

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

CC:DOM:P&SI:4-PLR-118591-98

Date:

September 28, 1999

In Re:

LEGEND

- Grantor =
- Corporation =
- Trust =
- Marital Trust =

- Family Trust =

- Spouse =
- Child 1 =
- Child 2 =
- Child 3 =
- Individual 1 =
- Individual 2 =

Dear :

This is in response to your letter of September 23, 1999, and prior correspondence, in which you requested a ruling concerning the estate and generation-skipping transfer tax consequences of the provisions of a will and trust.

Corporation is an S corporation under § 1361 of the Internal Revenue Code. A majority of the stock in Corporation is owned by Grantor, his children, his siblings, and their children. Grantor owns 16 percent of the stock in and holds a management position with Corporation. Grantor's children, Child 1, Child 2, and Child 3, own collectively less than 10 percent of the stock in Corporation, and no shareholder owns more than 20 percent of the stock.

On February 27, 1995, Grantor executed a will. Sections FIRST through THIRD of the will provide for specific bequests to members of Grantor's family. Section

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FOURTH provides that the residue of Grantor's estate is to be paid to Trust, a revocable trust that Grantor executed on February 27, 1995, and subsequently amended.

Article I of Trust provides that, during the Grantor's lifetime, the trustee is to pay Grantor so much or all of the net income or principal of the trust that Grantor directs, in writing.

Article IV(A) of Trust provides that, if Spouse should survive Grantor, the trustee is to distribute 25 percent of Grantor's stock in Corporation to the trustee of a marital trust (Marital Trust) to be established under the terms of Article VI of Trust. If Spouse does not survive Grantor, the stock will be distributed under the terms of Article IV(B).

Article IV(B) of Trust provides that, at Grantor's death, the trustee is to distribute the remaining stock in Corporation to the trustee of a family trust (Family Trust) to be established under Article VII.

Article VI of Trust provides the terms under which Marital Trust is to be administered. Article VI(A) provides that, upon Grantor's death, the trustee is to distribute all of the net income of the Marital Trust to Spouse in quarterly or more frequent installments, during her lifetime.

Article VI(B) of Trust provides that the trustee is to pay to Spouse principal of the marital trust that is necessary for her maintenance or support in the manner to which she was accustomed at the time of Grantor's death. If the principal of the marital trust consists of stock in Company, the trustee must consider other resources available to Spouse when deciding whether to distribute principal to her.

Article VI(C) of Trust provides that, upon the request of Spouse, the trustee is to convert non-income producing property to income producing property. If Spouse requests the trustee to convert the stock in Corporation held by the marital trust to income producing property, the trustee is first to provide each of Grantor's children with the right to purchase the stock at its then fair market value as determined by an independent appraisal and under such terms and conditions as would be agreed upon by parties dealing at arms length.

Article VI(D) of Trust provides that, upon Spouse's death, the trustee is to distribute the income for the period between the date of the last income distribution and the date of Spouse's death, free of trust to Spouse's estate. In addition, the trustee is, except to the extent Spouse's will contains a different direction for the payment of death taxes that specifically refer to the Marital Trust, make available from the corpus of the trust to the personal representative of Spouse's estate, the amount that the personal representative determines to be equal to the excess of (1) the death taxes that would have become payable by reason of spouse's death; over (2) the death taxes that would

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have become payable by reason of Spouse's death if, in the computation thereof, there had not been included any part of the property belonging to the Marital Trust. The remaining trust property shall be added to and consolidated with the Family Trust.

Article VI(G) of Trust provides that, it is Grantor's intent that Marital Trust shall qualify for the federal estate tax marital deduction and also qualify as a qualified subchapter S trust (QSST) under § 1361(d)(3).

Under Article VI(H)(1) of Trust, Spouse, alone, shall have the exclusive authority to vote the stock of Corporation held by the Marital Trust for as long as she serves as a trustee of the Marital Trust. If Spouse ceases to serve as trustee, then the remaining trustees shall vote the stock of Corporation held by Marital Trust.

Article VII(A) of Trust provides that Family Trust shall be administered for the benefit of Grantor's surviving issue. All funds distributed to the trustee are to be divided into as many equal shares as there are children of the Grantor then living or then deceased leaving surviving issue. The trustee shall hold one share for each then living child of Grantor.

Article XX.B.2. of Trust provides that Spouse, Child 1, Child 2, and Child 3 will be the trustees of the Marital Trust. In the event of the death, incapacity or failure to serve of any trustee, that trustee shall not be replaced and the remaining trustees shall continue to serve in the capacity.

Grantor has requested a ruling that the Corporation stock with which the Marital Trust will be funded will be qualified terminable interest property and that the Marital Trust will qualify for the marital deduction under § 2056(b)(7).

Law and Analysis

Section 2031 defines the decedent's gross estate to include the value of all property to the extent provided for in §§ 2033 through 2045.

Section 2033 includes in the decedent's gross estate, the value of all property to the extent of the interest held by the decedent at the time of the decedent's death.

Section 2056(a) provides that the value of a decedent's taxable estate shall 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.

Section 2056(b)(7) provides an exception to the general rule disallowing a marital deduction for terminable interest property passing from decedent to a surviving spouse,

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if the property passing to the spouse constitutes "qualified terminable interest property." Qualified terminable interest property is property that passes from the decedent, in which the surviving spouse has a qualifying income interest for life, and to which an election under § 2056(b)(7) applies. The surviving spouse has a qualifying income interest for life if the surviving spouse is entitled for life to all the income from the property payable annually or at more frequent intervals, and no person has a power to appoint any part of the property to any person other than the surviving spouse.

Section 20.2056(b)-7(d)(2) of the Estate Tax Regulations provides that, in determining if a spouse is entitled to all the income from trust property, the rules contained in § 20.2056(b)-5(f) apply.

Section 20.2056(b)-5(f)(1) provides that, if an interest is transferred in trust, the surviving spouse is entitled to all of the income from the entire interest or a specific portion of the entire interest, if the effect of the trust is to give her substantially that degree of beneficial enjoyment of the trust property during her life which the principles of the law of trusts accord to a person who is unqualifiedly designated as the life beneficiary of a trust. Such degree of enjoyment is given only if it was the decedent's intention, as manifested by the terms of the trust instrument and the surrounding circumstances, that the trust should produce for the surviving spouse during her life such an income, or that the spouse should have such use of the trust property as is consistent with the value of the trust corpus and with its preservation. The designation of the spouse as sole income beneficiary for life of the entire interest or a specific portion of the entire interest will be sufficient to qualify the trust, unless the terms of the trust and the surrounding circumstances considered as a whole evidence an intention to deprive the spouse of the requisite degree of enjoyment. In determining whether a trust evidences that intention, the treatment required or permitted with respect to individual items must be considered in relation to the entire system provided for the administration of the trust.

Section 20.2056(b)-5(f)(2) provides that, if the overall effect of a trust is to give the surviving spouse such enforceable rights as will preserve to her the requisite degree of enjoyment, it is immaterial whether that result is effected by rules specifically stated in the trust instrument, or, in their absence, by the rules for the management of the trust property and allocation of receipts and expenditures supplied by state law.

Section 20.2056(b)-5(f)(4) provides that a trustee's power to retain assets that consist substantially of unproductive property will not disqualify the spouse's lifetime income interest if the applicable rules for the trust administration require, or permit the spouse to require, that the trustee either make the property productive or convert it into productive property within a reasonable time.

Section 20.2056(b)-5(f)(5) provides that the spouse will not be entitled to all the income from the trust if the trust is funded with substantially unproductive property and

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the spouse cannot compel the trustee to either make the property productive or convert the trust assets into productive property.

In this case, Grantor owns 16 percent of the stock in Corporation. Section FOURTH of his will provides that the residue of his estate is to be paid to Trust. Article IV(A) of Trust provides that, if Spouse should survive Grantor, 25 percent of Grantor's stock in Corporation is to be distributed to Marital Trust. Marital Trust provides that the trustee is to distribute the net income of the Marital Trust to Spouse during her lifetime. Spouse will be a trustee of the trust and vote the stock of Corporation. If Spouse fails to act as trustee, the other trustees will vote the stock in Corporation.

Furthermore, Marital Trust also provides that, if the stock in Corporation should become unproductive, Spouse has the authority to require the trustee to convert the stock into income producing property. If Spouse requests the trustee to convert the stock into income producing property, Grantor's children have the right of first refusal to purchase the stock at its fair market value as determined by an independent appraisal and under such terms and conditions as would be agreed upon by parties dealing at arms length. This restriction does not prevent the trust from receiving full value for the stock if the stock is sold to the children, nor does it restrict the trustees' ability to sell the stock.

Based on the facts submitted and the representations made, we conclude that the Corporation stock with which the Marital Trust will be funded will be qualified terminable interest property and that the Marital Trust will qualify for the marital deduction under § 2056(b)(7).

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

The ruling contained in this letter is 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 yours,

Assistant Chief Counsel
(Passthroughs and Special
Industries)

By _____
George Masnik

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Chief, Branch 4

Enclosure (1)

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