

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
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Date:
SEPTEMBER 17, 2002

Re:
Legend:
Decedent =
Spouse =
X =
Y =
Z =
Trust =

Marital QTIP Trust =

Date 1 =
Date 2 =
Date 3 =
Date 4 =
State =
State Statute =
Year =

Dear :

This is in response to your letter dated August 22, 2002, and prior correspondence, in which several generation-skipping transfer (GST) tax rulings were requested.

Decedent and Spouse, the trustors, executed a revocable family trust, Trust, on Date 1 and amended the family trust on Date 2. Decedent died on Date 3, survived by Spouse and three adult children (X, Y, and Z) from a prior marriage. Two of the three adult children have issue.

Under Article 3.6 of the Trust, on Decedent's death, Decedent's separate and community property is to be distributed as follows: 25 percent is to be distributed to each of three trusts for the benefit of his children (Children's Separate Trusts). The remaining 25 percent is to pass to a "Marital QTIP Trust" for the benefit of Spouse.

Under the terms of the Marital QTIP Trust, Spouse is to receive the trust income for life. At the death of Spouse, the trust corpus is to be divided equally with one share for each family group composed of the then living descendants of a child of Decedent. Each share is to be further divided in the following manner: (1) one share held in a trust for each then living grandchild of Decedent (which grandchild is the child of Decedent's son who is the father of the family group) "Trusts for Grandchildren"; (2) one share for the family group composed of the then living descendants of any then deceased grandchild of Decedent (which grandchild is the child of Decedent's son who is the father of the family group.)

Under the terms of the three Children's Separate Trusts, the trustee has the discretion to pay trust income to such child as the trustee deems proper and desirable. The trustee also has discretion to distribute trust corpus to the child for necessary support, maintenance, education and health, but only if such child can demonstrate to the satisfaction of the trustee that child is not dependent on alcohol or drugs and has been free of such dependency for five years. The Children's Separate Trusts terminate on the last to occur of (1) the payment in full of a specified commercial bank loan; and (2) the elapse of five years after the death of Decedent, provided the child satisfies the same condition required for discretionary distributions. Upon termination of the Children's Separate Trusts, the corpus is to be distribute outright to the respective child. If a child dies before termination, the child's remaining trust estate shall be distributed to the deceased child's then living descendants by right of representation. All three of the Children's Separate Trusts terminated five years after the death of Decedent.

The trustees represent that Decedent's estate timely filed Form 706 (United States Estate (and Generation-Skipping Transfer) Tax Return) in Year. On Schedule M of Form 706, the executor made an election under section 2056(b)(7) of the Internal Revenue Code to treat the Marital QTIP Trust as qualified terminable interest property (QTIP). On Schedule R of Decedent's Form 706, the executor allocated \$ of the Decedent's unused generation-skipping transfer tax exemption to the Marital QTIP Trust. The executor did not check the box on Schedule R for signifying a "reverse" QTIP election under section 2652(a)(3).

On Date 4, State Court ordered the trustees to divide the Marital QTIP Trust into a GST Exempt Trust and GST Nonexempt Trust. The GST Exempt Trust will be funded with that fraction of the Marital QTIP Trust assets the numerator of which is \$ and the denominator of which is the date of death value of the Marital QTIP Trust estate. The GST Nonexempt Trust will consist of the balance of the Marital QTIP Trust assets.

Under State Statute, on petition by a trustee or beneficiary, the court, for good cause shown, may divide a trust into two or more separate trusts, if the court determines that dividing the trust will not defeat or substantially impair the accomplishment of the trust purposes or interests of the beneficiaries.

You have requested the following rulings.

- (1) The severance of the Marital QTIP Trust into a GST Exempt Trust and a GST Non-exempt Trust under the Date 4 court order, was a qualified severance under § 2642(a)(3).
- (2) The IRS grant an extension of time under § 301.9100 of the Procedure and Administration Regulations to make a reverse QTIP election under § 2652(a)(3) with respect to the GST Exempt Trust.
- (3) The GST Exempt Trust will have an inclusion ratio of zero under § 2642 and the GST Nonexempt Trust will have an inclusion ratio of one under § 2642.

LEGAL 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 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)(1) provides the general rule that no deduction is allowed under section 2056(a) 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 is treated as passing to the surviving spouse for purposes of section 2056(a) and no part of the property is treated as passing to any person other than the surviving spouse for purposes of section 2056(b)(1)(A).

Section 2056(b)(7)(B)(i) defines "qualified terminable interest property" as property: (1) that 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.

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

Section 2601 imposes a tax on every generation-skipping transfer which, under section 2611(a), is defined as a taxable distribution, a taxable termination, and a direct skip.

Section 2602 provides that the amount of tax imposed by section 2601 is the "taxable amount" multiplied by the "applicable rate." Section 2641(a) provides that for purposes of chapter 13, the term "applicable rate" means, with respect to any generation-skipping 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 respect to 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 to the trust or involved in the direct skip.

Section 2631(a) provides that, for purposes of determining the inclusion ratio, every individual shall be allowed a GST tax exemption of \$1,000,000 (adjusted for inflation under section 2631(c)) which 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 any allocation under section 2631(a), once made, is irrevocable.

Section 2632(a) provides that any allocation by an individual of his or her GST tax exemption under section 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 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 section 2056(b)(7), the estate of the decedent may elect to treat all of the property in the trust, for purposes of chapter 13, 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 tax exemption may be allocated to the QTIP trust. Section 26.2652-2(b) of the Generation-Skipping Transfer Tax Regulations provides that a "reverse" QTIP election is made on the return on which the QTIP election is made.

Section 2642(a)(3)(A) 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, generally, 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 this paragraph 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 IRS.

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 an election. Under section 301.9100-1(c), the Commissioner may grant a reasonable extension of time 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(a) provides that, in general, requests for extensions of time for regulatory elections that do not meet the requirements of section 301.9100-2 must be made under the rules of section 301.9100-3. 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.

Section 301.9100-3(b)(1)(v) provides in part 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.

Section 301.9100-3(b)(2) provides that a taxpayer will not be considered to have reasonably relied on a qualified tax professional if the taxpayer knew or should have known that the professional was not (i) competent to render advice on the regulatory election; or (ii) aware of all relevant facts.

Pursuant to the Date 4 court order, the Marital QTIP Trust was divided on a fractional basis in accordance with the applicable fraction of the Marital QTIP Trust and the terms of the GST Exempt Trust and the GST Nonexempt Trust, provide for the same succession of interests of beneficiaries as are provided in the original trust. Under these circumstances, we conclude that the Date 4 severance is a qualified severance under § 2642(a)(3).

Furthermore, based on the facts and representations made, the requirements of section 301.9100-3 have been met in this case. Accordingly an extension of time to make a "reverse" QTIP election with respect to the GST Exempt Trust is granted until 60 days after the date of this letter. This election should be made on a supplemental Form 706 (United States Estate (and Generation-Skipping Transfer) Tax Return) and filed with the Internal Revenue Service Center, Cincinnati, OH 45999.

Finally, we conclude that assuming the GST Exempt Trust and the GST Nonexempt Trust are funded as described above, the GST Exempt Trust will have an inclusion ratio of zero, and the GST Nonexempt Trust will have an inclusion ratio of one.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to each taxpayer.

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.

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.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent. A copy of this letter should be attached to the supplemental Form 706.

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