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Person To Contact:
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Date:
July 10, 2012

RE:

Legend

Decedent	=
Spouse	=
Date 1	=
Date 2	=
Accounting Firm	=
Court	=
State Statute 1	=
State Statute 2	=
State	=
a	=
b	=
c	=

Dear :

This letter responds to your letter dated January 23, 2012, and supplemental correspondence, requesting an extension of time under §§ 301.9100-1 and 301.9100-3 of the Procedure and Administration Regulations to make a qualified terminable interest property (QTIP) election for a trust; to divide the trust into exempt and non-exempt trusts; to make a reverse QTIP election with respect to the exempt trust, and to allocate Decedent's available GST exemption to the exempt trust; and rulings regarding the estate, gift, and income tax consequences of the proposed division of the non-exempt trust into two trusts and Spouse's assignment of his income interest in one of the resulting trusts.

Facts

The facts and representations submitted are summarized as follows. On Date 1, Decedent and Spouse (Trustors) created a joint revocable trust, Trust. Decedent died on Date 2 survived by Spouse, two children, and grandchildren.

Pursuant to Article Fourth of Decedent's will, the residue of her estate passed to Trust. Pursuant to Paragraph Sixth of Trust, upon the death of Decedent, the trustee divided Trust into three irrevocable trusts: Trust A, a trust to hold Spouse's property; Trust B, a credit shelter trust; and Trust C, a trust intended to qualify as a qualified terminable interest property trust (QTIP). The ruling requests in this letter pertain to Trust C. Spouse is the sole trustee of Trust C.

The terms of Trust C are set forth in Paragraph Sixth, Section C of Trust as follows. The trustee must distribute all income at least annually to Spouse during Spouse's lifetime. If payments of income from Trusts A, B, and C are insufficient, the trustee, in the trustee's discretion and with due consideration given to Spouse's income and other resources outside of the trust, may pay to or apply for Spouse's benefit so much of the principal of Trust C as the trustee deems proper or necessary for that purpose. Spouse has the power to require the trustee to convert unproductive property into productive property. Upon Spouse's death, any accrued or undistributed income shall be distributed to Spouse's estate, and the balance of Trust C will be added to Trust B and administered and distributed under the terms of Trust B. It is the intention of the Trustors that Trust C qualify as a QTIP trust. Section H provides that if Trust C may be subject to GST tax, the trustee may divide the trust into two separate subtrusts of equal or unequal value. The trustee is authorized to make a reverse QTIP election to treat Decedent as the transferor for GST tax purposes for all or a portion of Trust C and to allocate Decedent's GST exemption to one subtrust. Furthermore, under Paragraph Tenth, no interest in the principal or income of Trust C shall be anticipated, assigned or encumbered or be subject to any creditor's claim or to legal process, prior to its actual receipt by the beneficiary.

Spouse, as executor of Decedent's estate, retained Accounting Firm to prepare Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return, for Decedent's estate. Accounting Firm failed to elect to treat Trust C as QTIP property and make a reverse QTIP election with respect to all or a portion of Trust C. Spouse represents that prior to Date 2, Decedent had not allocated any of her GST exemption to lifetime transfers. Under the automatic allocation rules of § 2632(c) of the Internal Revenue Code, on Date 2, a of Decedent's GST exemption was allocated to Trust B, leaving b of Decedent's GST exemption available to allocate to a portion of Trust C, if the requested relief is granted.

If the relief requested in this letter is granted, Spouse will file a supplemental Form 706 for Decedent's estate and make a QTIP election with respect to Trust C, divide Trust C into Exempt Trust and Non-Exempt Trust pursuant to § 26.2654-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations; make the reverse QTIP election with respect to Exempt Trust, and allocate Decedent's available GST exemption to that trust. Spouse will petition State Court to authorize the division of Non-Exempt Trust into Trust 1 and Trust 2 and the modification of Trust instrument to allow Spouse to assign his income interest in Trust 1 to his children. Upon obtaining an order from State Court, Spouse will divide Non-Exempt Trust into Trusts 1 and 2, which will each have terms identical to Non-Exempt Trust and will be funded with assets on a pro-rata basis. Trust 1 will contain c percent of Non-Exempt Trust's assets, and the remaining assets of Non-Exempt Trust will fund Trust 2. Spouse will serve as trustee of all four trusts. Immediately upon funding Trust 1, Spouse will assign his income interest in Trust 1 to his children. To the extent the assignment results in a gift tax under § 2519, Spouse will waive his right to recover any gift tax from Trust 1 under § 2207A.

State Statute 1 provides that a court, for good cause, may divide a trust into two or more separate trusts if such division will not defeat or substantially impair the accomplishment of trust purposes or the interests of the beneficiaries. State Statute 2 provides if all of the beneficiaries of an irrevocable trust consent, they may compel modification or termination of the trust upon petition to the court.

Following these transactions, Trust 1 will continue in existence until Spouse's death. Spouse's children will receive the income interest in Trust 1 during Spouse's lifetime. Spouse will retain his right to receive discretionary principal distributions from Trust 1. Upon Spouse's death, the Trust 1 estate will be distributed to Trust B to be administered and distributed under the terms of Trust B.

Rulings Requested

1. Executor of Decedent's estate requests an extension of time under §§ 301.9100-1 and 301.9100-3 to: (i) make a QTIP election with respect to Trust C under § 2056(b)(7); (ii) sever Trust C into Exempt Trust and Non-Exempt Trust pursuant to § 26.2654-1(b)(1); (iii) make a reverse QTIP election with respect to Exempt Trust pursuant to § 2652(a)(3), and (iv) allocate Decedent's available GST exemption to Exempt Trust.

2. The assignment of Spouse's income interest in Trust 1 to his children will result in a gift by Spouse under § 2511 of Spouse's income interest in Trust 1 and a gift by Spouse under § 2519 of the entire interest in Trust 1, as determined on the date of the disposition, other than the value of the qualifying income interest in the assets in Trust 1.

3. The assignment of Spouse's income interest in Trust 1 to his children will not result in a gift by Spouse under § 2519 of the property transferred to Exempt Trust and Trust 2.

4. Following Spouse's assignment of his income interest in Trust 1 to his children, Trust 1 will not be includible in Spouse's gross estate under § 2044(b)(2).

5. When Spouse assigns his income interest in Trust 1 to his children, the value of Spouse's income and discretionary principal interest in Exempt Trust and Trust 2 will not be valued at zero under § 2702.

6. When Spouse waives his right of recovery provided by § 2207A(b), Spouse will be treated as having transferred the unrecovered gift tax amount to Trust 1, from which the recovery could have been obtained. The amount of the gift will be the amount of the reimbursement to which Spouse would have been entitled but for his waiver.

7. The division of Trust C into Exempt Trust and Non-Exempt Trust, the division, pursuant to Court order, of Non-Exempt Trust into Trust 1 and Trust 2, and the funding of such trusts on a pro-rata basis, will not disqualify Exempt Trust, Trust 1 or Trust 2 as QTIP trusts, and the subsequent assignment by Spouse of his income interest in Trust 1 to his children will not disqualify Exempt Trust or Trust 2 as QTIP trusts.

8. The division, pursuant to Court order, of Non-Exempt Trust into Trust 1 and Trust 2, on a pro-rata basis, will not be a recognition event for income tax purposes.

LAW AND ANALYSIS

Ruling 1

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, for purposes of the tax imposed by § 2001, the value of the taxable estate is 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 the general rule that no deduction shall be allowed under § 2056(a) for an interest passing to the surviving spouse if, on the lapse of time, on the occurrence of an event or contingency, or on the failure of an event or contingency to occur, the interest will terminate or fail.

Section 2056(b)(7)(A) provides that, in the case of qualified terminable interest property, such property shall be treated as passing to the surviving spouse, and for purposes of § 2056(a), no part of the property shall be treated as passing to any person

other than the surviving spouse.

Section 2056(b)(7)(B)(i) defines “qualified terminable interest property” as property: (1) which passes from the decedent; (2) in which the surviving spouse has a qualifying income interest for life; and (3) to which an election under § 2056(b)(7) applies.

Section 2056(b)(7)(B)(ii) provides that the surviving spouse has a qualifying income interest for life if: (1) the surviving spouse is entitled to all the income from the property; payable annually or at more frequent intervals, or has a usufruct interest for life in the property; and (2) no person has a power to appoint any part of the property to any person other than the surviving spouse.

Section 2056(b)(7)(B)(v) provides that an election under § 2056(b)(7) with respect to any property is to be made by the executor on the return of tax imposed by § 2001. The election, once made, is irrevocable.

Section 20.2056(b)-7(b)(4) of the Estate Tax Regulations provides, generally, that the QTIP election is made on the last estate tax return filed by the executor on or before the due date of the return, including extensions or, if a timely return is not filed, the first estate tax return filed by the executor after the due date.

Section 2601 imposes a tax on every generation-skipping transfer (GST). Section 2611 provides that a GST includes a taxable distribution, a taxable termination, and a direct skip.

Section 2602 provides that the amount of the GST tax is the taxable amount multiplied by the applicable rate. Section 2641(a) defines “applicable rate” as the product of the maximum federal estate tax rate and the inclusion ratio with respect to the transfer.

Section 2631(c), as in effect on Date 2, provided that, for purposes of determining the GST tax, every individual shall be allowed a GST exemption of $1,000,000 that may be allocated by such individual (or his executor) to any property with respect to which such individual is the transferor. Section 2631(b) provides that once an allocation of GST exemption is made, it is irrevocable.

Under § 2632(a), any allocation by an individual of his GST exemption may be made at any time on or before the date prescribed for filing the individual's estate tax return (including extensions).

Section 2632(c)(1), as in effect on Date 2, provides that any portion of an individual's GST exemption which has not been allocated within the time prescribed by

§ 2632(a) shall be deemed to be allocated as follows - (A) first, to property which is the subject of a direct skip occurring at the individual's death, and (B) second, to trusts with respect to which the individual is the transferor and from which a taxable distribution or a taxable termination might occur at or after the individual's death.

Section 26.2632-1(d)(1) provides, generally, that an allocation of decedent's unused GST exemption by the executor is made on Form 706.

Section 26.2632-1(d)(2) provides, in relevant part, that a decedent's unused GST exemption is automatically allocated on the due date for filing Form 706 to the extent not otherwise allocated by the decedent's executor on or before that date. Unused exemption is allocated pro rata (subject to the rules of § 26.2642-2(b)), on the basis of the value of the property as finally determined for estate tax purposes (chapter 11 value), first to direct skips treated as occurring at the transferor's death. The balance, if any, of unused GST exemption is allocated pro rata (subject to the rules of § 26.2642-2(b)) on the basis of the chapter 11 value of the nonexempt portion of the trust property to trusts with respect to which a taxable termination may occur or from which a taxable distribution may be made. However, no automatic allocation of GST exemption is made to a trust that will have a new transferor with respect to the entire trust prior to the occurrence of any GST with respect to the trust.

Under § 2652(a)(1) and § 26.2652-1(a)(1), the individual with respect to whom property was last subject to federal estate or gift tax is the transferor of that property for purposes of chapter 13.

Section 2652(a)(3) provides that in the case of any trust with respect to which a deduction is allowed to the decedent under § 2056(b)(7), the estate of the decedent may elect to treat all of the property in the trust for purposes of the GST tax as if the QTIP election had not been made. This election is referred to as the "reverse QTIP election." The consequence of a reverse QTIP election is that the decedent remains, for GST tax purposes, the transferor of the QTIP trust for which the election is made. As a result, the decedent's GST exemption may be allocated to the QTIP trust.

Section 26.2652-2(b) provides that the reverse QTIP election is to be made on the return on which the QTIP election is made.

Section 26.2654-1(b)(1)(i) provides, in part, that the severance of a trust that is included in the transferor's gross estate (or created under the transferor's will) into two or more trusts is recognized for purposes of chapter 13 if the trust is severed pursuant to a direction in the governing instrument providing that the trust is to be divided upon the death of the transferor, and (A) the terms of the new trusts provide in the aggregate for the same succession of interests and beneficiaries as are provided in the original trust; (B) the severance occurs (or a reformation proceeding, if required, is commenced) prior to the date prescribed for filing the federal estate tax return (including extensions

actually granted) for the estate of the transferor; and (C) the new trusts are severed on a fractional basis. If severed on a fractional basis, the separate trusts need not be funded with a pro rata portion of each asset held by the undivided trust. The trusts may be funded on a non pro rata basis provided funding is based on either the fair market value of the assets on the date of funding or in a manner that fairly reflects the net appreciation or depreciation in the value of the assets measured from the valuation date to the date of funding.

Section 2642(a)(1) provides that for purposes of chapter 13, the inclusion ratio with respect to any property transferred in a GST is the excess (if any) of 1 over the "applicable fraction." The applicable fraction, as defined in § 2642(a)(2), is a fraction, the numerator of which is the amount of GST exemption allocated to the trust (or to property transferred in a direct skip), and the denominator of which is the value of the property transferred to the trust or involved in the direct skip, reduced by the sum of any federal estate tax or State death tax actually recovered from the trust attributable to such property, and any charitable deduction allowed under § 2055 or 2522 with respect to such property.

Section 2642(b)(2)(A) provides, in part, that except as provided in § 2642(f), if property is transferred as a result of the death of the transferor, the value of such property for purposes of § 2642(a) is its value as finally determined for purposes of chapter 11. Section 2642(b)(2)(B) provides that any allocation to property transferred as a result of the death of the transferor is effective on and after the date of the death of the transferor.

Section 2642(g)(1)(A) provides that the Secretary shall by regulation prescribe such circumstances and procedures under which extensions of time will be granted to make an allocation of GST exemption described in § 2642(b)(2). Such regulations shall include procedures for requesting comparable relief with respect to transfers made before the date of the enactment of § 2642(g)(1)(A), which was enacted into law on June 7, 2001.

Section 2642(g)(1)(B) provides that in determining whether to grant relief, the Secretary shall take into account all relevant circumstances, including evidence of intent contained in the trust instrument or instrument of transfer and such other factors as the Secretary deems relevant. Section 2642(g)(1)(B) further provides that for purposes of determining whether to grant relief, the time for making the allocation shall be treated as if not expressly prescribed by statute.

Notice 2001-50, 2001-2 C.B. 189, provides that under § 2642(g)(1)(B), the time for allocating the GST exemption to lifetime transfers and transfers at death, the time for electing out of the automatic allocation rules, and the time for electing to treat any trust as a GST trust are to be treated as if not expressly prescribed by statute. The Notice further provides that taxpayers may seek an extension of time to make an allocation

described in § 2642(b)(1) or (b)(2) or an election described in § 2632(b)(3) or (c)(5) under the provisions of § 301.9100-3.

Sections 301.9100-1 through 301.9100-3 provide standards the Commissioner will use to determine whether to grant an extension of time to make a regulatory election.

Under § 301.9100-1(c), the Commissioner may grant a reasonable extension of time under the rules set forth in §§ 301.9100-2 and 301.9100-3 to make a regulatory election, or a statutory election (but no more than 6 months except in the case of a taxpayer who is abroad), under all subtitles of the Code except subtitles E, G, H, and I.

Section 301.9100-3(a) provides that requests for extensions of time for regulatory elections that do not meet the requirements of § 301.9100-2 must be made under the rules of § 301.9100-3. Requests for relief subject to § 301.9100-3 will be granted when the taxpayer provides the evidence to establish to the satisfaction of the Commissioner that the taxpayer acted reasonably and in good faith, and the grant of relief will not prejudice the interests of the Government.

Section 301.9100-3(b)(1)(v) provides that a taxpayer is deemed to have acted reasonably and in good faith if the taxpayer reasonably relied on a qualified tax professional, including a tax professional employed by the taxpayer, and the tax professional failed to make, or advise the taxpayer to make, the election.

Based on the facts submitted and the representations made, we conclude that the requirements of § 301.9100-3 and § 26.2654-1(b) have been satisfied. Accordingly:

1. Executor of Decedent's estate is granted 120 days from the date of this letter to file a supplemental Form 706 to make a QTIP election with respect to Trust C under § 2056(b)(7); sever Trust C into Exempt Trust and Non-Exempt Trust under § 26.2654-1(b)(1)(i); make a reverse QTIP election with respect to Exempt Trust under § 2652(a)(3), and allocate Decedent's available GST exemption to Exempt Trust. The allocation will be effective as of Decedent's date of death, Date 2. The supplemental Form 706 should be filed with the Internal Revenue Service Center, Cincinnati, Ohio 45999. A copy of this letter should be attached to the return. A copy of this letter is enclosed for this purpose.

Rulings 2 through 7

Section 2044(a) and (b) provides that the value of the decedent's gross estate includes the value of any property in which the decedent had a qualifying income interest for life and for which a deduction is allowed under § 2056(b)(7) and to which § 2519 (relating to dispositions of certain life estates) did not apply with respect to a disposition by the decedent of part or all of such property.

Section 2044(c) provides that for purposes of chapter 11 and chapter 13, property includible in the decedent's gross estate under § 2044(a) shall be treated as property passing from the decedent.

Section 2056(a) provides that, for purposes of the tax imposed by § 2001, the value of the taxable estate is 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 the general rule that no deduction shall be allowed under § 2056(a) for an interest passing to the surviving spouse if, on the lapse of time, on the occurrence of an event or contingency, or on the failure of an event or contingency to occur, the interest will terminate or fail.

Section 2056(b)(7)(A) provides that, in the case of qualified terminable interest property, such property shall be treated as passing to the surviving spouse, and for purposes of § 2056(a), no part of the property shall be treated as passing to any person other than the surviving spouse.

Section 2501 imposes a tax for each calendar year on the transfer of property by gift during such calendar year by an individual. Under § 2502(c), the gift tax imposed under § 2501 is the liability of the donor. Section 2511(a) provides 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 25.2511-1(c)(1) of the Gift Tax Regulations provides that the gift tax applies to gifts indirectly made. Thus, any transaction in which an interest in property is gratuitously passed or conferred upon another, regardless of the means or device employed, constitutes a gift subject to tax.

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

Section 25.2519-1(a) provides, in part, 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 § 2056(b)(7), the donee spouse is treated for purposes of chapters 11 and 12 as transferring all interests in property other than the qualifying income interest. For example, if the donee spouse makes a disposition of part of a qualifying income interest for life in trust corpus, the spouse is treated under § 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 § 2519 of the entire trust less the qualifying income interest, and is treated for purposes of § 2036 as having transferred the entire trust corpus, 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 § 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 the donee spouse is entitled to recover under § 2207A(b) (relating to the right to recover gift tax attributable to the remainder interest). 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).

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), 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. The value of 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(b)(1) provides that the failure of a person to exercise a right of recovery provided by § 2207A(b) upon a lifetime transfer subject to § 2519 is treated as a transfer for federal gift tax purposes of the unrecovered amounts to the person(s) from whom the recovery could have been obtained. See § 25.2511-1. The transfer is considered to be made when the right to recovery is no longer enforceable under applicable law and is treated as a gift even if recovery is impossible.

Section 25.2207A-1(b)(2) provides that the transferor subject to § 2519 may execute a written waiver of the right of recovery arising under § 2207A before that right of recovery becomes unenforceable. If a waiver is executed, the transfer of the unrecovered amounts by the transferor is considered to be made on the later of (i) the date of the valid and irrevocable waiver rendering the right of recovery no longer enforceable, or (ii) the date of the payment of the tax by the transferor.

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 to the tax) 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 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 § 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 § 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 § 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 who has received a distribution or takes the property prior to the expiration of the right of recovery.

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 upon the facts provided and representations made, we conclude:

2. The assignment of Spouse’s income interest in Trust 1 to his children will result in a gift by Spouse of Spouse's income interest in Trust 1 under § 2511 and a gift by Spouse under § 2519 of the entire interest of Trust 1 other than the value of Spouse's qualifying income interest. Spouse's gift tax liability for the transfer of his qualifying income interest in Trust 1 will be determined under § 25.2511-2;

3. The assignment of Spouse’s income interest in Trust 1 to his children will not result in a gift by Spouse of any portion of the assets in Exempt Trust or Trust 2 under § 2519;

4. After Spouse’s assignment of his income interest in Trust 1 to his children, Trust 1 will not be includible in Spouse’s gross estate under § 2044(a) because of the application of § 2044(b)(2);

5. When Spouse assigns his income interest in Trust 1 to his children, Spouse's interest in Exempt Trust and Trust 2 will not be treated as a retained interest for purposes of § 2702(a)(1) and, accordingly, Spouse's assignment of his income interest in Trust 1 to his children will not result in Spouse's interest in Exempt Trust or Trust 2 being valued at zero under § 2702;

6. Pursuant to § 2207A(b), Spouse has the right to recover from Trust 1 the amount of gift tax payable by Spouse because of the deemed transfer under § 2519. As a result, the deemed transfer under § 2519 will be treated as a net gift. The amount of the gift will equal the value of all the property then owned by Trust 1 subject to the qualifying income interest, determined on the date of disposition and reduced by the amount of gift taxes Spouse has the right to recover from Trust 1. If Spouse waives his right of recovery provided by § 2207A(b), then under § 2511, Spouse is treated as making an additional gift by transferring the unrecovered gift tax amount to Trust 1, from which the recovery could have been obtained. The amount of the gift will be the amount of reimbursement to which Spouse was entitled but for his waiver;

7. The division of Trust C into Exempt Trust and Non-Exempt Trust, and the division, pursuant to Court order, of Non-Exempt Trust into Trust 1 and Trust 2, on a pro-rata basis, will not cause Exempt Trust, Trust 1, or Trust 2 to fail to qualify as QTIP trusts under § 2056, and the assignment of Spouse's income interest in Trust 1 to his children will not cause Exempt Trust or Trust 2 to fail to qualify as QTIP trusts.

Ruling 8

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

Section 1001(a) provides that the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in § 1011 for determining gain, and loss shall be the excess of the adjusted basis provided in § 1011 for determining loss over the amount realized.

Section 1001(b) states that the amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received. Under § 1001(c), except as otherwise provided in subtitle A, the entire amount of gain or loss, determined under § 1001, on the sale or exchange of property shall be recognized.

Section 1.1001-1(a) of the Income Tax Regulations provides that the gain or loss realized from the conversion of property into cash, or from the exchange of property for other property differing materially either in kind or in extent, is treated as income or loss sustained.

Rev. Rul. 56-437, 1956-2 C.B. 507, provides that a partition of jointly owned property is not a sale or other disposition of property where the co-owners of the joint property sever their joint interests, but do not acquire a new or additional interest as a result of the transaction.

In Rev. Rul. 69-486, 1969-2 C.B. 159, a non-pro rata distribution of trust property was made in kind by the trustee, although the trust instrument and local law did not convey authority to the trustee to make a non-pro rata distribution of property in kind. The distribution was a result of a mutual agreement between the trustee and the beneficiaries. Because neither the trust instrument nor local law conveyed authority to the trustee to make a non-pro rata distribution, Rev. Rul. 69-486 held that the transaction was equivalent to a pro rata distribution followed by an exchange between beneficiaries, an exchange that required recognition of gain under § 1001.

Cottage Savings Ass'n v. Comm'r, 499 U.S. 554 (1991), concerns the issue of when a sale or exchange has taken place that results in realization of gain or loss under § 1001. In Cottage Savings, a financial institution exchanged its interests in one group

of residential mortgage loans for another lender's interests in a different group of residential mortgage loans. The two groups of mortgages were considered "substantially identical" by the agency that regulated the financial institution.

The Supreme Court in Cottage Savings concluded that § 1.1001-1 reasonably interprets § 1001(a) and stated that an exchange of property gives rise to a realization event under § 1001(a) if the properties exchanged are "materially different." In defining what constitutes a "material difference" for purposes of § 1001(a), the Court stated that properties are "different" in the sense that is "material" to the Code so long as their respective possessors enjoy legal entitlements that are different in kind or extent. Cottage Savings, 499 U.S. at 564-65. The Court held that mortgage loans made to different obligors and secured by different homes did embody distinct legal entitlements, and that the taxpayer realized losses when it exchanged interests in the loans. Cottage Savings, 499 U.S. at 566.

In the present case, it is consistent with the Supreme Court's opinion in Cottage Savings to find that the interest of the beneficiaries of Trust 1 and Trust 2 will not differ materially from the interests of the of the beneficiaries in Non-Exempt Trust. Under the proposed division, the interest of the beneficiaries in Trust 1 and Trust 2 will be substantially identical to their interests in Non-Exempt Trust prior to the proposed division of Non-Exempt Trust into Trust 1 and Trust 2. Because State law will authorize this pro rata division, the proposed division of Non-Exempt Trust into Trust 1 and Trust 2 with substantially identical terms and provisions will not result in the beneficiaries acquiring any new or additional interests. Therefore, the division of Non-Exempt Trust is not a sale or other disposition of property under Rev. Rul. 56-437 and does not result in a material difference in the legal entitlements enjoyed by the beneficiaries under Cottage Savings.

Based upon the facts and representations made, we conclude that:

8. The division, pursuant to Court order, of Non-Exempt Trust into Trust 1 and Trust 2, on a pro-rata basis, will not result in the recognition of gain or loss for purposes of § 61 or § 1001.

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

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

Furthermore, 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, no opinion is expressed or implied regarding whether Trust 1 will be included in Spouse's gross estate under § 2036.

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,

Associate Chief Counsel
(Passthroughs & Special Industries)

By: _____
Lorraine E. Gardner, Senior Counsel
Branch 4
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures: Copy for § 6110 purposes
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