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Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:9 PLR-139618-01
Date:
March 5, 2002

In Re:

LEGEND:

Court =

Date 1 =
Decedent =
Marital Trust =

Spouse =
State =
Statute A =
Statute B =
Trust =
Trustees =

X =

Dear :

This is in response to your July 16, 2001 letter, and subsequent correspondence, requesting a ruling concerning the federal gift tax treatment of the proposed severance of a trust into two trusts and Spouse's subsequent renunciation of her interest in one of the severed trusts.

The facts submitted and the representations made are summarized as follows. Decedent died testate, a resident of State. Except for certain pecuniary bequests, Decedent's Will and Codicil bequeathed and devised the bulk of Decedent's estate to a revocable trust (Trust) established by Decedent during his lifetime.

Article Second, Paragraph A of Trust provides that, upon Decedent's death, a marital trust (Marital Trust) shall be formed and funded with that portion of the trust's property that, when added to all property passing to Spouse otherwise than under Article Second, Paragraph A of Trust or that has passed to Spouse prior to Decedent's death, but that is determined to be included in Decedent's gross estate for federal estate tax purposes and that qualifies for the marital deduction, will reduce the federal estate tax due on Decedent's estate to the lowest possible amount, after taking advantage of all permissible credits and deductions. Article Second, Paragraph B of Trust provides that the balance of the trust's property is to constitute the principal of the residuary trust.

Article Second, Paragraphs A(1) and (3) of Trust provide that the net income of Marital Trust is to be distributed in quarterly or more frequent installments to Spouse. Trustees may distribute principal to Spouse for her maintenance, health, and support, taking into consideration her station in life and standard of living. Upon Spouse's death, any accrued and undistributed income will be paid to Spouse's estate and the then-remaining principal will be added to and distributed as though it had originally constituted the principal of the residuary trust set forth in Article Second, Paragraph B of Trust. Any increase in federal estate taxes and administration expenses imposed upon Spouse's estate resulting from the inclusion of Marital Trust's then-remaining principal in Spouse's estate will be paid from the then-remaining principal of Marital Trust.

Article Second, Paragraph B of Trust provides that the residuary trust's principal is to be divided into equal shares among Decedent's children who are then living and who are then deceased but who have then living issue and held in further trust. Article Second, Paragraph B(1) of Trust provides that each child is to receive the net income of the child's trust monthly and that the trustee may distribute trust principal to the child for the child's maintenance, education, comfort, and happiness, taking into consideration the child's station in life and standard of living. In addition, the trustee may distribute principal directly for the education or medical expenses of the child's children. It has been represented that all of Decedent's children are alive.

Article Second, Paragraph B(3) of Trust provides that upon each child's death the then-remaining principal of that child's trust shall be paid: (i) to or in trust for such persons including, but not limited to, such child's estate in such amounts or proportions as such child may appoint by will containing a specific reference to this power of appointment, regardless of when such will was executed, or in default of such appointment or insofar as it is not effectual; (ii) to the child's then-living issue, per stirpes, or in default of such issue, (iii) to Decedent's then-living issue, per stirpes. In the event principal is to be paid to a child for whom a trust (established under Article Second, Paragraph B of Trust) currently exists, that principal shall be added to that child's trust.

Article Sixth of Trust provides that no interest in income or principal shall be assignable by a beneficiary or available to anyone having a claim against a beneficiary, before actual distribution to the beneficiary.

Article Tenth, Paragraph H, of Trust provides the trustees with the authority to distribute assets in cash or in kind or partly each, and to make non pro-rata distributions. All distributions are to be valued as of the time of distribution.

Decedent died on Date 1. On the United States Estate (and Generation-Skipping Transfer) Tax Return, Form 706, for Decedent's estate, an election was made to treat Marital Trust as qualified terminable interest property (QTIP) pursuant to section 2056(b)(7)(B)(v) of the Internal Revenue Code. It has been represented that Marital Trust's current assets consist of cash and marketable securities.

Spouse and Trustees of Marital Trust have proposed the following transaction. Trustees will petition Court for an Order approving the severance of Marital Trust into two trusts (Marital Trust A and Marital Trust B), the funding of Marital Trusts A and B, and Spouse's subsequent renunciation of her entire interest in Marital Trust B. State law requires and it has been represented that Marital Trust A and B will have identical terms to Marital Trust and Marital Trust A and B will be treated as separate trusts for all purposes, from the effective date of the severance. The effective date of the severance will be the date Court enters the Order approving the severance and renunciation. Trustees will be the trustees of Marital Trusts A and B.

Marital Trusts A and B will be funded as follows. Marital Trust B will be funded with a fractional share of Marital Trust's assets sufficient to make gross gifts in the total amount of X to the trusts previously established for Decedent's children under Article Second, Paragraph B of Trust and pay all of the gift taxes attributable to those gifts. Marital Trust A will be funded with the balance of Marital Trust's assets. The funding of Marital Trusts A and B may or may not be made on a pro-rata basis.

After Marital Trust is severed and Marital Trusts A and B are funded, Spouse will renounce her entire interest in Marital Trust B. It has been represented that under State law, upon Spouse's renunciation, Marital Trust B will terminate and accelerate. Upon termination and acceleration, pursuant to the terms of Article Second, Paragraph B, Marital Trust B's property will be divided into trusts for Decedent's children. Decedent's children have agreed to pay all of the gift taxes attributable to Spouse's renunciation of her qualified income interest in Marital Trust B. Spouse will exercise her right to recover gift taxes paid that are attributable to Marital Trust B's property deemed transferred by section 2519 from Trustees, as the trustees of Marital Trust B, pursuant to section 2207A(b).

The following rulings have been requested:

1. The proposed severance of Marital Trust into two new trusts (Marital Trusts A and B) as permitted by State law, the funding of such trusts, even on a non-pro-

rata basis, and the subsequent renunciation by Spouse of her entire interest therein, will have no effect on the status of Marital Trusts A and B as QTIP trusts.

2. When Spouse renounces her qualified income interest in Marital Trust B, pursuant to section 2519, she will be deemed to have made a transfer of all of Marital Trust B's property, other than her qualifying income interest therein. Although Spouse will be personally liable for all gift tax attributable to the transferred property, if she exercises her right to recover the gift taxes paid that are attributable to the transferred property pursuant to section 2207A(b), she will have made a net gift. The amount of the net gift will be the transferred property's fair market value on the date of disposition, reduced by the gift taxes actually paid by Trustees, as the trustees of Marital Trust B, from the corpus of that trust.

3. If Spouse renounces her qualifying income interest in Marital Trust B, and such renunciation is conditioned upon the agreement of Decedent's children to pay all gift taxes attributable to the transfer of the income interest, Spouse will have made a net gift. The amount of the net gift will be the qualified income interest's fair market value on the date of disposition, minus the gift taxes actually paid by Decedent's children.

4. If Spouse renounces her entire interest in Marital Trust B, no part of the trust's property deemed transferred by section 2519 will be included in Spouse's gross estate pursuant to section 2044(b)(2).

5. If Spouse renounces her entire interest in Marital Trust B, such renunciation will not result in a transfer under section 2519 of any of the assets of Marital Trust A.

6. If Spouse renounces her entire interest in Marital Trust B, Spouse's interest in Marital Trust A will not be valued at zero pursuant to section 2702.

LAW:

Section 2044(a) provides that the value of the gross estate shall include the value of any property in which the decedent had a qualifying income interest for life. Section 2044(b) provides that section 2044(a) applies to any property if a deduction was allowed with respect to the transfer of such property to the decedent under section 2056(b)(7) and section 2519 did not apply with respect to a disposition by the decedent of part or all of such property.

Section 2056(b)(7) allows an estate tax marital deduction for qualified terminable interest property (QTIP). Under section 2056(b)(7)(B)(i), the term "qualified terminable interest property" means property that passes from the decedent, in which the surviving spouse has a qualifying income interest for life, and to which the QTIP election under section 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 the surviving spouse is entitled to all the income from the property, payable annually or at more frequent intervals, and no

person has a power to appoint any part of the property to any person other than the surviving spouse during the surviving spouse's life.

Section 2207A(b) provides that, if for any calendar year tax is paid under chapter 12 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 the total tax for such year under chapter 12 exceeds the total tax that 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(a) of the Gift Tax Regulations, if an individual is treated as transferring an interest in property by reason of section 2519, the individual is entitled to recover from the "person receiving the property" the amount of gift tax attributable to that property. The value of property to which section 25.2207A-1(a) applies is the value of all interests in the property other than the qualifying income interest. There is no right of recovery from any person for the property received by that person for which a deduction was allowed from the total amount of gifts, if no federal gift tax is attributable to the property. The right of recovery arises at the time the federal gift tax is actually paid by the transferor subject to section 2519.

Section 25.2207A-1(c) provides that the amount of federal gift tax attributable to all properties includible in the total amount of gifts under section 2519 made during the calendar year is the amount by which the total federal gift tax for the calendar year (including penalties and interest attributable to the tax) under chapter 12 of the Code that has been paid, exceeds the total federal gift tax for the calendar year (including penalties and interest attributable to the tax) under chapter 12 of the Code that would have been paid if the value of the properties includible in the total amount of gifts by reason of section 2519 had not been included.

Section 25.2207A-1(d) provides that a person's right of recovery with respect to a particular property is an amount equal to the amount determined in section 25.2207A-1(c) multiplied by a fraction. The numerator of the fraction is the value of the particular property included in the total amount of gifts made during the calendar year by reason of section 2519, less any deduction allowed with respect to the property. The denominator of the fraction is the total value of all properties included in the total amount of gifts made during the calendar year by reason of section 2519, less any deductions allowed with respect to those properties.

Section 25.2207A-1(e), provides that, 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.

Section 2501 imposes a tax on the transfer of property by gift by an individual. Under section 2502(c), the gift tax imposed under section 2501 is the liability of the donor. Section 2511 provides that the tax imposed by section 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) 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, and shall be included in computing the amount of gifts made during the calendar year.

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. Under section 2518(b) the term "qualified disclaimer" means 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, his legal representative, or the holder of the legal title to the property to which the interest relates no later than 9 months after the latter of 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 accepted the interest or any of its benefits; and (4) as a result of such refusal, 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.

Section 2519(a) provides that any disposition of all or part of a qualifying income interest for life in any property to which section 2519 applies is treated as a transfer of all interests in the property other than the qualifying income interest. Section 2519(b) provides that section 2519 applies to any property if a deduction was allowed with respect to the transfer of such property to the donor under section 2056(b)(7). Section 25.2519-1(a) provides that if a donee spouse makes a disposition of all or part of a qualifying income interest for life in any property for which a deduction was allowed under sections 2056(b)(7), the donee spouse is treated for purposes of chapters 11 and 12 of the Code as transferring all interests in property other than the qualifying income interest. If donee spouse makes a disposition of part of a qualifying income interest for life in trust corpus, the spouse is treated under section 2519 as making a transfer subject to chapters 11 and 12 of the entire trust other than the qualifying income interest for life. Therefore, the donee spouse is treated as making a gift under section 2519 of the entire trust less the qualifying income interest including that portion of the trust corpus from which the retained income interest is payable. A transfer of all or a portion of the income interest of the spouse is a transfer by the spouse under section 2511.

Section 25.2519-1(c)(1) provides that the amount treated as a transfer under section

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 section 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 section 25.2511-2.

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 section 2701(e)(2)) shall be determined as provided in section 2702(a)(2). Section 2702(a)(2) provides that the value of any retained interest which is not a qualified interest (as defined in section 2702(b)) shall be treated as being zero and the value of any retained interest that is a qualified interest (as defined in section 2702(b)) shall be determined under section 7520. Under section 25.2702-2(a)(3), the term "retained" means held by the same individual both before and after the transfer in trust.

Rev. Rul. 75-72, 1975-1 C.B. 310 holds that gift tax actually paid by the donee may be deducted from the value of transferred property where it is expressly shown or implied that payment of the tax by the donee or from the property itself is a condition of the transfer. Under section 2512 the value of a gift of property if the fair market value of the property for gift tax purposes. If a donor transfers by gift less than his entire interest in property, the gift tax is applicable to the interest transferred. Section 25.2511-1(e). The donor is primarily liable for the payment of the tax. Section 2502(d). Thus, if at the time of the transfer, the gift is made subject to a condition that the gift tax be paid by the donee or out of the transferred property, the donor receives consideration for the transfer in the amount of gift tax to be paid by the donee. Under these circumstances, the value of the gift is measured by the fair market value of the property or property right or interest passing from the donor, minus the amount of the gift tax actually paid by the donee.

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

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

> (2) Unless otherwise provided in the trust instrument, a trustee has the power:
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> . . . .
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> (b)(b) To sever any trust on a fractional basis into two or more separate

> and identical trusts for any reason or to segregate by allocation to a separate account or trust a specific amount from, a portion of, or specific assets included in, the trust property of any trust, unless expressly provided to the contrary in the trust instrument. Income earned on a segregated amount, portion, or specific asset after the segregation is effective passes with the amount, portion, or asset segregated. Each separate trust must be held and administered upon the identical terms and conditions of the trust from which it was severed. Subject to the terms of the trust, the trustee may take into consideration differences in federal tax attributes and other pertinent factors in administering the trust property of any separate account or trust, in making applicable tax elections, and in making distributions. A separate trust created by severance must be treated as a separate trust for all purposes from the date on which the severance is effective. The effective date of the severance may be retroactive to a date before the date on which the trustee exercises such power.

The law of State, at Statute B, provides, in pertinent part, that:

> (a) Unless expressly provided to the contrary in the trust instrument, the court may permit a trustee:
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> . . . .
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> 2. To sever any trust on a fractional basis into two or more separate trusts for any reason, and to segregate by allocation to a separate account or trust a specific amount from, a portion of, or a specific asset included in the trust property of any trust to reflect a disclaimer, to reflect or result in differences in federal tax attributes, to satisfy any federal tax requirement, to made federal tax elections, to reduce potential generation-skipping transfer tax liability, or for any other tax planning purposes or other reasons.
>
> a. A separate trust created by severance must be treated as a separate trust for all purposes from the effective date on which the severance is effective. The effective date of the severance may be retroactive to a date before the date on which the court approves the severance.
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> . . . .
>
> (b) A trust created by consolidation or severance under this section must be held on terms and conditions identical to those before the consolidation or severance, or upon such terms or conditions that the aggregate interest of each beneficiary after the consolidation or severance will be reasonably equivalent to that beneficiary's aggregate interests before the consolidation or severance. . . .

> (c) The terms of any trust before consolidation or a severance under paragraph (a) which permit qualification of that trust for an applicable federal tax deduction, exclusion, election, exemption, or other special federal tax status must remain identical in the consolidated trust or in each of the separate trusts created by severance.

RULING 1:

In this case, State law and the representations made herein, require the terms of Marital Trusts A and B to be identical to the terms of Marital Trust. Specifically, State law at Statute B, section (c) provides that the terms of any trust before a severance which permit qualification of that trust for a federal tax deduction, exclusion, election, exemption, or other special federal tax status must remain identical in each of the separate trusts created by the severance. Furthermore, Marital Trust satisfies the requirements for the marital deduction under section 2056(b)(7) and Decedent's estate made the election under section 2056(b)(7)(B)(v). Marital Trust will be severed into Marital Trusts A and B and the terms of each of these trusts will be the same as Marital Trust. Under these circumstances Marital Trusts A and B will be treated as qualified terminable interest property under section 2056(b)(7)(i).

The proposed severance of Marital Trust into two new trusts (Marital Trusts A and B) as permitted by State law, the proposed funding of such trusts (on a pro-rata or non pro-rata basis) as permitted by State law and the terms of Trust, and Spouse's proposed renunciation of her entire interest in Marital Trust B will have no effect on the status of Marital Trusts A and B as qualified terminable interest property trusts.

RULING 2:

Spouse's proposed renunciation of her entire interest in Marital Trust B will not be a qualified disclaimer under section 2518. Therefore, Spouse's renunciation of her entire interest in Marital Trust B will be a gift under section 2519. The value of Spouse's gift will be equal to the fair market value of Marital Trust B's property, determined on the date of the disposition (including any accumulated income and not reduced by any amount excluded from total gifts under section 2503(b) with respect to the transfer creating the interest), less the value of Spouse's qualifying income interest in Marital Trust B on the date of the disposition.

If Spouse exercises her right of recovery under section 2207A(b), Spouse's deemed gift of Marital Trust B's property under section 2519, will be treated as a net gift. Section 2207A(b) statutorily shifts the burden, but not the liability, for paying the gift tax due as a result of the operation of section 2519 to the donee. In reimbursing the donor for the gift tax the donor has paid as a result of the operation of section 2519, 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.

Accordingly, the value of Spouse's net gift will be equal to the fair market value of Marital Trust B's property, determined on the date of the disposition (including any accumulated income and not reduced by any amount excluded from total gifts under section 2503(b) with respect to the transfer creating the interest), less the value of Spouse's qualifying income interest in Marital Trust B on the date of the disposition, minus the amount of gift taxes actually paid by Trustees, as the trustees of Marital Trust B, from the transferred property, calculated pursuant to the terms of sections 25.2207A-1(c) and (d) and Rev. Rul. 81-223.

RULING 3:

Spouse's proposed renunciation of her qualified income interest in Marital Trust B will be a gift of the value of that interest under section 2511. If Decedent's children agree to pay any gift taxes attributable to that gift, Spouse's gift of her income interest will be a net gift. Under section 2512(b), the value of Spouse's gift will be measured by the fair market value of her income interest on the date of disposition, minus the amount of gift tax actually paid by Decedent's children attributable to that transfer, calculated pursuant to Rev. Rul. 81-223.

RULING 4:

When Spouse renounces her qualified income interest in Marital Trust B, she will be deemed to have made a transfer of all of the property of Marital Trust B, other than her qualifying income interest, under section 2519. Section 2044(a) provides that the value of Spouse's gross estate shall include the value of any property in which Spouse had a qualifying income interest for life. Section 2044(b)(2) provides that section 2044(a) does not apply to any property if section 2519 applies to the disposition of part or all of that property prior to Spouse's death. Therefore, pursuant to section 2044(b)(2), the property Spouse is deemed to have gifted under section 2519 will not be included in Spouse's gross estate.

RULING 5:

Pursuant to State law and the representations made herein, Marital Trusts A and B will be separate trusts for all purposes from the effective date of Court's Order. Therefore, Spouse's renunciation of her entire interest in Marital Trust B will not result in a transfer under section 2519 of any of the assets of Marital Trust A.

RULING 6:

Pursuant to State law and the representations made herein, Marital Trusts A and B will be separate trusts for all purposes from the effective date of Court's Order. As a result, Spouse's interest in Marital Trust A will be separate and distinct from her interest in Marital Trust B. Therefore, when Spouse renounces her entire interest in Marital Trust B, Spouse's interest in Marital Trust A is not treated as a retained interest for purposes of section 2702(a)(1). Accordingly, Spouse's renunciation of her entire interest in

Marital Trust B will not result in Spouse's interest in Marital Trust A being valued at zero under section 2702.

The rulings contained in this letter are based upon information and representations submitted by Spouse and Trustees 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.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, we are not opining on whether Spouse's renunciation is a disclaimer. This ruling is directed only to Spouse and Trustees, the taxpayers requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

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. In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely yours,
By: James F. Hogan
Senior Technician Reviewer, Branch 9
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures: Copy of this letter for section 6110