

INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

February 21, 2002

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Third Party Contact:

Index (UIL) No.: 2044.00-00

CASE MIS No.: TAM-158073-01/CC:PSI:B4

SB/SE Area Director, Area 6

Taxpayer's Name:

Taxpayer's Identification No:

Years Involved:

LEGEND:

Husband =
Wife =
Trust =

Trustee =
Successor Co-Trustees =
Corporate Trustee =
Contingent Successor Trustee =
Date 1 =
Date 2 =
Date 3 =
Date 4 =
\$x =
\$y =
\$z =

ISSUE:

What is the amount includible in Wife's gross estate under section 2044 of the Internal Revenue Code if, after Husband's estate makes a section 2056(b)(7) election with respect to 100 percent of the Marital Trust, some of the assets that initially funded the Marital Trust are transferred to the Family Trust, in conformance with the terms of Husband's will?

CONCLUSION:

The amount includible in Wife's gross estate under section 2044 is the value of the assets in the Marital Trust on Wife's date of death.

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FACTS:

Husband died on Date 1. Husband was survived by his spouse, Wife. Paragraph FIFTH of Husband's will directs that his residuary estate be given to Successor Co-Trustees and Contingent Successor Co-Trustee, under a certain Trust Agreement previously executed by Husband on Date 1, as amended, to be held, managed and distributed upon the terms, provisions and conditions as provided in said Trust Agreement as it now exists or as it may subsequently be amended.

Paragraph SIXTH of Husband's will provides that Husband's Personal Representative may elect to qualify any portion or all of any eligible terminable interest trust provided in Husband's aforesaid Trust Agreement, or any qualified terminable interest property for the marital deduction on any federal estate tax return filed.

Article FOURTH and Article FIFTH of the Third Amendment and Restatement to Husband's Trust provide that the Successor Co-Trustees shall divide the trust estate into two separate trusts, a Marital Trust and a Family Trust. Article FOURTH directs the Successor Co-Trustees to set aside in the Family Trust the largest possible amount (but not less than zero) which, after taking into consideration factors such as (a) the Unified Credit, (b) the allowable state death tax credit to the extent the use of such credit does not increase the death tax payable to any state, and (c) all items deducted on Husband's federal estate tax return, will result in the least amount (undiminished by any estate and inheritance tax) available for the marital portion without creating or increasing a federal estate tax on Husband's estate.

Article FOURTH directs the Successor Co-Trustees to designate the balance of the trust estate as the marital portion to specifically qualify as a Qualified Terminable Interest Property Trust under section 2056(b)(7) (the Marital Trust). Article FOURTH further directs the Successor Co-Trustees to pay all the income from the Marital Trust in convenient installments, but not less frequently than quarterly, to Wife during her lifetime. In the event the property consists of any substantial property, which is unproductive of income, Wife may require the Successor Co-Trustees to either make the property productive or convert it within a reasonable time to income producing property or to provide out of other assets of the trust, the equivalent of the income such property would produce if it were productive.

Further, if, in the opinion of the Corporate Trustee, during the life of Wife the income provided from the Marital Trust, together with receipts from other sources known to the Corporate Trustee, shall not be sufficient to suitably support and maintain Wife or in case of any emergency at any time befalling her such as accident or extraordinary financial distress, then the Corporate Trustee is authorized to use and expend, from time to time, such part of the principal of the Marital Trust as it may deem necessary to make up such deficiency or meet such emergency.

Upon the death of Wife, Article FOURTH provides that the Successor Co-Trustees, upon request, distribute from the Marital Trust to her Personal Representative an amount equal to federal estate tax attributable to inclusion of this trust in her taxable

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estate, and the balance shall be added to and administered under the provisions of the Family Trust established under Article FIFTH.

Article FIFTH requires that the Family Trust shall be administered as follows: Successor Co-Trustees shall pay to or expend for Wife, the net income from the trust estate and so much of the principal thereof as the trustees, in their sole and absolute discretion, may from time to time deem reasonably necessary and advisable for her health, maintenance, and support in reasonable comfort, and the support or education of the Husband's child. Upon the death of Wife, after estate administration has been completed, and all tax liabilities have been settled and paid, and the Personal Representative has been discharged, the Successor Co-Trustees shall thereupon assign, transfer, convey, and pay over the entire rest, residue and remainder of the trust estate to the Husband's child.

Husband's federal estate tax return was filed on Date 2. On Schedule M of the return, the executor made a Qualified Terminable Interest Property (QTIP) election under section 2056(b)(7) with respect to "100% of the Marital Trust." However, the executor erroneously indicated on Schedule M that the Marital Trust was being funded with \$x, which amount included the amount that would pass to the Family Trust under the terms of Trust. No estate tax was due on Husband's gross estate, even though Husband's unified credit was not effectively utilized.

On Date 3, the executor for Husband's estate filed supplemental information regarding the estate tax return, pursuant to section 20.6081-1(d) of the Procedure and Administration Regulations. The purpose of this supplemental information was to conform Schedule M of the return to Article FOURTH of the Trust Agreement which directed the trustees to fund the Family Trust prior to funding the Marital Trust. In accordance with the terms of the Trust Agreement, the Family Trust was funded with some of the assets originally transferred into the Marital Trust.

Wife died on Date 4. As of Wife's date of death, the value of the Marital Trust was \$y and the value of the Family Trust was \$z. On Wife's estate tax return, the executor included in her gross estate, \$y (the value of the Marital Trust as of Wife's date of death).

LAW AND ANALYSIS:

Section 2001(a) imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

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 that where, on the lapse of time, on the occurrence

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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) creates an exception to the terminable interest rule of section 2056(b)(1) and allows a marital deduction for qualified terminable interest property. Section 2056(b)(7)(A) provides that, in the case of qualified terminable interest property, for purposes of section 2056(a), such property shall be treated as passing to the surviving spouse, and for purposes of section 2056(1)(A), no part of the property shall be treated as passing to any person other than the surviving spouse.

Section 2056(b)(7)(B)(i) defines "qualified terminable interest property" as property: (1) which passes from the decedent, (2) in which the surviving spouse has a qualifying income interest for life, and (3) to which an election under section 2056(b)(7)(B)(v) applies. Section 2056(b)(7)(B)(v) provides that such an election, once made, shall be irrevocable.

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.

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 if a deduction was allowed with respect to the transfer of such property to the decedent under section 2056(b)(7).

In Rev. Rul. 84-105, 1984-2 C.B. 197, a trust created for the benefit of a decedent's surviving spouse was underfunded, and not contested by the surviving spouse. The amount by which the trust was underfunded was determined to be a taxable gift. The ruling states that the marital deduction allowed for the decedent's estate is the amount that should have funded the trust, not the amount that was used to fund the trust.

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In the instant case, on Husband's estate tax return, the executor elected to treat 100 percent of the Marital Trust as qualified terminable interest property under section 2056(b)(7). However, the executor erroneously indicated on Schedule M that the Marital Trust was being funded with \$x, which amount included the amount that would pass to the Family Trust under the terms of Trust. On Date 3, the executor for Husband's estate filed supplemental information to conform Schedule M of the return to terms of the Trust Agreement which directed the trustees to fund the Family Trust prior to funding the Marital Trust. Accordingly, the Family Trust was funded with some of the assets originally transferred into the Marital Trust. On the date of Wife's death, the value of the Marital Trust was \$y and the value of the Family Trust was \$z. Based upon the facts presented, we conclude that the amount includible in Wife's gross estate under section 2044 is the value of the Marital Trust on the date of Wife's death or \$y.

CAVEAT:

A copy of this technical advice memorandum is to be given to the taxpayer(s). Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.