

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact:

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Telephone Number:

Refer Reply To:

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Date:

June 03, 2004

Re:

Legend:

Decedent =

Spouse =

Daughter =

Date 1 =

Date 2 =

Date 3 =

Year =

Trust =

State Statute =

Amount 1 =

Amount 2 =

Amount 3 =

Amount 4 =

Dear :

This is in response to a letter dated April 28, 2004, and prior correspondence, requesting a ruling that the severance of Trust is a qualified severance under § 2642(a)(3) of the Internal Revenue Code (Code) and an extension of time under §§ 301.9100-1 and 301.9100-3 of the Procedure and Administration Regulations to make a “reverse” qualified terminable interest property (“QTIP”) election under § 2652(a)(3).

Facts

The facts submitted and representations made are as follows. Decedent died on Date 1, survived by Spouse. Articles IV and V of Decedent's Will, dated Date 2, provide that Decedent's residuary estate be divided pursuant to a formula into a Marital Trust and a Credit Shelter Trust. The Credit Shelter Trust was initially funded with Amount 1 and the Marital Trust was funded with Amount 2. Both the Credit Shelter Trust and the Marital Trust provide for the distribution of all income to Spouse during her life. Both trusts also provide the Trustee with discretion to distribute principal to Spouse for her support and maintenance. Upon the death of Spouse, the Credit Shelter Trust is to be added to the Marital Trust and held in further trust for the benefit of the Decedent's only child, Daughter.

On the Schedule M of Decedent's Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return, the executor checked the box to elect QTIP treatment for the Marital Trust. On the Schedule R, the executor allocated Amount 3 of Decedent's generation-skipping transfer (GST) exemption to the Credit Shelter Trust and Amount 4 to the Marital Trust. The executor, however, inadvertently failed to make a reverse QTIP election under § 2652(a)(3) with respect to the Marital Trust and otherwise to divide the Marital Trust to reflect the allocation of GST exemption. These errors were discovered in Year.

State Statute authorizes a trustee, without court authorization, to sever any trust on a fractional basis into two or more separate and identical trusts for any reason. Each separate trust must be held and administered upon the identical terms and conditions of the trust from which it was severed. The separate trust created by the severance must be treated as a separate trust for all purposes from the date the severance is effective. The effective date of the severance may be retroactive to a date before the date in which the trustee exercises such power. Pursuant to State Statute, on Date 3, the trustee divided the Marital Trust on a fractional basis into two separate shares, a GST exempt share and a nonexempt share. The exempt share consists of that fraction of the fair market value of the Marital Trust on the date of severance equal to Amount 4 divided by Amount 2. The nonexempt share consists of that fraction of the fair market value of the Marital Trust on the date of severance equal to 1 minus Amount 4 divided by Amount 2.

A ruling is requested that the severance of Marital Trust is a qualified severance under § 2642(a)(3). In addition, an extension of time under §§ 301.9100-1 and 301.9100-3 is requested for making a reverse QTIP election under § 2652(a)(3) with respect to the GST exempt share of the Marital 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 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) disallows this deduction 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.

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: (I) which passes from the decedent; (II) in which the surviving spouse has a qualifying income interest for life; and (III) to which an election under § 2056(b)(7) applies.

Section 2056(b)(7)(B)(ii) provides 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. Such an election, once made, shall be irrevocable.

Section 2601 imposes a tax on every generation-skipping transfer (within the meaning of subchapter B). A "generation-skipping transfer" is defined under § 2611(a) as: (1) a taxable distribution; (2) a taxable termination; and (3) a direct skip.

Section 2602 provides that the amount of the GST tax is determined by multiplying the taxable amount by the applicable rate. Section 2641(a) provides that the term "applicable rate" means with respect to any GST transfer, the product of the maximum federal estate tax rate and the inclusion ratio with respect to the transfer. Under § 2642(a)(1), the inclusion ratio with any property transferred in a generation-skipping transfer is generally defined as the excess of 1 over the "applicable fraction."

The applicable fraction, as defined in § 2642(a)(2) is a fraction, the numerator of which is the amount of GST exemption under § 2631 allocated to the trust (or to property transferred in a direct skip), and the denominator is the value of the property transferred reduced by the sum of any federal estate tax or state death tax actually recovered from the trust attributable to such property and any charitable deduction allowable under § 2055 or § 2522 with respect to such property.

Section 2631(a), as in effect for decedents dying before December 31, 2003, 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 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, 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 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 2652(a)(1) provides that for purpose of chapter 13, the term "transferor" means: (A) in the case of any property subject to the tax imposed by chapter 11, the decedent; and (B) in the case of any property subject to the tax imposed by chapter 12, the donor. An individual shall be treated as transferring any property with respect to which such individual is the transferor.

Section 2652(a)(3) provides, in pertinent part, 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 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) of the Generation-Skipping Transfer Tax Regulations 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 2642(a)(3) was enacted as part of the Taxpayer Relief Act of 2000, and provides for the qualified severance of a trust for GST tax purposes. Section 2642(a)(3) is effective in the case of severances occurring after December 31, 2000, and provides, generally, that if a trust is severed in a qualified severance, the trusts resulting from such severance shall be treated as separate trusts thereafter for GST tax purposes.

Section 2642(a)(3)(B)(i) provides that, for purposes of § 2642(a)(3)(A), the term “qualified severance” means the division of a single trust and the creation (by any means available under the governing instrument or under local law) of two or more trusts if the single trust was divided on a fractional basis, and the terms of the new trusts, in the aggregate, provide for the same succession of interests of beneficiaries as are provided in the original trust.

Section 2642(a)(3)(B)(ii) provides that if a trust has an inclusion ratio of greater than zero and less than 1, a severance is a qualified severance only if the single trust is divided into two trusts, one of which receives a fractional share of the total value of all trust assets equal to the applicable fraction of the single trust immediately before the severance. In such case, the trust receiving such fractional share shall have an inclusion ratio of zero and the other trust shall have an inclusion ratio of 1. Section 2642(a)(3)(B)(iii) provides that the term “qualified severance” includes any other severance permitted under regulations prescribed by the Secretary.

Section 2642(a)(3)(C) provides that a severance pursuant to § 2642(a)(B) may be made at any time. The Secretary shall prescribe by forms or regulations the manner in which the qualified severance shall be reported to the Internal Revenue Service.

Section 301.9100-1(c) provides that the Commissioner has discretion to grant a reasonable extension of time under the rules set forth in §§ 301.9100-2 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 301.9100-3 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).

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(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.

Pursuant to State Statute, on Date 3, the Marital Trust was divided on a fractional basis in accordance with the applicable fraction of the Marital Trust into two separate shares, the GST exempt share and the nonexempt share. State Statute provides that each separate trust must be held and administered upon the identical terms and conditions of the trust from which it was severed. Under these circumstances, we conclude that the Date 3 severance is a qualified severance under § 2642(a)(3). Therefore, assuming the GST exempt share and the nonexempt share are funded as described above, the GST exempt share will have an inclusion ratio of zero, and the nonexempt share will have an inclusion ratio of 1.

Finally, based on the facts and representations made, we have determined that the standards of §§ 301.9100-1 and 301.9100-3 have been met. Therefore, we rule that an extension of time to make a “reverse” QTIP election with respect to the GST exempt share is granted until 60 days from the date of this letter.

The reverse QTIP election should be made on a supplemental Form 706 (United States Estate (and Generation-Skipping Transfer) Tax Return). The severance may be reported by filing a statement identifying (A) the trust that is severed, the name of the transferor of the trust, the date of creation, the tax identification number, and the inclusion ratio with respect to the trust before severance; and (B) the new trusts created as a result of the severance, the name and tax identification number of the new trusts, the fraction of trust assets received by each trust, and the inclusion ratios with respect to the new trusts. Both the form and the statement are filed with the Internal Revenue Service Center, Cincinnati, OH 45999. A copy of this letter should be attached.

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.

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

Enclosure

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