

Internal Revenue Service

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Person To Contact: _____, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:9 – PLR-157771-03

Date:
March 16, 2004

In Re:

Legend

- Decedent =
- Spouse =
- Accountant =
- Trust =
- Trust B =
- Trust C =
- Date 1 =
- Date 2 =
- Date 3 =
- a =
- b =
- c =
- d =

Dear _____ :

This is in response to your letter dated September 30, 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 trust and nonexempt trust under § 26.2654-1(b)(1) of the Generation-Skipping Transfer (GST) Tax Regulations and to make a reverse qualified terminable interest

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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, survived by his spouse (Spouse) and three children from a previous marriage. Prior to his death, Decedent executed a pour over will and Decedent and Spouse executed a revocable trust (Trust).

Decedent's will provides in Article Ninth, subsection (iv), that the executor has the power to make the reverse QTIP election under § 2652(a)(3) with respect to any property for which the QTIP election under § 2056(b)(7) has been made.

Article V, Section A of Trust provides that upon Decedent's death the trust estate is to be divided into three trusts: spouse's trust (Trust A), QTIP trust (Trust B), and unified credit trust (Trust C).

Article V, Section A.1 provides that Trust A is to be funded with Spouse's separate property and Spouse's share of the couple's community property. Article V, Section A.2 provides that Trust B is to be funded with the minimum amount which, if subtracted from the value of Decedent's gross estate as finally determined for federal estate tax purposes, would result in no federal estate due with respect to Decedent's estate. Article V, Section A.3 provides that Trust C is to be funded with the balance of the trust estate.

Article V, Section B.1 provides that Spouse is to receive Trust A's net income quarter-annually. Spouse is to receive so much of Trust A's principal as she requests in writing. In addition, the trustees may pay or apply as much of Trust A's principal as is necessary to provide for Spouse's health, support, and maintenance. Spouse has a general power of appointment over Trust A's assets.

Article V, Section B.2 provides that Spouse is to receive Trust B's net income quarter-annually. Income accrued but not paid at Spouse's death is to be paid to Spouse's estate. Spouse is to receive payments of Trust B's principal to provide for her health and medical needs, if the trustees deem that the income payments from Trusts A, B, and C are insufficient.

Article V, Section B.3 provides that Spouse is to receive Trust C's net income quarter-annually. Spouse is to receive payments of Trust C's principal to provide for her health and medical needs, if the trustees deem that the income payments from Trusts A, B, and C are insufficient.

Article V, Section C.1 provides for the disposition of Trust A among Spouse's children from a former marriage upon Spouse's death.

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Article V, Section C.2 provides that upon Spouse's death, the assets of Trusts B and C are to be divided into as many equal shares as there are then living children of Decedent and deceased children of Decedent survived by issue. One equal share is to be allocated to each child and to each group composed of the living issue of a deceased child of Decedent.

Article V, Section C.2(a) provides that the trustee is to pay each child the entire net income from his or her trust at least quarter-annually. The trust's principal cannot be invaded for any reason. Upon the child's death, the balance of the trust is to be distributed to the child's then living issue by right of representation as provided in Article V, Section C.2(b). In the event the child dies without surviving issue, then the balance of the trust is to be distributed to Decedent's then living issue, by right of representation, free of trust; provided that if a recipient is the beneficiary of a trust established under Trust, then the assets are to be contributed to that trust and administered accordingly.

Article V, Section C.2(b) provides that each share allocated to a group composed of the issue of Decedent's deceased child is to be divided into separate trusts, by right of representation. The beneficiary of each trust is to receive trust income and principal to provide for his or her education. Income not distributed is to be added to principal. The beneficiary is to receive one-third of the trust principal when he or she attains age 25, one-half of the trust principal when he or she attains age 30, and the remaining trust principal when he or she attains age 35. In the event that a beneficiary dies before the expiration of his or her trust, the trust's remaining principal is to be distributed to the beneficiary's then living issue, by right of representation, free of trust. If the deceased beneficiary is not survived by issue, the remaining trust principal is to be distributed to Decedent's then living issue, by right of representation, free of trust; provided, however, that any principal distributed to a beneficiary for whom a trust has been established under Trust is to be contributed to that trust and administered accordingly.

Article V, Section C.2(c) provides that in the event the Decedent is not survived by issue or if all the members of a class of beneficiaries die before becoming entitled to receive complete distribution of any trust, then the undistributed balance of Trusts B and C or any trust established pursuant to Article V. C.2 is to be distributed to Decedent's heirs determined under the laws of succession.

Article VII, Section B.2 provides the trustees with the discretion to make the QTIP and reverse QTIP elections under §§ 2056(b)(7) and 2652(a)(3). Article VII, Section C.2 permits the trustees to sever Trust B into a GST exempt and nonexempt trust in connection with the making of the reverse QTIP election under § 2652(a)(3). Article VII, Section C.3 provides that each trust created by severing a trust into a GST exempt and nonexempt trust is to have the same terms as the

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original trust from which it is established. Article VII, Section F(2)(ii) recommends that, in the event Decedent has available GST exemption, the trustees should sever Trust B into a GST exempt and non-exempt trust and make the reverse QTIP election with respect to the GST exempt trust.

On Date 2, Spouse disclaimed her interest in Trust C. Pursuant to the terms of Article V, Section C.2 of Trust, Trust C was divided into three trusts, one for each of Decedent's surviving children.

Accountant was retained to prepare Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return, for Decedent's estate. The Form 706 was filed on Date 3. Trust C was funded with \$ a and Trust B was funded with \$ b. The QTIP election under § 2056(b)(7) was made on Schedule M attached to the Form 706 for Trust B's assets. No Schedule R, however, was attached to the Form 706.

It has been represented that Accountant did not make or advise Decedent's estate to make any allocation of Decedent's GST exemption, did not sever or advise Decedent's estate to sever Trust B into a GST exempt and nonexempt trust, and did not make or advise Decedent's estate to make the reverse QTIP election under § 2652(a)(3) with respect to the GST exempt trust. It has been further represented that Decedent's entire GST exemption was available for allocation at his death.

The trustee of Trust B requests an extension of time under §§ 301.9100-1 and 3 to sever Trust B into two separate trusts, GST Exempt Trust B and GST Nonexempt Trust B, under § 26.2654-1(b)(1) of the Generation-Skipping Transfer Tax Regulations, and to make a reverse QTIP election under § 2652(a)(3) with respect to GST Exempt Trust B, thereby causing the automatic allocation rules under § 2632(c) to allocate Decedent's remaining GST exemption of \$ c to the GST Exempt Trust B.

The formula for dividing Trust B's assets will be computed as follows: \$ c (Decedent's available GST exemption) divided by \$ b (the date of death value of Trust B) = d percent. GST Exempt Trust B will be funded with a fractional share of Trust B's assets equal to d percent, and the balance of Trust B's assets will be allocated to GST Nonexempt Trust B.

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.

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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

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§ 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.

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(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

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(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.

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 Decedent's estate tax return, \$a of Decedent's GST exemption was automatically allocated to Trust C pursuant to the automatic allocation rules of §§ 2632(e) and 26.2632-1(d)(2) because Spouse made a qualified disclaimer of her interest in Trust C. Following this allocation, \$ c of Decedent's GST exemption remained unused.

As a result of the QTIP election made on Decedent's estate tax return, Trust B's assets are includible in Spouse's gross estate pursuant to § 2044. Spouse, accordingly, is considered the transferor of Trust B's assets for GST tax purposes. Therefore, Decedent's remaining GST exemption could not be allocated to Trust B's assets. However, if Trust B is severed into two trusts, GST Exempt Trust B and GST Nonexempt Trust B, on a fractional basis, and a "reverse" QTIP election under § 2652(a)(3) is made with respect to GST Exempt Trust B, Decedent will be treated as the transferor of GST Exempt Trust B's assets and the automatic allocation rules under § 2632(e) will apply Decedent's remaining GST tax exemption of \$ c to GST Exempt Trust B.

Based on the facts submitted and the representations made, we conclude that the requirements of § 301.9100-3 have been satisfied. Accordingly, an extension of time of 60 days from the date of this letter is granted to sever Trust B into GST Exempt Trust B and GST Nonexempt Trust B and to file a supplemental Form 706 making the reverse QTIP election with respect to GST Exempt Trust B. Thereupon, the automatic allocation rules under § 2632(e) will apply Decedent's remaining GST tax exemption of \$ c to GST Exempt Trust B.

The supplemental Form 706 should be filed with the Internal Revenue Service Center, Cincinnati, Ohio 45999. 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 Decedent's remaining GST exemption to GST Exempt Trust B.

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.

This ruling is directed only to the taxpayers 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 taxpayers.

The rulings contained in this letter are based upon information and representations submitted by the taxpayers 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
Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure: Copy for section 6110 purposes
Copy of this letter