

## Internal Revenue Service

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Department of the Treasury  
Washington, DC 20224

[Third Party Communication:  
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Person To Contact:  
, ID No.

Telephone Number:

Refer Reply To:  
CC:PSI:9  
PLR-118175-04

Date:  
February 18, 2005

In Re:

### Legend:

Decedent	=
Spouse	=
Family Trust	=
Marital Trust	=
GST Exempt Marital Trust	=
GST Nonexempt Marital Trust	=
Child 1	=
Child 2	=
Date 1	=
A	=
B	=

Dear :

This is in response to your letter dated March 3, 2004, 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 died on Date 1, survived by his Spouse, Child 1, and Child 2. After making certain specific bequests, Section II, Paragraph E of Decedent's will provides that Family Trust is to be formed and funded with an amount equal to Decedent's available unified credit. Paragraph F provides that Marital Trust is to be formed and funded with the residuary of Decedent's estate.

Pursuant to Section III, Spouse is to receive all of the net income of Marital Trust at least quarterly and so much or all of the corpus of the trust to provide for Spouse's health, education, maintenance, and support. Spouse has a limited testamentary power to appoint the assets of Marital Trust to or for the benefit of any one or more of Decedent's descendants. Assets not effectively appointed are to be contributed to Family Trust and administered pursuant to that trust's terms. Upon Spouse's death, Spouse's estate is to receive any undistributed net income of Marital Trust.

Section IV provides that the trustee of Family Trust may distribute net income and/or corpus of Family Trust to Spouse, Child 1, and Child 2 to provide for their health, education, maintenance, and support. Spouse has a testamentary limited power to appoint the assets of Family Trust to or for the benefit of Decedent's descendants. Family Trust assets not effectively appointed are to be divided into one share each for Child 1 and Child 2. If Child 1 survives Spouse, the share for Child 1 is to be distributed free of trust to Child 1. If Child 2 survives Spouse, the share for Child 2 is to be held in further trust for Child 2's benefit. During the life of Child 2, Child 2 is to receive distributions of net income and/or corpus from her trust to provide for her health, education, maintenance, and support. Upon Child 2's death, the remaining trust assets are to be held in further trust for the then living descendants of Child 2 or, if none, to Decedent's then living descendants, per stirpes, or, if none, to the heirs at law of Decedent and Spouse.

Section IV further provides that if Child 1 and/or Child 2 predeceases Spouse leaving living descendants or if Child 2 dies survived by descendants before receiving all of the assets in her trust, the assets of the trust designated for Child 1 and Child 2 are to be held in a separate trust for descendants of Child 1 and Child 2. These descendants are to receive distributions of net income and/or corpus from their respective trust to provide for their health, education, maintenance, and support. When there is no longer a living child of the deceased child under the age of 21, the trust is to terminate and all of the remaining assets are to be distributed to the then living descendants of the deceased child, per stirpes, or if none, to Decedent's then living descendants, per stirpes, or if none, to the heirs at law of Decedent and Spouse.

Section V provides the executor with the power to allocate Decedent's available GST exemption, divide Marital Trust into a GST exempt and nonexempt trust, and make the reverse QTIP election under § 2652(a)(3) for the exempt trust.

Section VIII authorizes the executor to divide any trust established under the will, at any time into two or more separate trusts so that the federal GST tax inclusion ratio as defined in § 2642(a) for each trust shall be either zero or 1. Any such separate trusts are to have provisions that are identical to the original trust. If a trust is divided into separate trusts, the executor may make different tax elections (including the allocation of Decedent's available GST exemption) to each separate trust.

Upon Decedent's death, the executors of his estate engaged an accounting firm to prepare the Form 706, Estate (and Generation-Skipping Transfer) Tax Return, for Decedent's estate. The return reported that assets equal to \$ A will fund Family Trust. The QTIP election was made on Schedule M of the Form 706 for the assets in the Marital Trust. The accounting firm, however, failed to sever or advise the executors to sever the Marital Trust into a GST exempt and nonexempt trust and to make the reverse QTIP election under § 2652(a)(3) for the GST exempt trust. This failure was discovered when Spouse retained an attorney to review her estate planning documents.

No allocation of Decedent's available GST exemption was made on the Form 706. In addition, it has been represented that all of Decedent's GST exemption was available for allocation at his death. Further, it has been represented that none of the trusts established under the will have been funded and the administration of Decedent's estate remains open.

The executors propose to divide Marital Trust into the GST Exempt Marital Trust and the GST Nonexempt Marital Trust. The GST Exempt Marital Trust will be funded with a fractional share of the residue of Decedent's estate passing to the Marital Trust, the numerator of which is equal to the Decedent's remaining GST exemption after taking into account the automatic allocation of GST exemption to Family Trust, and the denominator of which is equal to the amount of the residue passing to the Marital Trust. The GST Nonexempt Marital Trust will be funded with the balance of the property passing to the Marital Trust. The GST Exempt Marital Trust and the GST Nonexempt Marital Trust will be funded on a non pro rata basis, 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 Decedent's date of death to the date of funding.

Executors are requesting an extension of time under § 301.9100-3 to sever Marital Trust into the GST Exempt Marital Trust and the GST Nonexempt Marital Trust, pursuant to § 26.2654-1(b)(1), and to make a reverse QTIP election under § 2652(a)(3) for the GST Exempt Marital Trust by filing a supplemental Form 706 so that the unused portion of Decedent's GST exemption will be deemed allocated to the GST Exempt Marital Trust resulting in the trust having a zero inclusion ratio.

#### 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 moneys 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)(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)(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)) that 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 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) of the Generation-Skipping Transfer Tax Regulations 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.

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. Although no allocations of Decedent's GST exemption were made on the Form 706, as filed, pursuant to §§ 2632(e) and 26.2632-1(d)(2), \$ A of Decedent's available GST exemption was automatically allocated to the Family Trust, leaving \$ B of Decedent's available GST exemption unused.

As a result of the QTIP election made on the estate tax return, the Marital Trust's assets will be includible in Spouse's gross estate pursuant to § 2044. Spouse, accordingly, will be the transferor of the Marital Trust's assets for GST tax purposes. Therefore, Decedent's remaining GST exemption may not be allocated to Marital Trust's assets. However, if the Marital Trust is severed into two trusts, the GST Exempt Marital Trust and the GST Nonexempt Marital Trust, and a reverse QTIP election under § 2652(a)(3) is made with respect to the GST Exempt Marital Trust, Decedent will be treated as the transferor of the GST Exempt Marital Trust's assets. Under the automatic allocation rules in § 2032(e), Decedent's remaining GST tax exemption of \$ B will be allocated to the GST Exempt Marital Trust. The GST Exempt Marital Trust will have an inclusion ratio of zero,

provided that \$ B is equal to the value of the trust's assets for federal transfer tax purposes.

Based on the facts submitted and the representations made, we conclude that the requirements of § 301.9100-3 have been satisfied. Accordingly, the estate is granted an extension of time of sixty (60) days from the date of this letter to sever the Marital Trust into the GST Exempt Marital Trust and the GST Nonexempt Marital Trust, and to file a supplemental Form 706 on which the reverse QTIP election is made for the GST Exempt Marital Trust.

The supplemental Form 706 should be filed with the Internal Revenue Service Center, Cincinnati, Ohio 45999. A copy of this letter should be attached to the return. A copy is enclosed for this purpose.

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

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed or implied as to the value of the assets included in Decedent's gross estate for federal estate tax purposes.

This ruling is directed only to the taxpayer requesting 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 & Special Industries)

Enclosures: Copy for ' 6110 purposes  
Copy of this letter

cc: