Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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Person to Contact:

Telephone Number:

Refer Reply To:
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Date:
February 19, 2003

Re:

LEGEND

Decedent =
Family Trust =

Year 1 =
Husband Separate Property Trust =
Wife Separate Property Trust =
Community Property Trust =

Date 1 =
$x =
$y =
Date 2 =
Date 3 =

Dear :

This is in response to your letter dated October 8, 2002, requesting a ruling under § 2056(b)(7) of the Internal Revenue Code.

The facts and representations submitted are summarized as follows: Decedent and his spouse created the Family Trust, a revocable intervivos trust, in Year 1. During the lifetimes of both spouses, the Family Trust was divided into three separate trusts: the Husband Separate Property Trust, the Wife Separate Property Trust, and the Community Property Trust.

Decedent died on Date 1. Under the provisions of the Family Trust, upon the death of Decedent, specific pecuniary bequests were to be made outright to certain named relatives of Decedent from the Husband Separate Property Trust. The

remaining assets of the Family Trust were then to be divided into three separate trusts: Trust A, Trust B, and Trust C.

Under Section 3.02 of the Family Trust Declaration, Trust A was to be funded with the surviving spouse's one-half interest in the couple's community property as well as her separate property. Under Section 3.03, Trust B was to be funded with the "Marital Deduction Amount," which was to "consist of the smallest fractional share of the Trust Estate that, if added to the total value for federal estate tax purposes of all other interests in property that pass or have passed from the Deceased Trustor to or in trust for the Surviving Trustor and if includible in the Deceased Trustor's gross estate for federal estate tax purposes and qualified for the marital deduction, will entirely eliminate (or reduce to the maximum possible extent) any federal estate tax at the death of the Deceased Trustor...." Under Section 3.04, Trust C was to be funded with the "Exemption Equivalent Amount," and "consist of all [Family Trust] property which is not allocated or allocable to Trust A pursuant to Section 3.02 of this Declaration, and is not allocated or allocable to Trust B pursuant to Section 3.03 of this Declaration."

Decedent's estate tax return, Form 706, was timely filed. On Schedule M of the estate tax return a QTIP election was made for the "Residue of Decedent's interest in the [Family Trust]" in the amount of $x. An estate tax liability of $y was reported and paid. It was subsequently discovered that the value of the property for which the QTIP election was made had been calculated incorrectly, and that if the amount of the deduction had been calculated and reported correctly, no estate tax liability would have been incurred. Decedent's estate tax return was filed in Date 2, and the statute of limitations on assessment will expire in Date 3.

The trustee of the Family Trust, who is also the personal representative of Decedent's estate, requests a ruling on the validity of the QTIP election made on Decedent's estate tax return for the value of the interest passing to Trust B pursuant to the terms of the Family Trust Declaration.

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, except as limited by § 2056(b), 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, but only to the extent that such interest is included in determining the value of the gross estate. Section 2056(b)(1) denies a marital deduction for an interest passing to the surviving spouse that is a "terminable interest." An interest is a terminable interest if the interest passing to the surviving spouse will terminate or fail on the lapse of time or on the occurrence of an event or contingency or on the failure of an event or contingency to occur and, on termination, an interest in the property passes to someone other than the surviving spouse.

Section 2056(b)(7) provides an exception to this terminable interest rule in the case of qualified terminable interest property (QTIP). For purposes of § 2056(a), qualified terminable interest property is treated as passing to the surviving spouse, and no part of the property is treated as passing to any person other than the surviving spouse. Under § 2056(b)(7)(B)(i), qualified terminable interest property is property which passes from the decedent, in which the surviving spouse has a qualifying income interest for life, and to which an election under § 2056(b)(7)(B)(v) applies.

Section 2056(b)(7)(B)(v) provides that the election to treat property as QTIP under § 2056(b)(7) is made by the executor on the return of tax imposed by § 2001. The election, once made, is irrevocable.

Section 20.2056(b)-7(b)(4)(i) of the Estate Tax Regulations provides that 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.

Section 20.2056(b)-7(b)(4)(ii) provides that an election may be revoked or modified on a subsequent return filed on or before the due date of the return, including extensions actually granted. If an executor appointed under local laws has made an election on the return of tax imposed by § 2001 with respect to one or more properties, no subsequent election may be made with respect to other properties included in the gross estate after the return of tax imposed by § 2001 is filed.

Rev. Proc. 2001-38, 2001-24 I.R.B. 1335, applies to elections under § 2056(b)(7) to treat property as qualified terminable interest property in situations where the election is not necessary to reduce the estate tax liability to zero, based on values as finally determined for federal estate tax purposes. The revenue procedure describes the circumstances in which such an election will be treated as a nullity for federal estate, gift, and generation-skipping transfer tax purposes. One example of an unnecessary QTIP election is an election made when the taxable estate (before allowance of the marital deduction) is less than the applicable exclusion amount under § 2010(c). The QTIP election is not necessary, because no estate tax would be imposed whether or not the election is made. Another example of an unnecessary QTIP election is one that is made for both a credit shelter trust and a marital trust. The QTIP election for the credit shelter trust is not necessary, because no estate tax is imposed on a credit shelter trust funded with an amount that does not exceed the applicable exclusion amount under § 2010(c).

In the instant case, a QTIP election under § 2056(b)(7)(B)(v) was made on Decedent's timely filed estate tax return. The property for which the election was made was described as the "Residue of Decedent's interest in the [Family Trust]." The residue of Decedent's interest in the Family Trust consisted of the assets remaining in

the Husband's Separate Property Trust after the distribution of the specific pecuniary bequests plus Decedent's one-half share of the assets of the Community Property Trust. However, under Sections 3.03 and 3.04 of the Family Trust Declaration, these assets were to be distributed to Trust B, which was to be funded with the "Marital Deduction Amount," and Trust C, which was to be funded with the "Exemption Equivalent Amount." Therefore, the QTIP election was made for both the QTIP trust and the credit shelter trust. Pursuant to Rev. Proc. 2001-38, the QTIP election with respect to Trust C, the credit shelter trust, will be treated as a nullity for federal estate, gift, and generation-skipping transfer tax purposes. However, since Trust B meets the requirements for qualified terminable interest property and the election under § 2056(b)(7)(B)(v) was made on a timely filed estate tax return, the QTIP election for the property passing to Trust B, the marital trust, is valid and irrevocable.

As a result of a miscalculation, the value of the property which passed to Trust B under the provisions of Section 3.03 of the Family Trust Declaration was reported incorrectly on Schedule M of Decedent's estate tax return. As a result of this miscalculation, the marital deduction claimed for Trust B was less than the amount that should have been claimed, resulting in an estate tax liability.

Based on the facts submitted and the representations made, we conclude that the description of the QTIP property on Schedule M does not invalidate the QTIP election for the property passing to Trust B pursuant to Section 3.03 of the Family Trust Declaration. Similarly, we conclude that the miscalculation of the value of the property passing to Trust B under the provisions of Section 3.03 does not preclude a marital deduction for the full value of the property which will actually fund Trust B under the terms of the governing instrument.

Accordingly, the personal representative of Decedent's estate should file a supplemental Form 706 with the Internal Revenue Service Center, Cincinnati, Ohio 45999, prior to the time prescribed by § 6511 for claiming a credit or refund. The supplemental Form 706 should supply the correct description of the trust for which the QTIP election was made and report the full value of the property subject to the QTIP election. A copy of this letter should be attached to the supplemental return. A copy is enclosed for that purpose.

The ruling contained in this letter is 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 ruling, it is subject to verification on examination.

Except as specifically ruled herein, we express or imply no opinion on the federal tax consequences of the transaction under the cited provisions or under any other provisions of the Code. In addition, we express or imply no opinion regarding the value of the property transferred to the trusts.

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.

Sincerely,

Katherine A. Mellody

Katherine A. Mellody
Senior Technician Reviewer, Branch 4
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures
Copy of letter
Copy for 6110 purposes