

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:9-PLR-104929-03
Date:
April 3, 2003

In Re:

LEGEND

- Decedent =
- Trust =
- Spouse =
- Daughter =
- Grandchildren =
- State Statute 1 =
- State Statute 2 =
- State Statute 3 =
- State Statute 4 =
- Date 1 =
- Date 2 =
- Date 3 =

Dear Sir:

This is in response to your letter, dated January 17, 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. On Date 1, Decedent created Trust, a revocable trust. On Date 2, Decedent executed a Will that directed the executor to distribute the residue of her estate to the Trust. Decedent died on Date 3.

Article Fourth of the Trust establishes two separate shares, Share 1 and Share 2. The trustee is to fund Share 1 with the minimum amount of trust assets eligible for the

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marital deduction that will result in the minimum amount of federal estate taxes due on Decedent's estate, after taking into account credits and deductions available to Decedent's estate. The trustee is to fund Share 2 with the balance of the trust estate. Article Fourth directs the trustee to elect to treat Share 1 as qualified terminable interest property.

Article Fifth provides that the trustee is to pay Spouse all of the net income from Share 1 at least quarter annually and so much of Share 1's principal as is necessary to maintain and support Spouse in his accustomed manner of living and to meet any emergency or untoward circumstance arising during Spouse's lifetime. At Spouse's death, the trustee is to pay any accumulated but undistributed Share 1 income to Spouse's estate. Share 1's remaining principal is to be held in further trust and administered as directed by Article Sixth of the Trust.

With respect to Share 2, the trustee is to pay Spouse, Daughter, and Grandchildren so much of Share 2's net income and principal as is necessary to provide for their support, maintenance, and education. Income not distributed is to be added to principal. At Spouse's death, trustee is to hold Share 2's remaining principal and undistributed income in further trust and administer these assets as directed by Article Sixth of the Trust. In the event Daughter and Grandchildren die during Share 2's term leaving surviving descendants, trustee is to pay the descendants so much of Share 2's income and principal as is necessary to provide for their support, maintenance, and education and to meet any extraordinary expenses in emergency or untoward circumstances.

Upon Spouse's death, Share 1's remaining principal and Share 2's remaining income and principal are to be administered in accordance with Article Sixth. Article Sixth provides that trustee is to pay Daughter and Grandchildren so much of the trust's net income and principal as is necessary to provide for their support, maintenance, and education. Income not distributed is to be added to principal. In the event Grandchildren die during the trust's term survived by descendants, the trustee is to pay the descendants so much of trust's net income and principal deemed necessary to provide for their support, maintenance, and education and to meet any extraordinary expenses in emergency or untoward circumstances.

At Daughter's death, the trustee is to divide the trust estate into two equal shares, one for each Grandchild, and distribute one share to each Grandchild, free of trust. In the event one of the Grandchildren predeceased Daughter and left descendants, the trustee is to pay the Grandchild's descendants his share, per stirpes. If the Grandchild predeceased Daughter and left no descendants, his share is to be paid to his sibling, the remaining Grandchild. If his sibling predeceased Daughter leaving descendants, the trustee is to pay the Grandchild's share to his sibling's descendants, per stirpes, free of trust. If his sibling died leaving no descendants, Grandchild's share is to be distributed to Decedent's surviving heirs, per stirpes, free of trust.

Article Tenth, subparagraph (b) provides that the trustee is authorized (but not directed) at any time to divide any trust created under the Trust agreement into two separate trusts so that the GST tax inclusion ratio for each trust will be either zero or one.

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Subsection (c) provides the trustee with the power to determine to which trust property the trustee will allocate Decedent's GST exemption.

Spouse, as executor of Decedent's estate, prepared the estate's Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return, and timely filed the return with the Service. Spouse listed Share 1 on Schedule M of the return and did not elect out of the QTIP election under § 2056(b)(7) for Share 1. Spouse did not attach a Schedule R to the return.

After the estate's Form 706 was filed, Spouse engaged an attorney to review his estate plan and the estate's Form 706. The attorney advised that it would have been advantageous for the estate if Spouse had elected under § 26.2654-1(b) of the Generation-Skipping Transfer Tax Regulations to sever Share 1 into a GST exempt QTIP trust and a GST nonexempt trust and had elected under § 2652(a)(3) to make a "reverse" QTIP election for the GST exempt QTIP trust.

Spouse requests an extension of time under §§ 301.9100-1 and 301.9100-3 to sever Share 1 into two separate trusts, a GST exempt QTIP trust and a GST nonexempt QTIP trust, pursuant to § 26.2654-1(b), and to make a "reverse" QTIP election under § 2652(a)(3) with respect to the GST exempt QTIP 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" as property:

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(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)) 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(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 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. The regulation also 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 values 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.

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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, generally, 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

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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 1 provides that unless expressly prohibited by the terms of the governing instrument, when property is held or to be held in a trust, the trustee is authorized, but not required, to divide the trust into two or more separate trusts of equal or unequal value if the trustee determines that division of the trust is in the best interests of the beneficiaries or could result in a significant decrease in current or future federal income, gift, estate, or generation-skipping transfer taxes, or any other tax.

State Statute 2 provides, in part, that a trustee may exercise the authority granted in this subchapter without procuring any judicial authorization or approval. Also, a trustee may exercise the authority granted in this subchapter to divide both funded and unfunded trusts.

State Statute 3 provides that if a trustee divides a trust into separate trusts under this subchapter, the terms of the separate trusts need not be identical but must provide for the same succession of interests and beneficiaries as are provided in the original trust. Differing tax elections may be made for each of the separate trusts.

State Statute 4 provides that this subchapter applies to all trustees regardless of whether the trust was created before, on, or after the date of enactment.

As a result of the QTIP election made on the Decedent's Form 706, the property in Share 1 is includible in Spouse's gross estate pursuant to § 2044. Spouse, accordingly, is considered the transferor of the property for GST tax purposes. Therefore, Decedent's remaining GST exemption may not be allocated to Share 1's assets. However, if Share 1 is severed into a GST exempt trust and a GST nonexempt trust, and a "reverse" QTIP election under § 2652(a)(3) is made for the GST exempt trust,

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Decedent will be treated as the transferor of the GST exempt trust and the automatic allocation rules of § 2632(e) will apply Decedent's remaining GST exemption to the property in that trust.

Based on the information 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 of sixty (60) days from the date of this letter is granted for severing Share 1, pursuant to § 26.2654-1(b), into a GST exempt QTIP trust and a GST nonexempt QTIP trust and to file a supplemental Form 706 making the "reverse" QTIP election with respect to the GST exempt QTIP trust.

The Form 706 should be filed with the Internal Revenue Service Center, Cincinnati, Ohio, 45999. A copy of this letter should be attached to the supplemental Form 706. A copy is enclosed for that 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. In this case, no allocation of Decedent's available GST exemption was made on the Form 706. Therefore, the automatic allocation rules of §§ 2632(e) and 26.2632-1(d)(2) operate to allocate Decedent's available exemption.

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.

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.

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

Sincerely,

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

Enclosures

Copy for section 6110 purposes
Copy of this letter

cc: