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Department of the Treasury
Washington, DC 20224

Person To Contact:
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Refer Reply To:
CC:PSI:B04 – PLR-145880-05
Date: MARCH 22, 2006

In Re:

Legend:

Trust Agreement =

Decedent =
Spouse =

Date 1 =
Son 1 =
Son 2 =
Son 3 =
Marital Trust =

Bank A =
Date 2 =
Court =
Date 3 =
Bank B =
Date 4 =
Date 5 =
State Statute 1 =
State Statute 2 =

Dear :

This is in response to a letter dated August 30, 2005, and other correspondence, requesting rulings regarding the federal gift and estate tax consequences of the proposed renunciation by Spouse of an interest in Marital Trust, as described below.

Facts

The facts submitted and representations made are as follows. During his life, Decedent executed a revocable trust agreement (Trust Agreement) and retitled his property in the name of the trustees. Decedent died on Date 1, survived by his Spouse, Son 1, Son 2, and Son 3.

Under the terms of Decedent's Trust Agreement, at Decedent's death, two trusts were established, Marital Trust and Family Trust. Under the terms of Marital Trust the trustee is to pay to Spouse for life all of the net income of Marital Trust, at least quarterly, and as much principal as the trustee deems necessary for Spouse's health, support, care, and comfort. At Spouse's death, any accrued, accumulated, or unpaid income will be paid to her estate. The remaining assets of Marital Trust (after payment of specified taxes and legal fees) will be divided into equal shares, one share for each then living child of Decedent, and one share for each then deceased child of Decedent with issue then living. Each share for a child will be distributed outright. Each share for a deceased child's issue will be further divided into equal shares, one share for each then living child of such deceased child of Decedent (grandchild) and one share for each then deceased grandchild with issue then living. Each share for a grandchild aged at least 21 will be distributed outright. Each share for a younger grandchild will be held in trust for the grandchild. Each share for the then living issue of a deceased grandchild will be distributed to such issue, per stirpes.

Article X of Trust Agreement provides, generally, that no interest of any beneficiary of a trust created by Trust Agreement shall be subject to encumbrance, assignment anticipation or alienation.

Decedent is named as trustee during his life; Spouse and Bank A are named as successor co-trustees upon Decedent's death.

By Court order dated Date 2, the Trust Agreement was modified to provide that if Spouse ceases to act as trustee, Sons 1, 2, and 3, or the competent survivor of them, will act as her successor individual co-trustees, with the corporate trustee exercising all authority concerning distributions of income and principal. Court order further provided that these individual co-trustees may remove and replace a corporate trustee and that all trustees are released from any liability due to a failure to diversify investments.

By Court order dated Date 3, Trust Agreement was modified to divide Marital Trust on a fractional basis into two separate trusts designated as GST Exempt Marital Trust and Marital Trust.

Spouse and Bank B (a successor of Bank A) currently serve as co-trustees of Marital Trust (Trustees). On Date 4, the Trustees 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 GST Exempt Marital Trust and Marital Trust as qualified terminable interest property (QTIP) under § 2056(b)(7) of the Internal Revenue Code.

On Date 5, the Trustees filed a petition with Court requesting an order, conditioned upon receipt of a favorable letter ruling from the Internal Revenue Service, modifying Marital Trust by authorizing the Trustees to divide Marital Trust into two trusts, Marital Trust A and Marital Trust B. The petition states that both Marital Trust A and Marital Trust B will be held under the terms of Trust Agreement, as modified by Court. The Trustees currently administering Marital Trust will continue to serve as the trustees of Marital Trust A and Marital Trust B. Marital Trust is currently funded entirely with publicly traded securities. Marital Trust B will be funded with no more than an amount equal to 75 percent of the assets of Marital Trust, and Marital Trust A will be funded with the balance of the assets of Marital Trust**.** It is anticipated both trusts will be funded to the extent possible on a pro rata basis.

In addition, Spouse, Son 1, Son 2, Son 3, and the Trustees will execute and file with Court an Agreement Concerning Net Gifts and Payment of Gift Taxes (Agreement). Under the proposed Agreement, Sons 1, 2, and 3 agree that if Spouse renounces all of her interests in Marital Trust B, Son 1, 2 and 3 will pay all resulting gift taxes "whether attributable to a remainder or a qualifying income interest," so that the resulting transfers by Spouse will be treated as net gifts and Spouse will have no responsibility for payment of gift taxes, or interest on gift taxes, as a result of the renunciation.

After the two trusts are funded, Spouse will execute and file with Court a renunciation of all of her right, title, and interest in Marital Trust B. Spouse's renunciation will not be a qualified disclaimer under § 2518.

The Trustees have further requested Court to find that upon Spouse's renunciation, under State law and consistent with Trust Agreement, Spouse's interest in Marital Trust B will pass as if Spouse had died on the date of her renunciation. Thus, Marital Trust B will terminate and the remainder will accelerate. The Trustees requested Court to order that upon this termination and acceleration, the assets of Marital Trust B will be divided into equal shares among Sons 1, 2, and 3, if they are then living; otherwise, the share of a deceased Son will pass, per stirpes, to the deceased son's then surviving issue, if any.

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 that a recipient of any beneficial interest under a testamentary or nontestamentary instrument may renounce in whole or in part, or with reference to specific fractional shares, undivided portions or assets thereof, by filing a written renunciation within the time provided. If the interest is not renounced within the time period provided, State Statute provides:

> [T]he interest renounced, and any future interest which is to take effect in possession or enjoyment at or after the termination of the interest renounced, passes as if the person renouncing had died on the date the interest was renounced. The person renouncing shall have no power to direct how the interest being renounced shall pass…

State Statute further provides that the right to renounce exists "irrespective of any limitation on the interest of the person renouncing in the nature of a spendthrift provision."

The taxpayers have requested the following rulings:

1. The proposed division of Marital Trust into Marital Trust A and Marital Trust B, and the funding of such trusts, as described above, will not affect the status of Marital Trust, GST Exempt Marital Trust, or of Marital Trust A and Marital Trust B as qualified terminable interest property under § 2056(b)(7)(B)(v).

2. Under § 2519, Spouse's renunciation of her qualifying income interest in Marital Trust B will be treated as a transfer by Spouse of all interests in Marital Trust B other than her qualifying income interest. Spouse will be treated as making a net gift; and, under § 2519, the amount of the net gift will be the fair market value of the transferred property on the date of disposition, reduced by the gift taxes attributable to the transferred property actually paid by Sons 1, 2, and 3.

3. Upon renouncing her qualifying income interest in Marital Trust B, Spouse will be treated as making a net gift, under § 2511. The amount of the net gift will be the fair market value of the qualifying income interest on the date of disposition, reduced by the gift taxes attributable to the qualifying income interest actually paid by Sons 1, 2, and 3.

4. After Spouse renounces her entire interest in Marital Trust B, no part of the value of the property in Marital Trust B that is deemed to be transferred under §2519 will be included in Spouse's gross estate pursuant to § 2044(b)(2).

5. Spouse's renunciation of her entire interest in Marital Trust B will not result in a transfer under § 2519 of any of the assets of Marital Trust A or of GST Exempt Marital Trust.

6. When Spouse renounces her entire interest in Marital Trust B, Spouse's interests in Marital Trust A and in GST Exempt Marital Trust will not be valued at zero under § 2702.

Ruling #'s 1-5:

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 (QTIP). Under § 2056(b)(7)(A), 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 2044 provides for the inclusion in the gross estate of the surviving spouse of the value of qualified terminable interest property for which a deduction was allowed under § 2056(b)(7) in the decedent's gross estate. Under § 2044(b)(2), section §2044 does not apply with respect to qualified terminable interest property treated as transferred for gift tax purposes by the surviving spouse during her lifetime under § 2519.

Section 2501 imposes a tax on the transfer of property by gift. Section 2511 provides that the gift tax imposed by section 2501 shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

Section 25.2511-2(a) 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 2518 provides that, if a person makes a qualified disclaimer with respect to any interest in property, the disclaimed interest is treated as if it had never been transferred to the person making the qualified disclaimer for purposes of the federal estate, gift, and generation-skipping transfer tax provisions. Section 25.2518-1(b) provides that, if a qualified disclaimer is made, the disclaimed property is considered as passing directly from the transferor of the property to the person entitled to receive the property as a result of the disclaimer.

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)(1), 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 the unified credit is available.

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 Court issues the requested order and that the proposed division of Marital Trust and Spouse's renunciation are both effective under State law, we conclude as follows.

1. The proposed division of Marital Trust into Marital Trust A and Marital Trust B, and the funding of the new trusts as described above will not affect the status of Marital Trust, GST Exempt Marital Trust, or of Marital Trust A and Marital Trust B as qualified terminable interest property under § 2056(b)(7)(B)(v).

2. Under § 2519, Spouse's renunciation of her qualifying income interest in Marital Trust B will be treated as a transfer by Spouse of all interests in Marital Trust B other than her qualifying income interest. Under §§ 25.2519-1(c)(1) and 25.2519-1(c)(4) the amount of the gift is equal to the fair market value of Marital Trust B on the date of the disposition (including any accumulated income), less the value of Spouse's qualifying income interest in the property on the date of the disposition, less the gift tax attributable to the transferred property.

3. Upon renouncing her qualifying income interest in Marital Trust B, Spouse will be treated as making a gift under § 2511. The amount of the gift will be equal to the fair market value of Spouse's qualifying income interest on the date of disposition, reduced by the gift tax attributable to the qualifying income interest actually paid by Sons 1, 2, and 3.

4. After Spouse renounces her entire interest in Marital Trust B, no part of the value of the property in Marital Trust B that is deemed to be transferred under § 2519 will be included in Spouse's gross estate pursuant to § 2044(b)(2).

5. Spouse's renunciation of her entire interest in Marital Trust B will not result in a transfer under § 2519 of any of the assets of Marital Trust A or of GST Exempt Marital Trust.

6. We have concluded in Ruling #5 that Spouse's renunciation of her entire interest in Marital Trust B will not result in a transfer by Spouse under § 2519 with respect to any interest in Marital Trust A or GST Exempt Marital Trust. Accordingly, Spouse will not be treated as making a deemed gift under § 2519 with respect to Marital Trust A or GST Exempt Marital Trust, while retaining an income interest in the transferred property. Compare, § 25.2519-1(g), Example 4. Accordingly, § 2702 does not apply with respect to the proposed transfer.

Except as specifically ruled herein, we express no opinion on the federal tax consequences of the transaction. In addition, we express or imply no opinion regarding the value of the property in Marital Trust.

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.

Sincerely yours,

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George Masnik, Chief
Branch 4
Office of Associate Chief Counsel
(Passthroughs and Special
Industries)

Enclosure
Copy for section 6110 purposes