Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:DOM:P&SI:4-PLR-115048-99
Date:
April 14, 2000

Legend:

Decedent =

Will =

Executor =

Spouse =

Child 1 =
Child 2 =

Children Trust =

QTIP Trust =

Trustee =

Date 1 =
Date 2 =

X =
Y =

State =

Dear :

This is in response to your letter dated February 4, 2000, and prior correspondence, in which your authorized representative requested rulings concerning the manner and timeliness of the qualified terminable interest property (QTIP) election and the "reverse" QTIP elections under §§ 2056(b)(7)(B) and 2652(a)(3) of the Internal Revenue Code, respectively, and the application of the generation-skipping transfer tax allocation rules under § 2632(c)(1).

Decedent died testate on Date 1, survived by Spouse, Child 1, and Child 2.

Item III of Will provides that at Decedent's death an amount equal in value to the applicable exclusion amount as defined in 2001(c) as amended, is to be placed in a trust for the

benefit of Spouse, Child 1, and Child 2 (“Children Trust”).

Item III (A) of Will provides that Trustee is to pay net income of Children Trust to Spouse, Child 1, and Child 2 for care, comfort, support, medical care, maintenance and welfare (not necessarily equally but according to their individual needs). Any net income not distributed is to be accumulated and added to principal. Under Item III (B), Trustee is to pay principal of Children Trust to Spouse, Child1, and Child 2 for care, comfort, support, medical care, maintenance, and welfare (not necessarily equally but according to their individual needs).

Item III (C) of Will provides that Child 1 is to receive one-half of the then remaining principal and undistributed net income upon attaining age 35. Child 2 is to receive the entire remaining balance of Children Trust when Child 2 attains age 35.

Item III (D) of Will provides that upon the death of either child prior to attaining age 35, such child’s share is to be retained by Trustee for child’s descendants, per stirpes, in a separate fund for each such descendant. Trustee is to pay net income and principal to each descendant for care, comfort, support, medical care, education and maintenance. If descendant dies before attaining age 35, such share is to be distributed equally for the benefit of other descendants of such child and if none, then to other child, or other child’s descendant, per stirpes. Trustee is to distribute the remaining balance of the share of each beneficiary upon such beneficiary attaining age 35.

Item IV of Will provides that the residue of the estate is to pass to QTIP Trust, a revocable trust established by Decedent during his lifetime that became irrevocable on his death. Article IV (A) of QTIP Trust provides that Trustee is to distribute net income to Spouse in convenient installments at least quarterly. Under Article IV (B), Trustee is to distribute principal to Spouse for maintenance, support, health, ease, comfort, and welfare. If Decedent’s executor makes an election to qualify the trust for the marital deduction under § 2056(b)(7) of the Code, Trustee is to distribute principal without regard to any standard.

Articles IV (C) and (D) of QTIP Trust provide that Spouse has a limited power to appoint, by will, all or part of principal and undistributed income, in favor of Child 1 or Child 2, or their descendants, per stirpes, either outright or in trust. In default of exercise of the power, the corpus is to be distributed to Decedent’s descendants, in equal shares, per stirpes. However, QTIP Trust is not to terminate with respect to any beneficiary who has not attained age 35. Under Article IV (D), upon Spouse’s death, QTIP Trust is to continue for any child, or descendant who has not attained age 35 and the trustee is to distribute net income and principal to the beneficiary for care, comfort, support, medical care, maintenance and education. When beneficiary attains age 35, Trustee is to distribute the entire remaining principal and any accumulated income of such beneficiary’s share. If a beneficiary dies prior to attaining age 35, then such share is to pass as directed in beneficiary’s will otherwise, to beneficiary’s living descendants, if any, per stirpes. In all cases, Trustee is to retain beneficiary’s share until he or she attains age 35.

Article VI provides that notwithstanding any other provisions of QTIP Trust, principal and undistributed income of any and all shares, shall be distributable to the beneficiary not later than 20 years and 11 months following the death of the last to die among Child 1 and Child 2 living at the date of the creation of QTIP Trust.

Article XII provides that QTIP Trust is to be administered in and governed by the laws of State.

Executor filed Form 706 (United States Estate (and Generation-Skipping Transfer) Tax Return) on Date 2 which was after the due date of the return. On Schedule M of the Form 706, Executor made an election under § 2056(b)(7) with respect to "Subtrusts A and B" of QTIP Trust. On Schedule R of the Form 706, Executor made an election under § 2652(a)(3) with respect to Subtrust A of QTIP Trust. On a rider to Schedule R of the Form 706, Executor states that QTIP Trust is to be segregated into two trusts: Subtrust A and Subtrust B. Executor further states that when the QTIP Trust is segregated, Subtrust A is to be funded with $X and the remainder is to pass to Subtrust B. The Form 706 filed on Date 2 was the first and only estate tax return filed by the estate.

Executor of Decedent's estate has requested the following rulings:

1. The elections under §§ 2056(b)(7) and 2652(a)(3) made on the Decedent's federal estate tax return filed after the due date of the return were made in the proper manner and in accordance with §§ 2056(b)(7) and 2652(a)(3).

2. The automatic allocation rules for allocating the generation-skipping transfer tax under § 2632(c)(1) apply to the Children Trust and Subtrust A of the QTIP Trust, such that both trusts have an inclusion ratio of zero under § 2642.

Ruling Request 1

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 a decedent's taxable estate shall 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.

Under § 2056(b)(1), a marital deduction is not allowed for certain "terminable interests" passing to the surviving spouse; that is, an interest passing to the spouse that will terminate or fail on the occurrence of certain events, and after such termination, the property passes to someone other than the surviving spouse.

Section 2056(b)(7)(A) provides that qualified terminable interest property (QTIP) shall be treated as passing to the surviving spouse and no part of such property shall be treated as passing to any person other than the surviving spouse. Thus, the value of such property is deductible from the value of the gross estate under § 2056(a). Under § 2044, the value of the trust on the death of the surviving spouse is includible in the gross estate of the spouse.

Section 2056(b)(7)(B)(i) defines 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 § 2056(b)(7)(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, and that such an election, once made, shall be irrevocable.

Section 20.2056(b)-7(b)(4)(i) provides that the election referred to in §§ 2056(b)(7)(B)(i) and (v) is made on the return of tax imposed by § 2001. The term “return of tax imposed by § 2001" is defined as the last estate tax return filed by the executor on or before the due date of the return, including extensions or, if a timely return is not filed, the first estate tax return filed by the executor after the due date.

Section 2601 imposes a tax on every generation-skipping transfer (GST), within the meaning of §§ 2611 through 2613, made by a transferor to a “skip person” (a person assigned to a generation that is two or more generations below the generation assignment of the transferor).

Under, § 2652(a)(1), for GST tax purposes, the term "transferor" means in the case of property subject to estate tax, the decedent in whose gross estate the property is included. Section 26.2652-1(a)(1) of the Generation-Skipping Transfer Tax Regulations provides that the individual with respect to whom property was most recently subject to Federal estate or gift tax is the transferor of that property for GST purposes. Thus, in the case of property subject to an election under § 2056(b)(7)(B)(v), the surviving spouse would become the transferor of the property for GST purposes.

However, § 2652(a)(3) provides that, with respect to any trust for which a deduction is allowed under § 2056(b)(7), the estate of the decedent may elect to treat all of the property in such trust for purposes of the GST provisions as if the election under § 2056(b)(7) 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 purposes, the transferor of the QTIP trust for which the election is made. As a result, that decedent's GST exemption described in § 2631 (discussed below) may be allocated to that QTIP trust.

Section 26.2652-2(a) provides that if an election is made to treat trust property as qualified terminable interest property under §§ 2523(f) or 2056(b)(7), the individual making the election may, for purposes of Chapter 13, elect to treat the property as if the QTIP election had not been made (i.e., a reverse QTIP election). The election is irrevocable and 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 a reverse QTIP election is made on the return on which the QTIP election is made.

In the present case, Form 706 was filed on Date 2 and was the first and only estate tax return filed by the Executor. The Executor reported all of the assets held in the QTIP Trust on Schedule M. Section 20.2056(b)-7(b)(4)(i) specifically provides that a QTIP election under §2056(b)(7)(B)(i) and (v) is made on the return of tax imposed by 2001. The term “return of tax imposed by 2001" means the last estate tax return filed by the executor on or before the due date of the return, including extensions, or if a timely return is not filed, the first estate tax return filed by the executor after the due date. In the case at hand, the election under § 2056(b)(7)(b)(v) was made on the first and only estate tax return filed by the Executor. Accordingly, in accordance with § 20.2056(b)-7(b)(4), the QTIP election was made in the proper manner and is effective for purposes of §§ 2056(b)(7)(B)(i) and (v).

As discussed below, a statement on the return indicated that QTIP Trust would be segregated into Subtrust A and Subtrust B. A reverse QTIP election under § 2652(a)(3) was made with respect to Subtrust A on Schedule R of the same Form 706 on which the QTIP election was made on Schedule M. Section 26.2652-2(b) provides that a reverse QTIP election is to be made on the return on which the QTIP election is made. Since the QTIP election made on the return was effective, the reverse QTIP election made on the return with respect to Subtrust A is also effective in accordance with § 2652(a)(3) and § 26.2652-2(b).

Ruling Request 2

Under § 2602, the amount of GST tax imposed on a transfer is equal to the taxable amount, multiplied by the "applicable rate."

Section 2641(a) provides that the "applicable rate" with respect to any generation-skipping transfer, is the product of the maximum Federal estate tax rate, and the inclusion ratio with respect to the transfer. Under § 2641(b), "maximum Federal estate tax rate" means the maximum rate imposed by § 2001 on the estates of decedents dying at the time of the relevant generation-skipping transfer. Under § 2642(a)(1), the "inclusion ratio" with respect to any property transferred in a generation-skipping transfer from a trust, is the excess of 1 (one) over the applicable fraction determined for the trust. Under § 2642(a)(2), the "applicable fraction" is a fraction, the numerator of which is the amount of GST exemption allocated to the trust, and the denominator of which is generally the value of the property transferred to the trust.

Section 2631 provides that for purposes of determining the applicable fraction and inclusion ratio used in computing the generation-skipping transfer tax, every individual is allowed a GST exemption of $1,000,000 (adjusted for inflation under § 2631(c)), which may be allocated by the individual, or the individual's executor, to any property of which the individual is the transferor for GST purposes under § 2652(a). Section 2631(b) provides that any allocation under § 2631(a), once made, is irrevocable.

Section 2632(a) provides that any allocation of the individual's GST exemption under § 2631(a) may be made at any time on or before the date prescribed for filing the estate tax return for the individual's estate (determined with regard to extensions), regardless of whether such return is required to be filed.

Sections 2632(c)(1)(A) and (B) provide that any portion of an individual's GST exemption which has not been allocated within the time prescribed in § 2632(a) shall be deemed to be allocated first, to property which is the subject of a direct skip occurring at the individual's death, and 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 2632(c)(2)(A) provides that an allocation under § 2632(c)(1) is to be made among the properties described in § 2632(c)(1)(A) and the trusts described in § 2632(c)(1)(B), as the case may be, in proportion to the respective amounts (at the time of allocation) of the nonexempt portions of such properties or trusts.

Section 26.2632-1(d)(1) provides that an allocation of a decedent's unused GST exemption by the executor of the decedent's estate is to be made on the appropriate United

States Estate (and Generation-Skipping Transfer) Tax Return (Form 706) filed on or before the date prescribed for filing the return (including extensions).

Section 26.2632-1(d)(2) provides that a decedent's unused GST exemption is automatically allocated on the due date for filing Form 706 to the extent the GST exemption is 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, first to direct skips treated as occurring at the transferor's death. The balance, if any, of unused GST exemption is allocated pro rata 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 any 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 generation skipping transfer with respect to the trust.

Section 2642(b)(2)(B) provides that any allocation of GST exemption to property transferred as a result of the death of the transferor is effective on and after the date of death of the transferor.

Sections 26.2654-1(b)(1)(i) and (ii) provide 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 GST purposes if: (1) 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; (2) 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 local law and (A) the terms of the new trusts provide in the aggregate for the same succession of interests and beneficiaries as are provided in the original trust; and (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) either (i) the new trusts are severed on a fractional basis, or (ii) the severance is required (by the terms of the governing instrument) to be made on the basis of a pecuniary amount.

Section 26.2654-1(b)(2) provides that if the governing instrument of a trust or local law authorizes the severance of the trust, a severance pursuant to that authorization is deemed timely if the executor indicates on the Federal estate tax return that separate trusts will be created (or funded) and clearly sets forth the manner in which the trust is to be severed and the separate trusts funded.

Section 35-50-122(b) of the State Code states:

> [w]hen property is held or to be held in a trust which is or would otherwise be partially exempted from the generation-skipping tax due to the allocation to such trust of a generation-skipping tax exemption, a trustee is authorized, but not required, to divide the trust into two (2) or more separate trusts, of equal or unequal value, in order to create one (1) or more trusts entirely exempt from the generation-skipping tax and one (1) or more trusts entirely subject to the generation-skipping tax. Other terms and provisions of both trusts will remain substantially identical in all respects to the original trust.

Section 35-50-122(a)(1) defines “generation-skipping tax” for these purposes as “the generation-skipping tax imposed by chapter 13 of the Internal Revenue Code.”

In the present case, the Form 706 was not filed by the due date (including extensions). Therefore, the GST exemption allocation made by the Executor on Schedule R of the estate’s Form 706 is inoperative. Accordingly, the GST exemption is to be automatically allocated in accordance with § 2632 (c)(1) and § 26.2632-1(d)(2).

It is represented that under the terms of the will, the Children Trust is to be funded with $Y. Further, as discussed above, Subtrust A is to be funded with $X. In addition, it is represented that no direct skips occurred at the Decedent’s death and Decedent’s available GST exemption, as of the date of death was $1,000,000. Accordingly, in view of the QTIP and reverse QTIP elections, and the severance of the QTIP Trust as described, Decedent’s GST exemption is automatically allocated, pursuant to § 2632(c), to Children Trust and Subtrust A. Assuming these trusts are properly funded, the inclusion ratio for each trust will be zero.

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 no opinion on the federal tax consequences of the transaction under the cited provisions or under any other provisions of the Code.

The rulings contained in this letter are 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.

Pursuant to a Power of Attorney on file, a copy of this letter is being sent to the authorized representative of taxpayer.

Sincerely yours,
George L. Masnik
Chief, Branch 4

Enclosure
Copy for section 6110 purposes