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Third Party Communication: None
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Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B09
PLR-154441-04

Date:
April 12, 2005

Decedent =
Revocable Trust =
Date 1 =
State =
Spouse =
x =
Individual =
Daughter 1 =
Daughter 2 =
Date 2 =
Court =

y =
Statute A =

Statute B =

Dear :

This is in response to the letter dated October 12, 2004, submitted on your behalf by your authorized representative, requesting rulings concerning the federal gift and estate tax treatment of the proposed severance of a trust into two trusts and the subsequent renunciation of a qualified income interest in one of the severed trusts.

The facts submitted and the representations made are summarized as follows:
Decedent created Trust on Date 1. Decedent died testate, a resident of State.

Article Five of Trust provides that the balance of the trust estate remaining after making all payments and distributions required to be made (upon the death of Decedent) in any foregoing provision of Trust is to be called the Residuary Trust Estate.

Article Six, Paragraph A of Trust provides that if Spouse survives Decedent, the Residuary Trust Estate shall become the principal of the Marital Trust. The trustees shall pay to Spouse during her lifetime the net income from the Marital Trust in quarterly or more frequent intervals. The trustees may distribute principal to Spouse during her lifetime for her maintenance, health, and welfare.

Article Six, Paragraph A(1) through A(4) of Trust, provides for distributions upon the death of Spouse, in the following order:

- (1) The trustees shall distribute to the personal representative of Spouse's estate any net income then on hand or accrued.
- (2) The trustees shall distribute to the personal representative of Spouse's estate the amount by which the total of all estate, inheritance, and succession taxes which are payable by reason of the death of Spouse is greater than the taxes would have been if no part of the principal of the Marital Trust had been required to be taken into account in the determination of the taxes.
- (3) The trustees shall distribute \$x to Individual, the son of Spouse, if Individual shall survive Spouse.
- (4) The trustees shall divide the balance of the principal of the Marital Trust into equal shares, one for the benefit of Daughter 1, or if she shall not survive Spouse, to such of Daughter 1's descendants as shall survive Spouse, in equal subshares *per stirpes*, and one for the benefit of Daughter 2, or if she shall not survive Spouse, to such of Daughter 2's descendants as shall survive Spouse, in equal subshares *per stirpes*.

Article Nine, Paragraph A(15) of Trust provides the trustees with the authority to distribute assets in cash or in kind or partly each, and to make non pro-rata distributions.

Article Fourteen of Trust provides that the right of any person to receive any amount of income or principal under the provisions of Trust shall not be anticipated, alienated, assigned or encumbered.

Decedent died on Date 2, survived by Spouse. On the United States Estate (and Generation-Skipping Transfer) Tax Return (Form 706) for Decedent's estate, an election was made to treat the Marital Trust as qualified terminable interest property pursuant to § 2056(b)(7)(B)(v) of the Internal Revenue Code.

As of the date of this ruling request, Daughter 1, Daughter 2, and Individual are still living.

Spouse has petitioned Court for an order to sever the Marital Trust into two separate and distinct marital trusts, to be called Marital Trust A and Marital Trust B. Marital Trust A and Marital Trust B will have terms identical to the Marital Trust, except that

Marital Trust B will not contain the provision in Article Six, Paragraph A(3) of Trust that provides for a distribution of \$x to Individual upon the death of Spouse, if he survives Spouse. Marital Trust A will continue to include this provision of Trust so that Individual's aggregate interest after the severance will remain the same as his interest in the Marital Trust before the severance, as required by State law.

Pursuant to Court's order, Marital Trust B will be funded with \$y and the balance of the Marital Trust's assets will fund Marital Trust A.

The order further provides that once the Marital Trust is severed into two separate trusts, Marital Trust A and Marital Trust B, Spouse will renounce her entire interest in Marital Trust B and will waive her right of recovery under § 2207(A)(b) for any gift taxes paid as a result of the renunciation. It has been represented that under State law, upon Spouse's renunciation, Marital Trust B will terminate and accelerate.

Upon the termination and acceleration of Marital Trust B occurring as a result of Spouse's renunciation of her interest in Marital Trust B, the assets of Marital Trust B shall be divided into shares for Daughter 1 and Daughter 2.

The following rulings have been requested:

1. The proposed severance of Marital Trust into two new trusts (Marital Trusts A and B) as permitted by State law, the funding of such trusts, and the subsequent renunciation by Spouse of her entire interest therein, will have no effect on the status of Marital Trusts A and B as QTIP trusts.
2. When Spouse renounces her qualified income interest in Marital Trust B, pursuant to § 2519, she will be deemed to have made a transfer of all of Marital Trust B's property, other than her qualifying income interest therein. Spouse is treated as making a gift under § 2519 of the fair market value of Marital Trust B reduced by the value of the qualified income interest of Spouse, and further reduced by the amount Spouse is entitled to recover under § 2207A(b).
3. When Spouse renounces her qualified income interest in Marital Trust B, the transfer of Spouse's income interest is a transfer by Spouse under § 2511. The amount of the gift will be the value of Spouse's qualified income interest.
4. When Spouse waives her right of recovery provided by § 2207A(b), she is treated as transferring the unrecovered gift tax amount to Daughter 1 and Daughter 2, from whom the recovery could have been obtained. The amount of the gift will be the amount of reimbursement to which Spouse was entitled.

5. When Spouse renounces her entire interest in Marital Trust B, no part of the trust's property deemed transferred by § 2519 will be included in Spouse's gross estate pursuant to § 2044(b)(2).
6. When Spouse renounces her entire interest in Marital Trust B, such renunciation will not result in a transfer under § 2519 of any of the assets of Marital Trust A.
7. When Spouse renounces her entire interest in Marital Trust B, Spouse's interest in Marital Trust A will not be valued at zero pursuant to § 2702.

LAW:

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(a) applies to any property if a deduction was allowed with respect to the transfer of such property to the decedent under § 2056(b)(7) and § 2519 did not apply with respect to a disposition by the decedent of part or all of such property.

Section 2056(b)(7) allows an estate tax marital deduction for qualified terminable interest property. Under § 2056(b)(7)(B)(i), the term "qualified terminable interest property" means property that passes from the decedent, in which the surviving spouse has a qualifying income interest for life, and to which the qualified terminable interest 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 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 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) of the Gift Tax Regulations, 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" 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 of the Code 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 of the Code 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 receiving the property prior to the expiration of the right of recovery.

Section 2501 imposes a tax on the transfer of property by gift by an individual. Under § 2502(c), the gift tax imposed under § 2501 is the liability of the donor.

Section 2511 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) 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 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 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 of the Code as transferring all interests in property other than the qualifying income interest. 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). 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 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.

The law of State, at Statute A, section (2)(bb), provides that unless otherwise provided in the trust instrument, a trustee has the power to sever any trust on a fractional basis into two or more separate and identical trusts for any reason or to segregate by allocation to a separate account or trust a specific amount from, a portion of, or specific assets included in, the trust property of any trust, unless expressly provided to the contrary in the trust instrument. Each separate trust must be held and administered upon the identical terms and conditions of the trust from which it was severed. Subject to the terms of the trust, the trustee may take into consideration differences in federal tax attributes and other pertinent factors in administering the trust property of any separate account or trust, in making applicable tax elections, and in making distributions. A separate trust created by severance must be treated as a separate trust for all purposes from the date on which the severance is effective. The effective date of the severance may be retroactive to a date before the date on which the trustee exercises such power.

The law of State, at Statute B, section (1)(a)(2), provides, in pertinent part, that unless expressly provided to the contrary in the trust instrument, the court may permit a trustee to sever any trust on a fractional basis into two or more separate trusts for any reason, and to segregate by allocation to a separate account or trust a specific amount from, a portion of, or a specific asset included in the trust property of any trust to reflect a disclaimer, to reflect or result in differences in federal tax attributes, to satisfy any federal tax requirement, to make federal tax elections, to reduce potential generation-skipping transfer tax liability, or for any other tax planning purposes or other reasons. A separate trust created by severance must be treated as a separate trust for all purposes from the effective date on which the severance is effective. The effective date of the

severance may be retroactive to a date before the date on which the court approves the severance.

The law of State, at Statute B, section (1)(b), provides, in pertinent part, that a trust created by consolidation or severance under this section must be held on terms and conditions identical to those before the consolidation or severance, or upon such terms or conditions that the aggregate interest of each beneficiary after the consolidation or severance will be reasonably equivalent to that beneficiary's aggregate interests before the consolidation or severance. In determining whether a beneficiary's aggregate interests are reasonably equivalent, the court shall consider the economic value of those interests to the extent that they can be valued, considering such actuarial factors as may be appropriate.

RULING 1:

Pursuant to the terms of the Marital Trust and the qualified terminable interest property election made by Decedent's estate, the assets of the Marital Trust are treated as qualified terminable interest property under § 2056(b)(7)(i). After the severance of the Marital Trust, Marital Trusts A and B will have terms identical to the Marital Trust, except that the provision for a distribution of a pecuniary amount to Individual will be retained in Marital Trust A and not Marital Trust B, so that Individual's aggregate interest before and after the severance remains reasonably equivalent, in accordance with Statute B, section B(1)(b). Under these circumstances the assets of Marital Trusts A and B will be treated as qualified terminable interest property under § 2056(b)(7)(i).

The proposed severance of the Marital Trust into two new trusts (Marital Trusts A and B) as permitted by State law, the proposed funding of such trusts, and Spouse's proposed renunciation of her entire interest in Marital Trust B will have no effect on the status of Marital Trusts A and B as qualified terminable interest property trusts.

RULING 2:

When Spouse renounces her qualified income interest in Marital Trust B, pursuant to § 2519, she will be deemed to have made a transfer of all of Marital Trust B's property, other than her qualifying income interest therein. Spouse is treated as making a gift under § 2519 of the fair market value of Marital Trust B determined on the date of 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) reduced by the value of the qualified income interest of Spouse, and further reduced by the amount Spouse is entitled to recover 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.

RULING 3:

When Spouse renounces her qualified income interest in Marital Trust B, the transfer of Spouse's income interest is a transfer by Spouse under § 2511. The amount of the gift will be the value of Spouse's qualified income interest on the date of disposition.

RULING 4:

When Spouse waives her right of recovery provided by § 2207A(b), she is treated as transferring the unrecovered gift tax amount to Daughter 1 and Daughter 2, from whom the recovery could have been obtained. The amount of the gift will be the amount of reimbursement to which Spouse was entitled. The transfer of the unrecovered amount of gift tax 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 pursuant to § 25.2207A-1(b)(2)

RULING 5:

When Spouse renounces her qualified income interest in Marital Trust B, she will be deemed to have made a transfer of all of the property of Marital Trust B, other than her qualifying income interest therein, under § 2519. Section 2044(a) provides that the value of Spouse's gross estate shall include the value of any property in which Spouse had a qualifying income interest for life. Section 2044(b)(2) provides that § 2044(a) does not apply to any property if § 2519 applies to the disposition of part or all of that property prior to Spouse's death. Therefore, no part of the property of Marital Trust B deemed transferred under § 2519 will be included in Spouse's gross estate pursuant to § 2044(b)(2).

RULING 6:

Pursuant to State law and the representations made herein, Marital Trusts A and B will be separate trusts from the effective date of Court's order. Therefore, 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.

RULING 7:

Pursuant to State law and the representations made herein, Marital Trusts A and B will be separate trusts for all purposes from the effective date of Court's order. As a result, Spouse's interest in Marital Trust A will be separate and distinct from her interest in Marital Trust B. Therefore, when Spouse renounces her entire interest in Marital Trust B, Spouse's interest in Marital Trust A is not treated as a retained interest for purposes of § 2702(a)(1). Accordingly, Spouse's renunciation of her entire interest in Marital Trust B will not result in Spouse's interest in Marital Trust A being valued at zero under § 2702.

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.

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.

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.

A copy of this letter must be attached to any income tax return to which it is relevant.

Sincerely,

Melissa C. Liquerman
Branch Chief, Branch 9
(Passthroughs & Special Industries)

cc: