

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:B09 / PLR-128690-01
Date:
March 25, 2002

Legend

- Trust =
- Decedent =
- Spouse =
- Date 1 =
- Date 2 =
- Date 3 =
- Date 4 =
- Date 5 =
- Date 6 =
- Survivor's Trust =
- Residual Trust =
- Credit Shelter Subtrust =
- Marital Subtrust =
- Daughter =
- Grandson =
- Date 7 =
- Court =
- Date 8 =

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Exempt Marital Subtrust =

Non-Exempt Marital Subtrust =

Date 9 =

Y =

Z =

Dear

This letter responds to your letter, dated April 27, 2001, and subsequent correspondence, submitted on behalf of Trust, requesting rulings under §§ 2652(a)(3) and 2654(b)(2) of the Internal Revenue Code.

The facts submitted and the representations made are summarized as follows: Decedent and Spouse created Trust, a revocable trust, on Date 1. They revised Trust on Date 2, Date 3, and Date 4. Decedent also executed her will on Date 1. Decedent executed a codicil to her will on Date 5. Decedent died on Date 6, survived by Spouse.

Article Fourth of Decedent's will, as amended, provides that the residue of Decedent's estate, excluding property over which Decedent had a power of appointment, should pass to the trustee of Trust. The residue of Decedent's estate shall be added to, administered, and distributed as a part of Trust, according to the terms of Trust on the date of Decedent's death, and any amendments thereafter made in accordance with the terms of Trust by the exercise of a power of amendment, appointment, withdrawal or otherwise.

Article IV, paragraph A of Trust provides that the first settlor to die shall be called the "Deceased Spouse" and the surviving settlor shall be called the "Surviving Spouse." On the death of the Deceased Spouse, the trustee shall divide the trust estate into the Survivor's Trust and the Residual Trust. In addition, the Residual Trust may be divided into the Credit Shelter Subtrust and the Marital Subtrust.

Article Fifth of Decedent's will provides that the trustee will determine whether to qualify any or all of the Residual Trust property as qualified terminable interest property.

Article Ninth of Decedent's will provides that the executor of the will is Decedent's husband, Spouse, or if he is unable or unwilling to so act, then the executor shall be Daughter and Grandson serving as co-executors of the will, or if either is unable or unwilling to so act, the one remaining shall serve as sole executor.

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Article III, paragraph C of the Trust instrument provides that on the death of the Deceased Spouse, the Surviving Spouse shall have the power to amend, revoke, or terminate the Survivor's Trust, but the Credit Shelter Subtrust and the Marital Subtrust may not be amended, revoked, or terminated.

Article IV, paragraph A.1. provides that the Survivor's Trust shall consist of the Surviving Spouse's interest in the community estate and the Surviving Spouse's separate estate, if any, included in the trust estate. Paragraph A.1.c. provides that the Survivor's Trust and the Residual Trust shall be equal, except for either spouse's separate property.

Article IV, paragraph C provides that during the joint lifetimes of the settlors, the trustee shall also pay to either settlor, or shall apply for his or her benefit, the entire net income of the settlor's separate estate, quarter-annually, or in more frequent installments. At the written request of the settlor who transferred the separate estate to the Trust, the trustee shall pay to him or her so much of the principal of the separate estate established by him or her as he or she shall request.

Article IV, paragraph A.2. provides that the Residual Trust shall consist of the balance of the trust estate representing the Deceased Spouse's interest in the community estate, and the Deceased Spouse's separate property, if any, included in the trust estate. The trustee and/or Deceased Spouse's executor are authorized to determine in their sole discretion whether to transfer and to qualify a portion of this trust as qualified terminable interest property, such portion to be designated as the Marital Subtrust. The trustee shall satisfy this amount in cash or kind, or partly in each, with assets selected by the trustee from those includible in the Deceased Spouse's gross estate and eligible for the marital deduction for federal estate tax purposes. The remaining portion shall be designated as the Credit Shelter Subtrust and shall not be less than the maximum amount as finally determined for federal estate tax purposes that will result in no federal tax payable after taking into account all available credits against the federal estate tax and all available deductions other than the marital deduction.

Article IV, paragraph D.2. provides that, on the death of the Deceased Spouse, the trustee shall pay to or apply for the benefit of the Surviving Spouse the net income of the Residual Trust in quarter-annual or more frequent installments. If the trustee considers the income insufficient, the trustee shall also pay to or apply for the benefit of the Surviving Spouse such sums out of principal as the trustee in the trustee's discretion considers necessary for the beneficiary's respective proper health, support, and maintenance after considering the beneficiary's other income or resources within and/or outside the trust estate known to the trustee. Payments out of principal to the Surviving Spouse shall be made first out of the Survivor's Trust until it is exhausted, and thereafter out of the Marital Subtrust until it is exhausted, and thereafter out of the Credit Shelter Subtrust.

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Article IV, paragraph D.3. provides that, on the death of the Deceased Spouse, the trustee shall pay to or apply for the benefit of the Surviving Spouse the net income of the Marital Subtrust in quarter-annual or more frequent installments. If the trustee considers the income insufficient, the trustee shall also pay to or apply for the benefit of the Surviving Spouse such sums out of principal as the trustee in the trustee's discretion considers necessary for the beneficiary's respective proper health, support, and maintenance after considering the beneficiary's other income or resources within and/or outside the trust estate known to the trustee. Payments out of principal to the Surviving Spouse shall be made first out of the Survivor's Trust until it is exhausted, and thereafter out of the Marital Subtrust until it is exhausted, and thereafter out of the Credit Shelter Subtrust.

Article V, paragraph B provides that, on the death of the Surviving Spouse, the trustee shall add any portion of the Survivor's Trust and, any portion of the Marital Subtrust not disposed of, to the Credit Shelter Subtrust and shall distribute the same as follows: (1) certain named real properties that remain in the trust at the death of the Surviving Spouse shall be distributed outright to Daughter, free of trust; (2) certain named real properties that remain in the trust at the death of the Surviving Spouse shall be distributed outright to Grandson, free of trust; (3) the rest and residue of Residual Trust shall be divided into equal shares, one for Daughter and one for Grandson and distributed outright, free of trust. If either Daughter or Grandson fails to survive Surviving Spouse, the share of the one so deceased shall be distributed to the group composed of their then living issue. Each share shall then be distributed outright, free of trust.

Article VI, paragraph 13 provides that the trustee(s) shall have the power to partition, allot, and distribute the trust estate, on any division or partial or final distribution of the trust estate, in undivided interests or in kind, or partly in money and partly in kind, at valuations determined by the trustee.

On Date 7, the trustee of Trust petitioned Court to modify and further divide Trust as of Decedent's death. On Date 8, Court issued an order adding paragraphs D.4. and D.5. to Article IV of the Trust instrument. Date 7 and Date 8 both occurred prior to the filing of Decedent's estate tax return.

Article IV, paragraph D.4.A.2.(a)., as amended by Court, provides the Marital Subtrust is to be allocated into two separate subtrusts entitled the Exempt Marital Subtrust and the Non-Exempt Marital Subtrust depending on the net value of the Marital Subtrust and the Credit Shelter Subtrust, as follows: (1) the trustee is to establish a separate Exempt Marital Subtrust upon electing a percentage or fraction in an amount up to the maximum sum allowed under the exemption provided for in § 2631 of the Internal Revenue Code of 1986, as amended, from the Marital Subtrust assets, subject to the sum of the exemption previously utilized in the Credit Shelter Subtrust; and (2) since the trustee is to elect to establish Exempt Marital Subtrust as above stated, the trustee shall establish a separate trust that shall be known as Non-Exempt Marital Subtrust that shall consist of the remainder of the assets of the Marital Subtrust.

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Article VI, paragraph 15, as amended by Court, authorizes the trustee to divide or sever (whether before or after a trust is funded and whether before or after any allocation of a GST exemption under § 2631 of the Internal Revenue Code of 1986, as amended, is made) any trust or any property used or to be used to fund or augment any trust under this Agreement, into two or more fractional shares or sub-shares. Those shares shall be held and administered by the trustee and the trustee may manage and invest such separate trusts jointly.

On or about Date 9, Decedent's estate timely filed a Form 706 - United States Estate (and Generation-Skipping Transfer) Tax Return ("Estate Tax Return") for Decedent. The Exempt Marital Subtrust and the Non-Exempt Marital Subtrust were listed on Schedule M of the Estate Tax Return. On Schedule R of the Estate Tax Return, Decedent's GST exemption was allocated in the following manner: \$y to the Credit Shelter Subtrust and \$z to the Exempt Marital Subtrust.

You have requested a ruling that the division of the Marital Subtrust into the Exempt Marital Subtrust and the Non-Exempt Marital Subtrust for purposes of making an election under § 2652(a)(3) is not prohibited by § 2654(b)(1) and the two qualified terminable interest trusts (QTIP) that exist after the division will be treated as separate trusts for all purposes under the generation-skipping transfer tax provisions in chapter 13 of the Code.

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 2601 imposes a tax on every generation-skipping transfer (GST).

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 generation-skipping transfer 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 generation-skipping transfer tax purposes, the transferor of the QTIP trust for which the election is made. As a result, the decedent's generation-skipping transfer tax 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 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.

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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) (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.

Section 26.2654-1(b)(3) provides that an individual's GST exemption under § 2632 may be allocated to the separate trusts created pursuant to this section at the discretion of the executor or the trustee.

Section 26.2654-1(b)(2) provides, in part, that if the governing instrument of a trust or local law authorizes the severance of the trust, a severance pursuant to that authorization is treated as meeting the requirement of paragraph (b)(1)(ii)(B) of this section if the executor indicates on the federal estate tax return that separate trusts will be created (or funded) and clearly sets forth the manner in which the trust is to be severed and the separate trusts funded.

Based on the information submitted and the representations made, 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. In addition, the reformation proceeding was instituted in Court prior to the date prescribed for filing the federal estate tax return, including extensions actually granted, for Decedent's estate. Article IV, paragraphs D.4.A.2.(a).(1). requires that the new trusts be severed on a fractional basis. The taxpayer represents that the trusts will be funded based on the fair market value of the assets on the date of funding 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. We therefore conclude the severance of the Marital Subtrust into the Exempt Marital Subtrust and the Non-Exempt Marital Subtrust will be recognized for purposes of chapter 13 under §26.2654-1(b)(1)(ii) and the two trusts will be treated as separate trusts in accordance with § 2654(b)(1).

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.

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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.

Pursuant to the Power of Attorney on file with this office, a copy of this letter is being sent to the trustee.

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,
James F. Hogan
Senior Technician Reviewer
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures:

Copy of this Letter
Copy for § 6110 purposes