Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Number: **200324023**
Release Date: 6/13/2003
Index Numbers: 664.00-00; 2056.00-00; 2044.00-00; 2519.00-00

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:B09-PLR-129527-02
Date:
February 26, 2003

Re: Private Letter Ruling Request

LEGEND

Decedent =

State =

Date 1 =

Taxpayer =

Child =

Separate Property QTIP =

Charitable Remainder Unitrust =

$x =

Charity 1 =

Charity 2 =

Charity 3 =

Agreement =

$y =

Dear :

This is in response to your representative's letter dated May 2, 2002, and other communications requesting rulings on the gift and estate tax consequences of a proposed transaction.

The facts and representations submitted are summarized as follows: Decedent, a resident of State, died testate on Date 1, survived by Taxpayer and Child.

Decedent's last will and testament provides for the residue of his estate to be divided between a marital deduction trust for his community property and a marital deduction trust for his separate property. The subject of this ruling is the marital deduction trust for his separate property (Separate Property QTIP). Article V of Decedent's last will and testament provides the terms for Separate Property QTIP.

Article V, Paragraph A(1) directs the trustee to pay all of the net income of Separate Property QTIP to Taxpayer during her lifetime at least annually.

Article V, Paragraph A(2) provides that if the net income of Separate Property QTIP is not adequate for Taxpayer's maintenance, support, health or education, the trustee is authorized to distribute such portions of the principal of the trust as, in the discretion of the trustee, are reasonable for such purposes.

Article V, Paragraph A(5) expresses Decedent's intention that Decedent's personal representative elect to have the assets passing to Separate Property QTIP qualify for the marital deduction under § 2056(b)(7) of the Internal Revenue Code.

Article V, Paragraph B provides that upon Taxpayer's death, the trustee shall establish Charitable Remainder Unitrust within the meaning of § 664(d)(2) and fund Charitable Remainder Unitrust with the remaining trust estate of Separate Property QTIP.

Article V, Paragraph B(1) provides, in part, that in each taxable year of Charitable Remainder Unitrust, the trustee shall pay to Child for such time as she survives, a unitrust amount equal to five percent (5%) of the net fair market value of the assets of the trust valued as of the first day of each taxable year of the trust. The unitrust amount shall be paid in equal quarterly amounts from income and, to the extent that income is not sufficient, from principal. Any income of the trust for a taxable year in excess of the unitrust amount shall be added to principal.

Article V, Paragraph B(4) provides, in part, that upon the death of Child, the trustee shall distribute all of the then principal and income of the trust (other than any amount due to Child or her estate) as follows: $x to Charity 1, $x to Charity 2, and the balance to Charity 3.

On Decedent's United States Estate (and Generation-Skipping Transfer) Tax Return (Form 706), the personal representative of Decedent's estate elected to treat Separate Property QTIP as qualified terminable interest property ("QTIP") under § 2056(b)(7).

Taxpayer, Child, Charity 1, Charity 2, Charity 3, the trustees of Separate Property QTIP and the individual who will serve as trustee of Charitable Remainder Unitrust propose to enter into Agreement pursuant to State law. Under the terms of Agreement, Separate Property QTIP will be divided into two separate trusts with provisions identical to those governing Separate Property QTIP. One trust ("Trust 1") will hold an amount of property which, if contributed to Charitable Remainder Unitrust, would cause the income interest in Charitable Remainder Unitrust to have a value of $y. The second trust ("Trust 2") will hold the remaining property of Separate Property QTIP. Following the severance Separate Property QTIP and the funding of Trust 1, Taxpayer will renounce her income interest in Trust 1. As a consequence of Taxpayer's renunciation, the assets in Trust 1 will pass to Charitable Remainder Unitrust to be held and administered in accordance with the provisions of Article V, Paragraph B of Decedent's last will and testament.

Taxpayer represents that Charitable Remainder Unitrust will satisfy the requirements of § 664(d). In addition, Taxpayer represents that she will seek reimbursement under § 2207A(b) for any gift tax paid by her or on her behalf as a result of the proposed transaction.

Taxpayer now requests the following rulings:

1. The QTIP election made on Decedent's federal estate tax return for Separate Property QTIP will be valid with regard to Trust 1 and Trust 2, and Trust 1 and Trust 2 will qualify as qualified terminable interest property trusts.

2. Taxpayer will be treated as making a gift of her qualifying income interest in Trust 1 under § 2511 and as making a gift of the remainder interest in Trust 1 under § 2519, and such gifts qualify for the gift tax charitable deduction.

3. The value of the property in Trust 1 deemed to be transferred under § 2519 will not be included in Taxpayer's gross estate under § 2044(a) because of the application of § 2044(b)(2).

4. Taxpayer's renunciation of her qualifying income interest in Trust 1 will not result in any gift tax treatment of any part of Trust 2.

5. Taxpayer's renunciation of her qualifying income interest in Trust 1 will not cause her interest in Trust 2 to be valued at zero under § 2702.

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)(2) provides that § 2044(a) applies to any property if a deduction was allowed with respect to the transfer of such property to the decedent under § 2056(b)(7) or § 2523(f), and § 2519 did not apply with respect to a disposition by the decedent of part or all of such property.

Section 20.2044-1(b) of the Estate Tax Regulations provides that for purposes of § 1014 and chapters 11 and 13 of subtitle B of the Code, property included in a decedent's gross estate under § 2044 is considered to have been acquired from or have passed from the decedent to the person receiving the property upon the decedent's death. Thus, for example, the property is treated as passing from the decedent for purposes of determining the availability of the charitable deduction under § 2055, the marital deduction under § 2056, and special use valuation under § 2032A.

Section 2056(a) provides that the value of the taxable estate shall, except as limited by § 2056(b), be determined by deducting from the value of the gross estate an amount equal to the value of any interest in property which 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.

Section 2056(b)(1) denies a marital deduction for interests passing to the surviving spouse that are "terminable interests", that is interests in property passing to the surviving spouse that 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 continency to occur, where 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. Under § 2056(b)(7), for purposes of § 2056(a), qualified terminable interest property is treated as passing to the surviving spouse and no part of the property is treated as passing to any person other than the surviving spouse.

Under § 2056(b)(7)(B)(i) and (ii), "qualified terminable interest property" means property which passes from the decedent, in which the surviving spouse is entitled for life 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.

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 § 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 § 25.2207A-1(a) of the Gift Tax Regulations, 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 the gift tax attributable to that property. The value of the property to which § 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 § 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 § 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 that has been paid exceeds the total federal gift tax for the calendar year (including penalties and interest attributable) under chapter 12 that would have been paid if the value of the properties includible in the total amount of gifts by reason of § 2519 had not been included.

Section 2501 provides that a tax is imposed on the transfer of property by gift by any individual.

Section 2511(a) provides, in part, 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 2519(a) provides that for purposes of chapter 11, any disposition of all or part of a qualifying income interest for life in any property to which § 2519(a) applies is treated as a transfer of all interests in the property other than the qualifying income interest. Section 2519(b) provides that § 2519(a) applies to any property if a deduction was allowed with respect to the transfer of such property to the donor under § 2056(b)(7) or § 2523(f).

Section 25.2519-1(a) provides that a transfer of all or a portion of the income interest of the spouse in qualified terminable interest property is a transfer by the 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 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 2522(a) provides that in computing taxable gifts for the calendar year, there shall be allowed as a deduction the amount of all gifts made during such year to or for the use of charitable organizations described in § 2522(a). However, under § 2522(c)(2) and § 25.2522-3(c)(1) and (2), where a donor transfers an interest property (other than an interest described in § 170(f)(3)(B)) to a person, or for a use described in § 2522(a) or (b) and an interest in the same property is retained by the donor, is transferred, or has been transferred (for less than an adequate and full consideration in money or money's worth) from the donor to a person, or for a use, not described in § 2522(a) or (b), no deduction is allowed for the interest that is or has been transferred to the person, or for the use, described in § 2522(a) or (b), unless the charitable interest is: (A) an undivided portion (not in trust) of the donor's entire interest; (B) a remainder interest (not in trust) in a personal residence or farm; (D) a remainder interest in a charitable remainder annuity trust or a charitable remainder unitrust (described in § 664) or a pooled income fund (described in § 642(c)(5)); (E) a guaranteed annuity interest or a unitrust interest; or (G) a qualified conservation contribution.

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 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, Decedent’s personal representative made a valid QTIP election under § 2056(b)(7) on Decedent’s Form 706 for Separate Property QTIP. The proposed severance of Separate Property QTIP into Trust 1 and Trust 2 will have no effect on the election under § 2056(b)(7) by Decedent’s estate to qualify Separate Property QTIP for the federal estate tax marital deduction. Therefore, Trust 1 and Trust 2 will qualify as qualified terminable interest property trusts.

When Taxpayer renounces her income interest in Trust 1, she will make a gift of her qualifying income interest under § 2511. In addition, Taxpayer will be treated as having made a transfer of all of the property in Trust 1, other than her qualifying income interest, under § 2519. Given that Taxpayer will exercise her right of recovery under

§ 2207A(b) for any gift tax paid by her or by the trustee of Trust 1 on her behalf, Taxpayer's deemed gift of property under § 2519 will be treated as a net gift. The value of Taxpayer's net gift under § 2519 will be equal to the fair market value of Trust 1's property, 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 Taxpayer's qualifying income interest in Trust 1 on the date of disposition, minus the amount of gift taxes actually paid by Taxpayer or by the trustee of Trust 1 on behalf of Taxpayer.

In this case, the entire amount that will be deemed transferred by Taxpayer under §§ 2511 and 2519 will pass to Charitable Remainder Unitrust for the benefit of Daughter, Charity 1, Charity 2, and Charity 3. Charitable Remainder Unitrust satisfies the requirements of § 664(d) and, therefore, the transfers by Taxpayer under §§ 2511 and 2519 will qualify for the gift tax charitable deduction under § 2522(a). In addition, the property in Trust 1 that is deemed to be transferred under § 2519 will not be included in Taxpayer's gross estate under § 2044(a) because of the application of § 2044(b)(2).

Upon Taxpayer's renunciation of her qualifying income interest in Trust 1, she will not be deemed to have made a gift of all or any portion of the property in Trust 2 because Trust 2 will be established and funded as a separate trust and will not be affected by Taxpayer's renunciation of her qualifying income interest in Trust 1.

Finally, pursuant to the representations made herein, Trust 1 and Trust 2 will be separate trusts for all purposes from the effective date of Agreement. As a result, Taxpayer's interest in Trust 1 will be separate and distinct from her interest in Trust 2. Therefore, when Taxpayer renounces her entire interest in Trust 1, Taxpayer's interest in Trust 2 is not treated as a retained interest for purposes of § 2702(a)(1). Accordingly, Taxpayer's renunciation of her entire income interest in Trust 1 will not result in Taxpayer's interest in Trust 2 being valued at zero under § 2702.

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

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.

Sincerely,
James F. Hogan

Senior Technician Reviewer
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure
Copy for 6110 purposes