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Department of the Treasury
Washington, DC 20224

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Person To Contact:
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Refer Reply To:
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Date:
January 25, 2011

Re:

Legend
Decedent =
Spouse =
Marital Trust =

Child 1 =
Child 2 =
Date 1 =
Date 2 =
Date 3 =
State =
State Statute 1 =
State Statute 2 =
State Statute 3 =

Dear :

This letter responds to your authorized representative's letter of July 21, 2010, and subsequent correspondence, requesting rulings regarding the federal gift and estate tax consequences of the proposed renunciation by Spouse of an interest in Marital Trust.

Facts

The facts and representations submitted are summarized as follows: During her life, Decedent created a revocable trust that was amended and restated on Date 1.

Decedent died on Date 2, survived by Spouse, Child 1 and Child 2. Under the terms of Decedent's trust agreement, at Decedent's death Marital Trust was established for the benefit of Spouse.

Under the terms of Marital Trust, the trustees are to pay Spouse all the net income in annual or more frequent intervals during his life. In addition, the trustees may distribute to Spouse as much principal as the trustees, in their absolute discretion, deem necessary for Spouse's health, support and maintenance. At Spouse's death, the remaining assets of Marital Trust are to be distributed as appointed by Spouse to and among Decedent's issue (currently, Child 1 and Child 2). If Spouse fails to exercise the limited power of appointment, the assets of Marital Trust will be divided into as many equal shares as there are children of Decedent's then living, and children of Decedent's then deceased who have issue then living.

Each share for a child will be held in separate trust. The trustees may distribute income and principal to or for the benefit of the beneficiary, as the trustees in their absolute discretion deem advisable. Upon the death of a child, the trustees will distribute the balance of the principal and remaining income of child's trust to and among such child's issue as the child may appoint by will. To the extent child does not exercise child's limited power of appointment, the balance of the trust assets will be divided into separate shares *per stirpes*.

Each share set aside for an issue of Decedent (the beneficiary) other than a child of Decedent, will be held in a separate trust. The trustees may distribute to the beneficiary all or any portion of the income and principal as the trustees in their absolute discretion deem advisable. Upon the death of the beneficiary, the trustees will distribute the balance of the principal and remaining income of beneficiary's trust to and among such child's issue as the child may appoint by will. To the extent the beneficiary does not exercise the beneficiary's limited power of appointment, the balance of the trust assets will be divided into separate shares *per stripes.*

Article VIII of Decedent's trust agreement provides, generally, that no interest of any beneficiary of a trust created by the trust agreement shall be subject to being taken or reached by attachment, levy, writing or other legal or equitable process to satisfy any claim against, or obligation of, a beneficiary. In addition, no portion of the income or principal shall be subject to anticipation or alienation by any beneficiary nor shall it be subject to attachment owing to obligations of any beneficiary.

On Date 3, the executor timely filed the Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return, for Decedent's estate. It is represented that, on the Schedule M attached to the return, an election was made to treat Marital Trust as qualified terminable interest property (QTIP) under § 2056(b)(7) of the Internal Revenue Code (Code).

Spouse is currently the sole trustee of Marital Trust. The trustee proposes to file a petition with a State court of competent jurisdiction requesting an order to sever Marital Trust into Trust 1 and Trust 2. Trust 1 will contain sufficient assets to make gifts to separate trusts for the benefit of Child 1 and Child 2 (collectively, children's residuary trusts) as well as pay all of the gift taxes, if any, attributable to those gifts. The remaining balance of the assets presently in Marital Trust will fund Trust 2 and will remain in place for the benefit of Spouse during his lifetime, and ultimately pass to the children's residuary trusts. Initially, Trust 1 and Trust 2 will be held under the same terms and conditions as Marital Trust. After severance, Spouse intends to make a disclaimer of his entire interest in Trust 1, resulting in the disclaimed property passing equally into the children's residuary trusts for the benefit of Child 1 and Child 2. It is represented that the disclaimer will not be a qualified disclaimer under § 2518.

State Statute 1 provides that, after notice to 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 impair the rights of any beneficiary or adversely affect achieving the purposes of the trust.

State Statute 2 provides, in relevant part, that a person may disclaim, in whole or in part, conditionally or unconditionally, any interest in or power over property, including a power of appointment. The disclaimer must be in writing, declare the writing to be a disclaimer, describe the interest or power to be disclaimed, and be signed by the person making the disclaimer. The disclaimer must be delivered or filed in a manner prescribed by statute. State Statute 2 further provides that a person may disclaim the interest or power even if its creator imposed a spendthrift provision or similar restriction on transfer.

State Statute 3 provides, in relevant part, that if the disclaimant is an individual, the disclaimed interest passes as if the disclaimant died immediately before the interest was created.

The trustee has requested the following rulings:

1. If Spouse renounces his 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.

2. If Spouse renounces his 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.

3. If Spouse renounces his entire interest in the property in Trust 1, and such renunciation is conditioned on Spouse's children's residuary trusts paying all gift taxes attributable to the transfer, the amount of the gift will be reduced by the gift taxes paid by the children's residuary trusts.

4. The division of Marital Trust into Trust 1 and Trust 2 by a State court of competent jurisdiction will not disqualify Marital Trust, Trust 1 or Trust 2 as QTIP trusts.

5. The renunciation and subsequent termination of Trust 1 will result in a gift of Spouse's 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.

6. After the division of Marital Trust into Trust 1 and Trust 2, the subsequent termination of Trust 1 will not cause Trust 2 to fail to be qualified as a QTIP trust.

7. The division of Marital Trust into Trust 1 and Trust 2 by a State court of competent jurisdiction over this matter on a non-pro rata basis will not be a recognition event for income tax purposes.

8. The termination of Trust 1 and the subsequent distribution of Spouse's interest in Trust 1 to the children's residuary trusts, based on the actuarial present values of the interests in Trust 1, will not be an income recognition event for Trust 1.

Rulings 1 through 6:

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. 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.

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 adequate 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.

Although § 2502(c) provides that the tax on the gift 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 donee.

As discussed above, with respect to the gift tax imposed as a result of a transfer under § 2519, § 2207A(b) statutorily shifts the burden, but not the liability, for paying the gift tax to the donee. In reimbursing the donor for the gift tax paid pursuant to the statute, 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, net gift treatment of a transfer under § 2519 is implicit under § 2207A(b).

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.

Based on the facts submitted and representations made, and assuming that (1) a State court of competent jurisdiction issues an order severing Marital Trust into Trust 1 and Trust 2, and (2) the proposed division of Marital Trust and Spouse's renunciation are both effective under State law, we conclude as follows:

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

2. Subject to our conclusion in Ruling 1, Spouse will not be treated as making a deemed gift under § 2519 with respect to Trust 2 while retaining an income interest in the transferred property. Consequently, § 2702 does not apply to the proposed transfer.

3. The renunciation and subsequent termination of Trust 1 will result in a gift under § 2519 by Spouse to the children’s residuary trusts. The amount of the gift of disclaimed property passing to the children’s residuary trusts will be reduced by the gift taxes paid by the children’s residuary trusts.

4. The division of Marital Trust into Trust 1 and Trust 2 by a State court of competent jurisdiction will not disqualify Marital Trust, Trust 1 or Trust 2 as QTIP Trusts.

5. The renunciation and subsequent termination of Trust 1 will result in a gift of Spouse’s 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.

6. After the division of Marital Trust into Trust 1 and Trust 2, the subsequent termination of Trust 1 will not cause Trust 2 to fail to qualify as a QTIP trust.

Rulings 7 & 8:

Section 61(a)(3) provides that gross income includes gain derived from dealings in property.

Section 1001(a) provides that the gain from the sale or other disposition of property is the excess of the amount realized over the adjusted basis provided in § 1011 for determining gain, and the loss is the excess of the adjusted basis provided in § 1011 for determining loss over the amount realized. Under § 1001(c), the entire amount of gain or loss must be recognized, except as otherwise provided.

Section 1.1001-1(a) of the Income Tax Regulations provides that, except as otherwise provided in subtitle A, the gain or loss realized from the exchange of property for cash or for other property differing materially either in kind or in extent is treated as income or loss sustained. An exchange of property results in the realization of gain or loss under § 1001 if the properties exchanged are materially different.

Rev. Rul. 56-437, 1956-2 C.B. 507, holds that the conversion of a joint tenancy in stock to a tenancy in common in order to eliminate the survivorship feature and the partition of a joint tenancy in stock are not sales or exchanges. Similarly, divisions of trusts are also not sales or exchanges of trust interests where each asset is divided pro rata among the new trusts. *See* Rev. Rul. 69-486, 1969-2 C.B. 159 (holding that a pro rata distribution of trust assets is not a sale or exchange).

In this case, the severance of Marital Trust into Trust 1 and Trust 2 with the same terms as Marital Trust will not result in any shift in beneficial interest in the assets of Marital Trust. Accordingly, the division of Marital Trust into Trust 1 and Trust 2 will not result in the realization of gain or loss under §§ 61 and 1001. In addition, the termination of Trust 1 and the non-pro rata distribution of assets in Trust 1 to the children's residuary trusts will be accomplished pursuant to the provisions of Trust 1 and State law. Accordingly, the termination of Trust 1 and subsequent distributions to the children's residuary trusts will not result in the realization of gain or loss under §§ 61 and 1001.

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.

Except as specifically ruled herein, we express or imply no opinion on the federal tax consequences of the transaction under the cited provisions or under any other provisions of the Code.

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,

Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

By: ______________________________
Leslie H. Finlow
Senior Technician Reviewer, Branch 4
Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures
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cc: