

## Internal Revenue Service

## Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

**CC:PS&I:Br9-PLR-119078-00**

Date:

Re:

February 5, 2001

Legend:

Decedent:

Spouse:

Trust Agreement:

Residuary Trust:

Trustee:

Spouse Revocable Trust:

C1:

C2:

C3:

Date 1:

Date 2:

State:

\$ W

\$ X

\$ Y

\$ Z

SB/SE Official:

Dear \_\_\_\_\_ :

This is in response to your firm's letter, dated September 29, 2000, requesting extensions of time under section 301.9100-1 of the Procedure and Administration Regulations to sever a trust into separate trusts, and a determination of the transferors and inclusion ratios, for generation-skipping transfer tax ("GSTT") purposes, of the separate trusts.

The facts as represented are as follows: Decedent died testate on Date 1, survived by Spouse and by children, C1, C2, and C3. During life, Decedent created a revocable trust under Trust Agreement that provided that, at the death of Decedent, the assets of the revocable trust were to be divided into two irrevocable trusts, a marital

PLR-119078-00

trust for the benefit of Spouse and a residuary trust ("Residuary Trust").

Under the terms of Trust Agreement, which governs Residuary Trust, Spouse possesses a qualifying income interest in Residuary Trust property for life. Trust Agreement also provides that Decedent's personal representative has the power to make an election for federal tax purposes to treat any portion or all of Residuary Trust as qualified terminal interest property ("QTIP").

Trust Agreement further provides that, upon the death of Spouse, the balance of Residuary Trust is to be divided into equal shares for the benefit of C1, C2, and C3, and that such share shall be distributed to a trust set up for that child, if any, by Spouse. If Spouse has created no trusts for C1, C2, or C3, then each child's share is to be held in Residuary Trust. C1, C2, and C3 are to receive the net income of their respective trust shares in not less than annual installments, and Trustee may invade the principal of the shares of C1, C2, or C3 for that child's maintenance in health, comfort, or education. At the death of C1, C2, or C3, Trust Agreement provides that the remaining corpus of the child's trust share is to be distributed per stirpes to the living descendants of that child or, if none, then per stirpes to the living descendants of Decedent.

On the Form 706 for Decedent's estate, the personal representative of Decedent's estate reported \$ W as the date of death value of Residuary Trust, and made an election under section 2056(b)(7) to treat 57.43936 percent of the assets of Residuary Trust as QTIP property ("QTIP portion"). The value of the QTIP portion at Decedent's date of death was \$ X. A deduction from Decedent's gross estate under section 2056(a) was claimed with respect to the QTIP portion. The remaining 42.56064 percent of the assets of Residuary Trust ("Non-QTIP portion"), with a date of death value amounting to \$ Y, was included in Decedent's gross estate. On a subsequently filed amended Form 706, Decedent's personal representative made a reverse QTIP election with respect to 58.52574 percent of the QTIP portion of Residuary Trust ("reverse QTIP portion"). The value of the reverse QTIP portion as of Decedent's date of death was \$ Z. The personal representative allocated 55.8 percent of Decedent's GSTT exemption to the Reverse QTIP portion, an amount equal to the value of that portion. The personal representative allocated the remaining 44.2 percent of the GSTT exemption, equal in value to \$ Y, to the Non-QTIP portion of Residuary Trust. No additions of assets have been made to Residuary Trust since its inception at the death of Decedent.

Spouse died on Date 2, survived by C1, C2, and C3. Spouse did not establish separate trusts for C1, C2, and C3. On the Form 706 for Spouse's estate, the personal representative included the QTIP portion of Residuary Trust in Spouse's gross estate and allocated all of Spouse's GSTT exemption to assets other than the QTIP portion.

Pursuant to section 737.402(2) of State law, unless expressly forbidden under the trust agreement, a trustee may, without seeking court authorization, sever a trust on

PLR-119078-00

a fractional basis into two or more separate trusts and, subject to the terms of the trust agreement, may take into consideration in such a severance differences in federal tax attributes and applicable tax elections.

The Trustee proposes to sever Residuary Trust on a fractional basis into three separate trusts, the Non-QTIP Trust, the QTIP Trust, and the Reverse QTIP Trust, as determined by the GSTT attributes of each portion of Residuary Trust assets. It is represented that the interests and beneficiaries of each new trust created will be identical to those of Residuary Trust.

The following rulings are requested:

(1) An extension of time will be granted in which to sever Residuary Trust into separate trusts.

(2) For GSTT purposes, the transferor of the Non-QTIP Trust will be Decedent, and that trust will have an inclusion ratio of zero.

(3) For GSTT purposes, the transferor of the QTIP Trust will be Spouse, and that trust will have an inclusion ratio of one.

(4) For GSTT purposes, the transferor of the Reverse QTIP Trust will be Decedent, and that trust will have an inclusion ratio of zero.

#### Law and Analysis

Section 2001(a) of the Internal Revenue Code 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 section 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)(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 section 2056(a) and, for purposes of section 2056(b)(1)(A), no part of the property shall be treated as passing to any person other than the surviving spouse.

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 section 2056(b)(7)(B)(v) applies.

PLR-119078-00

Section 2056(b)(7)(B)(v) provides that an election to treat property as qualified terminable interest property shall be made by the executor on the return of tax imposed by section 2001.

Section 2601 imposes a tax on every generation-skipping transfer.

Section 2602 provides that the amount of the tax imposed by section 2601 is the taxable amount of the transfer (as determined under sections 2621, 2622, 2623, and 2624) multiplied by the applicable rate.

Section 2611(a) defines a generation-skipping transfer as a taxable distribution, a taxable termination, or a direct skip.

Section 2631 provides that, for purposes of determining the inclusion ratio, every individual shall be allowed a GST exemption of \$1,000,000 which may be allocated by such individual (or his executor) to any property with respect to which such individual is the transferor.

Section 2641 defines the applicable rate as the maximum Federal estate tax rate multiplied by the inclusion ratio with respect to the transfer.

Section 2642(a)(1) defines the inclusion ratio for any property transferred in a generation-skipping transfer as the excess (if any) of 1 over --

(A) except as provided in subparagraph (B), the applicable fraction determined for the trust from which such transfer is made, or

(B) in the case of a direct skip, the applicable fraction determined for such skip.

Section 2642(a)(2) defines the applicable fraction as a fraction --

(A) the numerator of which is the amount of the GSTT exemption allocated to the trust (or in the case of a direct skip, allocated to the property transferred in such skip), and

(B) the denominator of which is --

(i) the value of the property transferred to the trust (or involved in the direct skip) reduced by

(ii) the sum of --

(I) any Federal estate tax or State death

PLR-119078-00

tax actually recovered from the trust  
attributable to such property, and

(II) any charitable deduction allowed  
under section 2055 or 2522 with respect to  
such property.

Section 26.2642-4(a) of the Generation-Skipping Transfer Tax Regulations provides, in general, that the applicable fraction for a trust is redetermined whenever additional exemption is allocated to the trust or when certain changes occur with respect to the principal of the trust. Except as otherwise provided in section 26.2642-4(a), the numerator of the redetermined applicable fraction is the sum of the amount of GSTT exemption currently being allocated to the trust (if any) plus the value of the nontax portion of the trust. The denominator of the redetermined applicable fraction is the value of the trust principal immediately after the event occurs. The nontax portion of a trust is determined by multiplying the value of the trust assets, determined immediately prior to an event, with respect to the principal of the trust, by the then applicable fraction.

Section 2652(a)(1) defines the term “transferor” as –

(A) in the case of any property subject to the tax imposed by  
chapter 11 (estate tax), the decedent, and

(B) in the case of any property subject to the tax imposed by  
chapter 12 (gift tax), the donor.

Section 2652(a)(3)(A) provides that, in the case of any trust with respect to which a deduction from the gross estate is allowed to the decedent under section 2056(b)(7) for qualified terminable interest property, the estate of the decedent may elect to treat all of the property in such trust, for purposes of the GSTT, as if the election to be treated as qualified terminable interest property had not been made. Such an election is referred to as a “reverse” QTIP election. The consequence of a “reverse” QTIP election is that the decedent remains, for GSTT purposes only, the transferor of the QTIP trust for which the election is made and all or any of the decedent’s GSTT exemption may be allocated to that QTIP trust.

Section 26.2652-2(c) of the Generation-Skipping Transfer Tax Regulations provides the transitional rule that, if a reverse QTIP election is made with respect to a trust before December 27, 1995, and GSTT exemption has been allocated to that trust, the transferor (or the transferor’s executor) may elect, before June 24, 1996, to treat the trust as two separate trusts, one of which has a zero inclusion ratio by reason of the transferor’s GSTT exemption previously allocated to the trust. The separate trust with the zero inclusion ratio consists of that fractional share of the value of the entire trust

PLR-119078-00

equal to the value of the nontax portion of the trust under section 26.2642-4(a). The reverse QTIP election is treated as applying only to the trust with the zero inclusion ratio. A trust subject to the election under section 26.2652-2(c) is treated as a trust created by two transferors. An election under this paragraph (c) is made by attaching a statement to a copy of the return on which the reverse QTIP election was made under section 2652(a)(3), is to be filed in the same place in which the original return was filed, and must be filed before June 24, 1996. The statement must indicate that an election is being made to treat the trust as two separate trusts and must identify the values of the two separate trusts.

Section 2654(b)(2) provides that, for purposes of the GSTT –

(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.

Section 26.2654-1(b)(1) (ii) of the Generation-Skipping Transfer Tax Regulations provides, in pertinent 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 the GSTT 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, in which case the new trusts need not be funded with a pro rata portion of each asset held by the undivided trust, 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 section

PLR-119078-00

26.2654-1(a)(ii) if it were paid to an individual.

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

Section 301.9100-1(c) of the Procedure and Administration Regulations provides, in pertinent part, that the Commissioner may grant a reasonable extension of time under the rules set forth in sections 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 Internal Revenue Code except Subtitles E, G, H, and I.

Section 301.9100-2 provides automatic extensions of time for making certain elections. Section 301.9100-3 provides extensions of time for making elections that do not meet the requirements of section 301.9100-2.

Section 301.9100-3(a) provides that requests for relief subject to this section 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.

In this case, the standards of sections 301.9100-1 and 301.9100-3 have been satisfied. The proposed severance of Residuary Trust will be on a fractional basis, determined by the GSTT characteristics of each portion of Residuary Trust assets. The severance will be pursuant to discretionary authority granted under State law. It is represented that the terms of the new trusts provide in the aggregate for the same succession of interests and beneficiaries as are provided in Residuary Trust. It is further represented that no additional assets will be placed in any new trust. Consequently, extensions of time for 60 days from the date of this letter are granted in which to elect to sever the QTIP and reverse QTIP portions of Residuary Trust pursuant to section 26.2652-2(c), and in which to elect to sever the Non-QTIP portion of Residuary Trust pursuant to section 26.2654-1(b). The relevant portions of Residuary Trust prior to severance and the new trusts when created have and will have, as is pertinent, the following transferors and inclusion ratios:

- (1) QTIP portion of Residuary Trust and QTIP Trust: The transferor is/will be Spouse, and the inclusion ratio is/will be one.
- (2) Non-QTIP portion of Residuary Trust and Non-QTIP Trust: The transferor is/will be Decedent, and the inclusion ratio is/will be zero.
- (3) Reverse QTIP portion of Residuary Trust and Reverse QTIP Trust: The transferor is/will be Decedent, and the inclusion ratio is/will be zero.

PLR-119078-00

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 elections must be made by filing with the SB/SE official for the office where Decedent's original and amended Forms 706 were filed copies of those returns (on which the QTIP and reverse QTIP elections were made) to which is attached a statement and a copy of this ruling, along with documentation of severance. The statement must describe the manner in which Residuary Trust is severed and identify the values of the resulting QTIP Trust, the Non-QTIP Trust, and the Reverse QTIP Trust.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Powers of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,  
Paul F. Kugler  
Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosure  
Copy for section 6110 purposes