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Department of the Treasury

**P.O. Box 7604
Ben Franklin Station
Washington, DC 20044**

Person to Contact:

Telephone Number:

Refer Reply To:

CC:DOM:P&SI:4 - PLR-122559-98
Date: December 30, 1998

Re:

LEGEND:

Decedent =
Spouse =
Trust =
EIN:
R =
S =
\$x =
\$y =

Dear _____ :

This is in response to your letter dated August 28, 1998, regarding the above captioned estate. On August 3, 1998, the Service issued PLR-104090-98 granting an extension of time under § 301.9100 of the Procedure and Administration Regulations to make the transitional rule election under § 26.2652-2(c) of the Generation-Skipping Transfer Tax Regulations. Rulings were also issued under §§ 1001 and 1015 of the Internal Revenue Code. This letter supercedes PLR-104090-98.

Decedent died testate on February 11, 1988. In 1983, Decedent established Trust. Upon Decedent's death, the majority of Decedent's estate passed to Trust. Under the terms of Trust, Spouse possessed a qualifying income interest for life in the Trust property. Upon Spouse's death, the remainder of the Trust property was to pass in equal shares to two other trusts created by Decedent in 1983: one trust for the benefit of Decedent's and Spouse's daughter, R, and her descendants, and one trust for the benefit of Decedent's and Spouse's daughter, S, and her descendants.

On Schedule M of the Decedent's estate tax return, the executrixes of Decedent's estate made a valid qualified terminable interest property (QTIP) election with respect to the entire Trust and also made a reverse QTIP election with respect to the entire Trust. On Schedule R of the Decedent's estate tax return, the executrixes allocated \$x of Decedent's generation-skipping transfer (GST) exemption to Trust. The executrixes did not split the QTIP Trust into an exempt trust and a nonexempt trust.

Subsequently, on August 28, 1998, the estate filed a statement attached to a copy of the Decedent's estate tax return on which the reverse QTIP election was made. The statement indicates that an election is being made to treat the Trust as two separate trusts, an exempt trust and a nonexempt trust. The exempt trust is to be funded with an amount equal to the fraction of \$x (Decedent's remaining GST exemption) over \$y (the value of the assets which funded the Trust at the time of Decedent's death) multiplied by the fair market value of the assets of the Trust on the date of the separation. The nonexempt trust is to be funded with the balance of the property held in Trust. The exempt trust will have an inclusion ratio of zero and the nonexempt trust will have an inclusion ratio of one. The statement identifies the values of the two separate trusts.

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)(7) provides that, in the case of qualified terminable interest property, the 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.

Section 2056(b)(7)(B)(i) defines "qualified terminable interest property" 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 2601 imposes a tax on every generation-skipping transfer. With regard to the generation-skipping transfer tax (GSTT), each individual is allowed an exemption of \$1,000,000

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

Section 2652(a)(3) provides that 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 the trust, for purposes of the GSTT chapter, as if the election to be treated as qualified terminable interest property 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 GSTT 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.

Section 26.2652-2(c) of the Generation-Skipping Transfer Tax Regulations provides that if a reverse QTIP election is made with respect to a trust prior to December 27, 1995, and GST exemption has been allocated to that trust, the transferor (or the transferor's executor) may elect to treat the trust as two separate trusts, one of which has a zero inclusion ratio by reason of the transferor's GST exemption previously allocated to the trust. The separate trust with the zero inclusion ratio consists of that fractional share of the value of the entire trust equal to the value of the nontax portion of the trust under § 26.2642-4(a). The reverse QTIP election is treated as applying only to the trust with the zero inclusion ratio. The election is made by attaching a statement to a copy of the return on which the reverse QTIP election was made under § 2652(a)(3). The statement must indicate that an election is being made to treat the trust as two separate trusts and must identify the values of the two separate trusts. The statement is filed in the same place in which the original return was filed and must be filed before June 24, 1996. A trust subject to the election is treated as a trust that was created by two transferors.

Section 301.9100-1(c) of the Procedure and Administration Regulations provides that the Commissioner of Internal Revenue may, in the Commissioner's discretion, grant a reasonable extension of the 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, provided the taxpayer demonstrates to the satisfaction of the Commissioner that (1) the taxpayer acted reasonably and in good faith, and (2) granting the relief will not prejudice the interests of the government.

Section 301.9100-2 provides automatic extensions of time for making certain elections. Section 301.9100-3 provides extensions of time for making elections that do not meet the requirements of § 301.9100-2.

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 granting relief will not prejudice the interests of the government. Section 301.9100-3(a).

In this case, the requirements of § 301.9100-1 and § 301.9100-3 have been met. Consequently, an extension of time for making the election to treat the Trust as two separate trusts, one of which has a zero inclusion ratio by reason of the transferor's GST exemption previously allocated to the Trust under § 26.2652-2(c), is granted until August 31, 1998.

Section 61(a)(3) provides that gross income includes gains derived from dealings in property.

Section 1001 provides that the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in § 1011 for determining gain, and the loss shall be the excess of the adjusted basis over the amount realized. Section 1001(b) provides that the amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received. Section 1001(c) provides that, except as otherwise provided in Subtitle A, the entire amount of gain or loss determined under § 1001 on the sale or exchange of property shall be recognized.

Section 1.1001-1(a) of the Income Tax Regulations provides that the gain or loss realized from a conversion of property into cash, or from an exchange of property for other money differing materially either in kind or extent, is treated as income or as loss sustained.

For purposes of § 1001, in an exchange of property, each party to the exchange gives up a property interest in return for a new or additional property interest. Such an exchange is a disposition under § 1001(a). See § 1.1001-1.

An exchange of property results in the realization of gain or loss under § 1001 if the properties exchanged are materially different. Cottage Savings Association v. Commissioner, 499 U.S. 554 (1991). There is a material difference when the exchanged properties embody legal entitlements "different in kind or

extent" or if they confer "different rights and powers." 499 U.S. at 565.

The essential question is whether, upon establishment of the exempt and the non-exempt subtrusts, the beneficiaries will have different rights to trust income and principal than they currently have. The Decedent's estate represents that the beneficiaries of both the exempt trust and the non-exempt trust will be the same as the beneficiaries of the original Trust (i.e., Spouse, with a life-interest, and Decedent's issue as remaindermen) and that all will be beneficiaries of both trusts. Although the Trust will be treated as two separate trusts, the two trusts will be governed by the same trust document that has governed the Trust. On that basis, we believe that the interests of the beneficiaries will not change when the two subtrusts of the Trust are established.

We conclude that no gain or loss will be recognized by the Trust under § 61 and § 1001 as a result of the making of the transitional rule election under § 26.2652-2(c) and the establishment of the exempt subtrust and the nonexempt subtrust. We believe that the exempt and nonexempt subtrusts embody legal entitlements substantially identical to those of the Trust and, consequently, are not materially different from it.

Section 1015 provides that the basis in property acquired by a transfer in trust generally is the same as it would be in the hands of the grantor, with adjustments for gain or loss recognized by grantor.

We conclude that, immediately after the severance of Trust into the exempt subtrust and the nonexempt subtrust, the adjusted basis of each trust in each asset that it holds will be the same as the adjusted basis of Trust in that asset immediately before the severance.

Except as we have specifically ruled herein, we express no opinion as to the consequences of this transaction under the cited provisions or under any other provisions of the Code.

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

A copy of this letter should be forwarded to the Service Center where the election was filed. A copy is enclosed for that purpose.

Sincerely yours,

Paul F. Kugler
Assistant Chief Counsel
(Passthroughs and Special
Industries)

Enclosures

Copy for section 6110 purpose
Copy of letter

Prior Written Determination Number 9845004