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**Department of the Treasury**

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**Date:** August 13, 1999

Re:

LEGEND:

Decedent =

Spouse =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Trust =

Child A =

Child B =

Child C =

Personal  
Representative =

x =

y =

This letter is in response to your submission of May 21, 1999, on behalf of Decedent's estate, in which you request rulings concerning a "reverse" qualified terminable interest

property (QTIP) election under § 2652(a)(3) of the Internal Revenue Code and the generation-skipping transfer (GST) tax consequences of a division of a trust.

Decedent died testate on Date 1. Decedent was survived by Spouse and three adult children. According to Article V of Decedent's will, the residue of Decedent's estate is to be distributed to the trustee of Trust, a revocable inter vivos trust created by Decedent that became irrevocable on Decedent's death.

Article II, Section A of Trust directs that after Decedent's death, the balance of Trust, after providing for a specific devise of real property to Child A, is to be held in a marital trust and governed pursuant to Article III, Section A.

Under Article III, Section A of Trust, the trustee is directed to pay to Spouse, for life, or to apply for her benefit, the entire net income of the trust, not less frequently than quarter-annually. The trustee (other than Spouse) also has the discretion to pay to Spouse, or to apply for her benefit, such sums of the trust principal as the trustee deems advisable for Spouse's best interests. In addition, Spouse has the right, at any time or times, upon written request to the trustee, to receive such sums of the trust principal as are reasonably necessary to provide for Spouse's health, maintenance, and support.

Article IV, Section A of Trust provides that upon the death of Spouse, the trustee is to divide the trust assets into equal shares for the benefit of Decedent's three children (Child A, Child B, and Child C).

Under Article IV, Section A(1), the trustee is directed to pay over and distribute to Child A, the share set aside for him. If Child A predeceases Spouse, Child A's share is to be distributed to his wife, if she is then living. If Child A's wife is not then living, Child A's share is to be held in trust for the benefit of his descendants who are then living and allocated among them per stirpes.

Article IV, Section A(2) provides that the share allocated to Child B is to be held as a separate trust for Child B's benefit. Pursuant to Article IV, Section B, the trustee has the discretion to pay to Child B, or apply for her benefit, so much of the net income or principal of the trust as the trustee deems advisable. At Child B's death, the remaining principal and any undistributed income shall be paid over and distributed to Child B's then living descendants, per stirpes.

Article IV, Section A(3) provides that the share allocated to Child C will also be held in a separate trust for Child C's benefit. Article IV, Section C gives the trustee the discretion to pay to Child C, or apply for her benefit, so much of the net income or principal of the trust as the trustee deems advisable. Upon Child C's death, the remaining principal and any undistributed income is to be divided into two equal shares. One share is to be added to and administered as part of the principal of the trust being held for Child B's benefit. If Child B predeceases Child C, Child B's share will be held in trust for the benefit of Child B's living descendants. The other share is to be distributed outright to Child A, if living, or to his wife if he is not then living. If neither Child A nor his wife survive Child C, Child A's share will be held in trust for the benefit of Child A's descendants.

It is represented that Decedent's estate was granted an extension of time, until Date 6, to file the Decedent's Form 706, Federal Estate and Generation-Skipping Transfer Tax Return. On Date 2, prior to Date 6, Decedent's estate filed the return. On Schedule M, the Personal Representative elected to treat a specified percentage of the marital trust established under Article III, Section A as qualified terminable interest property (QTIP) under § 2056(b)(7). A Schedule R was not filed with the return. Thus, the estate neither made a "reverse" QTIP election under § 2652(a)(3) nor allocated any of Decedent's available GST exemption.

After it was discovered that the Schedule R was not filed with Decedent's estate tax return, and prior to Date 6, several corrective measures were taken. First, the Personal Representative petitioned a state court to reform Articles III and IV of Trust. The Personal Representative's petition, which was agreed and consented to by all the beneficiaries of Trust, requested that Articles III and IV of Trust be reformed to provide for three separate marital trusts- Trust 1, Trust 2, and Trust 3. Spouse is the life income beneficiary of each marital trust and each of Decedent's children is a successor beneficiary of one of the trusts. Child A is the successor beneficiary of Trust 1, Child B is the successor beneficiary of Trust 2, and Child C is the successor beneficiary of Trust 3. The three trusts provide in the aggregate for the same succession of interests and beneficiaries that were provided in Trust. On Date 3, the state court granted the Personal Representative's request, and on Date 4, pursuant to the court order, the trustee divided Trust, on a fractional basis, into three equal trusts. Lastly, on Date 5, which was prior to Date 6, the Personal Representative filed a second estate tax return. A Schedule R was included with this return. On the Schedule R, a reverse QTIP election was made with respect to Trust 2 and Trust 3. Decedent's available GST tax exemption was allocated, \$x, or the smallest amount necessary

to derive an inclusion ratio of zero, to Trust 2 and \$y, or the remaining GST exemption, to Trust 3.

The estate has represented that Decedent did not use any of the GST exemption available under § 2631(a) during his life.

The following rulings have been requested:

1. The division of Trust into three trusts will be recognized for purposes of Chapter 13 of the Code.
2. The estate made a timely reverse QTIP election under § 2652(a)(3).
3. The Decedent's GST exemption will be allocated in accordance with the Schedule R as filed, and the inclusion ratio, as defined in § 2642, with respect to Trust 2, benefitting Child B, is zero.

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.

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.

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)(v) provides that an election under § 2056(b)(7) with respect to any property is to be made by the executor on the return of tax imposed by § 2001. The election, once made, is irrevocable.

Section 20.2056(b)-7(b)(4)(i) of the Estate Tax Regulations provides that the QTIP election is made on the return of tax imposed by § 2001. For purposes of this paragraph, the term "return of tax imposed by § 2001" means the last estate tax return filed by the executor on or before the due date of the return, including extensions or, if a timely return is not filed, the first estate tax return filed by the executor after the due date.

Under § 2044, 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 includible in the decedent's gross estate.

Section 2601 imposes a tax on every generation-skipping transfer (GST) made by a "transferor" to a skip person (a person assigned to a generation that is 2 or more generations below the generation assignment of the transferor) after October 22, 1986.

Under § 2602, the amount of the GST tax is determined by multiplying the amount of the GST transfer by the "applicable rate." Under § 2641, the applicable rate with respect to any generation-skipping transfer is the product of the maximum federal estate tax rate and the "inclusion ratio" with respect to the transfer. Section 2642(a) defines the inclusion ratio, in the case of a transfer from a trust, as the excess of 1 over the applicable fraction with respect to trust. The applicable fraction, with respect to a trust, is a fraction, the numerator of which is the amount of GST exemption allocated to the trust, and the denominator of which is the value of the property transferred to the trust (reduced as provided in the section).

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

Section 2631(b) provides that any allocation under § 2631(a) once made, is 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 the individual's estate (determined with regard to extensions), regardless of whether such a return is required to be filed.

Under § 2652, a "transferor" is defined, generally, as the last person with respect to whom the property was subject to an estate or gift tax. Thus, in the case of property subject to a

QTIP election that is subsequently includible in the surviving spouse's gross estate under § 2044, the surviving spouse would become the transferor of the property for GST purposes. However, § 2652(a)(3) provides that in the case of any trust with respect to which a deduction is allowed to the decedent 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 qualified terminable interest property 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 purposes, the transferor of the QTIP trust for which the election is made. As a result, the decedent's GST tax exemption may be allocated to the QTIP trust.

Section 26.2652-2(b) of the Generation-Skipping Transfer Regulations provides that the reverse QTIP election is made on the return on which the QTIP election is made.

Section 26.2654-1(a)(2) provides 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 the 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 each 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 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 § 26.2654-1(a)(1)(ii) if it were paid to an individual. If severed on a fractional basis, the separate trusts need not be funded with a pro rata portion of each assets held by the undivided trust. The trusts may be funded on a nonpro 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.

In the present case, prior to the due date of the estate tax return, including extensions, and pursuant to a court order, the trustee divided Trust into three equal trusts, one for the benefit of each of Decedent's children. The terms of these three trusts grant Spouse a qualifying income interest for life. After Spouse's death, the remainder of each trust is to pass to, or be held for the benefit of, one of Decedent's children, as prescribed in the original trust instrument. Therefore, the three trusts provide in the aggregate for the same succession of interests and beneficiaries that were provided in Trust. Further, Trust was severed prior to the due date, including extensions, for filing the Decedent's estate tax return. Thus, the division of Trust into three trusts will be recognized for purposes of Chapter 13 of the Code. See e.g., § 26.2654-1(b)(4), Example 1.

Decedent's estate initially failed to include the Schedule R with Decedent's Form 706, Federal Estate Tax Return. However, a second estate tax return was filed prior to the extended due date for filing Decedent's estate tax return. This estate tax return was the last estate tax return filed by the Personal Representative on or before the due date of the return, including extensions. Therefore, since both the QTIP and reverse QTIP elections were made on this return, the reverse QTIP election is timely. Further, the allocation of Decedent's GST exemption made on this return is timely and will be allocated in accordance with the Schedule R as filed. According to Schedule R, Decedent's GST exemption is allocated to Trusts 2 and 3. The GST exemption allocated to Trust 2 will be \$x, or the smallest amount necessary to derive an inclusion ratio of zero. Any remaining GST exemption is allocated to Trust 3.

Except as ruled above, we express or imply no opinion concerning the federal tax consequences of this transaction under the cited provisions of the Code or any other provision 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.

Sincerely yours,

Assistant Chief Counsel  
(Passthroughs and Special  
Industries)

By \_\_\_\_\_  
George Masnik  
Chief, Branch 4

Enclosure

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