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Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:4-PLR-103368-00

Date:

August 08, 2000

LEGEND

Taxpayer =
Decedent =
Daughters =
Trust =
Date =
Stock =
State =

Dear :

We received your letter dated July 17, 2000, and prior correspondence, requesting rulings regarding the proposed severance of a trust. This letter responds to that request.

FACTS

Decedent died testate on Date. Article NINTH of Decedent’s Last Will and Testament created a trust, Trust, to be funded with Decedent’s residuary estate. Under the terms of Trust, Taxpayer is to receive all of the net income from Trust during her lifetime. In addition, the trustees of Trust have the discretion to pay principal for Taxpayer’s health and comfort. On Taxpayer’s death, the assets remaining in Trust are to be divided into equal shares for each Daughter and held in further trust for the lifetime of each of the Daughters. Each Daughter is to receive the income from the Daughter’s share during her lifetime. The trustees have the discretion to distribute principal for the Daughter’s support, maintenance, health, and education. Each Daughter has testamentary general power of appointment over her share.

On Decedent’s estate tax return, Decedent’s estate elected to treat Trust as qualified terminable interest property (“QTIP”) as provided in § 2056(b)(7). Trust has not yet been funded. Under the proposed transaction, Trust is to be severed into two separate trusts having identical terms to those set forth in Article NINTH of Decedent’s will. One trust, Trust A, will contain only Stock. Stock represents all of the interests in certain corporations owned by Decedent at Decedent’s death. The other trust, Trust B, will contain the remaining Trust assets. The severance of Trust is authorized under the

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laws of State. After the severance, Taxpayer proposes to assign her income interest in Trust A to Daughters.

The following rulings have been requested:

1. The proposed funding of Trust as two separate trusts as permitted by State law and the subsequent assignment of the qualifying income interest in Trust A to Daughters will have no effect on the election under § 2056(b)(7) by the Decedent's estate to qualify Trust for the Federal estate tax marital deduction, nor the status of Trust A and Trust B as qualified terminable interest property.

2. If Taxpayer assigns Taxpayer's income interest in Trust A, Taxpayer will be deemed to have made a transfer of all of the property, other than the qualifying income interest, under § 2519. Pursuant to § 2207A(b), Taxpayer has the right to recover from Daughters the amount of the gift tax payable by Taxpayer due to this deemed transfer. As a result, this transfer will be treated as a net gift. The amount of the gift will equal the value of the entire property in Trust A subject to the qualifying income interest, determined on the date of disposition and reduced by the amount of gift taxes Taxpayer has the right to recover from Daughters.

3. If Taxpayer assigns Taxpayer's qualifying income interest in Trust A, Taxpayer will not be deemed to have made a gift of all or any portion of the property in Trust B.

4. If Taxpayer assigns her qualifying income interest in Trust A, the value of her interest in Trust B will not be valued at zero under § 2702.

5. If Taxpayer assigns her qualifying income interest in Trust A, the property in Trust A that is deemed to be transferred under § 2519 will not be included in Taxpayer's gross estate under § 2044(b)(2).

LAW AND ANALYSIS

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 which passes from the decedent, in which the surviving spouse has a qualifying income interest for life, and to which the QTIP 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 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)(2) provides that paragraph (a) applies to any property if § 2519 did not

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apply with respect to a disposition by the decedent of part or all of such property.

Section 2501 imposes a tax on the transfer of property by gift by an individual. Section 2502(c) provides that the payment of the gift tax 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 2512(b) provides that, where property is transferred for less than an adequate and full consideration in money or money's worth, the amount by which the value of the property exceeds the value of the consideration is deemed a gift.

Section 2519(a) provides that any disposition of all or part of a qualifying income interest for life in any property to which the section applies is treated as a transfer of all interests in the property other than the qualifying income interest. Section 2519(b) provides that paragraph (a) applies to any property if a deduction was allowed with respect to the transfer of such property to the donor under § 2056(b)(7).

For gift tax purposes, § 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 (1) the total tax for such year under chapter 12 exceeds (2) the total tax which 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.

Section 25.2519-1(a) of the Gift Tax Regulations provides that a transfer of all or a portion of the income interest of the spouse in QTIP property is a transfer by the spouse under § 2511. Section 25.2519-1(c) 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 QTIP 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 25.2511-2(a) provides that the gift tax is a primary and personal liability of the donor, is an excise upon the donor's 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.

Rev. Rul. 75-72, 1975-1 C.B. 310, holds that gift tax imposed on a transfer that is paid by the donee may be deducted from the value of the transferred property in determining the amount of the gift, if it is established that the payment of the tax by the donee or from the property itself is a condition of the transfer. If, at the time of the

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transfer, the 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 measured by the fair market value of the property passing from the donor minus the amount of the gift tax to be paid by the donee.

Rev. Rul. 81-223, 1981-2 C.B. 189, holds that, in determining the amount of the gift, the tax liability assumed by the donee may be deducted from the value of the transferred property, if the payment of the tax by the donee is a condition of the transfer.

Although § 2502(c) provides that the tax on the gift is the liability of the donor, in Rev. Rul. 75-72 and Rev. Rul. 81-223 the burden of the tax was shifted to the donees by agreement. The amount of the gift on which the gift tax was computed was reduced by the amount of gift tax paid by the donee.

As discussed above, with respect to the gift tax imposed as a result of a transfer under § 2519, § 2207A(b) statutorily shifts the burden, but not the liability, for paying the gift tax to the donee. In reimbursing the donor for the gift tax paid pursuant to the statute, the donee provides consideration for the gift. The donee's payment inures to the benefit of the donor because it reimburses the donor for gift tax that the donor was liable for and would otherwise be required to pay out of the donor's own funds. See Rev. Rul. 75-72. Accordingly, net gift treatment of a transfer under § 2519 is implicit under § 2207A(b).

Section 2702 provides special valuation rules in the case of transfers of interests in trusts. Under § 2702(a), 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 shall be determined as provided in paragraph (a)(2). Paragraph (a)(2) provides that the value of any retained interest that is not a qualified interest shall be treated as being zero. The value of any retained interest that is a qualified interest is determined under § 7520.

Based on the above, we conclude:

1. The proposed funding of Trust as two separate trusts as permitted by State law and the subsequent assignment of the qualifying income interest in Trust A to Daughters will have no effect on the election under § 2056(b)(7) by the Decedent's estate to qualify Trust for the Federal estate tax marital deduction, nor the status of Trust A and Trust B as qualified terminable interest property.

2. If Taxpayer assigns Taxpayer's income interest in Trust A, Taxpayer will be deemed to have made a transfer of all of the property, other than the qualifying income interest, under § 2519. Pursuant to § 2207A(b), Taxpayer has the right to recover from Daughters the amount of the gift tax payable by Taxpayer due to this

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deemed transfer. As a result, this transfer will be treated as a net gift. The amount of the gift will equal the value of the entire property in Trust A subject to the qualifying income interest, determined on the date of disposition and reduced by the amount of gift taxes Taxpayer has the right to recover from Daughters. Taxpayer's gift tax liability for her transfer of her qualifying income interest in Trust A will be determined under § 25.2511-2.

3. If Taxpayer assigns Taxpayer's qualifying income interest in Trust A, Taxpayer will not be deemed to have made a gift of all or any portion of the property in Trust B because Trust B will be established and funded as a separate trust and will not be affected by Taxpayer's assignment of her qualifying income interest in Trust A.

4. If Taxpayer assigns her qualifying income interest in Trust A, the value of her interest in Trust B will not be valued at zero under § 2702 because Trust B will be established and funded as a separate trust and will not be affected by Taxpayer's assignment of her qualifying income interest in Trust A.

5. If Taxpayer assigns her qualifying income interest in Trust A, the property in Trust A that is deemed to be transferred under § 2519 will not be included in Taxpayer's gross estate under § 2044(a) because of the application of § 2044(b)(2).

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under the cited provisions or any other provisions of the Code.

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

Sincerely,
Associate Chief Counsel
(Passthroughs and Special Industries)
By :Katherine A. Mellody
Senior Technician Reviewer, Branch 4

Enclosure

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