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INTERNAL REVENUE SERVICE
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OFFICE OF
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MEMORANDUM FOR: ASSOCIATE AREA COUNSEL
(Small Business/Self-Employed)

FROM: Chief, Branch 4
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)
CC:PSI:B04

SUBJECT: Computation of the credit for tax on prior transfers (TPT) in
the context of qualified terminable interest property (QTIP).

LEGEND

Transferor =
Spouse =
Date 1 =
Date 2 =

This memorandum responds to your request dated October 22, 2001 for our comments. Specifically, you requested that we consider the computation of the TPT credit under section 2013, where an interest in qualified terminable interest property (QTIP), as described in section 2056(b)(7), is transferred from Transferor to Spouse. You also requested that we consider whether Spouse's right to receive corpus, pursuant to the trustee's power to invade the trust to provide for Spouse's health, maintenance, and support is an interest that is taken into account in determining the value of property transferred to Spouse under section 2013.

In accordance with section 6110(k)(3) of the Internal Revenue Code, this memorandum should not be cited as precedent.

FACTS

Transferor died on Date 1. By direction of Transferor's will, a Marital Trust was created in the amount of \$. Under the terms of the trust, Transferor's surviving spouse (Spouse) received the right to all of the income for Spouse's lifetime, payable at least annually. In addition, the trustee possessed a power to invade the corpus of the Marital Trust "in order to pay to or for the benefit of my wife any amounts the trustee, in his sole discretion, deems necessary or

desirable, consistent with my wife's accustomed standard of living, for her health, maintenance, or support." No one, including Spouse, received a power to appointment Marital Trust property to anyone other than Spouse during Spouse's life. Spouse possessed a limited testamentary power of appointment exercisable only by express reference in her duly appointed will, to appoint the remaining trust assets one-half to Transferor's children and one-half to Spouse's children, per stirpes. The executor of Transferor's estate elected under section 2056(b)(7) to treat \$ of the net Marital Trust as qualified terminable interest property (QTIP). As a result, Transferor's estate claimed a marital deduction of \$ on Schedule M of Transferor's federal estate tax return (Form 706).

The actuarial value of Spouse's life interest in the Marital Trust, on Date 1 was % of the gross value of the property transferred to the trust. Spouse died on Date 2, three months after Transferor.¹ On Schedule Q of Spouse's estate tax return, Spouse's estate claimed a TPT credit under section 2013 on the basis that the net value of the property transferred from Transferor to Spouse for TPT credit purposes was \$. The amount of the credit was computed accordingly.

A notice of deficiency was issued to Spouse's estate on the basis that the net value of the property passing from Transferor to Spouse, for TPT credit purposes, was zero, and therefore no TPT credit is allowable.

ISSUE 1

Section 2056(a) provides that, for purposes of the tax imposed by section 2001, 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. Section 2056(b)(1) provides, in pertinent part, that no deduction shall be allowed under section 2056(a) 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.

Section 2056(b)(7) provides an exception to the rule of section 2056(b)(1) in the case of qualified terminable interest property. Under section 2056(b)(7)(A), qualified terminable interest property (QTIP) is treated as passing to the surviving spouse for purposes of section 2056(a), and no part of the property is treated as passing to any person other than the surviving spouse for purposes of section 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

¹ For purposes of this memorandum, we are assuming that Spouse was not terminally ill at Transferor's death. If Spouse was terminally ill at Transferor's death, the mortality component prescribed under section 7520 may not be used to determine the present value of Spouse's life interest in the Marital Trust. See section 20.7520-3(b)(3).

the surviving spouse has a qualifying income interest for life; and (iii) to which an election under section 2056(b)(7)(B)(v) applies. Generally, the spouse has a qualifying income interest for life in the trust property if the surviving spouse is entitled to all of 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 2056(b)(7)(B)(v) provides that an election under section 2056(b)(7) with respect to any property shall be made by the executor on the return of tax imposed by section 2001. Such an election, once made, shall be irrevocable.

Under section 2044, any property in which the decedent had a qualifying income interest for life and for which a deduction is allowed under section 2056(b)(7) is includible in the decedent's gross estate. Section 2044(c) provides that for purposes of the estate tax and generation-skipping transfer tax, property includible in the gross estate of the decedent under section 2044(a) shall be treated as property passing from the decedent.

In general, under section 2013, the decedent's estate is allowed a credit for estate tax paid on property transferred to the decedent from a transferor who died within ten years before, or within two years after the decedent. The amount of the credit is limited to the lesser of: (1) the amount of estate tax attributable to the inclusion of the property in the transferor's gross estate (the first limitation); and (2) the amount of estate tax attributable to the inclusion of the property in the transferee's gross estate (the second limitation).

The first limitation, the amount of the transferor's federal estate tax attributable to the transferred property, is determined, in accordance with section 2013(b). That section provides that the first limitation is an amount that bears the same ratio to the estate tax paid by the estate of the transferor as the value of the transferred property bears to the transferor's taxable estate (determined for purposes of the estate tax). The first limitation is expressed in section 20.2013-2(a) as follows:

$$\frac{\text{Value of Transferred Property}}{\text{Transferor's Taxable Estate}} \quad \times \quad \text{Federal Estate Tax Paid by Transferor's Estate}$$

The second limitation, the amount of estate tax attributable to the inclusion of the property in the transferee's gross estate, is defined in section 2013(c)(1) as the amount by which the estate tax imposed under section 2001 (computed without regard to section 2013) on the transferee's estate exceeds the tax computed on the transferee's estate by excluding from the transferee's estate the value of the transferred property.

Section 2013(d) provides rules for determining the value of the transferred property to be used in determining the first and second limitations. Section 2013(d) provides as follows:

(d) Valuation of Property Transferred.--The value of property transferred to the decedent [transferee] shall be the value used for purposes of determining the Federal estate tax liability of the estate of the transferor but—

* * *

(3) if the decedent was the spouse of the transferor at the time of the transferor's death, the net value of the property transferred to the decedent shall be reduced by the amount allowed under section 2056 (relating to the marital deduction) as a deduction from the gross estate of the transferor. (Emphasis added).

Section 20.2013-4(a) of the Estate Tax Regulations provides that, for purposes of section 2013, the value of the property transferred to the decedent is the value at which the property was included in the transferor's gross estate for purposes of the federal estate tax. If the decedent received a life estate or a remainder or other limited interest in property that was included in a transferor decedent's gross estate, the value of the interest is determined as of the date of the transferor's death on the basis of recognized valuation principles under sections 20.2031-7 and 20.7520. See section 20.2013-4(a), Example 2, illustrating a situation where a transferee receives a life estate in property included in the transferor's gross estate.

Section 20.2013-5 provides, in part, that in order to obtain the credit for tax on prior transfers, there must be a "transfer" of "property" from the transferor to the decedent. Section 20.2013-5(a) provides that the term "property" includes any beneficial interest in property including a general power of appointment. The term does not include a power of appointment over property that is not a general power. Section 20.2013-5(b) provides, in part, as follows:

The term "transfer" of property by or from a transferor means any passing of property or an interest in property under circumstances which were such that the property or interest was included in the gross estate of the transferor. In this connection, if the decedent receives property as a result of the exercise or nonexercise of a power of appointment, the donee of the power (and not the creator) is deemed to be the transferor of the property if the property subject to the power is includible in the donee's gross estate under section 2041 (relating to powers of appointment). Thus, notwithstanding the designation by local law of the capacity in which the decedent takes, property received from the transferor includes interests in property held by or devolving upon the decedent: . . . (5) as donee (possessor) of a general power of appointment (as defined in section 2041); (6) as appointee under the exercise of a general power of appointment (as defined in section 2041); or (7) as remainderman under the release or nonexercise of a power of appointment by reason of which the property is included in the gross estate of the donee of the power under section 2041. (Emphasis added)

In the present case, it is contended that, as a technical matter, the only state law property interest that passed to Spouse (the decedent transferee) from Transferor, the transferor, was a life income interest in the entire Marital Trust valued at \$ (\$ X). Under section 2013(d)(3), in determining the value of the property passing to the transferee for TPT credit purposes, the value of the property (in this case \$) must be reduced by “the amount allowed under section 2056” as a marital deduction (in this case \$ allowed under section 2056(b)(7)). Accordingly, the net value of the property passing to Spouse for TPT credit purposes is zero, and therefore, under the formulas for computing the first and second limitations, no credit is allowable.

The Petitioner, on the other hand, argues that the value of the property interests transferred from Transferor to Spouse for purposes of section 2013 total \$ comprised of: (1) \$, the portion of the Marital Trust subject to the QTIP election, since under sections 2056(b)(7) and 2044 this property is treated as passing to Spouse; plus (2) \$, the value of Spouse’s life interest in the portion of the Marital Trust not subject to the QTIP election (\$ X). Under section 2013(d)(3), this amount is reduced by \$, the amount allowed under section 2056 as a marital deduction. Accordingly, the net value of the property passing to Spouse is \$ (the value of Spouse’s life interest in the non-QTIP portion of the Marital Trust). Petitioner argues that the first and second limitations are computed using this amount as the value of the transferred property.

The regulations under section 2013 were issued prior to the passage of the Economic Recovery Tax Act of 1981 that enacted section 2056(b)(7). The regulations under section 2013, therefore, do not make any reference to QTIP. Moreover, the regulations under section 2056(b)(7) do not make any reference to the TPT credit. There is no clear authority as to the correct treatment in the situation presented here.

Nonetheless, we believe Petitioner’s position is correct in this case. Initially, we note the Petitioner’s position appears to be consistent with the purpose of section 2013, to alleviate the imposition of estate tax on the same property more than once within a ten year period. In this case, the life interest in the non-QTIP portion of the Marital Trust was transferred from Transferor to Spouse. This property interest was not subject to the marital deduction in Transferor’s estate, and thus generated estate tax in Transferor’s estate. Under section 20.2013-4(a) and section 20.2013-5(a), the actuarial value of the life income interest constitutes property that was transferred from Transferor to Spouse, that should, under the facts presented here, be eligible for the TPT credit.

Further, we believe the Petitioner’s position is supported by the applicable regulations. The contrary position is based on the fact that under state property law, the only interest that was transferred by Transferor to Spouse was a life interest in the QTIP and non-QTIP portions of the Marital Trust.

However, state law property concepts do not necessarily control for section 2013 purposes. Rather, as noted above, under sections 20.2013-5(a) and (b), in determining what “property” was “transferred” from the transferor to the transferee, the focus is not on the state law property interest that the transferee received from the transferor, but rather on the extent to which the property was included in the gross estate of the transferor, and will be subsequently included in the gross estate of the transferee. Thus, for example, the term “property” does not include a special power of appointment over property included in the transferor’s gross estate that is granted to a transferee. On the other hand, if the transferee receives a general power of appointment over property that was included in the transferor’s gross estate, then the transferee is treated as receiving an interest in the entire property subject to the power provided the property will be subject to inclusion in the transferees’ gross estate under section 2041. This is the case, notwithstanding that under state law, the power of appointment received by the transferee is generally not recognized as an interest in the property subject to the power.² Similarly, in the QTIP situation presented in this case, notwithstanding that under state law Spouse only received a life income interest from Transferor, under sections 20.2013-5(a) and (b), the entire QTIP portion of the Marital Trust constitutes property that was transferred from Transferor to Spouse. This is because 100% of this property was included in Transferor’s gross estate, and 100% will be subject to inclusion in Spouse’s gross estate under section 2044, regardless of the state law property interests that were created by Transferor and transferred to Spouse. Accordingly, we conclude that for purposes of computing the TPT credit, the value of the property transferred to Spouse includes the entire value of the QTIP portion of the Marital Trust (\$) plus the value of Spouse’s life income interest in the non-QTIP portion (\$).

ISSUE 2

As noted above, the trustee of the Marital Trust is authorized to pay to or for the benefit fo Spouse such amounts the trustee deems necessary or desirable “consistent with my wife’s accustomed standard of living, for her health, maintenance, or support.” The question presented is whether Spouse’s interest as a discretionary distributee of the non-QTIP portion of the Marital Trust corpus is to be taken into account in determining the value of the property passing to Spouse for TPT credit purposes. As discussed above, under section 20.2013-4(a), the value of any interest transferred must be determined based on recognized valuation principles.

Rev. Rul. 67-53, 1967-1 C.B. 265, describes a situation where the decedent-transferee received a life income interest in trust, subject to the power of

² Similarly, if under section 2040(a), 100% of jointly-held property is included in the transferor’s gross estate, the transferee would be treated as receiving 100% of the property from the transferor, notwithstanding that under state law, the transferor only owned a 50% undivided interest in the property and the transferee only received a 50% interest from the transferor.

the trustee, in his absolute and uncontrolled discretion, to withhold any or all of such income and to add all or any part of it to the principal of the trust. Upon the death of the transferor, the principal of the trust was to be paid to the transferor's then living children. The revenue ruling concludes that since the trustee's absolute and uncontrolled power to withhold income rendered the decedent-transferee's income interest incapable of valuation on the date of death of the transferor, no credit under section 2013 of the Code was allowable for such interest.

In Rev. Rul. 70-292, 1970-1 C.B. 187, the transferor's daughter received a life income interest in trust property. The life interest was subject to the power of the trustee to use so much of the trust income for the benefit of the transferor's surviving spouse as he deemed necessary for her comfort, support, hospital, or medical expenses. Under local law, use of the words "comfort and support" and "hospital and medical expenses" impliedly limited the trustee's power of invasion to the accustomed standard of living of the transferor's spouse. The revenue ruling concludes that since the trustee's power of invasion was limited by an ascertainable standard, the income interest of the transferor's daughter was susceptible of valuation. Further, under the facts presented, the likelihood that the trustee would divert income to the spouse was so remote as to be negligible. As a result, a credit under section 2013 was allowable with respect to the daughter's income interest.

Rev. Rul. 75-550, 1975-2 C.B. 357, provides an illustration of the method of computing the value, for purposes of section 2013, of a decedent's income interest in a trust that was subject to a trustee's discretionary power to invade corpus for the benefit of others that is limited by an ascertainable standard. The revenue ruling provides that the income interest is valued by taking into account the estimated amount of all possible invasions from the corpus on a year-to-year basis.

In this case, the trustee's power to invade corpus of the Marital Trust for amounts necessary or desirable to provide for Spouse's health, maintenance, and support is limited by an ascertainable standard. Therefore, Spouse's interest as a potential distributee of the Marital Trust is susceptible to valuation. Accordingly, the value of the property transferred to Spouse for purposes of the TPT credit computation should include the value of Spouse's interest in the corpus of the non-QTIP portion of the Marital Trust, determined in accordance with recognized valuation principles.³ We note, however, that the value of this interest is dependent on several factors including: Spouse's annual requirements for health, maintenance and support; the likelihood that trust corpus will be invaded on Spouse's behalf; and the extent to which the trustee takes Spouse's income interest in the Marital Trust

³As discussed above, the entire value of the QTIP portion of the Marital Trust is treated as transferred to Spouse for TPT credit purposes. Thus, only the Spouse's interest in the corpus of the non-QTIP portion is at issue. Also, invasions of trust corpus would decrease the value of the Spouse's income interest, as demonstrated in Rev. Rul. 75-550. To the extent it is determined that Spouse's corpus interest has value, an adjustment should be made to the value of Spouse's income interest.

and Spouse's other resources into account, under the terms of the trust and applicable state law, in determining the extent of the invasion power. See generally, Bogert, *The Law of Trusts and Trustees*, § 812 (Rev. 2d ed. 1981). The petitioner has the burden of establishing the value of the interest. Estate of Lloyd v. United States, 650 F.2d 1196, 1199-1200 (Ct. Cl. 1981).

If you have any questions please call .

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