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Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:4 - PLR-110124-00
Date: March 1, 2001

Re:

LEGEND:

Spouse	-
Decedent	-
Child 1	-
Child 2	-
Family Trust	-
Marital Trust	-
Corporation A	-
Corporation B	-
Date 1	-
Date 2	-
Date 3	-
State X	-
Statute	-

Dear :

This is in response to your May 11, 2000 letter requesting a ruling concerning the Federal gift tax treatment of the severance of a trust and proposed renunciation with respect to interests in the severed trust by Spouse.

According to the facts submitted, Decedent and Spouse, both residents of State X, established Family Trust on Date 1. Family Trust could be revoked or amended during the joint lives of Decedent and Spouse. Upon Decedent's death on Date 2, Family Trust was divided into two separate shares: the "Survivor's Trust," which consisted of the Spouse's separate property and Spouse's one-half of the community property and quasi-community property; and the "Deceased Spouse's Share," which consisted of the balance of the trust estate. Under Article V(B) of the Family Trust, the Deceased Spouse's Share was used to satisfy specific bequests, fund a grandchildren's trust, and fund a "Marital Trust" (Marital Trust). Child 1 is the trustee of the Marital Trust. The assets of the Marital Trust consistent primarily of closely-held stock in Corporation A and Corporation B, partnership interests, real estate, receivables, cash and other liquid assets.

Under the terms of Marital Trust, as set forth in Article VI(B) of the Family Trust, the net income is distributed quarterly to Spouse and the trustee may distribute principal to Spouse for her reasonable health, support, and maintenance. Upon Spouse's death, any accrued and undistributed income will be distributed to Spouse's estate and the corpus will be distributed to a residual trust described in Article VI(C) of the Family Trust. Article VI(B)(4)(C) provides that, if the trustee elects to qualify the Marital Trust for the federal estate tax marital deduction, any federal estate taxes imposed upon the surviving spouse's estate as a result of inclusion of the trust in the surviving spouse's estate will be paid from the income and principal of the Marital Trust.

Article VI(C) provides that, upon the death of the surviving spouse, the Martial Trust will be divided into two equal shares; one share for Child 1 and the other share for Child 2. The share for Child 1 will be distributed outright to Child 1. If Child 1 is not living at the death of the surviving spouse, Child 1's share will pass to the children of Child 1 who are living at that time. The share for Child 2 will be held in trust for the benefit of Child 2, with Child 2 receiving the net income and distributions of principal at the trustee's discretion for Child 2's reasonable health, support, maintenance and education. Upon Child 2's death, the share held for the benefit of Child 2 will be distributed to Child 1 or, if Child 1 is not then living, to Child 1's then living children. If Child 2 is not living at the death of the surviving spouse, the share for Child 2 lapses. If neither Child 1, Child 2, nor any children of Child 1 are living at the death of the surviving spouse, the residual trust will be divided into equal shares for Decedent's nieces and nephews living at that time.

On Decedent's United States Estate (and Generation-Skipping Transfer) Tax Return (Form 706), the Decedent's estate elected to treat the Marital Trust as qualified terminable interest property (QTIP) as provided for under § 2056(b)(7) of the Internal Revenue Code.

Spouse, and Child 1 as trustee of the Marital Trust, petitioned the appropriate local court to sever the Marital Trust into two separate trusts: Trust A and Trust B. An order was issued by the appropriate local court on Date 3 that divided the Marital Trust into Trust A and Trust B, each having terms identical to those of the Marital Trust. You have represented that all of the stock in Corporation A and Corporation B held by the Marital Trust and cash or cash equivalents will be used to fund Trust A. The remaining assets of the Marital Trust will be used to fund Trust B. The terms of Trust A and Trust B are identical to the terms and conditions of the Marital Trust. After the severance, Spouse will renounce her interest in Trust A. As a condition of the renunciation, the transferees have agreed to pay any gift tax imposed under §§ 2511 and 2519 as a result of Spouse's renunciation.

You request the following rulings:

1. The renunciation by Spouse of her interest in Trust A will not be treated as a gift by Spouse under § 2519 of any interest in Trust B.

2. The renunciation by Spouse of her interest in Trust A conditioned upon the transferees paying any gift tax attributable to the transfer, will reduce the value of the gift for gift tax purposes by the amount of the gift tax paid by the transferees.

3. The renunciation by Spouse of her interest in Trust A will not result in Spouse's interest in Trust B being valued at zero under § 2702.

Rulings #1 and #2:

Section 2501 of the Internal Revenue Code imposes a tax on the transfer of property by gift by an individual. Under § 2502(c), the gift tax imposed under § 2501 is the liability of the donor. Section 2511 provides that the tax imposed by § 2501 shall apply 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 25.2511-2(a) of the Gift Tax Regulations provides that the gift tax is a primary and personal liability of the donor, is an excise upon his 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 2512(b) provides that, where property is transferred for less than adequate and full consideration in money or money's worth, the amount by which the value of the property exceeds the value of the consideration is deemed a gift.

Section 2518(a) provides that, if a person makes a qualified disclaimer with respect to any interest in property, the estate, gift, and generation-skipping transfer tax provisions shall apply with respect to such interest as if the interest had never been transferred to such person. A "qualified disclaimer," as described in § 2518(b), is an irrevocable and unqualified refusal by a person to accept an interest in property, but only if: (1) the disclaimer is in writing; (2) the disclaimer is received by the transferor of the interest or his legal representative no later than 9 months after the date on which the transfer creating the interest in the person making the disclaimer is made, or the date on which the person making the disclaimer attains age 21; (3) the person making the disclaimer has not received the interest or any of it benefits, and (4) as a result of the disclaimer, the interest passes without any direction on the part of the person making the disclaimer to the decedent's spouse or to a person other than the person making the disclaimer. If the disclaimer is not a qualified disclaimer, for purposes of the Federal estate, gift, and generation-skipping transfer tax provisions, the disclaimer is disregarded and the disclaimant is treated as having received the interest. Thus, if the disclaimer is not a qualified disclaimer, then the disclaimant has made a gift of the value of the disclaimed interest. See §25.2518-1(b) of the Gift Tax Regulations.

Section 2519 provides that any disposition of all or a part of a qualifying income interest for life in property for which an election has been made under § 2056(b)(7) with respect to qualified terminable interest property (QTIP), is treated as the transfer of all interests in the property other than the qualifying income interest.

Section 25.2519-1(c)(1) 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 the disposition. The gift tax consequences of the disposition of the qualifying income interest are determined separately under § 25.2511-2.

Section 2207A(b) provides that if a gift tax is paid with respect to any person because of a transfer made by that person under § 2519, then that person shall be entitled to recover the gift tax attributable to the transfer from the person receiving the property. Under § 25.2207A-1(a), if an individual is treated as transferring an interest in property by reason of § 2519, the individual is entitled to recover from the "person receiving the property" the amount of gift tax attributable to that property. Under § 25.2207A-1(d), if the property is in trust at the time of the transfer, the "person receiving the property" is the trustee, and, if the property does not remain in trust, any person receiving the property prior to the expiration of the right of recovery.

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 § 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 or from the property itself.

Rev. Rul. 81-223, 1981-2 C.B. 189, holds that, in determining the amount of the gift, the value of the property transferred is reduced by the gift tax liability assumed by the donee, if the payment of the tax by the donee is a condition of the transfer. The donor's available unified credit must be used to reduce the tax liability that the donee has assumed to the extent the unified credit is available.

Although § 2502(c) provides that the gift tax imposed on a transfer 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 gift tax paid by the donees.

The law of State X, at Statute, provides that:

> On petition by a trustee or beneficiary, the court, for good cause shown, may divide a trust into two or more separate trusts, if the court determines that dividing the trust will not defeat or substantially impair the accomplishment of the trust purposes or the interests of the beneficiaries.

In the present case, after severance of the Marital Trust, the terms and dispositive provisions of Trust A and Trust B will be identical to the terms of the Marital Trust. Spouse's interest in both Trust A and Trust B will consist of the right to receive quarterly distributions of the trust's net income and discretionary distributions of principal by the trustee for Spouse's reasonable health, support, and maintenance. Upon Spouse's death, undistributed income from Trust A and Trust B will be distributed to Spouse's estate and the corpus of each trust will be distributed as provided in Article VI(C).

Spouse's proposed renunciation of her interest in Trust A will not be a qualified disclaimer under § 2518. Accordingly, Spouse's renunciation is treated as a transfer under § 2519 of the fair market value of the entire corpus of Trust A on the date of the renunciation, less the value of Spouse's qualifying income interest for life. In addition, Spouse's relinquishment of her interest in Trust A is a gift under § 2511 of the value of that interest. Because Trust A and Trust B will be separate trusts, the renunciation by Spouse of her interest in Trust A will not be treated as a gift under § 2519 of the Trust B remainder interest.

As a condition of Spouse's transfer, the parties have agreed that any gift tax imposed on the Spouse's transfer will be paid by the persons benefiting from the transfer. Consequently, under § 2512(b), the value of the gift of Spouse's interest in Trust A is measured by the fair market value of the interest minus the amount of gift tax to be paid attributable to that transfer. The amount of the gift made by the Spouse under § 2519 will be the value of the corpus of Trust A less the value of Spouse's qualifying income interest, reduced by the amount of the gift tax attributable to that interest paid by the person receiving the property under § 25.2207A-1(d).

Ruling #3:

Section 2702(a)(1) provides that, in general, solely for the purpose of 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 trust retained by the transferor or any applicable family member (as defined in § 2701(e)(2)) is zero, unless that retained interest is a qualified interest defined in § 2702(b).

Section 25.2702-2(a)(3) defines retained interest as an interest held by the same individual both before and after the transfer in trust.

Because Spouse severed the Marital Trust into two separate but identical trusts (Trust A and Trust B) under the laws of State X prior to her renunciation, Spouse's interest in Trust A was separate and distinct from her interest in Trust B. As a result of her transfer of her entire interest in Trust A, Spouse has not retained any interest in Trust A. Any interest that Spouse has in Trust B is separate and apart from any interest in Trust A that she transferred. Consequently, Spouse's interest in Trust B is not treated as a retained interest for purposes of § 2702(a)(1).

Accordingly, the renunciation by Spouse of her interest in Trust A will not result in Spouse's interest in Trust B being valued at zero under § 2702.

A copy of this letter should be attached to any gift, estate, or generation-skipping transfer tax returns that you may file relating to these matters.

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 the 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 above, no opinion is expressed or implied as to the federal tax consequences of this transaction described above under the cited provisions or any other provisions of the Code or regulations. We are specifically not commenting on whether, under applicable state law, Trust A terminates as a result of Spouse's renunciation.

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
Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure
Copy for section 6110 purposes