

## Internal Revenue Service

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## Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:04

PLR-135310-16

Date:

April 10, 2017

Re:

### LEGEND

Decedent =

Spouse =

A =

Law Firm =

Attorney 1 =

Attorney 2 =

Marital Trust =

Trust =

Trust A =

Trust B =

State Law =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Dear :

This letter responds to your representative's letter of November 3, 2016, requesting an extension of time under § 301.9100 and § 301.9100-3 of the Procedure and Administration Regulations to sever a trust into an exempt trust and a non-exempt trust for generation-skipping transfer (GST) tax purposes, 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, and to apply the automatic allocation rules to allocate Decedent's GST exemption to the exempt trust.

The facts and representations submitted are summarized as follows. Decedent died on Date 1 survived by Spouse.

#### Marital Trust created under Decedent's will

Under Article VII, Paragraph A(2) of Decedent's will, the residue of his estate is to be held in a trust (the Marital Trust) created for the lifetime benefit of Spouse. Article IX contains provisions specific to the Marital Trust. Under Article IX, Paragraph A, the trustee is to distribute all the net income of the Marital Trust to Spouse as long as she lives. The trustee may also distribute such principal to Spouse as the trustee in its sole and absolute discretion may determine is necessary for Spouse's health, maintenance, or support. Article IX, Paragraph B, provides, in part, that the Marital Trust is to terminate on Spouse's death, when the remaining principal is to be added to Trust and distributed as part of the properties of Trust.

Article XII, Paragraph W(1) provides, in pertinent part, that the trustee shall have the power to divide the property of any trust created under the will with an inclusion ratio, as defined in Chapter 13 of the Code, of greater than zero but less than one into two separate trusts representing two fractional shares, one such trust with an inclusion ratio of one (which shall be further designated as the "Non-Exempt Trust") and the other such trust with an inclusion ratio of zero (which shall be further designated as the "Exempt Trust"). If the trustee exercises the division power and creates a Non-Exempt Trust and an Exempt Trust, then all of the provisions applicable to such trust prior to such division shall apply to both the Non-Exempt Trust and the Exempt Trust.

#### Trust

Decedent and Spouse created Trust on Date 2 as a revocable trust. Trust became irrevocable on Decedent's death. Under Article II of Trust, on the death of the last survivor of Decedent and Spouse, the trustee is to allocate any property transferred to

Trust among trusts for the benefit of Decedent's and Spouse's children and their lineal descendants, as described in Article V of Trust.

#### Decedent's estate tax return

On Decedent's death, A (Executor) became the executor of Decedent's estate and trustee of the Marital Trust. Executor engaged Law Firm to represent him in the administration of Decedent's estate. Executor relied on Law Firm to prepare and timely file the Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return. Attorney 1 personally prepared or supervised preparation of the return, which was timely filed on Date 3.

The return reported the Marital Trust as Qualified Terminable Interest Property (QTIP) on Schedule M, and the executor, therefore, is deemed to have made a QTIP election to have the Marital Trust treated as qualified terminable interest property under § 2056(b)(7). However, Law Firm did not advise Executor to sever the Marital Trust into an exempt and non-exempt trust or to make a reverse QTIP to use Decedent's GST exemption. As a result, the Marital Trust was not severed, no reverse QTIP election was made on the Form 706, and Decedent's GST exemption was not allocated to the Marital Trust.

Spouse died on Date 4, whereupon the remaining Marital Trust assets passed to Trust. Thereafter, upon a review of the relevant documents, Attorney 2 met with Executor on Date 5 and advised him of the failure to make a reverse QTIP election with respect to Trust B and to allocate Decedent's remaining GST exemption to Trust B.

#### Proposed severance

Under State Law, the trustee may divide a trust into two or more separate trusts without a judicial proceeding if the result does not impair the rights of any beneficiary or adversely affect achievement of the purposes of the original trust.

Pursuant to State Law, Executor, as the trustee, will sever Trust into Trust A and Trust B. Trust A and Trust B will be funded on a fractional basis. Executor will allocate to Trust B a pro rata portion of each asset passing to the Marital Trust based on a fraction, the numerator of which would be the amount of Decedent's remaining unused GST exemption, and the denominator of which would be the fair market value of all assets passing to the Marital Trust as of Decedent's date of death. The balance of the Marital Trust assets will be allocated to Trust A. The terms of Trust A and Trust B will be identical to the terms of the Marital Trust. It is represented that Decedent has sufficient remaining GST exemption to allocate to Trust A.

#### 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 shall, except as limited by § 2056(b), be determined by deducting from the value of the gross estate an amount equal to the value of any interest in property which passes or has passed from the decedent to the 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 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 under this section with respect to such interest –

- (A) if an interest in such property passes or has passed (for less than an adequate consideration in money or money's worth) from the decedent to any person other than such 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;

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

Section 2056(b)(7)(B)(i) defines the term “qualified terminable interest property” as property which passes from the decedent, in which the surviving spouse has a qualifying income interest for life, and to which an election under this paragraph applies.

Section 2056(b)(7)(B)(v) provides, in part, that an election with respect to any property shall be made by the executor on the return of tax imposed by § 2001.

Section 2601 imposes a tax on every generation-skipping transfer (within the meaning of subchapter B) made by a “transferor” to a skip person. Under § 2611(a), the term “generation-skipping transfer” means a taxable distribution, a taxable termination, and a direct skip.

Section 2602 provides that the amount of the tax is the taxable amount multiplied by the applicable rate.

Section 2641(a) defines the term “applicable rate” with respect to any generation-skipping transfer, as the product of the maximum federal estate tax rate and the

inclusion ratio with respect to the transfer.

Section 2631(a), as in effect for the year at issue, provides that for purposes of determining the inclusion ratio, every individual shall be allowed a GST exemption amount which may be allocated by such individual (or his executor) to any property with respect to which such individual is the transferor. Section 2631(b) provides that any allocation under § 2631(a), once made, shall be irrevocable.

Section 2632(a) provides that any allocation by an individual of his or her GST 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 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 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 a 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, in part, 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. Unused GST exemption is allocated pro rata, on the basis of the value of the property as finally determined for purposes of chapter 11, first to direct skips treated as occurring at the transferor's death. The balance, if any, of unused GST exemption is allocated pro rata on the basis of the chapter 11 value of the nonexempt portion of the trust property to trusts with respect to which a taxable termination may occur or from which a taxable distribution may be made.

Section 2652(a)(1) provides, in part, that for purposes of chapter 13, the term "transferor" means in the case of any property subject to the tax imposed by chapter 11, and the decedent. An individual shall be treated as transferring any property with respect to which such individual is the transferor.

Section 2652(a)(3) provides, in part, that in the case of any trust with respect to which a deduction is allowed to the decedent under § 2056 by reason of subsection (b)(7), the estate of the decedent may elect to treat all of the property in such trust for GST tax purposes as if the election to be treated as qualified terminable interest property had not been made (reverse QTIP election).

Section 26.2652-2(a) provides, in part, that a reverse QTIP election is not effective unless it is made with respect to all of the property in the trust to which the QTIP election applies. Section 26.2652-2(b) provides that an election under § 2652(a)(3) is

made on the return on which the QTIP election is made.

Section 26.2654-1(b)(1) provides, in part, 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 –

- (i) The trust is severed pursuant to a direction in the governing instrument providing that the trust is to be divided upon the death of the transferor; or
- (ii) 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; and
  - (B) The severance occurs prior to the date prescribed for filing the Federal estate tax return (including extensions actually granted) for the estate of the transferor, and

(1) The new trusts are severed on a fractional basis.

Section 301.9100-1(c) provides that the Commissioner has discretion to grant a reasonable extension of time under the rules set forth in §§ 301.9100-1 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.

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 provides the standards used to determine whether to grant an extension of time to make an election whose due date is prescribed by a regulation (and not expressly provided by statute).

Based on the facts submitted and representations made, we conclude that the requirements of § 301.9100-3 are satisfied. Therefore an extension of time is granted until 120 days from the date of this letter to sever the Marital Trust into an exempt trust and a non-exempt trust, and to make a reverse QTIP election with respect to the exempt trust. Finally, we rule that the automatic allocation rules of § 2632(e)(1) apply to automatically allocate Decedent's unused GST exemption to the exempt trust.

The reverse QTIP election should be made on a supplemental Form 706. The supplemental Form 706 should be filed with the Cincinnati Service Center at the following address: Internal Revenue Service Center - Stop 82, Cincinnati, OH 45999. A copy of this letter should be attached to the supplemental Form 706. A copy of this letter is enclosed for this purpose.

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.

The rulings in this letter pertaining to the federal estate and/or generation-skipping transfer tax apply only to the extent that the relevant sections of the Internal Revenue Code are in effect during the period at issue.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code 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.

Sincerely,

Associate Chief Counsel  
(Passthroughs and Special Industries)

*Lorraine E. Gardner*

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

Enclosure  
Copy of letter for § 6110 purposes

cc: