

Internal Revenue Service

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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

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Date:

March 8, 2004

Decedent =
Trust =
Marital Trust =
Family Trust =
Spouse =
Trustees =
Attorney =
State =
State Statute 1 =
State Statute 2 =
Date 1 =
Date 2 =
Date 3 =
Date 4 =
Date 5 =
a =
b =

Dear _____ :

This is in response to your letter dated June 11, 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 and nonexempt trust for purposes of the Generation-Skipping Transfer (GST) tax and to make a reverse qualified terminable interest 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 executed the Trust, a revocable trust, on Date 1. Decedent died on Date 2, survived by Spouse.

The Trust provides in Section 2.3.B that, after Decedent's death, the Trust's assets are to be divided into two trusts, the Marital Trust and the Family Trust. Section 2.3.B provides that the Marital Trust is to be funded with Trust assets equal to the maximum allowable marital deduction. The Trust further provides that the Family Trust is to be funded with assets that are not eligible for the marital deduction and Trust assets remaining after the Marital Trust has been funded.

Section 2.5.A provides that Trustees are to distribute to Spouse, during her life, all of the Marital Trust's net income at least quarter-annually. Section 2.5.C provides Spouse with the power to withdraw up to one-half of the Marital Trust's original principal amount.

Section 2.5.E provides Spouse with a testamentary general power of appointment over one-half of the Marital Trust's original principal, less the aggregate principal amount of withdrawals Spouse has made during her lifetime pursuant to Section 2.5.C. In the event Spouse fails to fully exercise the general power of appointment, the unappointed assets are to be added to the Family Trust and administered according to the provisions of the Family Trust.

Section 2.6.A.1 provides that Trustees are to distribute from the Family Trust to Spouse as much of the Family Trust's net income as is necessary to provide for Spouse's health, maintenance, and support in her accustomed manner of living as of Decedent's death. Any income not distributed to Spouse may be distributed in equal or unequal shares to Decedent's children and their issue for their health, maintenance, support, and education.

Section 2.6.A.2 provides that if Trustees determine in their discretion that the Family Trust's income, together with Spouse's other resources, is insufficient to provide for Spouse's health, maintenance, and support in her accustomed manner

of living, then Trustees are authorized to use and expend such portion of the Family Trust's principal as is necessary for such purposes.

Section 2.6.B provides that upon Spouse's death, Trustees are to make certain distributions from the Family Trust for the benefit of specific charities. Potential beneficiaries of the Family Trust's remaining principal include individuals who are two or more generations below the Decedent's generation, therefore, distributions from the Family Trust may be subject to the GST tax.

Section 3.4 provides that in allocating assets among beneficiaries and trusts, Trustees may make any division or allocation in cash or in kind, or partly in cash and partly in kind.

Section 8.2.B authorizes and directs Trustees to allocate Decedent's available GST exemption in any manner that would be reasonable and beneficial to Decedent's estate and Trust.

After Decedent death, Decedent's estate hired Attorney to prepare the estate's Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return. The Form 706 was timely filed on Date 3. On Schedule M of the return, the estate claimed a marital deduction for the entire Marital Trust. However, inadvertently, no Schedule R was filed with the Form 706, and, consequently, a reverse QTIP election was not made under § 2652(a)(3) and none of Decedent's GST exemption was allocated on the Form 706. On Date 4, Trustees' new attorney discovered the failure to make the reverse QTIP election.

On Date 5, Decedent's estate filed a supplemental Form 706. On this return, the estate reported that fifty percent of the assets comprising the Marital Trust would fund a general power of appointment Marital Trust and the remaining fifty percent of the Marital Trust assets would fund the QTIP Marital Trust. The Form 706 also reported that the QTIP Marital Trust was divided into a GST Exempt QTIP Trust and a GST Non-Exempt QTIP Trust. On Schedule R of the supplemental Form 706, the estate made the reverse QTIP election with respect to the GST Non-Exempt QTIP Trust.

Trustees are requesting an extension of time pursuant to § 301.9100-1 to Date 5, to sever the QTIP Marital Trust into a GST Exempt QTIP Trust and a GST Non-Exempt QTIP Trust, pursuant to § 26.2654-1(b)(1) of the Generation-Skipping Transfer Tax Regulations, and to make the reverse QTIP election under § 2652(a)(3) with respect to the GST Exempt QTIP Trust.

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 § 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)(5) provides that, in the case of an interest in property passing from the decedent, if the surviving spouse is entitled for life to all the income from the entire interest, or all the income from a specific portion thereof, payable annually or at more frequent intervals, with power in the surviving spouse to appoint the entire interest, or such specific portion (exercisable in favor of such surviving spouse, or of the estate of such surviving spouse, or in favor of either, whether or not in each case the power is exercisable in favor of others), and with no power in any other person to appoint any part of the interest, or such specific portion, to any person other than the surviving spouse – (A) the interest or such portion thereof so passing shall, for purposes of § 2056(a), be considered as passing to the surviving spouse, and (B) no part of the interest so passing shall, for purposes of § 2056(b)(1)(A), be considered as passing to any person other than the surviving spouse. This paragraph shall apply only if such power in the surviving spouse to appoint the entire interest, or such specific portion thereof, whether exercisable by will or during life, is exercisable by such spouse alone and in all events.

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” 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)(ii) provides, in part, 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 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 § 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(a)(2)(i) provides, in part, that if there is more than one transferor with respect to a trust, the portions of the trust attributable to the different transferors are treated as separate trusts for purposes of chapter 13.

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

(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.

As provided in § 26.2654-1(b)(1)(ii), a trust may be severed pursuant to discretionary authority under local law. In this case, State Statute 1 provides that:

(1) A trustee has the power to perform in a reasonable and prudent manner every act that a reasonable and prudent person would perform incident to the collection, preservation, management, use, and distribution of the trust property to accomplish the desired result of administering the trust legally and in the trust beneficiaries' best interest.

(2) Subject to the standards described in subsection (1) and except as otherwise provided in the trust instrument, a trustee possesses all of the following specific powers:

* * * *

(ff) To divide trust property into 2 or more separate portions or trusts with substantially identical terms and conditions and to allocate property between them, in order to simplify administration for generation[-]skipping transfer tax purposes, to segregate property for management purposes, or to meet another trust objective.

State Statute 2 provides that:

(1) A trustee may do any of the following in connection with a tax matter:

(a) Make, revise, or revoke an available allocation, consent, or election affecting a tax that is appropriate in order to carry out the settlor's estate planning objectives and to reduce the overall burden of taxation, both in the present and in the future. This authority includes, but is not limited to, all of the following:

* * * *

(ii) Electing to allocate the exemption from the tax on generation[-]skipping transfers among transfers subject to estate or gift tax.

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)(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, it has been represented that all of Decedent's GST exemption was available for allocation at his death. Though no allocations of Decedent's GST exemption were made on Decedent's Form 706, as filed, pursuant to §§ 2632(e) and 26.2632-1(d)(2), \$a of Decedent's GST exemption was automatically allocated to the Family Trust, leaving \$b of Decedent's GST exemption unused.

In this case, because a QTIP election was made on Decedent's Form 706, the one-half portion of the Marital Trust over which Spouse does not have a general power of appointment (the QTIP Marital Trust) is includible in Spouse's gross estate under § 2044. The remaining one-half of the Marital Trust over which Spouse has a general power of appointment (the general power of appointment Marital Trust) is includible in Spouse's estate under § 2056(b)(5).

With respect to the QTIP portion of the Marital Trust, Spouse is considered the transferor for GST tax purposes. Therefore, Decedent's remaining GST exemption may not be allocated to the QTIP Marital Trust. However, if the QTIP Marital Trust is severed into a GST Exempt QTIP Trust and a GST Non-Exempt QTIP Trust, and a reverse QTIP election under § 2652(a)(3) is made for the GST Exempt QTIP Trust, Decedent will be treated as the transferor of the GST Exempt QTIP Trust, and the automatic allocation rules of § 2632(e) will apply Decedent's remaining GST exemption to the property in that trust.

Based on the information submitted and the representations made, we conclude that the requirements of § 301.9100-3 have been satisfied. Therefore, an extension of time to Date 5, the date the supplemental Form 706 was filed with the Service, is granted to sever the QTIP Marital Trust into a GST Exempt QTIP Trust and a GST Non-Exempt QTIP Trust, and to make the reverse QTIP election with respect to the GST Exempt QTIP Trust.

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

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reverse QTIP election is made §§ 2632(e) and 26.2632-1(d)(2) will operate to allocate Decedent's remaining GST exemption to the GST Exempt QTIP 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.

Except as specifically ruled herein, we express no opinion on the federal tax consequences of the transaction under the cited provisions or under any other provisions of the Code.

This ruling is directed only to the taxpayer who requested 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 your authorized representative.

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.

Sincerely,

Heather C. Maloy

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

Enclosures: Copy for section 6110 purposes
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