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Person To Contact:
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Telephone Number:

Refer Reply To:
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Date:
July 07, 2004

Legend

Decedent =
Date 1 =
Wife =
Date 2 =
Date 3 =
Executor =
Date 4 =
Accountant =

Dear :

This is in response to your letter dated September 9, 2003, and subsequent correspondence requesting rulings under §§ 2044, 2056, 2519, 2652, and 2654 of the Internal Revenue Code and § 301.9100-3 of the Procedure and Administration Regulations.

The facts and representations submitted are summarized as follows: Decedent died testate on Date 1, survived by Wife, a son, a daughter and three grandchildren. Wife died on Date 2.

Section 4.8(a) of Decedent's Will provides that any trust that may be subject to the generation-skipping transfer (GST) tax may be divided in the trustee's discretion into two separate trusts, so that one trust will have an inclusion ratio of zero and one trust will have an inclusion ratio of one. The trust estate shall be divided based on the fair market value of the trust assets at the time of the division. The two separate trusts may be created upon initial funding or at a later date, and shall have identical terms.

Section 6.1 of Decedent's Will provides that if Wife survives Decedent, Decedent's residuary estate shall be divided into two separate parts, each of which shall constitute a separate trust: Trust 1, a credit shelter trust, and Trust 2, a marital deduction trust.

Section 6.3 of Decedent's Will provides that Trust 1 should be funded with an amount equal to the largest fractional share that can pass free of federal estate and GST taxes on Decedent's gross estate, except those taxes, if any, which cannot be reduced by the unified credit, marital deduction, or any other credits, exemptions, or deductions.

Section 6.4 of Decedent's Will provides that the residue of Decedent's estate shall constitute Trust 2 and be administered as provided in Article 8.

Section 7.1 of Decedent's Will provides that during Wife's lifetime, the trustee has the discretion to distribute all or part of the net income or principal of Trust 1 to Wife. Section 7.3 provides that after Wife's death, the income of Trust 1 shall be divided equally between Decedent's children and paid at least quarterly.

Section 8.1 of Decedent's Will provides that the net income of Trust 2 shall be paid in quarterly or more frequent installments to or for the benefit of Wife for Wife's lifetime. Principal may be distributed, in the trustee's discretion, to or for the benefit of Wife as necessary for Wife's health, maintenance, support, and education to enable spouse to maintain the standard of living that she maintained during Decedent's lifetime.

On Date 3, Executor filed a timely Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return (estate tax return) on behalf of Decedent's estate. The marital deduction was taken on Schedule M with respect to the assets of both Trust 1 and Trust 2. Schedule R was not included in the estate tax return as filed on Date 3. The estate received a closing letter on Date 4.

Executor relied on Accountant to prepare the estate tax return for Decedent's estate. Accountant inadvertently failed to advise Executor about the available tax elections relating to QTIP trusts or of the possibility of splitting the QTIP trust into GST exempt and non-exempt shares. The errors on Decedent's estate tax return were discovered during the administration of Wife's estate.

Executor has requested the following rulings: (1) The QTIP election with respect to Trust 1 is void; (2) an extension of time to sever Trust 2 into Trust 2A and Trust 2B; and (3) an extension of time to make a reverse QTIP election with respect to Trust 2B.

Law

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

Section 2056(a) provides that the value of a decedent's taxable estate shall 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 that a deduction is not allowed for terminable interests that pass to the spouse. An interest is a terminable interest if the interest passing to the surviving spouse will terminate or fail on the lapse of time or on the occurrence of an event or contingency or on the failure of an event or contingency to occur, and on termination, an interest in the property passes to someone other than the surviving spouse.

Section 2056(b)(7)(A) provides that qualified terminable interest property shall be treated as passing to the surviving spouse and no part of such property shall be treated as passing to any person other than the surviving spouse. Thus, the value of such property is deductible from the value of the gross estate under § 2056(a) and is not treated as a terminable interest. Under § 2056(b)(7)(B)(i), qualified terminable interest property is property that passes from the decedent, in which the surviving spouse has a qualifying income interest for life, and to which an election under § 2056(b)(7)(B)(v) applies.

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

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

Section 2611(a) provides that the term "generation-skipping transfer" means: (1) a taxable distribution; (2) a taxable termination; and (3) a direct skip.

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 2632(a)(1) provides that any allocation by an individual of his 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 taxable termination might occur at or after such individual's death.

Section 26.2632-1(d)(2) of the Generation-Skipping Transfer Tax Regulations provides, in relevant part, that no automatic allocation of GST exemption 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 new trust.

Section 2652(a)(1) provides, in relevant part, 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 – (A) any trust with respect to which a deduction is allowed to the decedent under § 2056 by reason of subsection (b)(7) thereof, and (B) any trust with respect to which a deduction to the donor spouse is allowed under § 2523 by reason of subsection (f) thereof, the estate of the decedent or the donor spouse, as the case may be, 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.

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

Section 2654(b) provides that for purposes of the GST tax – (1) the portions of a trust attributable to transfers from different transferors shall be treated as separate trusts, and (2) substantially separate and independent shares of different beneficiaries in a trust shall be treated as separate trusts. Except as provided in the preceding sentence, nothing in chapter 13 is to be construed as authorizing a single trust to be treated as two or more trusts.

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 under the governing instrument or under local law; and (A) the terms of the new trust 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 pro rata basis provided funding is based on either the fair market value 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)(ii) if it were paid to an individual.

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 six 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(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 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 to advise the taxpayer to make, the election.

Ruling 1

A QTIP election has transfer tax consequences for the surviving spouse. Section 2044(a) and (b) provide generally that the value of the gross estate includes the value of any property in which the decedent has a qualifying income interest for life and with respect to which a deduction was allowed for the transfer of the property to the decedent under § 2056(b)(7). Under § 2519(a) and (b), any disposition of all or part of a qualifying income interest for life in any property with respect to which a deduction was allowed under § 2056(b)(7) is treated as a transfer of all interests in the property other than the qualifying income interest. Further, the surviving spouse will, in the absence of a “reverse QTIP” election under § 2652(a)(3), be treated as the transferor of the property for GST purposes under § 2652(a).

In the case of a QTIP election to which Rev. Proc. 2001-38, 2001-1 C.B. 1335, applies, the Service will disregard a QTIP election made under § 2056(b)(7) and treat it as null and void for purposes of §§ 2044(a), 2056(b)(7), 2519(a), and 2652. Rev. Proc.

2001-38 applies to QTIP elections under § 2056(b)(7) where the election was not necessary to reduce the estate tax liability to zero, based on values as finally determined for federal estate tax purposes. One example of an unnecessary QTIP election described in the revenue procedure is one that is made for both a credit shelter trust and a marital trust. The QTIP election for the credit shelter trust is not necessary, because no estate tax is imposed on a credit shelter trust funded with an amount that does not exceed the applicable exclusion amount under § 2010(c). Rev. Proc. 2001-38 does not apply in situations where a partial QTIP election was required with respect to a trust to reduce the estate tax liability and the executor made the election with respect to more property than was necessary to reduce the estate tax liability to zero; nor does it apply to elections that are stated in terms of a formula designed to reduce the estate tax to zero.

In this case, the election under § 2056(b)(7) to treat the assets in Trust 1 as QTIP was not necessary to reduce the estate tax to zero because no estate tax would have been imposed on the assets in Trust 1 whether or not the election was made, because Trust 1 is a credit shelter trust that was funded with an amount not exceeding the § 2010(c) exclusion amount. If relief under Rev. Proc. 2001-38 is granted, the estate's federal estate tax liability will remain at zero after applying the unified credit amount under § 2010.

Because the QTIP election in this case was not necessary to reduce the estate tax liability to zero, Rev. Proc. 2001-38 applies and the Service will disregard the QTIP election and treat it as null and void for purposes of §§ 2044, 2056(b)(7), 2519(a), and 2652. The property for which the election is disregarded will not be includible in Wife's gross estate under § 2044(a).

Rulings 2 and 3

In this case, because a QTIP election was made on Decedent's estate tax return, the assets of the QTIP Trust are includible in Wife's gross estate pursuant to § 2044. In addition, Wife is considered the transferor of such property for GST tax purposes, thereby initially precluding the allocation of Decedent's unused GST exemption to Trust 2. However, if Decedent's estate is allowed to make a "reverse" QTIP election under § 2652(a)(3) with respect to the assets of Trust 2, Decedent will be treated as the transferor of those assets for GST tax purposes.

Based on the facts submitted and the representations made, we conclude that the requirements of §§ 26.2654-1 and 301.9100-3 have been satisfied. Therefore, an extension of time is granted until 60 days from the date of this letter (i) to sever Trust 2 into Trust 2A and Trust 2B; and (ii) to make a "reverse" QTIP election under § 2652(a)(3) with respect to the assets of Trust 2B. As a result of the severance of Trust 2 and the "reverse" QTIP election with respect to the resulting Trust 2B, Decedent's remaining GST exemption is allocated in accordance with the rules provided in § 2632(e)(1).

A supplemental Form 706 should be filed on behalf of Decedent's estate with the Internal Revenue Service Center, Cincinnati, Ohio 45999. The supplemental Form 706 should list Trust 2A and Trust 2B on Schedule M. In addition, the "reverse" QTIP election for Trust 2B should be made on Schedule R. Trust 1 should not be listed on Schedule M or Schedule R. A copy of this letter should be attached to the supplemental return. A copy is enclosed for this purpose.

Except as expressly provided herein, no opinion is expressed or implied concerning the federal 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.

Pursuant to the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer's representative.

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

Sincerely,
Heather C. Maloy
Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosure
Copy of Letter for § 6110 purposes
Copy of Letter

cc: