

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **200427006**

Release Date: 7/2/04

Index Number: 2652.01-02; 9100.00-00,
2632.01-00

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:04 – PLR-133558-03
Date: MARCH 20, 2004

In Re:

Legend

H	=
W	=
Daughter 1	=
Daughter 2	=
Trust 1	=
Trust 2	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=
Date 5	=
Date 6	=
Date 7	=
Attorney	=
Accounting Firm	=
Law Firm	=
<u>a</u>	=
<u>b</u>	=
<u>c</u>	=
<u>d</u>	=

Dear :

This is in response to your letter, dated April 21, 2003, and subsequent correspondence, submitted on behalf of H's estate, requesting an extension of time under sections 301.9100-1 and 301.9100-3 of the Procedure and Administration

PLR-133558-03

Regulations to sever a trust into an exempt and non-exempt trust, to make "reverse" qualified terminable interest property (QTIP) elections with respect to two trusts, and to allocate H's generation-skipping transfer (GST) exemption to one of those trusts and the GST exempt portion of the other trust.

The facts and representations submitted are summarized as follows: On Date 1, H and W created Trust 1, a revocable trust. Trust 1 was amended and restated in its entirety on Date 2. On Date 3, H created Trust 2, an irrevocable life insurance trust. H transferred his interest in four insurance policies to Trust 2. H died within three years after the transfer of the insurance policies to Trust 2. H died on Date 4, survived by W and two children, Daughter 1 and Daughter 2. The current trustees of Trust 1 and Trust 2 are Daughter 1 and Daughter 2.

Under the terms of Trust 1, upon H's death, Trust 1 is to be divided into four separate trusts, including a "QTIP Trust" intended to qualify for the marital deduction under section 2056(a) of the Internal Revenue Code. W is to receive all the income of the QTIP Trust, payable at least annually, for her lifetime. Trustees may also make discretionary payments of principal for the health, medical and educational needs, and support and maintenance of W. Upon W's death, any accrued or undistributed net income of QTIP Trust shall be distributed in the manner and to the persons including W's estate or creditors, as W appoints by specific reference to this power in W's last will. Upon W's death, the QTIP Trust principal is to be distributed to the trustees of Trust 2, to be held, administered and distributed according to the terms of Trust 2.

Under the terms of Trust 2, upon H's death, if H is survived by W, a portion of Trust 2's assets (W's share) shall be held in trust for W. All of W's share's net income is to be paid annually to W. Trustees may also make discretionary payments of principal for the health, medical and educational needs, and support and maintenance of W. Moreover, no person shall have the right to appoint property of W's share to any person other than W for the remainder of W's lifetime. Trust 2 provides that the trustees have the authority to make a QTIP election for Trust 2 property. After both H's and W's death, the trustees are to divide W's share into two equal shares to be known as the Daughter 1 share and Daughter 2 share. The Daughter 1 share shall be distributed outright and free of trust to Daughter 1. If Daughter 1 does not survive W, then her share shall be allocated to her issue. If Daughter 1 does not have surviving issue then her share shall be added to the Daughter 2 share.

The Daughter 2 share shall be added to and held in trust for the remainder of Daughter 2's life in "Daughter 2 Trust". Under the terms of Trust 2, Daughter 2 shall have a limited power to appoint any portion of the Daughter 2 Trust's estate for the benefit of Daughter 2's issue. Upon Daughter 2's death, the trustees shall distribute any remaining assets of the Daughter 2 Trust pursuant to Daughter 2's exercise of the

PLR-133558-03

limited power of appointment. If Daughter 2 fails to exercise the limited power of appointment, the assets shall be allocated to Daughter 2's issue by right of representation. If Daughter 2 has no issue then living, the remaining assets shall be allocated to H's issue then living by right of representation.

Trust 1 and Trust 2 provide the trustees with the authority to make a reverse QTIP election on the Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return, for H's estate.

Paragraph 6.6 of Trust 2 provides that in allocating H's GST exemption, the trustees may include or exclude any property of which H is the transferor for generation-skipping purposes, including property transferred before H's death. The trustees may base the decision on prior transfers, gift tax returns, and other information. The allocations need not proportionately, equally, or in any other manner benefit the various transferees or beneficiaries.

Paragraph 6.7 of Trust 2 further provides, in part, if any of H's GST exemption, or another's GST exemption, is allocated to property of a trust under this document or to the exempt portion of that trust, and the trust results in a generation-skipping inclusion ratio other than zero, then the trustees must immediately create two separate trusts so each has a generation-skipping inclusion ratio of either zero (the exempt portion) or one (the nonexempt portion). The trustees do this by allocating to a nonexempt trust the minimum amount of property needed to create that trust with an inclusion ratio of one, while leaving an exempt trust with a zero inclusion ratio.

Upon H's death, W was appointed as executor of H's will. W also became the sole successor trustee of Trust 1. W engaged Accounting Firm and Attorney to advise her in federal gift, estate, and generation-skipping transfer tax matters and to prepare the Form 706 for H's estate. Attorney was a long time advisor of H and W and had done their estate tax planning.

The Form 706 for H's estate was filed late on Date 5. W, as executor, divided Trust 1 into four trusts, including a QTIP Trust (QTIP Trust 1). On the Form 706, an election was made to treat property held in QTIP Trust 1 and fractional portion of Trust 2 that was includible in H's gross estate (QTIP Trust 2) as qualified terminal interest property under section 2056(b)(7). On Schedule R, Generation-Skipping Transfer Tax, of Form 706, the executor reported that none of H's allowable GST exemption had been allocated to H's lifetime transfers and the maximum allowable GST exemption was still available for allocation. Schedule R reflected an allocation of \$a of H's available GST exemption to the credit shelter trust, Decedent's Trust, and an incorrect allocation of \$b of H's available GST exemption to the Daughter 2 Trust. It is represented that the correct amount transferred to the Daughter 2 Trust is \$c, and the overallocation of \$d is

PLR-133558-03

void under section 26.2632-1(b)(2)(i) of the Generation-Skipping Transfer Tax Regulations. It is also represented that W relied on Accounting Firm and Attorney to advise W in the preparation of the return, and Accounting Firm and Attorney failed to make, or advise W to make the reverse QTIP elections with respect to the two QTIP trusts.

W died on Date 6. Daughter 1 and Daughter 2 were duly appointed as successor co-executors of H's will and co-executors of W's will. Daughter 1 and Daughter 2 engaged Law Firm and Accounting Firm to advise them in federal gift, estate, and generation-skipping transfer tax matters and to prepare the Form 706 for W's estate. The Form 706 for W's estate was timely filed on Date 7. However, while reviewing the Form 706 for H's estate, Law Firm discovered that the reverse QTIP elections had not been made on H's Form 706 with respect to the QTIP trusts, that H's remaining GST exemption had not been allocated to those trusts, and that the GST exempt portion of Trust 2 had not been bifurcated from the GST non-exempt portion of Trust 2.

You are requesting an extension of time under section 301.9100-3 to sever Trust 2 into GST exempt and non-exempt trusts, to make reverse QTIP elections pursuant to section 2652(a)(3) with respect to QTIP Trust 1 and the GST exempt portion of QTIP Trust 2, and to allocate H's remaining GST exemption to QTIP Trust 1 and the GST exempt portion of QTIP Trust 2.

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 shall, except as limited by section 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 section 2056(a), such property shall be treated as passing to the surviving spouse, and for purposes of section 2056(b)(1)(A), no part of such property shall be treated as passing to any person other than the surviving spouse.

PLR-133558-03

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 section 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 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, shall be irrevocable.

Section 2044(a) provides that the value of the gross estate shall include the value of any property to which section 2044 applies in which the decedent had a qualifying income interest for life.

Section 2044(b) provides, in relevant part, that section 2044 applies to any property if a deduction was allowed with respect to the transfer of such property to the decedent under section 2056(b)(7).

Section 2044(c) provides that for purposes of chapter 11 and chapter 13, property includible in the gross estate of the decedent under section 2044(a) shall be treated as property passing from the decedent.

Section 2652(a)(1) provides that for purposes 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 section 2056(b)(7), the estate of the decedent may elect to treat all of the property in such trust for purposes of this chapter as if the election to be treated as qualified terminable interest property had not been made (reverse QTIP election).

Section 26.2652-2(a) 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 section

PLR-133558-03

2652(a)(3) is made on the return on which the QTIP election is made.

Section 26.2654-1(b)(1)(i) 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 trust is severed pursuant to a direction in the governing instrument providing that the trust is to be divided upon the death of the transferor.

Section 26.2654-1(b)(3) provides that an individual's GST exemption under section 2632 may be allocated to the separate trusts created pursuant to this section at the discretion of the executor or trustee.

Section 2601 imposes a tax on every generation-skipping transfer. Section 2611(a) provides that the term "generation-skipping transfer" means: (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) defines the term "applicable rate" with respect to any GST as the product of the maximum federal estate tax rate and the inclusion ratio with respect to the transfer.

Section 2642(a)(1) provides that, generally, the inclusion ratio with respect to any property transferred in a GST is the excess (if any) of 1 over the "applicable fraction." Section 2642(a)(2) provides, in part, that the applicable fraction 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 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 section 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 2631(b) provides that any allocation under section 2631(a), once made, shall be irrevocable.

Section 2632(a)(1) provides that any allocation by an individual of his or her GST 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 26.2632-1(d)(1) provides, in part, that except as otherwise provided in section 26.2632-1(d), an allocation of a decedent's unused GST exemption by the

PLR-133558-03

executor of the decedent's estate is made on the appropriate United States Estate (and Generation-Skipping Transfer) Tax Return (Form 706 or Form 706NA) filed on or before the date prescribed for filing the return by section 6075(a) (including any extensions actually granted (the due date)). An allocation of GST exemption with respect to property included in the gross estate of a decedent is effective as of the date of death.

Section 2642(b)(2)(A) provides that if property is transferred as a result of the death of the transferor, the value of such property for purposes of 2642(a) shall be its value as finally determined for purposes of chapter 11; except that, if the requirements prescribed by the Secretary respecting allocation of post-death changes in value are not met, the value of such property shall be determined as of the time of the distribution concerned. Section 2642(b)(2)(B) provides that any allocation to property transferred as a result of the death of the transferor shall be effective on and after the date of the death of the transferor.

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 section 2642(b)(1) or (2), and an election under section 2632(b)(3) or (c)(5). Such regulations shall include procedures for requesting comparable relief with respect to transfers made before the date of the enactment of section 2642(g)(1), which was enacted into law on June 7, 2001.

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, 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 section 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 GST 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 section 2642(b)(1) or (b)(2) or an election described in section 2632(b)(3) or (c)(5) under the provisions of section 301.9100-3.

Under section 301.9100-1(c), the Commissioner may grant a reasonable extension of time under the rules set forth in sections 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,

PLR-133558-03

G, H, and I. Section 301.9100-1(b) provides that a regulatory election includes an election whose due date is prescribed by a notice published in the Internal Revenue Bulletin.

Section 301.9100-2 provides an automatic extension of time for making certain elections.

Section 301.9100-3(a) provides, in pertinent part, that 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 section 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) provides, in part, except as provided in section 301.9100-3(b)(3)(i) through (iii), 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(c)(1) provides, in pertinent part, that the Commissioner will grant a reasonable extension of time to make a regulatory election only when the interests of the Government will not be prejudiced by the granting of relief.

As a result of the QTIP election made on H's Form 706, the property of QTIP Trust 1 and QTIP Trust 2 is includible in W's gross estate pursuant to section 2044. Accordingly, W is considered the transferor of the property for GST tax purposes, and H's remaining GST exemption may not be allocated to the assets of these trusts. However, if QTIP Trust 2 is severed into two portions and reverse QTIP elections under section 2652(a)(3) are made with respect to QTIP Trust 1 and the GST exempt portion of QTIP Trust 2, H will be treated as the transferor of the QTIP Trust 1 trust assets and the GST exempt portion of QTIP Trust 2.

Based on the facts submitted and the representations made, we conclude that the requirements of section 301.9100-3 have been satisfied. Accordingly, an extension of time of 60 days from the date of this letter is granted to sever Trust 2 into the GST exempt trust and the GST non-exempt trust pursuant to Paragraphs 6.6 and 6.7 of Trust 2, to make reverse QTIP elections with respect to QTIP Trust 1 and the GST exempt portion of QTIP Trust 2, and to allocate H's remaining GST exemption to QTIP Trust 1 and the GST exempt portion of QTIP Trust 2.

PLR-133558-03

The reverse QTIP elections and the GST exemption allocations should be made on Supplemental Form 706 filed with the Internal Revenue Service Center, Cincinnati, Ohio 45999. A copy of this letter should be attached to the form. A copy is enclosed for this purpose.

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. 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.

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.

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

Sincerely,

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

Enclosures

Copy for section 6110 purposes
Copy of this letter

cc:

cc: