Internal Revenue Service

Number: **200406004**
Release Date: 02/06/2004
Index Number: 2044.01-00; 2056.07-00;
2523.06-01

Department of the Treasury
Washington, DC 20224

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:PSI:B09 – PLR-107818-03
Date:
October 31, 2003

Legend

Donor =

Spouse =

Property =
Trust =
Attorney =

Dear :

This is in response to a letter dated January 24, 2003, submitted by your authorized representative, requesting a ruling on the gift and estate tax consequences of the establishment of the proposed qualified terminable interest property (QTIP) trust.

The facts and representations are as follows. Donor and Spouse are married, United States citizens. Donor proposes to transfer Property to the Trust, an irrevocable marital trust.

Paragraph 3.1. of the Trust provides that while Spouse and Donor are both living, the trustee shall pay the net income to Spouse at least quarter-annually and may pay Spouse all or any part of the principal for any purpose. If Spouse survives Donor, the trustee shall pay the entire property of the Trust to Spouse.

Paragraph 3.2. provides that if Donor survives Spouse, the trustee is to pay the net income to Donor at least quarter-annually for life. Upon Donor's death, the remaining principal is to be distributed as Donor may appoint by will to his issue and charitable organizations. Any principal not appointed or used for payment of estate taxes is to pass in trust to Donor's then living children and the issue of any deceased child of Donor.

Paragraph 9.2. (b) provides that Spouse, in the case of property being held for her benefit, and Donor, in the case of property held for his benefit, may require the trustee to make nonproductive assets productive.

Paragraph 11. provides that on Spouse's death, unless her will provides otherwise, the trustee shall pay directly or to her estate any increase in estate and inheritance taxes caused by including the trust property in her gross estate. The same applies at Donor's death, should he survive Spouse. The payment of such tax, however, may not be made from trust property that is not includible in the person's federal gross estate or that is exempt from state inheritance or estate tax.

Donor will serve as the initial trustee of the Trust. Upon Spouse's death, Attorney will serve as an independent trustee or co-trustee. Although the Trust does not prohibit Spouse from serving as trustee, if she does serve as trustee she is prohibited under paragraph 7.8. from possessing or participating in the exercise of any power or discretion in favor of herself or her issue. Paragraph 7.8. further provides that no trustee shall possess or participate in the exercise of any power or discretion that would otherwise be a general power of appointment under § 2041(b)(1).

Donor requests the following rulings:

1. Donor may make an election pursuant to § 2523(f) with respect to each transfer of property by Donor to the Trust during the life of Spouse and while he and Spouse are married, so that each such transfer will qualify for the gift tax marital deduction under § 2523(a).

2. Upon the death of Donor, if he predeceases Spouse, no part of the Trust property with respect to which Donor made a gift tax QTIP election will be includible in Donor's gross estate for estate tax purposes; and that distributions of the Trust principal to Spouse by Donor as the trustee will not be considered transfers by Donor for gift tax purposes.

3. If Donor survives Spouse, with respect to the remaining Trust property for which Donor made a gift tax QTIP election:

(a) at Spouse's death, so long as Spouse and Donor are married at that time, the executor of Spouse's estate may make an election pursuant to § 2056(b)(7) with respect to such property so that the property will qualify for the estate tax marital deduction under § 2056(a);

(b) if the executor of Spouse's estate makes an estate tax QTIP election with respect to such property, that portion of the property for which the estate tax QTIP election is made will be included in Donor's gross estate for estate tax purposes upon his subsequent death under § 2044(a) and not under § 2036 or § 2038 or any other authority; and

(c) if the executor of Spouse's estate does not make an estate tax QTIP election with respect to any part of such property, that part will not be included in Donor's gross estate for estate tax purposes.

Section 2001(a) provides that a tax is imposed on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

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

Section 2056(a) provides an estate tax deduction for interests in property passing to a surviving spouse. Section 2056(b)(7) permits a deduction for qualified terminable interest property passing from the decedent to the surviving spouse for which an election under § 2056(b)(7)(B)(v) applies.

Section 2056(b)(7)(B)(ii) provides that a 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 2519 provides that any disposition of all or part of a qualifying income interest for life in 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)) shall be treated as a transfer of all interests in such property other than the qualifying income interest.

Section 2523(a) provides that if a donor transfers during the calendar year by gift an interest in property to a donee who at the time of the gift is the donor's spouse, there shall be allowed as a deduction in computing taxable gifts for the calendar year an amount with respect to such interest equal to its value.

Section 2523(b)(1) provides that 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, such interest transferred to the spouse will terminate or fail, no deduction shall be allowed with respect to such interest if the donor retains in himself, or transfers or has transferred to any person other than such donee spouse, an interest in such property, and if by reason of such retention or transfer the donor or such person may possess or enjoy any part of such property after such termination or failure of the interest transferred to the donee spouse.

Section 2523(f)(1) provides, generally, that in the case of qualified terminable interest property, such property shall be treated as transferred to the donee spouse, and no part of such property shall be considered as retained in the donor or transferred to any person other than the donee spouse.

Section 2523(f)(2) defines the term "qualified terminable interest property" as any property which is transferred by the donor spouse, in which the donee spouse has a qualifying income interest for life, and to which an election under § 2523(f) applies.

Section 2523(f)(3) provides that for purposes of § 2523(f), rules similar to the estate tax rules of clauses § 2056(b)(7)(B)(ii), (iii), and (iv) shall apply.

Section 2523(f)(4)(A) provides that an election under § 2523(f) with respect to any property shall be made on or before the date prescribed by § 6075(b) for filing a gift tax return with respect to the transfer (determined without regard to § 6019(2)) and shall be made in such manner as the Secretary shall by regulations prescribe. Section 2523(f)(4)(B) provides that an election under § 2523(f), once made, shall be irrevocable.

Section 2523(f)(5)(A) provides, generally, that in the case of any qualified terminable interest property in which the donor spouse has retained an interest, such property shall not be includible in the gross estate of the donor spouse, and any subsequent transfer by the donor spouse of an interest in such property shall not be treated as a transfer for purposes of the gift tax.

Section 2523(f)(5)(B) provides that the exclusion in § 2523(f)(5)(A) shall not apply with respect to any property after the donee spouse is treated as having transferred such property under § 2519, or such property is includible in the donee spouse's gross estate under § 2044.

Section 25.2523(f)-1(d)(1) of the Gift Tax Regulations provides, generally, that under § 2523(f)(5)(A), if a donor spouse retains an interest in qualified terminable interest property, any subsequent transfer by the donor spouse of the retained interest in the property is not treated as a transfer for gift tax purposes. Further, the retention of the interest until the donor spouse's death does not cause the property subject to the retained interest to be includible in the gross estate of the donor spouse.

Section 25.2523(f)-1(d)(2) provides that under § 2523(f)(5)(B), the rule contained in § 25.2523(f)-1(d)(1) does not apply to any property after the donee spouse is treated as having transferred the property under § 2519, or after the property is includible in the gross estate of the donee spouse under § 2044.

Section 25.2523(f)-1(f), Example 10, illustrates the application of § 25.2523(f)-1(d) as follows:

> Retention by donor spouse of income interest in property. On October 1, 1994, D transfers property to an irrevocable trust under the terms of which trust income is to be paid to S for life, then to D for life and, on D's death, the trust corpus is to be paid to D's children. D elects under § 2523(f) to treat the property as qualified terminable interest property. D dies in 1996, survived by S. S subsequently dies in 1998. Under § 2523(f)-1(d)(1), because D elected to treat the transfer as qualified terminable interest property, no part of the trust corpus is includible in D's gross estate because of D's retained interest in the trust corpus. On S's subsequent death in 1998, the trust corpus is includible in S's gross estate under § 2044.

Section 25.2523(f)-1(f), Example 11, illustrates the application of § 25.2523(f)-1(d) as follows:

> Retention by donor spouse of income interest in property. The facts are the same as in Example 10, except that S dies in 1996 survived by D, who subsequently dies in 1998. Because D made an election under § 2523(f) with respect to the trust, on S's death the trust corpus is includible in S's gross estate under § 2044. Accordingly, under § 2044(c), S is treated as the transferor of the property for estate and gift tax purposes. Upon D's subsequent death in 1998, because the property was subject to inclusion in S's gross estate under § 2044, the exclusion rule in § 25.2523(f)-1(d)(1) does not apply under § 25.2523(f)-1(d)(2). However, because S is treated as the transferor of the property, the property is not subject to inclusion in D's gross estate under § 2036 or § 2038. If the executor of S's estate

made a § 2056(b)(7) election with respect to the trust, the trust is includible in D's gross estate under § 2044 upon D's later death.

In this case, the trustee is required to pay all the net income of the Trust at least quarter-annually to Spouse for her lifetime. If any trust asset becomes nonproductive, Spouse may require the trustee to sell the nonproductive asset and invest the proceeds in productive property. Thus, Spouse has the right to receive all of the net income from the Trust for life. In addition, no person has a power to appoint, during Spouse's lifetime, any part of the Trust to any person other than Spouse. Therefore, Spouse will have a qualifying income interest for life in the property, and Donor may make a gift tax QTIP election under § 2523(f) with respect to the property he transfers to the Trust. In that event, on the death of Spouse, the interest in the Trust will be includible in Spouse's gross estate under § 2044(a), unless Spouse has made a disposition of her income interest subject to § 2519. If Donor does not make a gift tax QTIP election, then the interest will not be includible in Spouse's gross estate.

Donor, as trustee of the Trust, has the power to pay to Spouse all or any part of the principal. Although Donor has the discretionary power as trustee to distribute principal from the Trust to Spouse, the exercise of this power will not be considered a transfer for gift tax purposes in accordance with § 2523(f)(5)(A).

If Spouse predeceases Donor, Donor will receive the net income of the Trust quarter-annually for life. Donor will have the power to make the trustee convert nonproductive assets into income producing assets. No person will have any power to appoint any of the trust property to anyone other than Donor during his lifetime. Therefore, on the death of Spouse, Donor will have a qualifying income interest for life in the trust property, and Spouse's estate may make an estate tax QTIP election under § 2056(b)(7) with respect to all or a part of the property in Trust at Spouse's death.

If an estate tax QTIP election is made by Spouse's estate, trust property for which the election was made will be includible in Donor's estate under § 2044 at his death (assuming no prior disposition by Donor subject to § 2519). If an estate tax QTIP election is not made by Spouse's estate, the trust property will not be includible in Donor's estate at his death.

If Donor makes a valid gift tax QTIP election pursuant to § 2523(f) and Donor predeceases Spouse, the assets transferred to the Trust by Donor will not be included in Donor's gross estate.

Consequently, based on the facts presented, we rule as follows:

1. If Donor makes a valid gift tax QTIP election pursuant to § 2523(f), each transfer by Donor to the Trust for the benefit of Spouse will qualify for the marital deduction for gift tax purposes under § 2523(a).

2. If Donor makes a valid gift tax QTIP election pursuant to § 2523(f) and predeceases Spouse, no part of the trust will be includible in Donor's gross estate. Furthermore, distributions of the Trust principal to Spouse by Donor as the trustee will not be considered transfers by Donor for gift tax purposes.

3. (a) If Donor makes a valid gift tax QTIP election pursuant to § 2523(f) and survives Spouse, the executor of Spouse's estate will be entitled to make an estate tax QTIP election under § 2056(b)(7) with respect to trust assets remaining at Spouse's death, and only that portion of the property subject to the QTIP election will ultimately be includible in Donor's gross estate under § 2044.

   (b) If Donor makes a valid gift tax QTIP election pursuant to § 2523(f) and survives Spouse, then, on the subsequent death of Donor, no portion of the trust assets will be includible in Donor's gross estate for estate tax purposes unless the executor of Spouse's estate elects to qualify a portion or all of the trust assets under § 2056(b)(7). If the executor of Spouse's estate elects to qualify a portion or all of the trust assets under § 2056(b)(7), then only that portion of the corpus for which the election is made will be includible in Donor's gross estate for estate tax purposes under § 2044 and not under § 2036 or § 2038.

   (c) If Donor makes a valid gift tax QTIP election pursuant to § 2523(f) and survives Spouse then, to the extent that an election under § 2056(b)(7) is not made with respect to part or all of the Trust corpus remaining at Spouse's death, that portion of the Trust for which an election under § 2056(b)(7) is not made will not be includible in Donor's gross estate for estate tax purposes.

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.

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

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

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.

Sincerely,

Melissa C. Liquerman
Branch Chief, Branch 9
Office of Associate Chief Counsel
(Passthroughs & Special Industries)