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Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:4 - PLR-124802-01
Date:
June 13, 2001

Re:

LEGEND:

Decedent =

Spouse =

D =

E =

County =

State =

State Statute =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Trust =

Dear :

This is in response to your correspondence dated April 13, 2001, and prior correspondence requesting a ruling concerning the estate and gift tax consequences of

the proposed severance of the Marital Trust and Spouse's proposed renunciation of her interest in the severed trust under §§ 2207A, 2519, and 2702 of the Internal Revenue Code.

The facts and representations submitted are summarized as follows: On Date 1, Decedent and Spouse (referred to as "the Settlors") executed Trust. Settlors transferred community property and separate property to Trust. During the joint lives of Settlors, Trust could be revoked by either Settlor. In the event of revocation, the Settlors will receive the portion of the trust property attributable to the Settlor's respective contribution to Trust.

Under Article III of Trust, the trustee is to distribute to the Settlors the entire net income of the community property in quarterly payments. In addition, if the net income of the community property is insufficient, the trustee may distribute principal of the community property for the health, education, support and maintenance of the Settlors. In addition, the trustee is to pay to the Settlor whose separate property was transferred to the Trust, the entire net income of that settlor's separate property. The trustee also has discretion to distribute principal of a Settlor's separate property for that Settlor's health, education, support, and maintenance.

Under Article IV, upon the death of either Settlor with the other Settlor surviving, the trustee is to distribute the property interests of the deceased Settlor consisting of all or any part of the deceased Settlor's one-half community property share and the deceased Settlor's separate property, as such Settlor appoints by will or as appointed by written instrument filed with the trustee during the Settlor's lifetime.

On the death of either Settlor, the trustee is to divide the portion of the Trust estate that was not effectively appointed by the deceased Settlor, into three separate trusts: the Survivor's Trust; the Marital Trust; and the Residuary Trust. The Survivor's Trust is to consist of the surviving Settlor's interest in the community property and the surviving Settlor's separate property held in Trust. The Marital Trust is to consist of that fractional share of the residue of the trust estate, the numerator of which is the amount necessary to reduce the federal estate tax imposed on the estate of the first Settlor to die to zero (taking into account final federal estate tax values), and the denominator of which is the final federal estate tax values of the Trust property excluding the property passing to the Survivor's Trust.

The trustee of the Marital Trust is to pay to or apply for the benefit of the surviving Settlor during his or her lifetime, quarterly or at more frequent intervals, the entire net income of the Marital Trust. In addition, if the trustee determines that the income is insufficient, the trustee may distribute principal of the Marital Trust for the Settlor's health, support, and maintenance. In determining whether to make a principal distribution from the Marital Trust, the trustee is to first make such distributions from the Survivor's Trust, except that the trustee may make such principal distributions from the

Residuary Trust (discussed below) for any reason the trustee deems this to be advisable. Upon the death of the surviving Settlor, the balance of the Marital Trust is to be added to the Residuary Trust, to be administered as if it had been an original part of the Residuary Trust. However, the trustee is to first pay out of the principal of the Marital Trust any federal estate taxes attributable to the Marital Trust by reason of the death of the surviving Settlor.

Under Article lV, Paragraph 7.e., if the surviving Settlor disclaims his or her interest in all or a portion of the property of the Marital Trust, the portion subject to the disclaimer is to pass to the Residuary Trust to be administered thereunder.

The Residuary Trust is to consist of the balance of the Trust estate. The trustee of the Residuary Trust is to pay or apply for the benefit of the surviving Settlor during her lifetime, the entire net income of the trust in quarterly or more frequent intervals. If the income is insufficient, the trustee in its discretion may distribute principal for the surviving Settlor's health, support, and maintenance. In determining whether to make principal distributions to the surviving settlor, the trustee is to first make distributions from the Survivor's Trust, thereafter from the Marital Trust, and thereafter from the Residuary Trust. However, the trustee, if it deems it advisable, may make the payments first from the Residuary Trust.

Under Article lV, Paragraph 8.d, upon the death of the surviving Settlor, the trustee is to divide the Residuary Trust into as many equal shares as there are children of the Settlors living and children of the Settlors then deceased leaving issue surviving. The trustee is to allocate one equal share to each living child of the Settlors and one equal share to each group composed of the living issue of a deceased child of the Settlors. Each share allocated to a living child of the Settlors is to be a separate trust. The trustee is to pay or apply for the benefit of the child the entire net income of the trust, payable quarterly or at more frequent intervals. Principal distributions may be made in the trustee's discretion for the child's health, support and maintenance. When the child attains age fifty (50) the trustee is to distribute to the child the undistributed balance of the child's trust.

Each share allocated to a group composed of the living issue of a deceased child of the Settlors is to held as a separate trust. If no child of the Settlors deceased child is living who is under the age of twenty-five, the share is to be distributed free of trust to the Settlors' deceased child's issue then living, by right of representation.

If a child of the Settlors' deceased child is living who is under the age of twenty-five (25), the share is to be retained in a separate trust for all of such deceased child's issue's benefit. Such trust will terminate at the time that no child of trustors' deceased child is living who is under age twenty-five. Upon termination, the remaining balance of the trust is to be distributed, free of trust, to the then living issue of the Settlors' deceased child, by right of representation.

Article VI covers disclaimers. Article VI, Paragraph 2. provides that in the event of a disclaimer by the surviving Settlor of all or any part of any interest or benefit provided to the surviving Settlor under the Marital Trust, the interest or benefit disclaimed shall be distributed as part of the Residuary Trust. Article VI, Paragraph 3. provides that in the event of a disclaimer, other than a disclaimer by the surviving Settlor of any interest provided under the Marital Trust, to the extent disclaimed, the disclaimed gift, bequest or other interest shall devolve as though the disclaimant had predeceased the first Settlor to die.

Decedent died on Date 2. At that time, pursuant to the terms of Trust, Spouse became the sole trustee of Trust. Spouse, pursuant to her authority under Trust, appointed the Decedent and Spouse's two children, D and E to serve with Spouse as co-trustees. On Date 3, the trustees filed with the Superior Court of County, State, a petition to divide the Marital Trust. In accordance with the petition, the Marital Trust is to be divided into an Exempt Marital Trust (to be subject to a reverse QTIP election under section 2652(a)(3)), and two Non-exempt Marital Trusts. The Exempt Marital Trust is to be funded with an amount equal to Decedent's unused generation-skipping transfer tax (GST tax) exemption. The balance of the assets will be divided between Non-exempt Marital Trusts A and B. See section 26.2654-1(b)(1).

The federal estate tax return (Form 706) for Decedent's estate was filed on Date 4. On the return, the trustees made the election under § 2056(b)(7)(B)(v) to treat the Marital Trust as qualified terminable interest property (QTIP). The trustees indicated their intention to sever the Marital Trust into three trusts, the "Exempt Marital Trust", the "Non-exempt Marital Trust A", and the "Non-exempt Marital Trust B", in accordance with the petition filed with County court. On Date 5, the court issued its order authorizing the severance of the Marital Trust as described above.

It is represented that the Marital Trust will be severed pursuant to the Court's order into an Exempt Marital Trust, Non-exempt Marital Trust A, and Non-exempt Marital Trust B. The division of the Marital Trust will comply with the requirements of § 26.2654-1(b)(1) of the Generation-Skipping Transfer Tax Regulations. A detailed description of the property interests that comprise the Marital Trust has been provided. It is represented that the division of the Marital Trust assets into an Exempt Marital Trust and a Non-exempt Marital Trust will be made on a fractional pro rata basis, and that upon the further distribution of marital assets between the two non-exempt marital trusts, the value of the assets held by each trust will be a pro rata portion of the value of the assets that would have been allocated to a single non-exempt marital trust prior to distribution, and that the division of the non-exempt marital trust assets will not generate any additional valuation discounts. The severed trusts will be held under the same terms and conditions as provided in the Marital Trust. In addition, it is represented that State law requires that upon severance, the trustee must treat each severed trust as a separate trust for all purposes, from the effective date of the severance.

After the severance, Spouse proposes to renounce her interest in Non-exempt Marital Trust A. Upon Spouse's renunciation, the assets of Non-exempt Marital Trust A will pass, pursuant to Article IV, Paragraph 7.e., and Article Vl, Paragraph 2., to the Residuary Trust. Spouse also proposes to disclaim her interest in the Residuary Trust. Upon petition by the trustees of Trust, the Superior Court of State, County, on Date 6, issued an order that upon Spouse's renunciations the assets of the Residuary Trust including the assets of Nonexempt Marital Trust A, will pass as if Spouse had predeceased Decedent. Therefore, the renounced property (including all income and principal interests attributable thereto) is to pass to, two equal and separate trusts, to be administered and distributed for the benefit of D and E, under the terms of Article IV, Paragraph 8.d of Trust.

The gift tax attributable to the transfer will be paid from the property of Non-exempt Marital Trust A.

Under State Statute, unless the creator of an interest provides for a specific disposition of the interest in the event of a disclaimer, a disclaimed interest is to descend, or pass in the case of a present interest, as if the disclaimant had predeceased the creator of the interest.

You have requested the following rulings:

1. Spouse's renunciation of her interests in Non-exempt Marital Trust A and the Residuary Trust, will not be deemed to be a transfer of her interest in Exempt Marital Trust or in Non-exempt Marital Trust B.

2. In determining the value of Spouse's gift resulting from Spouse's renunciation of her interests in Non-exempt Marital Trust A and the Residuary Trust, the value of Spouse's income interest in Exempt Marital Trust and in Non-exempt Marital Trust B will not be valued at zero under section 2702.

3. In determining the amount of Spouse's gift resulting from Spouse's renunciation of her interests in Non-exempt Marital Trust A and the Residuary Trust, the amount of the gift will be reduced by the gift taxes paid by the trustee of Non-exempt Marital Trust A.

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, in pertinent part, that no deduction shall be allowed under § 2056(a) where, on the lapse of time, on the occurrence of an event or contingency, or on the failure of an event or contingency to occur, an interest passing to the surviving spouse will terminate or fail.

Section 2056(b)(7) provides an exception to the rule of § 2056(b)(1) in the case of qualified terminable interest property. Under § 2056(b)(7)(A), qualified terminable interest property (QTIP) is treated as passing to the surviving spouse for purposes of § 2056(a), and no part of the property is treated as passing to any person other than the surviving spouse for purposes of § 2056(b)(1). Section 2056(b)(7)(B)(i) provides that 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 2501 imposes a tax on the transfer of property by gift during the year by an individual, resident or nonresident. Section 2502(c) provides that the gift tax is the liability of the donor.

Section 2511(a) provides that the gift tax imposed by § 2501 applies whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible. Section 2512(b) provides that where property is transferred for less than an adequate consideration in money's worth, the amount by which the value of the property exceeds the value of the consideration is deemed a gift.

Section 2702 provides special valuation rules in the case of transfers of interests in trust. Under § 2702(a), in determining whether a transfer of an interest in trust to (or for the benefit of) a member of the transferor's family is a gift, and the value of such transfer, the value of any interest in such transfer retained by the transferor or any applicable family member shall be determined as provided in § 2702(a)(2). Section 2702(a)(2) provides that the value of any retained interest that is not a qualified interest shall be treated as being zero. The value of any retained interest that is a qualified interest is determined under § 7520.

Section 2519(a) provides that for gift and estate tax purposes, any disposition of all or part of a qualifying income interest for life in any property to which the section applies shall be treated as a transfer of all interests in such property other than the qualifying income interest. Section 2519(b) provides that section 2519(a) applies to any property, if a deduction was allowed with respect to the transfer of such property under § 2056(b)(7).

Section 25.2519-1(a) of the Gift Tax Regulations provides that a transfer of all or a portion of the income interest of the surviving spouse in QTIP property is a transfer by

the surviving spouse under § 2511. Section 25.2519-1(c) provides that the amount treated as a transfer under § 2519 upon a disposition of all or part of a qualifying income interest for life in QTIP property is equal to the fair market value of the entire property subject to the qualifying income interest, determined on the date of the disposition (including any accumulated income and not reduced by any amount excluded from total gifts under § 2503(b) with respect to the transfer creating the interest), less the value of the qualifying income interest in the property on the date of disposition. The gift tax consequences of the disposition of the qualifying income interest are determined under § 25.2511-2.

Section 25.2511-2(a) provides that the gift tax is a primary and personal liability of the donor, is an excise upon the donor's act of making the transfer, is measured by the value of the property passing from the donor, and attaches regardless of the fact that the identity of the donee may not then be known or ascertainable.

Section 2207A(b) provides that, if for any calendar year tax is paid under chapter 12 (gift tax) with respect to any person by reason of property treated as transferred by such person under section 2519, such person shall be entitled to recover from the person receiving the property the amount by which (1) the total tax for such year under chapter 12 exceeds (2) the total tax which would have been payable under such chapter for such year if the value of such property had not been taken into account for purposes of chapter 12. Under section 25.2207A-1(e), if the property is in trust at the time of the transfer, the person receiving the property is the trustee.

Rev. Rul. 75-72, 1975-1 C. B. 310, holds that if, at the time of the transfer, the gift is made subject to a condition that the gift tax is to be paid by the donee or out of the transferred property, then the donor receives consideration for the transfer in the amount of the gift tax to be paid by the donee. Thus, under section 2512(b), the value of the gift is measured by the fair market value of the property passing from the donor minus the amount of the gift tax to be paid by the donee. See also, Rev. Rul. 81-223, 1981-2 C.B. 189.

Although § 2502(c) provides that the tax on the gift is the liability of the donor, in Rev. Rul. 75-72 and Rev. Rul. 81-223, the burden of the tax was shifted to the donees by agreement. The amount of the gift on which the gift tax was computed was reduced by the amount of the gift tax paid by the donee. As discussed above, with respect to the gift tax imposed as a result of a transfer under § 2519, § 2207(b) statutorily shifts the burden, but not the liability for paying the gift tax to the donee. By reimbursing the donor for the gift tax paid pursuant to the statute, the donee provides consideration for

the gift. The donee's payment inures to the benefit of the donor because it reimburses the donor for gift tax that the donor was liable for and would otherwise be required to pay out of the donor's own funds. See Rev. Rul. 75-72. Accordingly, net gift treatment of a transfer under § 2519 is implicit under § 2207(b).

Based upon the facts and representations submitted and the authority above, we conclude that if Wife renounces Spouse's interest in Non-exempt Marital Trust A and in the Residuary Trust, then:

1. Spouse will not be deemed to have made a gift of the property in the Non-exempt Marital Trust B or in the Exempt Marital Trust;

2. Spouse's income interest in Non-exempt Marital Trust B and the Exempt Marital Trust will not be valued at zero under § 2702; and

3. If Spouse's renunciations are conditioned on the payment of all gift taxes attributable to the transfers from the property of the Non-exempt Marital Trust A, the amount of Spouse's gift will be reduced by the gift taxes paid from the Non-exempt Marital Trust A property.

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

In accordance with the power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

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

Sincerely yours,
GEORGE MASNIK
Chief, Branch 4
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure
Copy of letter for section 6110 purposes