

## Internal Revenue Service

Department of the Treasury

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Person to Contact:

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### LEGEND

Taxpayer =

Decedent =

Date 1 =

Date 2 =

x\$ =

y% =

z% =

Child =

Children =

Trustee =

Trust A =

Trust A Marital Share =

Trust B =

Dear :

This refers to your representative's letter dated September 11, 2000 and prior correspondence, requesting the following Federal gift tax rulings:

1. Trustee's distribution to Taxpayer of all but x\$ of the Trust A Marital Share pursuant to the settlement agreement will not be treated as a disposition under Internal Revenue Code § 2519.

2. Taxpayer's nonqualified disclaimer of her interest in the Trust A Marital Share will be treated as a disposition of Taxpayer's qualifying income interest for life under section 2519. Accordingly, as a result of the disclaimer, Taxpayer is treated as making the following gifts for Federal gift tax purposes: (i) a gift under section 2511 of her qualifying income interest in the Trust A Marital Share that remains after Trustee's distribution of principal under the settlement agreement; and (ii) a gift under section 2519 of the fair market value of the entire property of the Trust A Marital Share that remains after the Trustee's distribution of principal under the settlement agreement, less the sum of (a) the value of her qualifying income interest (determined after the settlement agreement distribution to Taxpayer), and (b) the amount of gift tax that may be recovered by Taxpayer from the Trustee of the Trust A Marital Share under section 2207A(b).

3. Taxpayer's waiver of her right to recover the amount of gift tax that Taxpayer may be entitled to recover from the Trustee of the Trust A Marital Share under section 2207A(b) by reason of her disclaimer will constitute a gift under section 2511 by Taxpayer in the amount of the unrecovered gift taxes.

The facts and representations submitted are as follows.

Decedent died on Date 1. Decedent was survived by his wife, Taxpayer. Decedent's will provided for certain specific bequests with the residue of his estate passing to Trust A, an inter vivos revocable trust established by Taxpayer prior to his death. Prior to establishing Trust A, Decedent had created and funded another revocable trust, Trust B. Trust B was not specifically amended and superseded by Trust A.

Trust A provides for the establishment of three trusts. Trust A provides that y% of Decedent's adjusted gross estate is to be allocated to a marital trust (Trust A Marital Share) for the benefit of Taxpayer. The terms of this trust provide that Taxpayer receive annually all of the income and as much of the principal as the trustee may determine to be in her best interests. On Taxpayer's death, the remaining principal of this trust is to be distributed to the other two trusts established pursuant to the terms of Trust A. The primary beneficiary of one of these trusts is Decedent's Child, and the primary beneficiaries of the other trust are Taxpayer's Children.

Under Trust B, an amount equal to z% of Decedent's adjusted gross estate is to be held for the benefit of Taxpayer. The terms of Trust B provide that Taxpayer is to receive annually all of the income and as much of the principal as the trustee may determine to be in her best interests. On Taxpayer's death, the trust grants her the testamentary power to appoint the balance of Trust B to any person or persons (including her estate, creditors or the creditors of her estate).

Decedent's executor interpreted Decedent's dispositive instruments as requiring Decedent's estate to be disposed of under the terms of Trust A. Accordingly, on Decedent's federal estate tax return, the executor treated all of the property of Trust B as subject to the terms of Trust A. The executor then elected to treat the Trust A Marital Share as qualified terminable interest property under section 2056(b)(7).

Taxpayer, Decedent's lineal descendants and the trustees of Trusts A and B have been involved in substantial and continuing litigation involving, inter alia, the extent to which the terms of Trust A or Trust B control the disposition of the marital share. The parties propose to resolve the marital share issue in accordance with the terms of a settlement agreement that provides, in part:

1. Trustee will allocate the marital and residuary shares of Decedent's estate in accordance with the provisions of Trust A.
2. Trustee will distribute to Decedent's Child the entire income and principal of the trust established for his benefit under Trust A that is attributable to the residuary share.
3. Pursuant to the discretionary authority granted by the provisions of the Trust A Marital Share, Trustee will distribute to Taxpayer in her best interests the amount allocated to the Trust A Marital Share less x\$;
4. Taxpayer will renounce her interest in the remaining Trust A Marital Share property including, but not limited to, any right to recover taxes, interest or penalties that may be recovered under section 2207A(b) by Taxpayer from the Trust A Marital Share.
5. After Taxpayer's renunciation, the Trustee shall distribute the x\$ of property remaining subject to the Trust A Marital Share to the trusts established for Decedent's Child and Taxpayer's Children.

The county probate court approved the settlement agreement on Date 2. The court's order provides that under applicable state law and the provisions of Trust A, Trustee is authorized to make each and every distribution as described in the settlement agreement.

## LAW AND ANALYSIS:

Section 2056(a) provides that for purposes of the tax imposed by section 2001, the value of the taxable estate shall, except as limited by subsection (b), be determined by deducting from the value of the gross estate an amount equal to the value of any interest in property which passes or has passed from the decedent to his surviving spouse, but only to the extent that such interest is included in determining the value of the gross estate.

Section 2056(b)(1) provides, in pertinent part, that where, on the lapse of time, on the occurrence of an event or contingency, or on the failure of an event or contingency to occur, an interest passing to the surviving spouse will terminate or fail, no deduction shall be allowed under this section with respect to such interest-

(A) if an interest in such property passes or has passed (for less than an adequate and full consideration in money or money's worth) from the decedent to any person other than such surviving spouse (or the estate of such spouse); and

(B) if by reason of such passing such person (or his heirs or assigns) may possess or enjoy any part of such property after such termination or failure of the interest so passing to the surviving spouse;

and no deduction shall be allowed with respect to such interest (even if such deduction is not disallowed under subparagraphs (A) and (B))-

(C) if such interest is to be acquired for the surviving spouse, pursuant to directions of the decedent, by his executor or by the trustee of a trust.

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 this paragraph applies.

Section 2056(b)(7)(B)(ii) provides, in relevant part, that a surviving spouse has a qualifying income interest for life if (I) the surviving spouse is entitled to all of 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, excluding a power exercisable only at or after the death of the surviving spouse.

Section 2501 provides that a tax, computed as provided in section 2502, is hereby imposed for each calendar year on the transfer of property by gift during such calendar year by any individual, resident or nonresident.

Section 2511(a) provides, in relevant part, that the 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.

Treas. Reg. § 25.2511-1(a) provides that the gift tax applies to a transfer by way of gift 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 2519(a) provides that for purposes of Chapters 11 and 12 of Subtitle B, relating to the estate and gift tax, any disposition of all or part of a qualifying income interest for life in any property to which section 2519 applies shall be treated as a transfer of all interests in such property other than the qualifying income interest. Section 2519(b) provides, in relevant part, that section 2519 applies to any property if a deduction was allowed with respect to the transfer of such property to the donor under section 2056(b)(7).

Treas. Reg. § 25.2519-1(c)(1) provides that the amount treated as a transfer under section 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 section 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.

Treas. Reg. § 25.2519-1(e) provides “[t]he exercise by any person of a power to appoint qualified terminable interest property to the donee spouse is not treated as a disposition under section 2519, even though the donee spouse subsequently disposes of the appointed property.”

Section 2207A(b) provides generally that if a gift tax is paid with respect to any person because of a transfer made by that person under section 2519, then that person shall be entitled to recover the tax attributable to the transfer from the person receiving the property.

Under § 25.2207A-1(a), if an individual is treated as transferring an interest in property by reason of section 2519, the individual is entitled to recover from the “person receiving the property” 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, if the property does not remain in trust, any person receiving the property prior to the expiration of the right of recovery.

Section 2518(a) provides, in part, that if a person makes a qualified disclaimer with

respect to any interest in property, then subtitle B of the Code shall apply with respect to such interest as if the interest had never been transferred to such person. Section 2518(b)(2) provides, in part, that a disclaimer will not be treated as a qualified disclaimer unless it is made within nine months after the date on which the transfer creating the interest in such property is made.

### Ruling #1

Taxpayer, Decedent's lineal descendants, and the trustees of Trusts A and B have been involved in substantial and continuing litigation. Pursuant to the provisions of the Trust A Marital Share, Trustee possessed the power to appoint property from the Trust A Marital Share to Taxpayer in her best interests. Under the terms of the settlement agreement, Trustee will distribute to Taxpayer, pursuant to the discretionary authority granted by the Trust A Marital Share, all but x\$ of the Trust A Marital Share, and Taxpayer will disclaim her interest in the remaining property of the Trust A Marital Share. The probate court's order, approving the settlement agreement, provides that the distribution of principal to Taxpayer was authorized under the provisions of the Trust A Marital Share.

The Trust A Marital Share satisfies the requirements of section 2056(b)(7), because the property passed from Decedent, Taxpayer has a qualifying income interest for life, and the executor made the election under section 2056(b)(7). The distribution to Taxpayer was made pursuant to a power to appoint qualified terminable interest property to the donee spouse. See Treas. Reg. § 25.2519-1(e). Accordingly, Trustee's distribution pursuant to the marital share of all but x\$ of the Trust A Marital Share will not constitute a disposition under section 2519.

### Ruling #2

The settlement agreement provides that following the distribution to Taxpayer of all but x\$ of the Trust A Marital Share, Taxpayer will disclaim her interest in the remaining property of the Trust A Marital Share. The settlement agreement further provides that Taxpayer will waive her right to recover the gift tax that she may be entitled to recover under section 2207A(b) from the Trust A Marital Share.

The term "disposition," as used in section 2519, applies broadly to circumstances in which the surviving spouse's right to receive the income is relinquished or otherwise terminated, by whatever means. See H. R. Rep. No. 201, 97<sup>th</sup> Cong., 1<sup>st</sup> Sess. 161 (1981) that states:

The bill provides that property subject to a [QTIP election] will be subject to transfer taxes at the earlier of (1) the date on which the spouse disposes (either by gift, sale, or otherwise) of all or part of the qualifying income interest, or (2) upon the spouse's death.

The estate tax marital deduction provisions are intended to provide a special tax benefit that allows property to pass to the surviving spouse without the decedent's estate paying tax on its value. Tax is deferred on the transfer until the surviving spouse either dies or makes a lifetime disposition of the property. See Rev. Rul. 98-8, 1998-1 C.B. 541. It is necessary under the estate and gift tax laws to tax the transfer of the remainder interest because the predeceased spouse's estate received a marital deduction for the terminable interest property, and after the inter vivos transfer of the qualifying income interest, the remainder will no longer be included in the surviving spouse's estate under section 2044.

Where the gift tax will be imposed as a result of a transfer under section 2519, section 2207A(b) statutorily shifts the tax burden, but not the liability, for paying the gift tax to the donee. The amount treated as transferred under section 2519 should be reduced by the portion of the gift tax that may be recovered by Taxpayer under section 2207A(b).

Because Taxpayer's disclaimer of her income interest in the Trust A Marital Share will not be a qualified disclaimer under section 2518, Taxpayer's relinquishment of the income interest in the Trust A Marital Share will be treated as a disposition of Taxpayer's qualifying income interest for life under section 2519. Accordingly, as a result of the disclaimer, Taxpayer is treated as making the following gifts for Federal gift tax purposes: (i) A gift under section 2511 of her qualifying income interest in the Trust A Marital Share that remains after the Trustee's distribution of principal under the settlement agreement; and (ii) a gift under section 2519 of the fair market value of the entire property of the Trust A Marital Share that remains after the Trustee's distribution of principal under the settlement agreement, less the sum of (a) the value of her qualifying income interest (determined after the settlement agreement distribution to Taxpayer), and (b) the amount of gift tax that may be recovered by Taxpayer from the Trustee of the Trust A Marital Share under section 2207A(b).

### Ruling #3

Taxpayer's disclaimer will provide that Taxpayer waives the right to recover from the Trustee the portion of gift tax that Taxpayer may be entitled to recover under section 2207A(b). Failure of a person to exercise a right of recovery provided by section 2207A(b) upon a lifetime transfer subject to section 2519 is treated as a transfer for Federal gift tax purposes of the unrecovered amounts to the persons from whom such recovery could have been obtained. See Treas. Reg. § 25.2511-1. Accordingly, because Taxpayer will waive her right to recover gift taxes that she is otherwise entitled to recover, the amount of the unrecovered gift taxes will be treated as a taxable transfer under section 2511 from Taxpayer to the person or persons receiving the remainder interest. See Treas. Reg. § 25.2207A-1(e).

The rulings contained in this letter are based upon information and representations submitted by Taxpayer and accompanied by a penalties 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 and examination.

Except as expressly provided herein, we express or imply no opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter under any provisions of the Code.

This ruling is directed only to the taxpayer(s) 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.

Sincerely yours,  
Melissa C. Liquerman  
Senior Technician Reviewer  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosure: Copy of §6110 purposes