

INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

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CASE MIS No.: TAM-106637-03

Taxpayer's Name:
Taxpayer's Address:

Taxpayer's Identification No:
Date of Death:
Date of Conference:

LEGEND

Spouse =
Decedent =
Date 1 =
Child 1 =
Child 2 =
Class A Stock =
Class B Stock =
X =
Revocable Trust =
Date 2 =
\$a =
Family Foundation =
\$b =

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ISSUE

If a trust for the benefit of Spouse is funded, in part, with stock that has never paid dividends, does that portion of the trust qualify for the federal estate tax marital deduction as qualified terminable interest property (QTIP) under § 2056(b)(7) of the Code?

CONCLUSION

The entire Qualified Marital Trust, including the portion of the trust funded with non-dividend producing stock, qualifies for the federal estate tax marital deduction under § 2056(b)(7).

FACTS

Decedent, a resident of _____, died on Date 1 survived by Spouse, Child 1 and Child 2. Decedent's assets at the time of his death included shares of Class A Stock and Class B Stock of X, a closely-held corporation.

Decedent executed Revocable Trust on Date 2. Revocable Trust generally provides that all assets, other than two pecuniary distributions of Class A Stock and Class B Stock equal to Decedent's available exemption from the generation-skipping transfer tax, shall be distributed to the Qualified Marital Trust.

Article 4.02 of Revocable Trust sets forth the provisions governing the Qualified Marital Trust.

Article 4.02(1) provides that all the net income shall be paid to Spouse. Article 4.02(2) provides, in part, that the trustee shall pay to Spouse such sums of principal as the trustees deem necessary for Spouse's health, support or maintenance in her accustomed manner of living.

Article 4.02(4)(i) provides that upon Spouse's death, the trustee shall distribute the sum of \$a to Family Foundation, provided that such distribution be reduced by any gifts made by Decedent or Spouse to Family Foundation prior to their deaths.

Article 4.02(4)(ii) provides that Spouse shall have a limited testamentary power of appointment over the remaining trust assets, other than Class A Stock and Class B Stock. Spouse is authorized to exercise the power of appointment in favor of any one or more of Decedent's issue, the spouses of Decedent's issue or any charitable organizations, in any amounts or proportions.

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Article 4.02(4)(ii) provides for the alternate disposition of the remaining trust assets in the event Spouse fails to effectively exercise her limited testamentary power of appointment.

Article 5, entitled “General Trust Provisions”, provides, in part, that despite any other provision of this agreement to the contrary:

5.01. Marital Deduction Qualification. All provisions of this agreement shall be construed and applied so that the gifts to the Qualified Marital Trust shall be capable of qualifying for the marital deduction, and any provision of this agreement incapable of being so construed or applied shall be inapplicable to such gifts and trust. The trustee shall not exercise any power under this agreement (other than the power to make an election under Section 2056(b)(7) of the Internal Revenue Code) in a manner that would disqualify all or any portion of the gifts to the Qualified Marital Trust for the marital deduction. Spouse shall have the right at any time to require the trustee of the Qualified Marital Trust to make the trust assets productive or to convert the trust assets into productive assets.

5.10. Intent Regarding Class A Stock and Class B Stock. I intend that while X is a privately held company, all Class A Stock will be retained in the Qualified Marital Trust or Restricted Trusts for the benefit of Child 1 and her issue and all Class B Stock will be retained in the Qualified Marital Trust or Restricted Trusts for the benefit of Child 2 and her issue. Accordingly, I have authorized the disposition of such stock only under very limited circumstances.

Article 6 enumerates certain provisions that apply to the exercise of all trustee functions under this agreement. Included among these provisions is a proviso regarding shares of Class A Stock and Class B Stock.

Article 6.02(2)(v)(f) addresses extraordinary stock decisions related to the shares of Class A Stock and Class B Stock.

Article 6.02(2)(v)(f)(1) defines “extraordinary stock decisions” as all determinations by the trustee in connection with any sale, redemption, conversion, exchange or other disposition of shares of either Class A Stock or Class B Stock.

Article 6.02(2)(v)(f)(2) provides, in part, that while X is a privately owned company, no extraordinary stock decision shall be made without the concurrence of shareholders holding at least 80% of all shares of Class A Stock and Class B stock, taken collectively (including the shares affected by such decision).

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Article 6.03 provides that except as otherwise limited by this agreement, the trustees shall have the following powers or, where so provided, duties exercisable without approval, order or license of any court:

6.03(5). Principal and Income. To allocate receipts and disbursements between principal and income in the trustee's discretion. Without limiting the generality of the foregoing, the trustee shall have the power to allocate expenses of administration of the trust to income or principal or partly to each, in such manner as the trustee deems advisable; provided that the trustee shall have no power to allocate to income an amount of administration expenses that would constitute a "material limitation" on the rights or interests of my wife or any charitable beneficiary within the meaning of the Treasury Regulations under Sections 2056 and (or) 2055 of the Internal Revenue Code.

Pursuant to the terms of Revocable Trust, the Qualified Marital Trust was funded with both income producing assets and shares of Class A Stock and Class B Stock. On Decedent's federal estate tax return (Form 706), Decedent's estate claimed a marital deduction under § 2056(b)(7) for the entire Qualified Marital Trust in the amount of \$b.

LAW AND ANALYSIS

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

Section 2056(a) provides that, for purposes of the tax imposed by § 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 § 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)(A) provides that, in the case of qualified terminable interest property, the entire property is treated as passing to the surviving spouse for purposes of § 2056(a), and no part of such property shall be treated as passing to any person other than the surviving spouse for purposes of § 2056(b)(1)(A).

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

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spouse has a qualifying income interest for life; and (iii) to which an election under § 2056(b)(7)(B)(v) applies.

Section 2056(b)(7)(B)(ii) provides that the surviving spouse will be considered to have a qualifying income interest for life 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 § 2056(b)(7) with respect to any property shall be made by the executor on the return of tax imposed by § 2001. Such an election, once made, shall be irrevocable.

Section 20.2056(b)-7(d)(2) of the Estate Tax Regulations provides that, in general, the principles outlined in § 20.2056(b)-5(f) relating to whether the spouse is entitled for life to all the income from a trust qualifying for a marital deduction under § 2056(b)(5) are applicable in determining whether the spouse is entitled to all the income from the property as required under § 2056(b)(7).

Section 20.2056(b)-5(f)(1) provides that if an interest is transferred in trust, the surviving spouse is regarded as “entitled for life to all the income” from the property only if the spouse has that degree of beneficial enjoyment of the property which is accorded to a person who is unqualifiedly designated as a life beneficiary. The requisite degree of enjoyment is given only if it was the decedent’s intention, as manifested by the instrument and surrounding circumstances, that the property should produce for the surviving spouse, during life, such an income, or that the spouse should have such use of the property as is consistent with the value of the corpus and with its preservation.

Section 20.2056(b)-5(f)(4) provides that a trustee’s power to retain the trust assets which consist substantially of unproductive property will not disqualify the spouse’s lifetime income interest if the applicable rules for the trust administration require, or permit the spouse to require, that the trustee either make the property productive or convert it into productive property within a reasonable time.

Section 20.2056(b)-5(f)(5) provides that the spouse’s lifetime income interest will be disqualified if the primary purpose of the trust is to safeguard the property without providing the spouse with the required beneficial enjoyment. Such trusts include those that expressly provide for the accumulation of income and those that indirectly accomplish a similar purpose. The example is given in which the corpus of a trust consists substantially of property unlikely to be income producing during the spouse’s life and the spouse cannot compel the trustee to convert or otherwise deal with the property as described in § 20.2056(b)-5(f)(4). Such a trust would not meet the requisite standards for deductibility.

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As a general rule, interpretation of a trust instrument must be made under the law of the jurisdiction governing the agreement. Estate of Ellingson, 964 F.2d 959, 963 (9th Cir. 1992); Estate of Nicholson v. Commissioner, 94 T.C. 666, 672-73 (1990). Under _____ law, trusts are interpreted by ascertaining the intent of the settlor as expressed in the language used in the trust instrument.

- . Where possible, effect should be given to all words in the trust instrument.

In this case, the central issue is whether the shares of Class A Stock and Class B Stock held as part of the Qualified Marital Trust qualify for the marital deduction.

Article 4.02 of Revocable Trust provides that Spouse is entitled to all of the net income of the Qualified Marital Trust as well as discretionary distributions of principal.

Article 5.01 provides that despite any other provision to the contrary, Spouse has the right at any time to require the trustee of the Qualified Marital Trust to make the trust assets productive or to convert the trust assets into productive assets. Thus, although shares of Class A Stock and Class B Stock comprise a portion of the assets held in the Qualified Marital Trust, the terms of Revocable Trust expressly grant Spouse the power to make those assets productive as contemplated under § 20.2056(b)-5(f)(4).

Article 5.10 provides that the trustees may dispose of the shares of Class A Stock and Class B Stock only under limited circumstances. This provision does not mean that there are no circumstances under which the trustees may dispose of the shares of Class A Stock and Class B Stock. Rather, Spouse's right under Article 5.01 to make the trust assets productive is one of the limited circumstances under which the trustee may dispose of shares of Class A Stock and the Class B Stock.

Article 6.02(2)(v)(f)(1) defines extraordinary stock decisions as "all determinations by the trustee." If Spouse exercises her right under Article 5.01 to compel the trustees to make the Class A Stock and Class B Stock productive or to convert those shares into productive assets, Spouse, and not the trustees, will have made a determination in connection with the disposition of shares. Thus, the requirements set forth in Article 6.02(2)(v)(f) do not limit or usurp Spouse's productive property power.

We believe the terms of Revocable Trust are not ambiguous. Even if the language of the trust instrument were deemed to be ambiguous, we could look to the first two sentences of Article 5.1 as an aid in trust construction. See Rev. Rul. 75-440, 1975-2 C.B. 372. Those sentences generally provide that (i) all provisions of Revocable Trust shall be construed so that the gifts to the Qualified Marital Trust shall

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be capable of qualifying for the marital deduction, and (ii) the trustee shall not exercise any power in a manner that would disqualify all or any portion of the gifts to the Qualified Marital Trust for the marital deduction. Given the statements of intent contained in the savings clauses and the overall construction of Revocable Trust, we would interpret the language of Revocable Trust in such manner as to provide that the trustee of the Qualified Marital Trust may dispose of the shares of Class A Stock and Class B Stock if Spouse exercises her power to make those assets productive.

Based on the foregoing, we conclude that the entire Qualified Marital Trust, including the shares of Class A Stock and Class B Stock, qualifies for the estate tax marital deduction under § 2056(b)(7).

CAVEAT

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