

Internal Revenue Service

Department of the Treasury

Number: **200403072**

Washington, DC 20224

Release Date: 1/16/2004

Index Numbers: 2632.01-00; 2642.00-00
9100.00-00

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:9-PLR-123552-03

Date:

October 7, 2003

Re:

LEGEND:

Donor	=
Daughter	=
Trust 1	=
Trust 2	=
Trust 3	=
State Statute 1	=
State Statute 2	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=
Date 5	=
Date 6	=
Date 7	=
Year 1	=
Year 2	=
<u>a</u>	=
<u>b</u>	=
<u>c</u>	=
<u>d</u>	=
<u>e</u>	=
X	=

PLR-123552-03

Dear Trustee:

This is in response to your letter dated March 18, 2003, and subsequent correspondence, in which you requested rulings on behalf of Donor's estate concerning an extension of time to allocate Donor's available generation-skipping transfer (GST) exemption to transfers to an irrevocable trust pursuant to § 2642(g) of the Internal Revenue Code and § 301.9100-3 of the Procedure and Administration Regulations, the GST tax consequences of severing the trust, and the merging of one of the resulting trusts.

The facts and representations submitted are summarized as follows. On Date 1, Donor created two irrevocable trusts, Trusts 1 and 2, for the benefit of Daughter and Daughter's issue.

Section 1.2 of Trust 1 provides that Donor's GST exemption is to be allocated to the trust.

Section 3.1 provides that the trustee is to pay to or apply for the benefit of Daughter, Daughter's spouse, grandchild, and the spouse and issue of grandchild, as much trust income and principal deemed necessary for their health, maintenance, support, and education. Income not distributed is to be added to principal. There is no requirement to equalize distributions among beneficiaries.

Section 3.3 provides Daughter with a limited power to appoint 10 percent of the trust estate in favor of her issue by written instrument delivered to the trustee or by will. Any portion of the trust estate not effectively appointed is to be held in further trust for grandchild's life. Upon the death of the survivor of Daughter and grandchild, the trustee is to distribute the balance of the trust estate to grandchild's then living issue by right of representation.

Section 7.12 provides that, unless sooner terminated, any trust established under Trust 1 or created by the exercise of a power of appointment conferred by Trust 1, will terminate 21 years after the death of the survivor of the trust beneficiaries alive on Date 1. Upon termination all trust principal and undistributed income is to be distributed to the trust's income beneficiaries in proportion to their income interest therein, if fixed, if not, the trust estate shall be distributed equally among the income beneficiaries.

The pertinent provisions of Trust 2 are identical to Trust 1 except Section 1.2 of Trust 2 prohibits the trustee from allocating any of the Donor's GST exemption to Trust 2's property. In addition, Section 11.3 of Trust 2 grants the trustee the power to amend the terms of Trust 2 to grant any of Donor's issue who are trust beneficiaries a testamentary general power of appointment. On Date 2, the trustee modified Trust 2 to include Section 11.4, which grants Daughter a testamentary general power of

PLR-123552-03

appointment over the largest amount of Trust 2's assets that would not result in state or federal estate tax.

On Date 3, Donor transferred \$a in cash and securities to each trust. No gift tax return was filed in Year 1 due to Donor's attorney's illness and Donor's age and poor health. Several years later in Year 2, the trustee's attorney discovered that a Year 1 Form 709 had not been filed and the GST allocation had not been made.

As of Date 4, the value of Trust 1's assets had increased to \$b, which was in excess of Donor's available GST exemption. Because Trust 1 was intended to be a generation-skipping trust with a zero inclusion ratio, the trustees, pursuant to a state court order, distributed assets with a value of \$c to Trust 2. After the distribution, Trust 1 had a value of \$a and Trust 2 had a value of \$d. Immediately thereafter, Donor's GST exemption was allocated to Trust 1 on a Form 709 filed on Date 5. As a result, Trust 1 has a GST inclusion ratio of zero and Trust 2 has an inclusion ratio of one.

On Date 6, Daughter died. In the first codicil to her will, Daughter exercised her general power of appointment, transferring property equaling \$e from Trust 2 to Trust 1. Daughter's GST exemption was allocated to the transferred property. The property has been held as a separate trust (Trust 3) that has the same terms as Trust 1.

On Date 7, Donor died. Other than distributions to Daughter's spouse, no other distributions or additions of principal have been made from Trust 1, Trust 2, or Trust 3.

Subsequently, §2642(g) was added to the Internal Revenue Code in P.L. 107-16, §564(a), and the Internal Revenue Service issued Notice 2001-50, 2001-34 I.R.B.189. Donor's estate has requested a ruling under §§ 2642(g) and 301.9100-3. In the event relief is granted, the assets transferred to Trust 2 pursuant to the court order discussed above will result in Trust 2 having an inclusion ratio of X. Thus, Donor's estate intends to petition a state court to divide Trust 2 into two trusts having exactly the same terms pursuant to State Statute 1. In general, State Statute 1 provides that a state court 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's purposes or the interests of the beneficiaries.

Trust 2's assets will be divided on a pro-rata fractional basis between two succeeding trusts (Trusts 2a and 2b). Trust 2a will receive a fractional share of the total current value of all of Trust 2's property equal to X percent (the portion of Trust 2's property that would be GST tax exempt immediately before the severance as a result of the

PLR-123552-03

allocation of Donor's available GST exemption to Trust 1), so that Trust 2a will have an inclusion ratio of zero after the severance. Trust 2b will receive Trust 2's remaining property and have a GST inclusion ratio of one.

After the severance, Donor's estate intends to petition a state court to merge Trust 2a into Trust 1 pursuant to State Statute 2. In general, State Statute 2 provides that a state court may combine trusts if the court determines that administration as a single trust will not defeat or substantially impair the accomplishment of the trust purposes or the interest of the beneficiaries.

Donor's estate requests the following rulings:

- (1) that an extension of time be granted under §§ 2642(g) and 301.9100-3 to allocate Donor's available GST exemption to the Date 3 transfer to Trust 1, and that such allocation will be based on the value of the property transferred to Trust 1 on Date 3;
- (2) that the proposed division of Trust 2 on a pro-rata fractional basis into two separate trusts, Trusts 2a and 2b, in accordance with applicable state law, will be a qualified severance under § 2642(a)(3), and that Trust 2a will have an inclusion ratio of zero and Trust 2b will have an inclusion ratio of one; and
- (3) that upon merging Trusts 1 and 2a, the resulting trust will have a zero inclusion ratio for GST tax purposes.

Ruling Request 1:

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

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 his executor) to any property with respect to which such individual is the transferor.

Section 2632(a)(1) 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.

PLR-123552-03

Section 2642(b)(1) provides that, except as provided in § 2642(f), if the allocation of the GST exemption to any transfers of property is made on a gift tax return filed on or before the date prescribed by § 6075(b) for such transfer or is deemed to be made under § 2632(b)(1) or (c)(1) the value of such property for purposes of § 2642(a) shall be its value as finally determined for purposes of chapter 12 (within the meaning of § 2001(f)(2)), or, in the case of an allocation deemed to have been made at the close of an estate tax inclusion period, its value at the time of the close of the estate tax inclusion period, and such allocation shall be effective on and after the date of such transfer, or, in the case of an allocation deemed to have been made at the close of an estate tax inclusion period, on and after the close of such estate tax inclusion period.

Section 2642(g)(1)(A) provides, generally, that the Secretary shall by regulation prescribe such circumstances and procedures under which extensions of time will be granted to make an allocation of GST exemption described in § 2642(b)(1) or (2), and an election under § 2632(b)(3) or (c)(5).

Section 2642(g)(1)(B) provides that in determining whether to grant relief under this paragraph, the Secretary shall take into account all relevant circumstances, including evidence of intent contained in the trust instrument or instrument of transfer and such other factors as the Secretary deems relevant. For purposes of determining whether to grant relief under this paragraph, the time for making the allocation (or election) shall be treated as if not expressly prescribed by statute.

Notice 2001-50, 2001-34 I.R.B. 189, provides that under § 2642(g)(1)(B), the time for allocating the GST exemption to lifetime transfers and transfers at death, the time for electing out of the automatic allocation rules, and the time for electing to treat any trust as a generation-skipping trust are to be treated as if not expressly prescribed by statute. The Notice further provides that taxpayers may seek an extension of time to make an allocation described in § 2642(b)(1) or (b)(2) or an election described in § 2632(b)(3) or (c)(5) under the provisions of § 301.9100-3.

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). Under § 301.9100-1(b), a regulatory election

PLR-123552-03

includes an election whose due date is prescribed by a notice published in the Internal Revenue Bulletin. In accordance with § 2642(g)(1)(B) and Notice 2001-50, taxpayers may seek an extension of time to make an allocation described in § 2642(b)(1) or (b)(2) or an election described in § 2632(b)(3) or (c)(5) under the provisions of § 301.9100-3.

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.

Based on the facts submitted and the representations made, we conclude that the requirements of § 301.9100-3 have been satisfied. Therefore, Donor's estate is granted an extension of time of 60 days from the date of this letter to make an allocation of Donor's available GST tax exemption to the Date 3 transfer to Trust 1. The allocation will be effective as of Date 3, the date of the transfer to Trust 1, and the gift tax value of the transfer will be used in determining the amount of Donor's GST exemption to be allocated to Trust 1. Trust 1 will have an inclusion ratio of zero, provided the amount of GST exemption allocated to Trust 1 is equal to the value of the property transferred to Trust 1 for federal gift tax purposes.

The allocation should be made on a supplemental Form 709 and filed with the Internal Revenue Service Center, Cincinnati, OH 45999. A copy of this letter should be attached to the supplemental Form 709. A copy is enclosed for this purpose.

Ruling Request 2:

Section 2642(a)(3)(A) provides that if a trust is severed in a qualified severance, the trusts resulting from such severance shall be treated as separate trusts thereafter for purposes of chapter 13.

Section 2642(a)(3)(B)(i) provides that 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 -- (I) the single trust was divided on a fractional basis, and (II) 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

PLR-123552-03

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 one.

Section 2642(a)(3)(C) provides that a severance may be made at any time.

In this case, Trust 2 will be severed into two separate trusts, Trusts 2a and 2b, having the same terms as Trust 2 in accordance with the provisions of State Statute 1. Since the terms of Trusts 2a and 2b will be identical to Trust 2's terms, the terms of Trusts 2a and 2b, in the aggregate, provide for the same succession of interests of beneficiaries as are provided in Trust 2.

In addition, it is represented that Trust 2's property will be divided on a pro-rata fractional basis between Trusts 2a and 2b. Trust 2a will receive a fractional share of the total current value of all of Trust 2's property equal to X percent (the portion of Trust 2 that would be GST tax exempt immediately before the severance), and Trust 2b will receive Trust 2's remaining property.

Accordingly, based upon the facts submitted and the representations made, we conclude that the proposed division of Trust 2 into Trusts 2a and 2b, will be a "qualified severance" within the meaning § 2642(a)(3), provided the state court approves the partition on the terms set forth herein. Trust 2a will have an inclusion ratio of zero. Trust 2b will have an inclusion ratio of one.

Ruling Request 3:

Section 2602 provides that the amount of tax imposed by § 2601 is the taxable amount multiplied by the applicable rate. Section 2641 provides that the applicable rate is the product of the maximum federal estate tax rate and the inclusion ratio with respect to the transfer.

Section 2642(a) provides, in part, that the inclusion ratio with respect to any property transferred in a generation-skipping transfer will be equal to the excess (if any) of 1 over the applicable fraction determined for the trust from which such transfer is made. The applicable fraction, generally, is a fraction the numerator of which is the amount of the GST exemption allocated to the trust, and the denominator of which is the value of the property transferred to the trust.

Section 2652 provides that the transferor for generation-skipping transfer tax purposes is the decedent for purposes of chapter 11 and the donor for purposes of chapter 12.

Section 26.2642-4(a)(2) provides that if separate trusts created by one transferor are consolidated, a single applicable fraction for the consolidated trust is determined. The numerator of the redetermined applicable fraction is the sum of the nontax portions of each trust immediately prior to the consolidation.

PLR-123552-03

In the present case, except for Sections 1.2 and 11.3 of Trust 2a the terms of Trust 1 and Trust 2a are identical. In addition, Trusts 1 and 2a will have a zero inclusion ratio provided the requirements of Rulings 1 and 2 are satisfied. Finally, Donor is the transferor for GST tax purposes of both Trusts 1 and 2a. See § 2652. Accordingly, based on the facts submitted and the representations made, upon merging Trusts 1 and 2a, the resulting trust will have a zero inclusion ratio for GST tax purposes, provided the requirements of Rulings 1 and 2 are satisfied and the state court approves the merger on the terms set forth herein.

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.

Except as specifically ruled herein, we express or imply no opinion on the federal tax consequences of the transaction under the cited provisions or under any other provisions of the Code. In addition, we express or imply no opinion regarding the value of the property transferred to the trusts.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative.

This ruling is directed only to the taxpayers requesting 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)

Enclosures

Copy for section 6110 purposes
Copy of this letter

cc: