Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:PSI:B09
PLR-121557-06

Date:
September 28, 2006

Legend

Decedent =
Trust =

Date 1 =
Wife =

Dear Sir:

This is in response to your letter dated April 13, 2006, requesting a ruling that the Service will disregard marital deductions taken on Decedent's federal estate tax return.

Decedent created Trust, a revocable trust, on Date 1. Articles V, VI, and VII of the Trust Agreement provide for specific bequests and payments to be made from Trust at Decedent's death. Articles VIII, IX, and X provide for the disposition of the remainder of the trust. Article XI provides for the distribution of the trust after the deaths of both Decedent and Wife.

Article VIII of the Trust agreement provides that the remainder of the revocable trust shall be divided into two separate shares called the Marital Share and the Family Share.

Article IX of the Trust agreement provides that a marital deduction should be taken with respect to the Marital Share. During Wife's life, income from the Marital Share shall be paid to Wife at least quarter-annually, and distributions of principal may be made to wife under an ascertainable standard set forth in the instrument. In addition, Wife has the power to withdraw each year the greater of $5,000 or five percent of the value of the principal of the Marital Share. On Wife's death, the trustees are to pay Wife's estate the amount of federal estate and state death taxes owed by her estate with respect to the inclusion of the principal of the Marital Share in her estate. Any undistributed principal shall be distributed to the Family Share.

Article X of the Trust agreement provides that net income from the Family Share shall be paid to Wife at least quarter-annually. The trustees may also distribute principal, in their sole discretion, for Wife's health, maintenance, and support.

Article XI provides for the distribution of the Family Share to Decedent's living children in ten annual payments after the deaths of both Decedent and Wife.

Within nine months of Decedent's death, a Form 706, United States Estate (and Generation-Skipping Transfer) Tax return, was filed on behalf of Decedent's estate. On the estate tax return, the Decedent's personal representative elected qualified terminable interest property (QTIP) treatment for the entire date-of-death value of Trust.

You have asked that we disregard the marital deduction taken with respect to the value of the specific bequests made under Articles V, VI, and VII as they do not qualify for the marital deduction. In addition, you have asked that we disregard the deduction taken with respect to the Family Share portion of Trust as it was not necessary to reduce the estate tax liability to zero.

Section 2056(a) provides that the value of the 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.

Section 2056(b)(1) provides that a deduction is not allowed for terminable interests that pass to the spouse. 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)(A) provides that qualified terminable interest property 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) and is not treated as a terminable interest. Under § 2056(b)(7)(B)(i), qualified terminable interest property is property that 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 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. Such an election, once made, shall be irrevocable.

A QTIP election has transfer tax consequences for the surviving spouse. Section 2044(a) and (b) provides generally that the value of the gross estate includes the value of any property in which the decedent has a qualifying income interest for life and with respect to which a deduction was allowed for the transfer of the property to the decedent under § 2056(b)(7). Under § 2519(a) and (b), any disposition of all or part of a qualifying income interest for life in any property with respect to which a deduction was allowed under § 2056(b)(7) is treated as a transfer of all interests in the property other than the qualifying income interest. Further, the surviving spouse will, in the absence of a "reverse QTIP" election under § 2652(a)(3), be treated as the transferor of the property for generation-skipping transfer tax purposes under § 2652(a).

Under Rev. Proc. 2001-38, 2001-24 C.B. 1335, the Service will disregard certain QTIP elections made under § 2056(b)(7) and treat them as null and void for purposes of §§ 2044(a), 2056(b)(7), 2519(a), and 2652. Rev. Proc. 2001-38 applies to QTIP elections under § 2056(b)(7) where the election was not necessary to reduce the estate tax liability to zero, based on values as finally determined for federal estate tax purposes. Section 2 of the revenue procedure provides an example where the decedent's will provides for a "credit shelter trust" to be funded with an amount equal to the applicable exclusion amount under § 2010(c), with the balance of the estate passing to a marital trust intended to qualify under § 2056(b)(7). In the example, the estate makes QTIP elections with respect to both the credit shelter trust and the marital trust. The QTIP election for the credit shelter trust was not necessary, because no estate tax would have been imposed whether or not the QTIP election was made for that trust. Rev. Proc. 2001-38 does not apply in situations where a partial QTIP election was required with respect to a trust to reduce the estate tax liability and the executor made the election with respect to more trust property than was necessary to reduce the estate tax liability to zero; nor does it apply to elections that are stated in terms of a formula designed to reduce the estate tax to zero.

In this case, the specific bequests made in Articles V, VI, and VII do not qualify for the marital deduction because they are made to individuals other than the Decedent's surviving spouse. Accordingly, the marital deduction taken with respect to the value of the specific bequests is void. In addition, the QTIP election made with respect to the value of the property passing to the Family Share of Trust was not necessary to reduce the estate tax liability to zero. In this case, the estate tax would have been zero whether or not the election was made with respect to the Family Share. Accordingly, we rule that the QTIP election with respect to the value of the property passing to the Family Share is null and void for purposes of §§ 2044, 2056(b)(7), 2519, and 2652. The value of the specific bequests and the property held in the Family Share will not be includible in Wife's gross estate under § 2044. Further, Wife will not be treated as making a gift under § 2519 if Wife disposes of the income interest with respect to the Family Share. Finally, Wife will not be treated as the transferor of the specific bequests or the property in the Family Share for generation-skipping transfer tax purposes under § 2652.

Except as expressly provided herein, no opinion is expressed or implied concerning the federal tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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.

Pursuant to the Power of Attorney on filed with this office, a copy of this letter is being sent to the taxpayer's representative.

Sincerely,

Melissa C. Liquerman

Melissa C. Liquerman
Branch Chief, Branch 9
(Passthroughs & Special Industries)

Enclosure (1)