

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:DOM:P&SI:4-PLR-112682-99

Date:
December 22, 1999

Re:

LEGEND:

- Decedent =
- Trust =
- Second Amendment =
- Trust B =
- Spouse =
- \$x =
- \$y =
- \$z =
- School =
- Charity =
- A =
- B =
- C =
- D =
- E =
- F =

Dear :

This is in response to your representative's letter dated November 10, 1999, and prior correspondence, in which rulings are requested on the application of sections 2519 and 2522 of the Internal Revenue Code.

Decedent executed the Trust in 1993 and amended it twice before his death. A, B, and C were designated as the trustees. The Trust became irrevocable at Decedent's death in 1994. Pursuant to the terms of the Trust, as amended by the Second Amendment, the residue of the Trust property was distributed at Decedent's death as follows: \$x was paid outright to Spouse; \$y was distributed to Trust A; and the balance was distributed to Trust B.

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Under the terms of Trust B, all of the income is to be paid to Spouse for her life. The trustees may distribute or apply for Spouse's benefit such principal as the trustees deem advisable for Spouse's support in the accustomed manner of living, and maintenance in health and reasonable comfort. On Spouse's death, \$z is to be paid outright to School, an educational institution described in section 2522(a)(2). However, if Decedent created and funded a charitable remainder trust in that amount for School, the bequest would lapse. The balance of the Trust B corpus is to be paid to Charity. Before his death, Decedent did, in fact, create and fund the charitable remainder trust for School, and the bequest to School, accordingly, lapsed.

An election was made on the estate tax return (Form 706) filed for Decedent's estate to treat Trust B as qualified terminable interest property under section 2056(b)(7), and a marital deduction was allowed to Decedent's estate for the value of the property passing to Trust B.

D, E, and F are currently the trustees of Trust B. The parties propose to terminate Trust B and distribute the corpus as follows. Spouse will receive, outright, cash or assets equal to the present value of her income interest in Trust B at the time, determined in accordance with section 7520 and the applicable regulations, and the section 7520 interest rate applicable for the month Trust B is terminated. At the same time, Charity will receive outright the balance of the Trust B assets; i.e., cash or assets equal to the corresponding present value of the remainder interest in Trust B.

You have asked us to rule that:

(1) the termination of Trust B as proposed will constitute a disposition, under section 2519, by Spouse of her qualifying income interest, resulting in a gift by Spouse under section 2519 equal to the value of the Trust B corpus less the present value of Spouse's income interest in Trust B; and

(2) Spouse is entitled to a gift tax deduction under section 2522 for the value of the property passing to Charity.

Section 2044(a) provides that the value of the gross estate includes the value of any property described in section 2044(b) in which the decedent had a qualifying income interest for life. Section 2044(b) provides that section 2044 applies to any property if a deduction was allowed with respect to the transfer of the property to the decedent under section 2056(b)(7).

Under section 2044(c), property includible in the gross estate of the decedent under section 2044(a) is treated as property passing from the decedent for estate and generation-skipping transfer tax purposes.

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Section 2056(a) provides that the value of the taxable estate is, except as limited by section 2056(b), 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.

Under section 2056(b)(1), if an interest passing to the surviving spouse will terminate, no deduction is allowed with respect to such interest if, after termination of the spouse's interest, an interest in the 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 the surviving spouse (or the estate of the spouse).

Section 2056(b)(7)(A) provides that qualified terminable interest property (QTIP), for purposes of section 2056(a), is treated as passing to the surviving spouse, and no part of the property is treated as passing to any person other than the surviving spouse. In general, under section 2056(b)(7)(B)(i), qualified terminable interest property is property that passes from the decedent in which the spouse receives a qualifying income interest for life (defined in section 2056(b)(7)(B)(ii)), and with respect to which the executor makes an election to treat the property as QTIP.

Section 2511(a) provides that the gift tax applies 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, for gift and estate tax purposes, 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 the section applies to any property if a deduction was allowed with respect to the transfer of the property to the donor under section 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 section 2056(b)(7), the donee spouse is treated, for purposes of the estate and gift tax, as transferring all interests in property other than the qualifying income interest.

Under section 25.2519-1(c)(1), the amount treated as a transfer upon 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

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income and not reduced by any amount excluded from total gifts under section 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(f) provides that the sale of qualified terminable interest property, followed by the payment to the donee spouse of a portion of the proceeds equal to the value of the spouse's income interest, is considered the disposition of the qualifying income interest.

Example 1 of § 25.2519-1(g) describes a situation where, under D's will, a personal residence valued for estate tax purposes at \$250,000 passes to S for life, and after S's death to D's children. D's executor made a valid election to treat the property as qualified terminable interest property. During 1995, when the fair market value of the property is \$300,000 and the value of S's life interest in the property is \$300,000, S makes a gift of S's entire interest in the property to D's children. The example concludes that pursuant to § 2519, S is treated as making a gift in the amount of \$200,000 (i.e., the fair market value of the qualified terminable interest property of \$300,000 less the fair market value of S's qualifying income interest in the property of \$100,000). In addition, under § 2511, S makes a gift of \$100,000 (i.e., the fair market value of S's income interest in the property).

In Example 2 of § 25.2519-1(g), the facts are the same as in Example 1 except that during 1995, S sells S's income interest in the property to D's children for \$100,000. Pursuant to § 2519, S is treated as making a gift of \$200,000 (\$300,000 less \$100,000, the value of the qualifying income interest in the property). S does not make a gift of the income interest under § 2511, because the consideration received for S's income interest is equal to the value of the income interest.

The term "disposition," as used in section 2519, applies broadly to circumstances in which the surviving spouse's right to receive the income is relinquished or otherwise terminated, by whatever means. H. Rep. No. 201, 97th Cong., 1st Sess. 161 (1981).

For purposes section 2519, a division of qualified terminable interest property based on the actuarial values of the spousal life interest and remainder (i.e., a commutation) is considered a disposition by the spouse of the qualifying income interest resulting in a gift of the remainder interest. See § 25.2519-1(f); Rev. Rul. 98-8, 1998-7 I.R.B. 24. See also, Novotny v. Commissioner, 93 T.C. 12, 18 (1989), in which the spouse and the remaindermen sold the underlying property and divided the proceeds based on the actuarial values of the income interest and the remainder. In Novotny, the court stated that the commutation constituted a disposition of the spouse's qualifying income interest, for purposes of section 2519.

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Section 2522(a) provides that, in computing taxable gifts for the calendar year, there shall be allowed as a deduction the amount of all gifts made to or for the use of certain charitable, etc., organizations and purposes described in §25.2522(a)(1)-(4).

In the present case, the proposed transaction is similar to those described in Example 2 of § 25.2519-1(g) and § 25.2519-1(f). Therefore, under section 2519, the proposed transaction in which Spouse will relinquish her income interest in Trust B in exchange for a payment of a portion of the Trust B corpus equal to the present value of her income interest constitutes a disposition of her income interest. Accordingly, Spouse will be treated as making a gift for federal gift tax purposes of an amount equal to the value of the Trust B property reduced by the present value of Spouse's income interest in Trust B determined in accordance with section 7520 and the applicable regulations, based on the section 7520 interest rate for the month that Trust B is terminated.

As a result of the transaction, in accordance with the terms of the Trust B instrument, this amount will pass outright to Charity, the designated remainder beneficiary. Charity is an organization described in section 2522(a). Accordingly, a gift tax deduction under section 2522 will be allowable for the amount Spouse is treated as transferring under section 2519. This result is consistent with the terms of Trust B. If the proposed commutation does not occur and Trust B continues until Spouse's death, the Trust B property, which will be includible in Spouse's gross estate under section 2044, will pass outright to Charity. Spouse's estate would be entitled to a deduction under section 2055(a) for the value of the Trust B property passing to Charity.

Except as we have specifically ruled herein, we express no opinion under the cited provisions or under any other provision of the Code.

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

Sincerely yours,
George Masnik, Chief, Branch 4
Office of the Assistant Chief Counsel
(Passthroughs and Special Industries)

Enclosure
copy for 6110 purposes