

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact:

Telephone Number:

Refer Reply To:

CC:PSI:B04 – PLR-169200-03

Date:

August 12, 2004

In Re:

LEGEND:

Decedent =
Spouse =
Trust =

GST Exempt Trust =

GST Non-exempt Trust =

Date 1 =
Date 2 =
Date 3 =
Daughter =
Lawyer =
Law Firm =
a =
b =
c =
d =
e =

Dear :

This is in response to your letter dated November 21, 2003, and other correspondence, requesting an extension of time under section 2642(g) of the Internal Revenue Code and section 301.9100-3 of the Procedure and Administration Regulations to sever a trust into GST exempt and GST non-exempt trusts, make a “reverse” QTIP election under section 2652(a)(3) with respect to the GST exempt trust and to make an allocation of the generation-skipping transfer (GST) exemption to the GST exempt trust under section 2642(b)(1) and (2).

The facts and representations submitted are summarized as follows:

On Date 1, Decedent executed his will. Paragraph SIXTH, section A, of the will provides, in part, that the residue and remainder of Decedent's estate shall be placed in Trust. If Spouse survives Decedent, during Spouse's lifetime, the net income of the Trust shall be paid to her, at least quarterly. During her lifetime, the trustees shall pay principal to her for her health, support, or maintenance, as the trustees from time to time think desirable. During her lifetime, Spouse shall additionally have a right to withdraw from principal up to \$5,000 at any time and, in addition, if she is living on December 31 of any year, to withdraw up to 5% of the fair market value of the principal determined on December 31 of that year.

Paragraph SIXTH, section B, provides that on Spouse's death, the principal remaining after the payments required by other sections of the will shall be held and distributed in accordance with subparagraph C.

Paragraph SIXTH, section C, provides that the trustees shall divide the principal into equal shares, so that there will be one share for each child of Decedent who is then living and each child who is then deceased represented by issue then living, excluding Daughter and issue of Daughter. Of each such share, a% shall be paid outright to each child then living or to the then living issue, per stirpes, and of each child then deceased, b% shall be held in trust as a separate trust. During each child's lifetime, the net income of the separate trust shall be paid to each child, at least quarterly, and the trustees shall pay principal to each child for the health, support, or maintenance of that child or the child's descendants or for the education of the child's descendants as the trustees from time to time think desirable.

At each child's death, any remaining principal shall be paid to each child's descendants, per stirpes, or in default of such descendants to Decedent's then living descendants, per stirpes. The trust provides that if any principal is distributable to a grandchild under the preceding provisions, the principal paid to the grandchild shall be retained as a separate trust for the benefit of that grandchild. The net income of the trust shall be paid to grandchild, at least quarterly, and the trustees may pay principal to the grandchild for health, maintenance, or support as the trustees from time to time think desirable. Each grandchild shall have the right to withdraw up to one-third of the principal after reaching age 25, one-half of the balance of the principal upon reaching age 35, and the entire balance after reaching age 40. At each grandchild's death, any remaining principal shall be paid to grandchild's descendants per stirpes, or in default of such descendants to the descendants of grandchild's parent who is a child of Decedent, or in default of such descendants to the descendants of Decedent.

Paragraph EIGHTH provides that the trustees shall divide what otherwise would be one trust into two or more sub-trusts to reflect different tax elections and to claim the benefit of tax exemptions. Any such division shall be made on a fractional share basis,

each sub-trust receiving a fairly representative portion of the appreciation or depreciation in the property available for funding the trust from which the sub-trusts are derived. The dispositive, administrative, and other provisions of each sub-trust shall, except as otherwise expressly provided herein, be identical to the provisions of the trust from which it is derived. In particular, as of the date of Decedent's death, the trustees shall divide the principal of a sub-trust of the Trust, one funded with the portion the executors elect to qualify for the federal estate tax marital deduction, and one funded with the portion the executors do not elect to qualify for the federal estate tax marital deduction.

Paragraph ELEVENTH, section A, provides that the executors may allocate any part of Decedent's GST exemption which has not been irrevocable utilized during Decedent's lifetime in such manner as the executors shall determine.

Paragraph ELEVENTH, section B, provides that for purposes of fully utilizing Decedent's GST exemption, if Spouse survives Decedent, the executors may make the election provided for in section 2652(a)(3) to the extent the executors have elected to treat all or part of the property passing under the will or under any deed of trust of which Decedent is settler as qualified terminable interest property (QTIP) under section 2056(b)(7).

Paragraph ELEVENTH, section C, provides that the executors may elect not to have the deemed allocation provisions of section 2632(b) apply to transfers made by Decedent during his lifetime.

Paragraph ELEVENTH, section D, provides that to the extent that the allocation of any GST exemption would not result in a particular trust being completely exempt from GST tax, the trustees may separate such trust into two trusts representing fractional shares of the trust being divided, one of which is exempt from the GST tax (exempt trust) and one of which is fully subject to the said tax (non-exempt trust). In the case of a trust which has not received assets at the time the exemption is allocated, the separation shall occur prior to any funding of the trust.

Paragraph ELEVENTH, section E, provides that if the executors have elected to qualify all or a portion of a trust for the benefit of Spouse under the terms of this will for the marital deduction and there is a separate trust for which the executors have made the election pursuant to section 2652(a)(3) and to which the executors have allocated any part of Decedent's GST exemption (exempt marital trust), and there is a separate trust for the benefit of Spouse (non-exempt marital trust), the trustees shall pay all death taxes on both trusts payable by reason of the death of Spouse from the non-exempt marital trust, unless such payment would be considered an addition to the exempt marital trust for GST purposes.

Paragraph ELEVENTH, section F, provides that any trust that will be included in the gross estate of Spouse may be divided in order to permit the executors of the estate

of Spouse to allocate some or all of the GST exemption of Spouse to one of such separate trusts so that such separate trust would be fully exempt from GST tax.

Decedent died on Date 2, survived by Spouse. The executors of Decedent's estate retained Lawyer of Law Firm to represent the executors in legal matters relating to the administration of the estate, including review of the federal estate tax return (Form 706). On Schedule M of Form 706, the executors made an election under section 2056(b)(7) to treat the entire value of Trust as QTIP property, and claimed a deduction for this amount. However, no Schedule R was filed with the Form 706. Consequently, no election was made under section 2652(a)(3) and none of Husband's GST exemption was allocated on the Form 706. After the executors prepared the Form 706, the return was submitted to Law Firm for review. Law Firm reviewed the return and timely filed the return with the Internal Revenue Service on Date 3.

Recently, Law Firm reviewed the actions taken so far in the administration of the estate. During the review, Law Firm discovered for the first time that inadvertently the return did not include Schedule R, as necessary to make a "reverse" QTIP election and an allocation of the available GST exemption.

During his lifetime, Decedent made taxable gifts in the amount of \$c. Of these gifts, \$d were gifts to grandchildren. Decedent's executors propose to allocate \$d of Decedent's GST exemption to these gifts. The executors propose to divide Trust into two trusts: the GST Exempt Trust and the GST Non-exempt Trust. It is represented that the severance will be done on a pro rata basis. The executors propose to make a "reverse" QTIP election with respect to the GST Exempt Trust and to allocate Decedent's remaining GST exemption of \$e to the GST Exempt Trust.

You have requested an extension of time under section 2642(g) and sections 301.9100-1 and 301.9100-3 to sever Trust into the GST Exempt Trust and the GST Non-exempt Trust, to make a "reverse" QTIP election under section 2652(a)(3), and to make an allocation of Decedent's GST exemption to the GST Exempt Trust under section 2642(b)(1) and (2).

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 section 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)(3) provides, in part, that an interest passing to the surviving spouse shall not be considered as an interest which will terminate or fail on the death of such spouse if such death will cause a termination or failure of such interest only if it occurs within a period not exceeding six months after the decedent's death and such termination or failure does not occur.

Section 2056(b)(7)(A) provides that, in the case of qualified terminable interest property, such property shall be treated as passing to the surviving spouse for purposes of section 2056(a), and no part of the property shall be treated as passing to any person other than the surviving spouse for purposes of section 2056(b)(1)(A).

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 section 2056(b)(7)(B)(v) applies.

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

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

Section 2044(c) provides that for purposes of chapter 11 and chapter 13, property includible in the gross estate of the decedent under section 2044(a) shall be treated as property passing from the decedent.

Section 2601 imposes a tax on every generation-skipping transfer (GST). A GST is defined under section 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 section 2642(a)(1), the inclusion ratio with respect to any property transferred in a generation-skipping transfer is generally defined as the excess (if any) of 1 over the "applicable fraction." The applicable fraction, as defined in section 2642(a)(2) is a fraction, the numerator of which is the amount of the GST exemption

allocated to the trust (or to property transferred in a direct skip), and the denominator of which is the value of the property transferred to the trust or involved in the 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 section 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 section 2631(a), once made, shall be irrevocable.

Section 2632(a)(1) provides that any allocation by an individual of his GST exemption under section 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 26.2632-1(b)(2)(i) of the Generation-Skipping Transfer Tax Regulations provides that an allocation of GST exemption to property transferred during the transferor's lifetime, other than in a direct skip, is made on Form 709.

Section 2652(a)(1) provides, in pertinent 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 any trust with respect to which a deduction is allowed to the decedent's estate under section 2056(b)(7), the estate of the decedent may elect to treat all of the property in the trust, for purposes of chapter 13, 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 tax exemption may be allocated to the QTIP trust.

Section 26.2652-2(a) provides that the election must be made with respect to all property held in a QTIP trust.

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

Section 2642(a)(3)(A) provides, generally, that if a trust is severed in a qualified severance, the trusts resulting from such severance shall be treated as separate trusts thereafter for GST tax purposes.

Section 2642(a)(3)(B)(i) provides, generally, that for purposes of section 2642(a)(3)(A), the term "qualified severance" means the division of a single trust and the creation (by any means available under the governing instrument or under 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.

Section 2642(a)(3)(B)(ii) provides that 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 shall have an inclusion ratio of zero and the other trust shall have an inclusion ratio of 1.

Section 2642(a)(3)(B)(iii) provides that the term "qualified severance" includes any other severance permitted under regulations prescribed by the Secretary.

Section 2642(a)(3)(C) provides that a severance pursuant to this paragraph may be made at any time. The Secretary shall prescribe by forms or regulations the manner in which the qualified severance shall be reported to the IRS.

Section 2642(b)(2)(A) provides that if property is transferred as a result of the death of the transferor, the value of such property for purposes of section 2642(a) shall be its value as finally determined for purposes of chapter 11; except that, if the requirements prescribed by the Secretary respecting allocation of post-death changes in value are not met, the value of such property shall be determined as of the time of the distribution concerned. Section 2642(b)(2)(B) provides that any allocation to property transferred as a result of the death of the transferor shall be effective on and after the date of the death of the transferor.

Under section 301.9100-1(c), the Commissioner may grant a reasonable extension of time under the rules set forth in sections 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, in pertinent part, that requests for extensions of time for regulatory elections that do not meet the requirements of section 301.9100-2 must be made under the rules of section 301.9100-3. Requests for relief subject to section 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 in part 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.

Section 301.9100-3(b)(2) provides that a taxpayer will not be considered to have reasonably relied on a qualified tax professional if the taxpayer knew or should have known that the professional was not (i) competent to render advice on the regulatory election; or (ii) aware of all relevant facts.

In this case, since a QTIP election was made on the Form 706, the assets of Trust are currently includible in Spouse's gross estate pursuant to section 2044. In addition, Spouse is considered the transferor of such property for GST tax purposes, thereby initially precluding the allocation of Decedent's remaining unused GST exemption to Trust. However, if Trust is severed into the GST Exempt Trust and the GST Non-exempt Trust in accordance with section 2642(a)(3) and Decedent's estate is granted an extension of time to make a "reverse" QTIP election under section 2652(a)(3) with respect to the assets of the GST Exempt Trust, Decedent will be treated as the transferor of those assets for GST tax purposes.

Based on the facts submitted and representations made in this case, we conclude that the standards of sections 301.9100-1 and 301.9100-3 have been satisfied. Consequently, an extension of time under section 2642(g) and sections 301.9100-1 and 301.9100-3 to sever Trust into the GST Exempt Trust and the GST Non-exempt Trust, to make a "reverse" QTIP election under section 2652(a)(3), and to make an allocation of the GST exemption under section 2642(b)(1) and (2) is granted until 60 days after the date of this letter.

This election and allocation of GST exemption should be made on a supplemental Form 706 United States Estate (and Generation-Skipping Transfer) Tax Return and 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 this purpose.

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

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.

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 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 and Special Industries)

Enclosures

Copy for section 6110 purposes
Copy of this letter