

Internal Revenue Service

Number: **200508001**

Release Date: 2/25/05

Index Number: 2652.01-02, 2632.00-00

Department of the Treasury

Washington, DC 20224

[Third Party Communication:

Date of Communication: Month DD, YYYY]

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B09

PLR-101050-04

Date: November 16, 2004

In Re:

Legend:

- Taxpayer 1 =
- Taxpayer 2 =
- Trust =

- Marital Trust =
- Decedent's Trust =
- Survivor's Trust =
- State =
- State Statute =
- Date 1 =
- Date 2 =
- A =
- B =
- C =
- D =

Dear :

This is in response to your letter dated December 9, 2003, and subsequent correspondence, requesting rulings that the severance of a trust into an exempt and non-exempt trust for generation-skipping transfer (GST) tax purposes is a qualified severance under § 2642(a)(3) of the Internal Revenue Code, and that, as a result of the severance, a reverse qualified terminable interest property (QTIP) election made under § 2652(a)(3) for the trust will be effective to allocate GST exemption to the exempt trust.

The facts and representations submitted are summarized as follows. On Date 1, Taxpayer 1 and Taxpayer 2 formed a revocable trust (Trust).

Article 3.2 of Trust provides that upon the death of the first to die of Taxpayer 1 and Taxpayer 2, Trust is to be divided into three trusts, Survivor's Trust, Decedent's Trust, and Marital Trust. The trustee is to allocate trust assets constituting the surviving spouse's separate property and the survivor's share of the couple's community property to Survivor's Trust. The trustee is to allocate assets equal to Taxpayer 1's remaining unified credit to Decedent's Trust, and the trustee is to allocate the remaining trust assets to Marital Trust.

Article 3.3 provides that the surviving spouse is to receive all of the net income of Survivor's Trust at least quarter-annually. The surviving spouse has a general power of appointment over Survivor's Trust. Upon the surviving spouse's death, any property not effectively appointed is to be distributed free of trust to named beneficiaries.

Article 3.4 provides that the surviving spouse is to receive all of the net income of Decedent's Trust at least quarter-annually, and trust principal to provide for the surviving spouse's health, education, and support. Upon the surviving spouse's death, the trust estate is to be distributed free of trust to named beneficiaries.

Article 3.5 provides that the surviving spouse is to receive all of the net income of Marital Trust at least quarter-annually, and trust principal to provide for the surviving spouse's health, education, and support. Income earned but not distributed prior to the surviving spouse's death is to be distributed to the surviving spouse's estate. Upon the surviving spouse's death, the trust estate is to be distributed free of trust to named beneficiaries. It has been represented that some of these beneficiaries are skip persons within the meaning of § 2613.

Taxpayer 1 died on Date 2. Taxpayer 2, as the executor of Taxpayer 1's estate retained two tax professionals to prepare the Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return, for Taxpayer 1's estate. The return reflected that Marital Trust was funded with \$ A and Decedent's Trust was funded with \$ B.

On Schedule M of the return, Taxpayer 2 elected to treat Marital Trust as a QTIP trust under § 2056(b)(7). On Schedule R of the return, Taxpayer 2 allocated \$ B of Taxpayer 1's available GST exemption to Decedent's Trust and \$ C of Taxpayer 1's available GST exemption to Marital Trust. In addition, Taxpayer 2 made the reverse QTIP election under § 2652(a)(3) for Marital Trust on the Schedule R. Marital Trust was funded with assets that exceeded the GST exemption allocated to Marital Trust on the Schedule R. The two tax professionals retained by Taxpayer 1 to prepare Taxpayer 1's estate tax return inadvertently failed to sever or advise Taxpayer 2 to sever Marital Trust into a GST exempt marital trust and a GST non-exempt marital trust.

The trustee of Marital Trust intends to petition State court pursuant to State Statute to divide Marital Trust into a GST exempt marital trust and a GST non-exempt marital trust. The formula for dividing Marital Trust's assets will be computed as follows: $\$ C$ (Taxpayer 1's GST exemption allocated to Marital Trust on Schedule R of the estate tax return) divided by $\$ A$ (the date of death value of Marital Trust as reflected on Schedule M of the estate tax return) equals D percent. The GST exempt marital trust will be funded with a fractional share of Marital Trust's assets equal to D percent, and the balance of Marital Trust's assets will be allocated to the GST non-exempt marital trust.

The trustee of Marital Trust is requesting rulings that the severance of Marital Trust into a GST exempt marital trust and a GST non-exempt marital trust will be a qualified severance under § 2642(a)(3), and that, as a result of the reverse QTIP election and Trust severance, the GST exempt marital trust will have an inclusion ratio of zero.

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 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 shall be allowed 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 and: (A) an interest in such property passes or has passed (for less than an adequate and full consideration in money or money's worth) from the decedent to any person other than the surviving spouse (or the estate of such spouse); and (B) if by reason of such passing such person (or his heirs or assigns) may possess or enjoy any part of such property after such termination or failure of the interest so passing to the surviving spouse.

Section 2056(b)(7)(A) provides that, in the case of qualified terminable interest property, the entire property shall be treated as passing to the surviving spouse for purposes of § 2056(a), and no part of the property shall be treated as passing to any person other than the surviving spouse for purposes of § 2056(b)(1).

Section 2056(b)(7)(B)(i) defines "qualified terminable interest property" (QTIP) as property: (1) which passes from the decedent; (2) in which the surviving spouse has a qualifying income interest for life; and (3) to which an election under § 2056(b)(7)(B)(v) applies.

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. The election, once made, is irrevocable.

Under § 2044(a), any property in which the decedent possessed a qualifying income interest for life and for which a deduction was allowed under § 2056(b)(7) is includable in the decedent's gross estate.

Section 2601 imposes a tax on every generation-skipping transfer (GST).

Section 2602 provides that the amount of tax is the taxable amount multiplied by the applicable rate. Section 2641(a) defines "applicable rate" as the product of the maximum federal estate tax rate and the inclusion ratio with respect to the transfer.

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 by his or her executor) to any property with respect to which such individual is the transferor. Section 2631(b) provides that once an allocation of GST exemption is made, it is irrevocable.

Under § 2632(a), the allocation of the GST exemption may be made at any time on or before the date prescribed for filing the individual's estate tax return (including extensions).

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 the individual's death, and (B) second, to trusts with respect to which the individual is the transferor and from which a taxable distribution or a taxable termination might occur at or after the individual's death.

Section 2642(a) provides the method for determining the inclusion ratio.

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.

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 § 2056(b)(7), the estate of the decedent may elect to treat all of the property in the trust, for purposes of the GST tax, 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 exemption may be allocated to the QTIP trust. This election is not effective unless it is made for all of the property in the trust for which the QTIP election applies.

Section 26.2652-2(b) of the Generation-Skipping Transfer Tax Regulations provides that the reverse QTIP election is to be made on the return on which the QTIP election is made.

State Statute provides, in relevant part, that a trustee has the powers granted by the court upon petition that are necessary or appropriate to accomplish a purpose of the trust.

Based upon the facts submitted and the representations made, and provided that Marital Trust is severed according to applicable State law, the proposed severance of Marital Trust into a GST exempt marital trust and a GST non-exempt marital trust will constitute a qualified severance within the meaning of § 2642(a)(3).

Further, provided the GST exempt marital trust is funded with assets equal to D percent of Marital Trust's assets, the reverse QTIP election will be effective to allocate GST exemption of \$ C to the GST exempt marital trust and the inclusion ratio of the GST exempt marital trust will be zero.

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.

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

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.

Sincerely,

Melissa Liquerman

Melissa Liquerman
Branch Chief, Branch 9
(Passthroughs & Special Industries)

cc: