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Department of the Treasury
Washington, DC 20224

[Third Party Communication:
Date of Communication: Month DD, YYYY]

Person To Contact: _____, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B09
PLR-100979-04

Date:
July 16, 2004

In Re:

Legend:

- Decedent =
- Spouse =
- Law Firm 1 =
- Law Firm 2 =
- State =
- State Statute =
- Date 1 =
- Date 2 =
- A =
- B =
- C =
- D =

Dear _____ :

This is in response to your letter dated December 22, 2003, and subsequent 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.

The facts and representations submitted are summarized as follows. Decedent died on Date 1. He was survived by Spouse and four children. Article Fourth of Decedent's will provides for the creation of four trusts, one for the benefit of each of his children, and a trust for Spouse (marital trust).

Article Fourth (A) provides that Decedent's children are to receive income and principal from their trusts to provide for their health, maintenance, and support. Income not distributed in a year is to be accumulated. In the event the principal of the marital trust is exhausted, Spouse is to receive income and principal from the children's trusts to provide for her health, maintenance, and support. Each child has a testamentary limited power of appointment over his or her trust. Assets not effectively appointed are to be distributed to the child's heirs, provided that assets distributed to an heir for whom a trust has been established under Article Fourth (A) are to be contributed to that trust and administered accordingly.

Article Fourth (B) provides that the children's trusts are to be funded with an amount that does not exceed the sum of the allowable unified credit and the credit for state death taxes. Article Fourth (C) provides that the marital trust is to be funded with the residue of Decedent's estate.

Article Fourth (C) further provides that Spouse is to receive all of marital trust's income, and so much of marital trust's principal to provide for her health, maintenance, and support. Spouse has a testamentary limited power to appoint marital trust's assets among the couple's then living issue. Assets not effectively appointed are to be held in further trust as provided in Article Fifth.

Article Fifth provides that if Spouse predeceases Decedent or if Spouse does not effectively appoint marital trust's assets, the assets are to be divided into equal shares so as to provide one share for each of Decedent's then living children and grandchildren and held in further trust. Each child or grandchild is to receive income and principal from their trust to provide for their maintenance, support, health, and education. Income not distribute in a year is to be accumulated. Each child and grandchild has a testamentary limited power to appoint his or her trust's assets. Assets not effectively appointed are to be distributed to the child's or grandchild's heirs, provided that assets distributed to an heir for whom a trust has been established under Article Fifth are to be added to that trust and administered accordingly.

Spouse retained Law Firm 1 to prepare the estate tax return for Decedent's estate. The estate tax return was timely filed on Date 2. The QTIP election was made on Schedule M of the estate tax return for the marital trust. In preparing the estate tax return, however, Law Firm 1 failed to divide the marital trust into a GST exempt marital trust and a GST nonexempt marital trust, and failed to make the reverse QTIP election under § 2652(a)(3) for the GST exempt marital trust.

Shortly thereafter, Spouse retained Law Firm 2 to provide personal estate tax planning. Law Firm 2 discovered that the marital trust had not been divided into a GST exempt and nonexempt marital trust, and that the reverse QTIP election had not been made for the GST exempt marital trust.

It has been represented that all of Decedent's GST exemption was available for allocation at his death. The estate tax return does not reflect an allocation of Decedent's GST exemption. The estate tax return reflects that the children's trusts were funded with a total of \$A in assets. As a result, \$B of Decedent's GST exemption is available for allocation.

It has been further represented that the estate will seek a State court order pursuant to State Statute, in effect on Date 2, from the appropriate State court to sever the marital trust into a GST exempt and nonexempt marital trust, and that the terms of the GST exempt and nonexempt marital trusts will be identical.

The estate is requesting an extension of time under §§ 301.9100-1 and 3 to sever the marital trust into a GST exempt marital trust and a GST nonexempt marital trust, under § 26.2654-1(b)(1) of the Generation-Skipping Transfer Tax Regulations, and to make a reverse QTIP election under § 2652(a)(3) for the GST exempt marital trust.

The formula for dividing the marital trust's assets will be computed as follows: \$B (Decedent's available GST exemption) divided by \$C (the date of death value of the marital trust as reflected on Schedule M of the estate tax return) equals D percent. The GST exempt marital trust will be funded with a fractional share of the marital trust's assets equal to D percent, and the balance of the marital trust's assets will be allocated to the GST nonexempt marital trust.

Law and 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 § 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 and (A) an interest in such 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 (B) if by reason of such passing such person (or his heirs or assigns) may possess or enjoy any part of such property after such termination or failure of the interest so passing to the surviving spouse.

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 for purposes of § 2056(b)(1).

Section 2056(b)(7)(B)(i) defines “qualified terminable interest property” (QTIP) 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 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. The election, once made, is irrevocable.

Under § 2044(a), any property in which the decedent possessed a qualifying income interest for life and for which a deduction was allowed under § 2056(b)(7) is includable in the decedent’s gross estate.

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

Section 2602 provides that the amount of tax is the taxable amount multiplied by the applicable rate. Section 2641(a) defines “applicable rate” as the product of the maximum federal estate tax rate and the inclusion ratio with respect to the transfer.

Section 2642(a) provides the method for determining the inclusion ratio.

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)) that 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(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 the individual’s death, and (B) second, to trusts with respect to which the individual is the transferor and from which a taxable distribution or a taxable termination might occur at or after the individual’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 § 2056(b)(7), the estate of the decedent may elect to treat all of the property in the trust, for purposes of the GST tax, 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 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(a)(2)(i) provides, in part, that 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 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. 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 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 paragraph (a)(1)(ii) of this section if it were paid to an individual.

Under § 301.9100-1(c), 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.

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 a regulatory election.

Section 301.9100-2 provides for 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 § 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)(iii) provides that a taxpayer is deemed to have acted reasonably and in good faith if the taxpayer failed to make the election because, after exercising reasonable diligence (taking into account the taxpayer's experience and the complexity of the return or issue), the taxpayer was unaware of the necessity for the election.

State Statute, in effect on Date 2, provides that the court, for cause shown, may authorize the division of a trust into two or more separate trusts upon such terms and conditions and with such notice as the court shall direct.

In this case, it has been represented that all of Decedent's GST exemption was available for allocation at his death. Although no allocations of Decedent's GST exemption were made on the estate tax return, as filed, pursuant to §§ 2632(e) and 26.2632-1(d)(2), \$A of Decedent's GST exemption was automatically allocated to the children's trusts, leaving \$B of Decedent's GST exemption unused.

As a result of the QTIP election made on the estate tax return, the marital trust's assets will be includible in Spouse's gross estate pursuant to § 2044. Spouse, accordingly, will be the transferor of the marital trust's assets for GST tax purposes. Therefore, Decedent's remaining GST exemption may not be allocated to the marital trust's assets. However, if the marital trust is severed into two trusts, a GST exempt marital trust and a GST nonexempt marital trust, and a reverse QTIP election under § 2652(a)(3) is made with respect to the GST exempt marital trust, Decedent will be treated as the transferor of the GST exempt marital trust's assets. Under the automatic allocation rules in § 2632(c) (redesignated as § 2032(e) by P.L. 107-16, § 561(a)), Decedent's remaining GST tax exemption of \$B will be allocated to the GST exempt marital trust.

Based on the facts submitted and the representations made, we conclude that the requirements of § 301.9100-3 have been satisfied. Accordingly, the estate is granted 60

days from the date that the estate obtains a State court order severing the marital trust into a GST exempt marital trust and a GST nonexempt marital trust, the terms of which are identical, to sever the marital trust and to file a supplemental estate tax return on which the reverse QTIP election is made for the GST exempt marital trust.

The supplemental estate tax return should be filed with the Internal Revenue Service Center, Cincinnati, Ohio 45999. A copy of the State court order severing the marital trust and a copy of this letter should be attached to the return. A copy is enclosed for this purpose.

An extension of time to make the reverse QTIP election under § 2652(a)(3) does not extend the time to make an allocation of any remaining GST exemption. Once the reverse QTIP election is made §§ 2632(e) and 26.2632-1(d)(2) will operate to allocate \$B of Decedent's remaining GST exemption to the GST exempt marital trust.

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. Specifically, no opinion is expressed or implied as to the value of the assets included in Decedent's gross estate for federal estate tax purposes.

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.

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

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.

Sincerely,

Heather C. Maloy

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

Enclosure: Copy for section 6110 purposes
Copy of this letter

cc: