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Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:B04-PLR-156556-02

Date:

SEPTEMBER 24, 2003

Re:

LEGEND:

- Decedent =
- Surviving Spouse =
- Credit Shelter Trust =

- Son 1 =
- Son 2 =
- Date 1 =
- Date 2 =
- Date 3 =
- a =
- b =
- c =
- d =
- e =
- f =

Dear :

This is in response to your August 26, 2002 letter and other correspondence requesting a ruling that the Service disregard the qualified terminable interest property (QTIP) election made on the Decedent's federal estate tax return.

The facts submitted are as follows:

Decedent executed a will on Date 1. Article Fourth of the will provides that, if Surviving Spouse survives Decedent, Decedent bequeaths to his two sons, Son 1 and Son 2, as co-trustees of the Credit Shelter Trust, a sum equal to the applicable amount in section 6018(a)(1) of the Internal Revenue Code, adjusted as provided in sections

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6018(a)(3) and 6018(a)(4) [as provided in the Code as it existed in Date 1], less the value of any property includible in the taxable estate and passing under another Article of this will or otherwise than under this will, and for which no deduction is allowed under section 2055 or 2056. The co-trustees are directed to hold said sum in the Credit Shelter Trust and to pay the net income thereof to Surviving Spouse, for the remainder of her life, in quarterly or more frequent installments.

Article Fourth also provides that the co-trustees are authorized at any time and from time to time to distribute to Surviving Spouse so much of the principal of the Credit Shelter Trust, including the whole thereof, as the co-trustees determine, in the exercise of their absolute discretion, to be desirable for the comfortable maintenance, support, medical care and welfare of Surviving Spouse, considering her other sources of income known to the co-trustees. Upon the death of Surviving Spouse, the principal of the Credit Shelter Trust and any accrued or undistributed net income shall be distributed to Son 1 and Son 2, in equal shares, share and share alike and per stirpes.

In Article Fifth Decedent bequeathed the residue of Decedent's estate to Surviving Spouse.

Decedent died on Date 2. Surviving Spouse, Son 1, and Son 2 survived Decedent. After specific bequests and expenses reduced the gross estate, \$a remained to fund the Credit Shelter Trust under Article Fourth and transfer the residue to Surviving Spouse. Of \$a, \$b should have been transferred to the Credit Shelter Trust and \$c should have been transferred outright to Surviving Spouse.

Surviving Spouse, as executor of Decedent's estate, filed a federal estate tax return (Form 706) on Date 3. On Schedule M of the return, the executor reported \$d as the amount of property passing to Surviving Spouse from the residuary; treated \$d as "qualified terminable interest property (lifetime income right in nearly all net assets of estate placed in trust for two sons)," and made a QTIP election for that amount. The remaining \$e was transferred to the Credit Shelter Trust. This caused the Credit Shelter Trust to be underfunded by \$f. Surviving Spouse later placed the \$d in a revocable trust.

Following the filing of the estate tax return, the error regarding what amounts should have funded the Credit Shelter Trust and what amounts should have passed outright to Surviving Spouse were discovered. Those assets representing \$f, plus appreciation, the amount by which the Credit Shelter Trust was underfunded, were transferred to a separate trust (Excess Exemption Trust). Those assets representing \$c, plus appreciation, are held by Surviving Spouse.

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You have requested the following ruling:

The QTIP election is ineffective and null and void in accordance with Rev. Proc. 2001-38, 2001-24 I.R.B. 1335 and, therefore:

- (a) Neither the Credit Shelter Trust nor the Excess Exemption Trust will be included in the gross estate of Surviving Spouse under section 2044.
- (b) Surviving Spouse will not be treated as making a gift under section 2519 if Surviving Spouse disposes of the income interest from the Credit Shelter Trust or the Excess Exemption Trust.
- (c) Surviving Spouse will not be treated as the transferor of the Credit Shelter Trust or the Excess Exemption Trust assets for generation-skipping transfer tax (GST) purposes under section 2652(a).

LAW AND ANALYSIS

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 section 2056(a) and is not treated as a terminable interest. Under section 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 section 2056(b)(7)(B)(v) applies.

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

Section 20.2056(b)-7(b)(4)(i) of the Estate Tax Regulations provides that the QTIP election is made on the return of tax imposed by section 2001 (or section 2101). The term "return of tax imposed by section 2001" means the last estate tax return (Form 706 (United States Estate (and Generation-Skipping Transfer) Tax Return)) filed by the executor on or before the due date of the return, including extensions or, if a timely return is not filed, the first estate tax return filed after the due date.

A QTIP election has transfer tax consequences for the surviving spouse. Section 2044(a) and (b) provides generally that the value of the gross estate includes the value of any property in which the decedent had 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 section 2056(b)(7).

Section 2519(a) and (b) provide that 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 section 2056(b)(7) is treated as a transfer of all interests in the property other than the qualifying income interest.

Section 2652(a) provides that the surviving spouse will be treated as the transferor of the property for generation-skipping transfer tax purposes in the absence of a "reverse QTIP" election under section 2652(a)(3).

In the case of a QTIP election to which Rev. Proc. 2001-38 applies, the Service will disregard a QTIP election under section 2056(b)(7) and treat it as null and void for purposes of sections 2044(a), 2056(b)(7), 2519(a), and 2652. Rev. Proc. 2001-38 applies to situations where a predeceased spouse's estate made an unnecessary QTIP election under section 2056(b)(7) that did not reduce the estate tax liability of the estate. For example, in some cases, the decedent's will provided for a "credit shelter trust" to be funded with an amount equal to the applicable exclusion amount under section 2010(c), with the balance of the estate passing to a marital trust intended to qualify under section 2056(b)(7). The estate made QTIP elections for both the credit shelter trust and the marital trust. The QTIP election for the credit shelter trust was not necessary, because no estate tax would have been imposed whether or not the QTIP election was made for that trust. 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 trust 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.

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In this case, the executor mistakenly transferred \$d, an amount equal to \$c and \$f to Surviving Spouse and made a QTIP election with respect to \$d. \$f should have been transferred to the Credit Shelter Trust pursuant to Article Fourth of Decedent's will. Article Fifth provides that the residuary estate would pass outright to Surviving Spouse. After funding the Credit Shelter Trust, \$c, not \$d, should have passed outright to Surviving Spouse. Pursuant to Article Fifth, Decedent bequeathed to Surviving Spouse the entire interest in the property in the residuary estate, not only a "qualified income interest" to Surviving Spouse. Accordingly, the QTIP election with respect to the \$d, the amount passing outright to Surviving Spouse from the residuary estate, is ineffective. The amount, \$c, passing to Surviving Spouse, will qualify for the marital deduction under section 2056(a). The QTIP election is ineffective for \$c for purposes of sections 2044(a), 2519(a), and 2652.

Further, executor made a QTIP with respect to \$f, an amount that would qualify as a qualifying income interest, but passes to the Credit Shelter Trust under Decedent's will. The QTIP election for \$f is unnecessary because no estate tax would have been imposed whether or not the QTIP election was made for that trust. Accordingly, the Service will disregard the QTIP election for \$f and treat it as null and void for purposes of sections 2044(a), 2519(a), and 2652.

Therefore, based on the facts submitted and representations made, we conclude that the QTIP election is ineffective for \$c passing outright to Surviving Spouse and null and void for \$f under Rev. Proc. 2001-38. Accordingly, we conclude that neither the Credit Shelter Trust nor the Excess Exemption Trust will be included in the gross estate of Surviving Spouse under section 2044, Surviving Spouse will not be treated as making a gift under section 2519 if Surviving Spouse disposes of the income interest from the Credit Shelter Trust or the Excess Exemption Trust, and Surviving Spouse will not be treated as the transferor of the Credit Shelter Trust or the Excess Exemption Trust assets for generation-skipping transfer tax purposes under section 2652(a).

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. Further, we do not express an opinion whether Surviving Spouse section 2501 would apply to dispositions of Surviving Spouse's income interest in the Credit Shelter Trust or the Excess Exemption Trust.

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.

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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 yours,

Lorraine E. Gardner
Senior Counsel, Branch 4
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure:

Copy of letter for section 6110 purposes