1) to sever the Marital Trust pursuant to § 26.2654-(1)(b) into a GST-exempt QTIP trust and a GST-nonexempt QTIP trust; and (2) to make a reverse QTIP election under § 2652(a)(3) with respect to the GST-exempt QTIP Trust.

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 § 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 shall be allowed 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 shall be treated as passing to the surviving spouse for purposes of § 2056(a), and no part of the property shall be treated as passing to any person other than the surviving spouse.

Section 2056(b)(7)(B)(i) defines "qualified terminable interest property" as 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) applies.

Section 2601 imposes a tax on every generation-skipping transfer (GST).

Section 2631(a) provides that every individual shall be allowed a GST exemption of \$1,000,000 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 once an allocation of GST exemption is made, it is irrevocable.

Under § 2632(a), the allocation of the GST exemption 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 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 the individual's death, and (B) second, to trusts with respect to which

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such individual is the transferor and from which a taxable distribution or a taxable termination might occur at or after the individual's death.

Section 26.2632-1(d)(2) of the Generation-Skipping Transfer Tax Regulations supplies the method for the automatic allocation of any unused GST exemption. First, the exemption is allocated pro rata to direct skips on the basis of their value for estate tax purposes. The balance is then allocated pro rata, on the basis of estate tax values, to trusts with respect to which a taxable termination may occur or from which a taxable distribution may be made. No automatic allocation is made to a trust that will have a new transferor with respect to the entire trust prior to the occurrence of any GST with respect to the trust. The automatic allocation is irrevocable.

Section 2652(a)(1) provides that, for purposes of Chapter 13, the term "transferor" means- (A) in the case of any property subject to the tax imposed by Chapter 11, the decedent, and (B) in the case of any property subject to the tax imposed by Chapter 12, the donor. An individual shall be treated as transferring any property with respect to which such individual is the transferor.

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 § 2056(b)(7), the estate of the decedent may elect to treat all of the property in the trust, for purposes of the generation-skipping transfer tax, as if the election to be treated as qualified terminable interest property 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 tax 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 the reverse QTIP election is to be made on the return on which the QTIP election is made.

Section 26.2654-1(b)(1)(ii) 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 the governing instrument does not require or otherwise direct severance but the trust is severed pursuant to discretionary authority granted either under 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 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

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that would meet the requirements of § 26.2654-1(a)(1)(ii) if it were paid to an individual. 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 nonpro rata 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.

Section 26.2654-1(b)(2) provides that, if a court order severing the trust has not been issued at the time the Federal estate tax return is filed, the executor must indicate on a statement attached to the return that a proceeding has been commenced to sever the trust and describe the manner in which the trust is proposed to be severed. A copy of the petition or other instrument used to commence the proceeding must also be attached to the return. 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 requirement 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.

Under section 301.9100-1(c) of the Procedure and Administration Regulations the Commissioner may grant a reasonable extension of time under the rules set forth in §§ 301.9100-2 and 301.9100-3 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 Code except subtitles E, G, H, and I.

Section 301.9100-2 provides an automatic extension 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 § 301.9100-2 must be made under the rules of § 301.9100-3. Requests for relief subject to § 301.9100-3 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 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.

State law 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

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determines that dividing the trust will not defeat or substantially impair the accomplishment of the trust purposes or the interests of the beneficiaries.

In this case, because a QTIP election was made on Decedent's Form 706 with respect to the Marital Trust, the assets of the Marital Trust will be included in Spouse's gross estate under § 2044. Spouse is considered the transferor of such property for GST tax purposes, thereby precluding the allocation of Decedent's unused GST tax exemption to any portion of Marital Trust. However, if Decedent's estate is allowed to make a reverse QTIP election under §§ 2652(a)(3) and 26.2652-2(b) with respect to any portion of the assets of Marital Trust, Decedent will be treated as the transferor of such assets for GST tax purposes.

Based on the facts submitted and representations made, we conclude that the standards of §§ 301.9100-1 and 301.9100-3 have been satisfied. Therefore, an extension of time is granted until 60 days from the date of this letter for severing the Marital Trust, pursuant to § 26.2654-1(b), into the GST-exempt QTIP trust and the GST-nonexempt QTIP trust and for filing a Schedule R and making a "reverse" qualified terminable interest property election under § 2652(a)(3) with respect to the GST-exempt QTIP trust. The elections should be made on a supplemental Form 706 filed with the Internal Revenue Service Center, Cincinnati, OH 45999. A copy of this letter should be attached to the supplemental Form 706. A copy is enclosed for that purpose.

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. We note, however, that an extension of time in which to make a reverse QTIP election under § 2652(a)(3) does not extend the time in which to allocate any of Decedent's GST tax exemption remaining unused at his death. Accordingly, in view of the reverse QTIP election, Decedent's unused GST tax exemption will be allocated in accordance with the rules of §§ 2632(e) and 26.2632-1(d)(2).

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 who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

Heather C. Maloy
Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures

Copy for section 6110 purposes
Copy of this letter