Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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Person to Contact:

Telephone Number:

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Date:
January 15, 2003

Legend

Decedent =
Date 1 =
Trust 1 =
Date 2 =
Date 3 =
Date 4 =
Date 5 =
Spouse =
Daughter 1 =
Daughter 2 =
Trust 2 =

Trust 3 =
Date 6 =
Attorney =
Date 7 =
Date 8 =
Date 9 =

Bank =

Court =

x =

y =

Dear :

This is in response to your letter dated July 17, 2002, requesting an extension of time under § 301.9100-3 of the Procedure and Administration Regulations to sever a trust, to make a reverse qualified terminable interest property (QTIP) election, and to allocate Decedent's Generation-Skipping Transfer (GST) tax exemption.

The facts and representations submitted are summarized as follows: Decedent executed his will on Date 1. Decedent created Trust 1 on Date 2. Trust 1 was amended on Date 3 and Date 4. Decedent died on Date 5, survived by Spouse, Daughter 1, and Daughter 2. Trust 1 became irrevocable on Decedent's death. Item I of Decedent's will bequeaths Decedent's entire estate to Trust 1.

Article III, Subparagraph (B)(1)(e) of Trust 1 provides that on Decedent's death, if Spouse survives Decedent, after deduction of certain specific bequests, the residue of Trust 1 should be divided into Trust 2 and Trust 3. Trust 2 should be funded with assets that qualify for the marital deduction in an amount equal to the minimum amount that will result in the lowest federal estate tax being imposed on Decedent's estate after allowing for the unified credit and any other allowable credits and deductions. All assets not allocated to Trust 2 shall be allocated to Trust 3.

Article III, Subparagraph (B)(2)(a) provides that during Spouse's life, the Trust 2 income shall be paid to Spouse in installments at least quarterly. In addition, the trustee of Trust 2 has the discretion to distribute Trust 2 principal to Spouse as necessary or advisable for her use and benefit. On Spouse's death, the undistributed income from Trust 2 shall be distributed to Spouse's estate and the balance of the assets of Trust 2 shall become a part of and administered in the same manner as the assets of Trust 3.

Article III, Subparagraph (B)(2)(b) provides that the Trust 3 income shall be paid at least quarterly to Daughter 1 and Daughter 2 (the "primary beneficiaries") equally. Upon the death of either Daughter 1 or Daughter 2, the share of income of the daughter shall be paid to or for the benefit of the children of such deceased daughter per stirpes. Upon the death of both primary beneficiaries, the trust shall terminate and all the then remaining assets shall be divided equally and distributed one half to the children of Daughter 1 and one half to the children of Daughter 2 per stirpes.

On or before Date 6, Decedent's estate timely filed a Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return, prepared by Attorney. On Schedule M of the Form 706, Attorney made an election under § 2056(b)(7) to treat the entire value of Trust 2 as QTIP property, and claimed a deduction in that amount. Attorney inadvertently did not advise Decedent's estate to sever Trust 2 into an exempt marital trust and a non-exempt marital trust. In addition, Attorney inadvertently failed to make a reverse QTIP election under § 2652(a)(3) to treat Decedent as the transferor of any portion of Trust 2 for GST tax purposes, and did not make an effective allocation of Decedent's GST tax exemption to any portion of Trust 2.

The error was discovered while preparing the Form 706 for Spouse's estate. On Date 9, Bank, as successor executor of Decedent's estate and trustee of Trust 2, filed a petition with Court on behalf of the current and contingent remainder beneficiaries to sever Trust 2 into an exempt marital trust and a non-exempt marital trust. The petition provides that the new trusts will have identical terms and conditions as Trust 2 and that Trust 2 will be severed on a fractional basis.

Bank has requested a extensions of time to sever Trust 2 into two separate trusts and to make a reverse QTIP election with respect to one of the resulting trusts.

Section 2001(a) of the Internal Revenue Code 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 the purposes of the tax imposed by § 2001, the value of the taxable estate is determined, except as limited by § 2056(b), 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 his surviving spouse, but only to the extent that such interest is included in determining the value of the gross estate.

Section 2056(b)(1) provides, in pertinent part, that where, on the lapse of time, on the occurrence of an event or contingency, or on the failure of an event or contingency to occur, an interest passing to the surviving spouse will terminate or fail, no deduction shall be allowed with respect to such interest.

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 § 2056(a), and no part of such property shall be treated as passing to any person other than the surviving spouse for purposes of § 2056(b)(1)(A).

Section 2056(b)(7)(B)(i) provides that the term "qualified terminable interest property" means property: (I) that passes from the decedent; (II) in which the surviving spouse has a qualifying income interest for life, and; (III) to which an election under § 2056(b)(7)(B)(v) applies.

Section 2056(b)(7)(B)(ii) provides that the surviving spouse has a qualifying income interest for life if: (I) the surviving spouse is entitled to all the income from the property, payable annually or at more frequent intervals, or has a usufruct interest for life in the property, and; (II) no person has a power to appoint any part of the property to any person other than the surviving spouse.

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

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 tax exemption of $1,000,000 (adjusted for inflation under § 2631(c) that 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 tax 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 any portion of an individual’s GST tax exemption that has not been allocated within the time prescribed by subsection (a) shall be deemed to be allocated as follows - (A) first, to property that 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 that no automatic allocation of GST tax exemption is made to a trust that will have a new transferor with respect to the entire trust prior to the occurrence of any generation-skipping transfer with respect to the trust.

Section 2652(a)(1) provides 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, in pertinent part, that in the case of any trust with respect to which a deduction is allowed to the decedent under § 2056(b)(7), the estate of the decedent 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 (a “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(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 generation-skipping transfer 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.

Under § 26.2654-1(b)(1)(ii), 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) 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.

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(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 advise the taxpayer to make, the election.

In this case, because a QTIP election was made on Decedent's Form 706 with respect to Trust 2, the assets of Trust 2 will be included in Spouse's gross estate under § 2044 at her death unless there is a disposition under § 2519. Spouse is considered the transferor of such property for GST tax purposes, thereby initially precluding the allocation of Decedent's unused GST tax exemption to any portion of Trust 2. If Decedent's estate is allowed to make a reverse QTIP election under §§ 2652(a)(3) and 26.2652-1(a)(3) with respect to any portion of the assets of Trust 2, however, Decedent will be treated as the transferor of such assets for GST tax purposes.

In this case, the terms of the new trusts provide in the aggregate for the same succession of interests and beneficiaries as are provided in Trust 1. The petition to Court provides that the new trusts will be severed on a fractional basis and that the trusts will be funded either based on 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 date of Decedent's death to the date of funding.

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. Accordingly, an extension of time is granted until 60 days from the date of this letter to sever Trust 2 and to make a reverse QTIP election under § 2652(a)(3) with respect to the GST exempt trust. The election should be made on a supplemental From 706. A copy of this letter should be attached to each supplemental Form 706 and filed with the Internal Revenue Service Center, Cincinnati, Ohio 45999.

The severance of Trust 2 into a GST exempt trust and a GST nonexempt trust will be recognized for GST tax purposes and the two trusts will be treated as separate trusts in accordance with § 2654(b)(1). Provided that none of the Decedent's GST tax exemption was utilized during his lifetime and in view of the severance of Trust 2 and reverse QTIP election with respect to the resulting GST exempt trust, $x will be automatically allocated to Trust 3 and $y will be automatically allocated to the resulting exempt marital trust in accordance with the rules provided in § 2632(e)(1). Accordingly, both Trust 3 and the resulting GST exempt trust will have inclusion ratios of zero after the severance and reverse QTIP.

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.

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

Sincerely,

Heather C. Maloy

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

Enclosures
Copy of this Letter
Copy for § 6110 purposes