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Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:4 - PLR-157950-02

Date: SEPTEMBER 15, 2003

Re:

Legend:

Wife =

Husband =

Date 1 =

Date 2 =

Revocable Trust Agreement =

Child 1 =

Child 2 =

Child 3 =

Child 4 =

State =

y =

x =

State 2 =

z =

Court =

Dear _____ :

This is in response to a letter dated October 17, 2002, and subsequent correspondence, requesting an extension of time under § 301.9100-1 of the Procedure and Administration Regulations to sever Marital Trust II into three trusts, pursuant to § 26.2654-1(b)(1) of the Generation-Skipping Transfer (GST) Tax Regulations and

requesting a ruling that the subsequent severance of one of the trusts will be a qualified severance under § 2642(a)(3) of the Internal Revenue Code.

Facts

The facts submitted and representations made are as follows. Wife died on Date 1, in 1989, survived by Husband, Child 1, Child 2, Child 3, and Child 4.

Under the terms of Wife's Revocable Trust Agreement, at her death, the trust assets are first to be divided between Marital Trust I, to be funded under a formula taking into account the maximum marital deduction amount allowable in State, and Marital Trust II, to be funded under a formula taking into account the minimum amount necessary to eliminate federal estate tax after taking into account available credits against estate tax and the value of Marital Trust I.

Under the terms of Marital Trust I, during his life, Husband is to receive all of the net income at least quarterly, as much principal as the trustee deems necessary or desirable for Husband's support, comfort, maintenance, or benefit, and any amount of principal Husband requests. Husband is granted a testamentary general power of appointment over the trust assets remaining at his death. Any assets that Husband does not appoint pass under the provisions for distributing the remainder of Marital Trust II.

Under the terms of Marital Trust II, during his life, Husband is to receive all of the net income at least quarterly and as much principal as the trustee deemed necessary or desirable for Husband's support, comfort, maintenance, or benefit. At Husband's death, one-fifth of the remaining trust assets is to be distributed pursuant to the terms of Article VII (as discussed below) to three designated charities, and four-fifths of the remaining trust assets are to be distributed to Family Trust (discussed below.)

The residue of the trust assets is to be divided into two parts. One part, designated as "Charities' Part, is to be funded with one-fifth of the residue. Under the terms of Article VII of Wife's Revocable Trust Agreement, the Charities' Part (and income attributable to that part from Wife's date of death) is to be distributed outright to three specified charities.

The remaining four-fifths of the residue is to pass to "Family Trust". Under the terms of Family Trust, contained in Article VI(b)) of the trust agreement, during Husband's life, the independent trustee is to pay to any among Husband and Wife's issue living from time to time any amount of income that trustee determines and any amount of principal that trustee deems necessary or desirable for such beneficiaries' support, comfort, maintenance, education or benefit. At Husband's death, the remaining assets of Family Trust are to be held in further trust and divided into equal shares, one share for each of Wife's then-living children or deceased children who are survived by issue.

During a child's life, the trustee can accumulate the income of each child's share until the child reaches age 35 when all of the income from that share must be distributed to the child at least quarterly. The independent trustee may distribute to the child as much of the principal of the child's share as that trustee deems necessary or desirable for the child's support, comfort, maintenance, education, or benefit. Upon reaching age 35, a child may withdraw from the child's share an aggregate of 30 percent of the principal; and upon reaching age 45, a child may withdraw an aggregate of 30 percent of the remaining principal. The rights of withdrawal are cumulative. If a child dies, then that portion of the corpus with respect to which immediately prior to death, the child possessed a right of withdrawal, may be appointed by the child pursuant to the exercise of a testamentary general power of appointment. The balance of the deceased child's share (in addition to any part over which the child failed to exercise the power) will be held in trust for the child's then-living issue, or, if none, will be distributed equally among the deceased child's then-living siblings or, if none, the then-living issue of a deceased sibling.

When any individual among a deceased child's issue who are income beneficiaries dies, that individual's share will be paid outright by right of representation to that individual's then living issue, or, if none, in equal shares to that individual's siblings then living, or, if none, by right of representation to the then living issue of the donor.

On the Schedule M of Wife's Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return, the executor checked the box to elect qualified terminable interest property (QTIP) treatment for Marital Trust II. On Part 2, line 1 of the Schedule M, the executor reported the entire date of death value of Marital Trust II as \$x, describing this amount as the date of death value of the trust after the deduction of \$y for State 2 estate taxes and before the payment of federal and State estate taxes from Marital Trust II. On Part 2, line 3 of the Schedule M, the executor reported that \$z in federal and State estate taxes was paid. On the Schedule R, the executor made a reverse QTIP election under § 2652(a)(3) for all of the property in Marital Trust II and allocated Wife's \$1 million GST exemption to Marital Trust II.

Because Wife's available lifetime unified credit had been exhausted by other bequests, the residuary bequests to Family Trust and Charities' Part were not funded at the time of Wife's death.

On Date 2, in 1994, Husband died, testate, survived by Child 1, Child 2, Child 3, and Child 4. In his Will, Husband exercised his general power of appointment over Marital Trust I by appointing to his estate an amount equal to the estate taxes generated by the inclusion in his gross estate of Marital Trust I and Marital Trust II. In accordance with Wife's Revocable Trust Agreement, the assets remaining in Marital Trust I after the exercise of Husband's general power were combined with the assets remaining in Marital Trust II. Pursuant to the trust agreement, one-fifth of the combined assets was distributed to Charities' Part and paid outright to the three designated

charities. Four-fifths of the combined assets were distributed to the Family Trust. Pursuant to the trust agreement, the Family Trust was further divided into four equal separate trusts for Child 1, Child 2, Child 3, and Child 4, respectively. Each among Child 1, Child 2, Child 3, and Child 4 has attained the age of 45, and each has exercised, in full, that child's rights of withdrawal over the child's trust. Thus, each child has withdrawn 51% of the principal of the child's respective trust. No discretionary distributions have been made from any of these trusts.

The trustees under the Revocable Trust Agreement propose to request an order from the appropriate State court severing Marital Trust II, effective as of Wife's date of death, into three separate subtrusts: the Charities Trust, the 51% Trust, and the 49% Trust. The Charities Trust will consist of one-fifth of the value of Marital Trust II at Wife's date of death after the payment of \$Z in estate taxes paid with respect to the Wife's estate. The 51% Trust will consist of 51 percent of the remaining four-fifths of the value of Marital Trust II at Wife's date of death after the payment of such estate taxes. The 49% Trust will consist of 49 percent of the remaining four-fifths of the value of Marital Trust II at Wife's date of death after the payment of such estate taxes. Each of the three subtrusts will provide that the trust assets will be held for Husband's benefit during his life under the same terms as those governing the original Marital Trust II and that any distributions of principal be made pro rata from each of the three subtrusts.

The Charities Trust will provide that, at Husband's death, the assets remaining in that trust will be distributed under the terms of Article VII of Revocable Trust Agreement to the specified charities. The 51% Trust will provide that, at Husband's death, the remaining trust assets will be divided into equal shares for each of Wife's four children and held as separate trusts. During a child's life, all of the income from the child's trust must be distributed to the child at least quarterly. The independent trustee may distribute to the child as much of the principal of the child's trust as that trustee deems necessary or desirable for the child's support, comfort, maintenance, education, or benefit. Upon reaching age 35, a child may withdraw from the child's trust an aggregate of one-half of the principal; and upon reaching age 45, a child may withdraw the balance. A child who has a right of withdrawal but who dies before exercising it may appoint by will any part of the child's trust subject to that withdrawal right. Any part of the trust over which the child failed to exercise that power will be held in trust for the child's then-living issue, or, if none, will be distributed equally among the deceased child's then-living siblings or, if none, the then-living issue of a deceased sibling.

The 49% Trust will provide that, at Husband's death, the remaining trust assets will be divided into equal shares for each of Wife's four children and held as separate share trusts. During a child's life, all of the income from the child's trust must be distributed to the child at least quarterly. The independent trustee may distribute to the child as much of the principal of the child's trust as that trustee deems necessary or desirable for the child's support, comfort, maintenance, education, or benefit. At the child's death, the child's trust will be divided among the deceased child's then-living issue and held in further trust under the terms of Wife's Revocable Trust Agreement.

Under the court order, the distribution that was made after Husband's death to the designated charities, under the terms of Article VII of Wife's Revocable Trust Agreement, to the extent attributable to Marital Trust II assets, will be treated as having been distributed from Charities Trust. The assets that were distributed to Child 1, Child 2, Child 3 and Child 4 after Husband's death pursuant to the exercise of their withdrawal rights with respect to Family Trust, to the extent attributable to Marital Trust II assets will be treated, as having been distributed from the 51% Trust.

The balance of the Marital Trust II assets that, after Husband's death, were distributed to the four separate trusts established for Child 1, Child 2, Child 3 and Child 4, will fund the 49% trust, which will be divided into four separate trusts, one for the benefit of each of Child 1, Child 2, Child 3 and Child 4. Each Child's trust will be further severed into two separate subtrusts, the 49% Exempt Subtrust with an inclusion ratio of zero and the 49% Nonexempt Subtrust with an inclusion ratio of 1. The 49% Exempt Subtrust will consist of 93.41% of the value of the assets of each Child's 49% Trust on the date of severance. The 49% Nonexempt Subtrust will consist of the balance of the assets of each Child's trust.

Under the court order, the property comprising Marital Trust I at the time of Husband's death (but after Husband's exercise of his testamentary power of appointment) will be treated as passing to a separate trust after Husband's death, with respect to which Husband is the transferor for GST tax purposes under § 2652. This separate trust will then be severed, effective as of Husband's date of death, in the same manner as described above regarding the Marital Trust II property.

The trustees request rulings that:

1. An extension of time is granted under § 301.9100-1 to sever Marital Trust II into three subtrusts, as proposed, under § 26.2654-1(b)(1).
2. After severance of Marital Trust II, Wife's available GST Exemption under § 2631 is treated as allocated, in total, to the 49% Trust.
3. After severance of Marital Trust II, each of the separate Trusts held for Child 1, Child 2, Child 3, and Child 4 under the 49% Trust will have an inclusion ratio of .06592.
4. The proposed severance of the 49% Trust into the 49% Exempt Subtrust and the 49% Nonexempt Subtrust will be a qualified severance under § 2642(a)(3); thus, after that severance, the 49% Exempt Subtrust will have an inclusion ratio of zero and the 49% Nonexempt Subtrust will have an inclusion ratio of 1.

Law and Analysis

Section 2601 imposes a tax on every generation-skipping transfer (GST) (within the meaning of subchapter B). A GST is defined under 2611(a) as: (1) a taxable distribution; (2) a taxable termination; and (3) a direct skip.

Section 2602 provides that the amount of the GST tax is determined by multiplying the taxable amount by the applicable rate. Section 2641(a) provides that the term "applicable rate" means with respect to any GST transfer, the product of the maximum federal estate tax rate and the inclusion ratio with respect to the transfer. Under § 2642(a)(1), the inclusion ratio with any property transferred in a generation-skipping transfer is generally defined as the excess of 1 over the "applicable fraction". The applicable fraction, as defined in 2642(a)(2) is a fraction, the numerator of which is the amount of GST exemption under 2631 allocated to the trust (or to property transferred in a direct skip), and the denominator is the value of the property transferred reduced by the sum of any federal estate tax or state death tax actually recovered from the trust attributable to such property and any charitable deduction allowable under § 2055 or § 2522 with respect to such property.

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 2631(c)) which may be allocated by such individual (or his executor) to any property with respect to which such individual is the transferor. Section 2631(b) provides that any allocation under 2631(a), once made, shall be irrevocable.

Section 2632(a) provides that any allocation by an individual of his or her GST exemption under 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 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.

Under § 2642(a)(3)(A), if a trust is severed in a qualified severance, the trusts resulting from such severance will be treated as separate trusts for purposes of generation-skipping transfer tax. Section 2642(a)(3)(B) provides that a "qualified severance" means the division of a single trust and the creation (by any means available under the governing instrument or local law) of two or more trusts if the single trust was divided on a fractional basis, and the terms of the new trusts, in the aggregate, provide for the same succession of interests of beneficiaries as are provided in the original trust. If a trust has an inclusion ratio of greater than zero and less than 1, a severance is a qualified severance only if the single trust is divided into two trusts, one of which receives a fractional share of the total value of all trust assets equal to the applicable fraction of the single trust immediately before the severance. In such case,

the trust receiving such fractional share will have an inclusion ratio of zero and the other trust will have an inclusion ratio of 1. Under § 2642(a)(3)(C), a qualified severance may be made at any time. Section 2642(a)(3) was enacted as part of the Taxpayer Relief Act of 2000, and is effective in the case of severances occurring after December 31, 2000.

Section 26.2654-1(b)(1) provides rules, that were applicable prior to the enactment the qualified severance rules under section 2642(a)(3), under which the severance of a trust that is included in the transferor's gross estate into two or more trusts will be recognized for GST tax purposes. Under the regulation, if the governing instrument does not require severance, the trust must be severed pursuant to discretionary authority granted either under the governing instrument or under local law. The severance must occur (or a reformation proceeding be commenced) prior to the date prescribed for filing the federal estate tax return for the estate of the transferor. The trusts must either be severed on a fractional basis or a pecuniary basis (if so required by the governing instrument). 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.

Under § 2652(a)(1), for purposes of chapter 13, the term "transferor" means the decedent, in the case of any property subject to tax imposed by chapter 11 and, the donor, in the case of any property subject to tax imposed by chapter 12. The individual with respect to whom property was most recently subject to federal estate or gift tax is the transferor of that property for purposes of chapter 13. Section 26.2652-1(a)(1) of the Generation-Skipping Transfer Tax Regulations. Thus, an individual may be a transferor even though there is no transfer of property under local law at the time the federal estate or gift tax applies. Section 26.2652-1(a)(2) states that for purposes of chapter 13, a transfer is subject to federal gift tax if a gift tax is imposed under § 2501(a) (without regard to exemptions, exclusions, deductions, and credits). Under § 26.2654-1(a)(2)(i), if there is more than one transferor with respect to a trust, the portions of the trust attributable to the different transferors are treated as separate trusts for purposes of chapter 13.

Section 301.9100-1(c) provides that the Commissioner has discretion to 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 Internal Revenue Code except subtitles E, G, H, and I.

Section 301.9100-3 provides the standards used to determine whether to grant an extension of time to make an election whose due date is prescribed by a regulation (and not expressly provided by statute).

Requests for relief under § 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 that granting 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.

In this case, we have determined that relief under §§ 301.9100-1 should be granted. Consequently, an extension of time is granted until 60 days from the date of this letter for commencing the court proceeding to sever Marital Trust II, as proposed, under § 26.2654-1(b)(1). We also rule that, if severance occurs as a result of the court proceeding, in view of the allocation of GST exemption that was made by Wife's estate prior to promulgation of § 26.2654-1(b)(1), Wife's available GST Exemption under § 2631 is treated as allocated, in total, to the 49% Trust. Further, after severance of Marital Trust II, each of the separate Trusts held for Child 1, Child 2, Child 3, and Child 4, under the 49% Trust will have an inclusion ratio of .06592. Finally, we rule that the proposed severance of the 49% Trust into the 49% Exempt Subtrust and the 49% Nonexempt Subtrust will be a qualified severance under § 2642(a)(3); thus, after that severance, the 49% Exempt Subtrust will have an inclusion ratio of zero and the 49% Nonexempt Subtrust will have an inclusion ratio of 1.

The election under § 26.2654-1(b)(1) must be made by attaching a statement to a copy of the Schedule R filed by Wife's estate. The statement must indicate that a proceeding has been commenced to sever Marital Trust II and describe the manner in which Marital Trust II is proposed to be severed. A copy of the petition filed must also be attached. Further, for purposes of the qualified severance provisions under § 2642(a)(3), a statement must also be submitted pursuant to § 2642(a)(3)(C), describing the manner in which the resulting 49% Trust is proposed to be severed in accordance with § 2642(a)(3) and with this letter. A copy of this letter must also be attached to the statements and is enclosed for this purpose. The statements and attachments should be filed with the Cincinnati Service Center -- Stop 82, Internal Revenue Service, Cincinnati, OH 45999.

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,

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

Enclosure

Copy for section 6110 purposes
Copy of this letter

cc: