Internal Revenue Service

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Person To Contact:

Telephone Number:

Refer Reply To:
CC:PSI:B04
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Date: OCTOBER 22, 2012

RE:

Legend

Decedent
Marital Trust
Spouse
Son 1
Son 2
Son 3
State
Date 1
Date 2
Date 3
a
b
c
State Statute 1
State Statute 2
State Statute 3
State Statute 4
Co-trustee

Dear :

This letter responds to your authorized representative's letter dated April 24, 2012, requesting gift and estate tax rulings with respect to the proposed division of a marital trust and the proposed renunciation by Spouse of her interest in one of the divided marital trusts.

The facts and representations submitted are summarized as follows:

Decedent executed a will on Date 1. The will established Marital Trust which provided an income interest to Decedent's wife, Spouse, and remainder interest to Decedent's and Spouse's sons, Son 1, Son 2, and Son 3.

Decedent died on Date 2. Decedent's executors elected to treat Marital Trust as qualified terminable interest property (QTIP) under § 2056(b)(7) of the Internal Revenue Code. The current trustees of Marital Trust are Spouse and Co-trustee.

Under the terms of Article 7 of the will, Spouse is entitled to receive annually all of the net income of Marital Trust during her lifetime and discretionary distributions of principal to (1) support Spouse in the standard of living to which she was accustomed at the time of Decedent's death and (2) pay for Spouse's medical, dental, hospital, nursing expenses, and expenses of invalidism.

Article 7 also provides that upon Spouse's death, the accumulated net income of Marital Trust will be distributed to Spouse's estate. Under the terms of Article 8 of the will, the principal balance of Marital Trust remaining at Spouse's death will be distributed, in equal shares, to three separate trusts, one trust to benefit Son 1, one trust to benefit Son 2, and one trust to benefit Son 3. Each trust provides that the beneficiary will receive income and discretionary distributions of principal as necessary for the beneficiary's maintenance, welfare, and education to sustain his standard of living similar to which he was accustomed at the time of Decedent's death. One-half of the balance of each trust will be distributed to the beneficiary when the beneficiary reaches the age of a and the balance will be distributed at the age of b. Currently, Son 1 and Son 2 are over the age of b, and Son 3 is between the age of a and b.

The assets of Marital Trust are invested primarily in marketable securities. Due to past differences of opinion as to investment advisory and trustee fees, Spouse, Decedent's sons, and former co-trustees engaged in mediation and entered into a settlement agreement under which Co-Trustee was appointed as a co-trustee with Spouse. Spouse and Decedent's sons continued to have different opinions about the proper investment and management of the trust assets and have executed a Trust Settlement Agreement, dated Date 3 (Date 3 Agreement). Pursuant to the Date 3 Agreement, (i) Marital Trust will be divided into two trusts, Trust 1 and Trust 2. Trust 1 will consist of c percent of the assets of Marital Trust, and Trust 2 will consist of the balance of assets in Marital Trust; (ii) Spouse agrees to renounce her entire interest in Trust 1, so that the assets of Trust 1 would become immediately distributable in the following proportions: one-third to Son 1, one-third to Son 2, one-sixth to Son 3, and one-sixth to a trust for the benefit of Son 3; (iii) the terms of Trust 2 will be modified to grant Spouse a testamentary limited power of appointment to appoint the assets of Trust 2 among a class consisting of Decedent's and Spouse's lineal descendants and charitable organizations, and, in default of such appointment, the principal of the trust assets is to be added to the trusts created for the respective beneficiaries and distributed as provided in Article 8; (iv) Co-Trustee agrees to resign; and (v) Son 1, Son 2, Son 3, and the trustees of the trust for the benefit of Son 3 agree to pay any and all gift taxes incurred by Spouse in connection with Spouse's renunciation of her interest in Trust 1, or to reimburse Spouse for the payment of such gift taxes. The Date 3 Agreement and the parties' rights and obligations under the agreement are contingent upon receipt by the trustees of Marital Trust of a favorable private letter ruling from the Internal Revenue Service.

State Statute 1 provides that after notice to all qualified beneficiaries, a trustee may combine two or more trusts into a single trust or divide a trust into two or more separate trusts, if the result does not materially impair rights of any beneficiary or adversely affect achievement of the purposes of the trust.

State Statute 2 provides that on distribution of trust property or the division or termination of a trust, a trustee may make distributions in divided or undivided interests, allocate particular assets in proportionate or disproportionate shares, value the trust property for those purposes and adjust for resulting differences in valuation.

State Statute 3 provides, in relevant part, that a person may disclaim, in whole or part, any interest in property or any power over property, including a power of appointment. The disclaimer must: (a) be in writing or otherwise recorded by inscription on a tangible medium or by storage in an electronic or other medium in a manner that allows the disclaimer to be retrieved in perceivable form; (b) declare that the person disclaims the interest in the property or in the power; (c) describe the interest in property or power over property that is disclaimed; (d) be signed by the person making the disclaimer; and (e) be delivered or filed in the manner provided by statute.

State Statute 4 provides, in relevant part, that if the disclaimant is an individual, the disclaimed interest passes as if the disclaimant had died immediately before the time of distribution.

You have requested the following rulings:

1. The division of Marital Trust into Trust 1 and Trust 2 will not disqualify Marital Trust, Trust 1 or Trust 2 as QTIP trusts.

2. The renunciation by Spouse of her entire interest in Trust 1 will result in a gift by Spouse of her income interest in Trust 1 under § 2511, and a gift of the entire fair market value of the assets in Trust 1, as determined on the date of

the disposition, less the value of the qualifying income interest in the assets in Trust 1 under § 2519.

3. After the division of Marital Trust into Trust 1 and Trust 2, Spouse's renunciation of her interest in Trust 1 will not cause Trust 2 to fail to be qualified as a QTIP trust.

4. If Spouse renounces her entire interest in the property in Trust 1, Spouse will not be deemed to have made a gift of the property in Trust 2 under § 2519.

5. If Spouse renounces her entire interest in the property in Trust 1, the value of Spouse's interest in Trust 2 will not be valued at zero under § 2702.

6. If Spouse renounces her entire interest in the property in Trust 1, and such renunciation is conditioned on Decedent's sons (or the trust for the benefit of Son 3) paying all gift taxes attributable to the transfer, the amount of the gift will be reduced by the gift taxes paid.

7. Upon the distribution of assets from Trust 1 to Decedent's sons (and the trust for the benefit of Son 3), the recipient will receive a carryover basis for income tax purposes in the assets received, and the carryover basis will be increased (but not above the fair market value of the property at the time of the gift) by the amount of gift tax paid by the respective recipient.

Rulings 1 and 3

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.

Under § 2056(b)(1), a marital deduction is not allowable for an interest in property passing to the surviving spouse that is a "terminable interest." An interest passing to the surviving spouse is a terminable interest if it 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 the terminable interest rule in the case of qualified terminable interest property (QTIP). Under § 2056(b)(7), qualified terminable interest property 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 2056(b)(7)(B)(ii) provides that the surviving spouse has a qualifying income interest for life if (I) the surviving spouse is entitled to all the income from the property, payable annually or at more frequent intervals and (II) no person has a power to appoint any part of the property to any person other than the surviving spouse.

In this case, after the division of Marital Trust into Trust 1 and Trust 2, Spouse will continue to be entitled to all the income from the property, payable annually or at more frequent intervals in Trust 1 and Trust 2. Further, no person, other than Spouse, will have a power to appoint any part of the property in Trust 2 to any person other than the surviving spouse. Accordingly, Spouse will continue to have a qualifying income interest in Trust 1 and Trust 2. Further, after the division of Marital Trust into Trust 1 and Trust 2 and Spouse's renunciation of her interest in Trust 1, Spouse will continue to have a qualifying income interest in Trust 2. Based upon the facts and representations made, we conclude that the division of Marital Trust into Trust 1 and Trust 2 will not disqualify Marital Trust, Trust 1, or Trust 2 as QTIP Trusts and that Spouse's renunciation of her interest in Trust 1 will not cause Trust 2 to fail to be qualified as a QTIP trust.

Rulings 2, 4 and 6

Section 2501 imposes a tax on the transfer of property by gift. Section 2511 provides that the gift 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 an adequate and full consideration in money or money's worth, the amount of the gift is the amount by which the value of the property transferred exceeds the value of the consideration received in exchange.

Section 2519 provides that for gift tax purposes any disposition by the surviving spouse of all or part of a qualifying income interest for life in any property for which a deduction was allowed under § 2056(b)(7) is treated as a transfer by the surviving spouse of all interests in the property other than the qualifying income interest. The transfer of the qualifying income interest is a transfer subject to gift tax under § 2511.

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 qualified terminable interest 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 25.2519-1(c)(4) provides that the amount treated as a transfer under § 25.2519-1(c)(1) is further reduced by the amount of gift tax the donee spouse is entitled to recover under § 2207A(b). If the donee spouse is entitled to recover gift tax under § 2207A(b), the amount of the gift tax recoverable and the value of the remainder interest treated as transferred under § 2519 are determined by using the same interrelated computation applicable for other transfers in which the transferee assumes the gift tax liability. The gift tax consequences of failing to exercise the right of recovery are determined separately under § 25.2207A-1(b).

Under §§ 2207A(b) and 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" (as defined in § 25.2207A-1(e)) the amount of gift tax attributable to that property. Under § 25.2207A-1(e), if the property is in trust at the time of the transfer, the "person receiving the property" is the trustee, and any person who has received a distribution of the property prior to the expiration of the right of recovery if the property does not remain in trust. Under § 25.2207A-1(b), the failure of a person to exercise a right of recovery provided by § 2207A(b) is treated as a transfer for federal gift tax purposes of the unrecovered amounts to the persons from whom the recovery could have been obtained.

Rev. Rul. 75-72, 1975-1 C.B. 310, holds that if, at the time of the transfer, a 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 the fair market value of the property passing from the donor less 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 tax liability that is to be subtracted from the value of the transferred property, the donor's available unified credit must be used to reduce the gift tax liability that the donee has assumed to the extent unified credit is available.

In this case, Spouse will renounce her entire interest in Trust 1 and Spouse will retain her income interest in Trust 2. The Date 3 Agreement provides that Son 1, Son 2, Son 3, and the trustees of Son 3’s trust agree to pay any and all gift taxes incurred by Spouse in connection with Spouse’s renunciation of her interest in Trust 1, or to reimburse Spouse for the payment of such gift taxes. Based upon the facts and representations made, we conclude that Spouse’s renunciation of her entire interest in Trust 1 will result in a gift by Spouse of her income interest in Trust 1 under § 2511, and a gift by Spouse of the entire fair market value of the assets in Trust 1, as determined on the date of the disposition, less the value of the qualifying income interest under § 2519 and § 25.2519-1(c)(1). Further, we conclude that if Spouse renounces her entire interest in the property of Trust 1, Spouse will not be deemed to have made a gift of the property in Trust 2 under § 2519. We also conclude that if Spouse renounces her entire interest in Trust 1 and such renunciation is conditioned upon Son 1, Son 2, Son 3, and the trustees of Son 3’s trust paying all gift taxes attributable to the transfer, under § 25.2519-1(c)(4), the amount of the gift by Spouse will be reduced by the gift taxes paid.

Ruling 5

Section 2702(a)(1) provides that 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)) shall be determined as provided in § 2702(a)(2).

Section 2702(a)(2) provides that the value of any retained interest which is not a qualified interest (as defined in § 2702(b)) shall be treated as being zero and the value of any retained interest that is a qualified interest (as defined in § 2702(b)) shall be determined under § 7520. Under § 25.2702-2(a)(3), the term "retained" means held by the same individual both before and after the transfer in trust.

In this case, Marital Trust will be divided into two separate trusts, Trust 1 and Trust 2. We have concluded in Ruling 4 that Spouse’s renunciation of her entire interest in Trust 1 will not result in a transfer under § 2519 with respect to any interest in Trust 2. Accordingly, Spouse will not be treated as making a deemed gift under § 2519 with respect to Trust 2. Accordingly, § 2702 does not apply with the division of Marital Trust and the renunciation by Spouse of her entire income interest in Trust 1. Based upon the facts and representations made, we conclude that the value of Spouse’s interest in Trust 2 will not be valued at zero under § 2702.

Ruling 7

Section 1015(a) provides that with respect to property acquired by gift after December 31, 1920, the basis shall be the same as it would be in the hands of the donor or the last preceding owner by whom it was not acquired by gift, except that if such basis (adjusted for the period before the date of the gift as provided in § 1016) is greater than the fair market value of the property at the time of the gift, then for the purpose of determining loss the basis shall be such fair market value. If the facts necessary to determine the basis in the hands of the donor or the last preceding owner are unknown to the donee, the Secretary shall, if possible, obtain such facts from such donor or last preceding owner, or any other person cognizant thereof. If the Secretary finds it impossible to obtain such facts, the basis in the hands of the donor or last preceding owner shall be the fair market value of the property as found by the Secretary as of the date or approximate date at which, according to the best information that the Secretary is able to obtain, the property was acquired by the donor or last preceding owner.

Section 1015(b) provides that if property is acquired by a transfer in trust (other than a transfer in trust by a gift, bequest, or devise), the basis shall be the same as it would be in the hands of the grantor increased in the amount of gain or decreased in the amount of loss recognized to the grantor on such transfer.

Section 1015(d) provides that with respect to property acquired by gift after September 2, 1958, the basis shall be the basis determined under subsection (a), increased (but not above the fair market value of the property at the time of the gift) by the amount of gift tax paid with respect to the gift.

Section 1.1015-4(a) provides that where a transfer of property is in part a sale and in part a gift, the unadjusted basis of the property in the hands of the transferee is the sum of (1) whichever of the following is the greater: (i) the amount paid by the transferee for the property, or (ii) the transferor's adjusted basis for the property at the time of the transfer, and (2) the amount of increase, if any, in basis authorized by § 1015(d) for gift tax paid.

In this case, Spouse is considered to be making a gift to Son 1, Son 2, Son 3, and the trust for the benefit of Son 3 of her income interest in Trust 1 under § 2511 and a gift of the entire fair market value of the assets in Trust 1, less the value of the qualifying income interest under § 2519. Accordingly, based upon the facts submitted and representations made, we conclude that upon the distribution of assets from Trust 1 to Decedent’s sons (and the trust for the benefit of Son 3), the recipient will receive a carryover basis for income tax purposes in the assets received, and the carryover basis will be increased (but not above the fair market value of the property at the time of the gift) by the amount of gift tax paid by the respective recipient.

In accordance with the Power of Attorney on file with this office, we have sent a copy of this letter to your authorized representatives.

Except as expressly provided herein, we neither express nor imply any opinion concerning the 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.

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.

Sincerely,

Lorraine E. Gardner
Senior Counsel, Branch 4
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures
Copy for § 6110 purposes
Copy of this letter