Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
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Date:
March 21, 2001

Legend:

Decedent

Spouse/Executrix

A

Trust 1

Trust 2

Trust 3

Trust 4

Date 1

Date 2

Date 3

Date 4

Date 5

Date 6

Date 7

a

b

c

Dear :

We received your submissions dated November 21, 2000 and December 12,

2000, requesting (1) a ruling that the severance of Trust 1 into two separate trusts pursuant to § 26.2654-1(b)(1) of the Generation Skipping Transfer (GST) Tax Regulations will be recognized for GST tax purposes; and (2) an extension of time under § 301.9100 of the Procedure and Administration Regulations to make a "reverse" qualified terminable interest property (QTIP) election under § 2652(a)(3) of the Internal Revenue Code with respect to the assets in Trust 3. This letter responds to your request.

Decedent executed a trust agreement on Date 1 and amended the terms of the trust agreement on Date 2, Date 3, and Date 4. Decedent executed a will on Date 5. Decedent died testate on Date 6, survived by Spouse. Decedent's estate timely filed the Federal Estate and Generation Skipping Transfer Tax Return (Form 706) on Date 7.

Article 5.1 of Decedent's will directs that the residue of Decedent's estate, including all lapsed legacies (but excluding property over which Decedent has a power of appointment), is to be bequeathed to the then acting trustee, as trustee, to be added to and administered under the terms of the trust agreement signed by Decedent on Date 1, and as amended to the date of Decedent's death.

Article 4.2 of the trust agreement provides that the trustee will allocate to Trust 2 a sum equal to the largest amount that can pass free of federal estate tax by reason of the unified credit, after taking account of any adjusted taxable gifts made by Decedent, and the state death tax credit allowable to Decedent's estate but no other credit, reduced by the following:

> (a) payments from or charges to the principal of Decedent's estate or this trust that are not allowed as deductions in computing the amount of federal estate taxes on Decedent's estate; and
>
> (b) the value of any other property interests that are included in Decedent's gross estate which pass in a manner that will not qualify for the marital or charitable deductions.

The remaining trust property, or all of the trust property if there is no property allocated to Trust 2, will be allocated to Trust 1. In making the computation to separate the trust property, values as finally determined for federal estate tax purposes will control.

Article 5.5 of the trust agreement provides that upon Spouse's death, any remaining income [from Trust 1] will be paid to Spouse's estate and the remaining principal [of Trust 1] will be added to the principal of Trust 2.

Article 11.1 of the trust agreement provides that regardless of other provisions herein to the contrary, the trustee will divide property held in any trust with a generation skipping inclusion ratio of less than 100% into separate fractional trusts, each to have

an inclusion ratio of 100% or zero. Each such trust will be administered as a separate trust.

On Schedule M of Decedent's Form 706, Executrix made a QTIP election for Trust 1. However, Executrix did not make a reverse QTIP election with respect to Trust 1 and did not allocate Decedent's GST exemption. At the death of Decedent, Trust 2 was not funded because Decedent's unified credit was exhausted otherwise. Trust 1 was not severed prior to the date prescribed for filing the Form 706 and the Form 706 did not contain a statement that Trust 1 would be severed.

Executrix, who had no knowledge or experience with estate tax matters, hired a certified public accounting ("CPA") firm to file the Form 706 and accompanying schedules. The CPA firm spends a significant amount of its practice in estate planning and tax administration. The CPA firm was aware of all relevant facts regarding the estate tax matters of Decedent's estate. The CPA firm admitted that it completed the Form 706, Schedule M, but failed to prepare Schedule R to make the reverse QTIP election, even though the estate intended to make the reverse QTIP election.

It is represented that Decedent allocated $a of Decedent's GST exemption against Decedent's lifetime transfers. In addition, because Decedent bequeathed $b to Decedent's grandson A, $b of Decedent's GST exemption is deemed allocated to that direct skip to Decedent's grandson A. Therefore, it is represented that $c of Decedent's GST exemption is available for further allocation.

You now propose to sever Trust 1 into two trusts, Trust 3 and Trust 4. Trust 3 will be funded with an amount equal to $c. Trust 4 will be funded with the balance.

You have requested (1) a ruling that a severance of Trust 1 into Trust 3, a trust with an inclusion ratio of zero, and Trust 4, a trust with an inclusion ratio of one, will be recognized for GST tax purposes; and (2) an extension of time to make a reverse QTIP election for Trust 3.

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 determined, except as limited by § 2056(b), 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 his surviving spouse but only to the extent that such interest is included in determining the value of the gross estate.

Section 2056(b)(7)(A) provides that in the case of qualified terminable interest

property –

(i) for purposes of § 2056(a), such property is treated as passing to the surviving spouse, and

(ii) for purposes of § 2056(b)(1)(A), no part of such property is treated as passing to any person other than the surviving spouse.

Section 2056(b)(7)(B)(i) provides that, in general, the term "qualified terminable interest property" means 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)(B)(v) applies.

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

Section 2044(b)(1) provides that § 2044 applies to any property if a deduction was allowed with respect to the transfer of such property to the decedent under § 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 § 2044(a) shall be treated as property passing from the decedent.

Section 2601 imposes a tax on every generation-skipping transfer, defined in § 2611 as a taxable distribution, a taxable termination, and a direct skip.

Section 2652(a) provides in part that for purposes of this chapter –

(1) Except as provided in this subsection or § 2653(a), the term "transferor" includes, in the case of any property subject to the tax imposed by chapter 11, the decedent.

An individual shall be treated as transferring any property with respect to which such individual is the transferor.

....

(3) 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 purposes of this chapter as if the election to be treated as qualified terminable interest property had not been made.

Section 2631(a) provides that, for purposes of determining the inclusion ratio, every individual is allowed a GST exemption of $1,000,000 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, is irrevocable.

Section 2632(a)(1) provides that any allocation by an individual of his 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(c)(1) provides that any portion of an individual's GST exemption that has not been allocated within the time prescribed by § 2632(a) is 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 26.2632-1(d)(2) of the Generation-Skipping Transfer Tax Regulations provides that a decedent's unused GST exemption is automatically allocated on the due date for filing Form 706 or Form 706NA to the extent not otherwise allocated by the decedent's executor on or before that date. The automatic allocation occurs whether or not a return is actually required to be filed. Unused GST exemption is allocated pro rata (subject to the rules of § 26.2642-2(b)), on the basis of the value of the property as finally determined for purposes of chapter 11 (chapter 11 value), first to direct skips treated as occurring at the transferor's death. The balance, if any, of unused GST exemption is allocated pro rata (subject to the rules of § 26.2642-2(b)) on the basis of the chapter 11 value of the nonexempt portion of the trust property (or in the case of trusts that are not included in the gross estate, on the basis of the date of death value of the trust) to trusts with respect to which a taxable termination may occur or from which a taxable distribution may be made. The automatic allocation of GST exemption is irrevocable, and an allocation made by the executor after the automatic allocation is made is ineffective. No automatic allocation of GST exemption is made to a trust that

will have a new transferor with respect to the entire trust prior to the occurrence of any GST with respect to the trust. In addition, no automatic allocation of GST exemption is made to a trust if, during the nine month period ending immediately after the death of the transferor –

(i) No GST has occurred with respect to the trusts; and

(ii) At the end of such period no future GST can occur with respect to the trust.

Section 26.2652-2(b) provides in part that a reverse QTIP election is made on the return on which the QTIP election is made.

Section 26.2654-1(b)(1) provides in part 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 –

(i) 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; or

(ii) 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 each of the new trusts provide in the aggregate fractions 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) (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 nonpro 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.

Section 301.9100-1(c) of the Procedure and Administration Regulations provides that the Commissioner in exercising the Commissioner's discretion 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 Internal Revenue Code except subtitles E, G, H, and I.

Section 301.9100-2 provides automatic extensions of time for 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 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) provides that except as provided in paragraphs (b)(3)(i) through (iii) of this section, a taxpayer is deemed to have acted reasonably and in good faith if the taxpayer –

(i) Requests relief under this section before the failure to make the regulatory election is discovered by the Internal Revenue Service (IRS);

(ii) Failed to make the election because of intervening events beyond the taxpayer's control;

(iii) Failed to make the election because, after exercising reasonable diligence (taking into account the taxpayer's experience and the complexity of the return or issue), the taxpayer was unaware of the necessity for the election;

(iv) Reasonably relied on the written advice of the Internal Revenue Service (IRS); or

(V) 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.

Section 301.9100-3(c)(1)(i) provides in part that the interests of the Government are prejudiced if granting relief would result in a taxpayer having a lower tax liability in the aggregate for all taxable years affected by the election than the taxpayer would have had if the election had been timely made (taking into account the time value of money).

Based on the facts submitted and representations made, we conclude that the requirements of § 26.2654-1 have been met in this case. Therefore, we conclude that the severance of Trust 1 into Trust 3 and Trust 4, as provided, will be recognized for GST tax purposes. We grant an extension of time to sever Trust 1 into Trust 3 and Trust 4 within 60 days after the date of this letter. Based on the facts submitted and representations made, we conclude that the requirements of § 301.9100-3 have been met in this case. We grant an extension of time to make a reverse QTIP election for Trust 3 under § 2652(a)(3) until 30 days after the date of this letter. The 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 exemptions. Consequently, Decedent's remaining GST exemption is allocated under the deemed allocation rules of § 2632(c).

Except as specifically ruled herein, we express or imply no opinion concerning the federal tax consequences of this transaction under the cited provisions or any other provisions of the Code.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,
Paul F. Kugler
Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure: Copy for § 6110 purposes