

Date 7 =
Date 8 =

Dear :

This letter responds to your authorized representative's letter dated November 13, 2014, requesting rulings concerning the federal income, gift, and estate tax treatment of the judicial severance of a marital trust and the renunciations by Spouse of her interests in one of the divided marital trusts.

FACTS

The facts submitted and the representations made are summarized as follows:

On Date 1, Grantor created Trust, a revocable trust. Trust was amended by Grantor several times prior to Grantor's death on Date 2, at which time Trust became irrevocable. Grantor was survived by Spouse, Child 1, and Child 2.

Sections 2.05 and 2.06 of Trust provide that upon the death of Grantor survived by Spouse, the trustee is to divide the trust estate into separate trusts, Marital Trust and Credit Shelter Trust.

Section 2.05 of Trust governs Marital Trust and requires the trustee to pay Spouse all the net income of Marital Trust in quarterly or more frequent intervals for her lifetime. In addition, section 2.05 of Trust provides that the trustee may distribute to Spouse as much principal as the trustee in its sole discretion, deems advisable for Spouse's support, maintenance, and welfare, including any needs arising from accidents, illness, or other emergencies. Upon Spouse's death, the remaining principal and income of Marital Trust is to be distributed to Credit Shelter Trust, after payment of any taxes attributable to Marital Trust's inclusion in Spouse's estate.

Section 2.05 of Trust further provides that Spouse may disclaim rights to receive income and principal from part or all of Marital Trust, as Spouse specifies in a writing deposited with the trustee during Spouse's lifetime. Section 2.05 of Trust provides that assets disclaimed by Spouse are to be held in further trust (the Disclaimer Trust). From the Disclaimer Trust, the trustee may distribute to Spouse during her lifetime as much of the net income and principal as the trustee, in its sole discretion, deems advisable for Spouse's support, maintenance, and welfare, including any needs arising from accidents, illness, or other emergencies. Upon Spouse's death, the remaining principal and income of Disclaimer Trust are to be distributed to Credit Shelter Trust.

Section 2.06 of Trust governs the Credit Shelter Trust and provides that the trustee is to pay Spouse during her lifetime all the net income and principal of Credit Shelter Trust as

the trustee, in its sole discretion, deems advisable for Spouse's support, maintenance, and welfare, including any needs arising from accidents, illness, or other emergencies. Section 2.06 of Trust further provides that the trustee also may pay to the issue or other beneficiaries as designated by Grantor, not necessarily in equal shares, so much of the remainder of net income and principal as the trustee, in its sole discretion, deems advisable for a beneficiary's support, maintenance, and welfare, including any needs arising from accidents, illness, or other emergencies.

Section 2.07 of Trust provides for distribution of the trust estate after the death of Spouse, or after the death of Grantor should Spouse not survive the Grantor. Section 2.07 of Trust provides for the conditional funding of a separate trust for the benefit of Grantor's then living grandchildren, and further provides that all the rest, residue, and remainder of the trust estate (including Credit Shelter Trust) shall be divided and distributed in equal shares to Child 1 and Child 2. Section 2.08 of Trust provides that in the event a child of Grantor does not survive the termination of Trust, then the assets held in the deceased child's share of the Trust estate shall instead be held in further trust for the benefit of the then surviving children of such child or the deceased children of such child having surviving issue.

Section 6.01 of Trust provides that Trust is to be governed by State law.

It is represented that on Date 3, Spouse executed a qualified disclaimer with respect to all of Spouse's right, title, and interest in Credit Shelter Trust in accordance with § 2518 and State Statute 1 and State Statute 2.

On Date 4, the executors of Grantor's estate timely filed Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return. On Schedule M of Grantor's Form 706, an election was made to treat Marital Trust as qualified terminable interest property (QTIP) pursuant to § 2056(b)(7) of the Internal Revenue Code.

As of the date of this ruling request, Spouse, Child 1, and Child 2 are still living.

On Date 5, the trustee of Trust petitioned Court for an order, pursuant to authority under State Statute 3 and State Statute 4, to sever Marital Trust into two separate and distinct marital trusts, to be called Marital Trust 1 and Marital Trust 2. Included in the petition was a request to modify certain administrative provisions of Trust and to correct scrivener's errors.

On Date 6, Spouse conditionally renounced her entire interest in Marital Trust 1 and Disclaimer Trust in accordance with State Statute 1 and State Statute 2. It is represented that the renunciations will not be qualified disclaimers under § 2518. The renunciations are conditioned upon the following: (a) the entering of an order by Court approving the petition filed on Date 5; (b) the issuance of a favorable response from the

Internal Revenue Service to this request for a private letter ruling; and (c) the execution of a net gift agreement between Spouse and Child 1 and Child 2.

In a net gift agreement, dated Date 7, Child 1 and Child 2 agreed as follows: (a) any and all gift tax imposed on Spouse's gift of Spouse's qualifying income interest under § 2511 will be paid by Child 1 and Child 2; (b) Child 1 and Child 2 will be personally and solely responsible for any such gift tax liability; and (c) Spouse also will exercise Spouse's right of recovery under § 2207A(b) to recover from Child 1 and Child 2 the gift tax attributable to the deemed gift under § 2519.

On Date 8, Court entered an order approving the judicial severance of Marital Trust and the modification of Trust as set forth in the petition. Pursuant to Court's order, each of Marital Trust 1 and Marital Trust 2 is considered a separate trust for all purposes and each such trust shall be funded with such assets of Marital Trust as the trustee, in its sole discretion, determines to be appropriate, and each such trust shall be held, administered, and distributed pursuant to the same terms.

State Statute 1 provides that a person may disclaim, in whole or in part, conditionally or unconditionally, any interest in or over property. State Statute 1 further provides that a disclaimer becomes irrevocable when any conditions to which the disclaimant has made the disclaimer are satisfied and when the disclaimer is delivered and filed in accordance with State law.

State Statute 2 provides that upon the disclaimer of a preceding interest, a future interest held by a person other than the disclaimant takes effect as if the disclaimant had died or ceased to exist immediately before the time of distribution, but a future interest held by the disclaimant is not accelerated in possession or enjoyment as a result of the disclaimer.

State Statute 3 provides that after notice to the qualified beneficiaries, a trustee may divide a trust into two or more separate trusts if the result does not impair rights of any beneficiary or adversely affect achievement of the purposes of the trusts.

State Statute 4 provides that a separate trust created by severance must be treated as a separate trust for all purposes from the date on which the severance is effective.

You have requested the following rulings:

1. The judicial severance of Marital Trust into Marital Trust 1 and Marital Trust 2 on a non-pro rata basis will not cause Marital Trust, Marital Trust 1, Marital Trust 2 or any beneficiary of these three trusts to recognize any ordinary income or loss, or capital gain or loss, under § 61 or 1001.

2. The judicial severance of Marital Trust into Marital Trust 1 and Marital Trust 2 will not disqualify Marital Trust 1 or Marital Trust 2 as QTIP trusts under § 2056.
3. Spouse's renunciations of her interests in Marital Trust 1 and Disclaimer Trust will not cause Marital Trust 2 to fail to be qualified as a QTIP trust under § 2056.
4. Spouse's renunciations of her interests in Marital Trust 1 and Disclaimer Trust will result in a gift by Spouse of Spouse's qualifying income interest in Marital Trust 1 under § 2511 and a gift of all of the other property and other interests in property then owned by Marital Trust 1, other than Spouse's qualifying income interest in Marital Trust 1, under § 2519.
5. As a result of Spouse's renunciations of her interests in Marital Trust 1 and Disclaimer Trust, Spouse will not be deemed to have made a gift of the property held in Marital Trust 2 under § 2519.
6. In determining the amount of Spouse's gift resulting from Spouse's renunciations of her interests in Marital Trust 1 and Disclaimer Trust, the amount of the gift will be reduced by the gift taxes paid or to be paid by or recovered from Child 1 and Child 2.
7. In determining the value of Spouse's gift resulting from Spouse's renunciations of her interests in Marital Trust 1 and Disclaimer Trust, the value of Spouse's interest in Marital Trust 2 will not be valued at zero under § 2702.
8. After Spouse's renunciations of her interests in Marital Trust 1 and Disclaimer Trust, no part of the property of Marital Trust 1 or Disclaimer Trust deemed transferred under § 2519 will be includible in Spouse's gross estate under § 2044(a) because of the application of § 2044(b)(2).

LAW AND ANALYSIS

Ruling 1

Section 61(a)(3) provides that gross income includes gains derived from dealings in property.

Section 1001(a) provides that the gain from the sale or other disposition of property is the excess of the amount realized over the adjusted basis provided in § 1011 for determining gain, and the loss is the excess of the adjusted basis provided in § 1011 for determining loss over the amount realized. Under § 1001(c), the entire amount of gain or loss must be recognized, except as otherwise provided.

Section 1.1001-1(a) of the Income Tax Regulations provides that, except as otherwise provided in subtitle A of the Code, the gain or loss realized from the exchange of

property for other property differing materially either in kind or in extent, is treated as income or as loss sustained.

Under § 1.1001-1(h)(1), the severance of a trust, occurring on or after August 2, 2007, is not an exchange of property for other property differing materially either in kind or in extent if--(i) an applicable state statute or the governing instrument authorizes or directs the trustee to sever the trust; and (ii) any non-pro rata funding of the separate trusts resulting from the severance, whether mandatory or in the discretion of the trustee, is authorized by an applicable state statute or the governing instrument.

An exchange of property results in the realization of gain under § 1001 if the properties exchanged are materially different. Cottage Savings Ass'n v. Comm'r, 499 U.S. 554 (1991). Properties exchanged are materially different if the properties embody legal entitlements "different in kind or extent" or if they confer "different rights and powers." Id. at 565.

A partition of jointly owned property is not a sale or other disposition of property where the co-owners of the joint property sever their joint interests in order to extinguish their survivorship interests. See Rev. Rul. 56-437, 1956-2 C.B. 507.

The severance of Marital Trust into Marital Trust 1 and Marital Trust 2 on a non-pro rata basis is consistent with Rev. Rul. 56-437, is authorized by State law, and is not inconsistent with the provisions of Marital Trust. Therefore, the severance is consistent with § 1.1001-1(h)(1). Accordingly, based on the facts submitted and the representations made, we conclude that the judicial severance of Marital Trust into Marital Trust 1 and Marital Trust 2 on a non-pro rata basis will not cause Marital Trust, Marital Trust 1, Marital Trust 2 or any beneficiary of these three trusts to recognize any ordinary income or loss, or capital gain or loss, under § 61 or 1001.

Rulings 2 and 3

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, except as limited by § 2056(b), 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, but only to the extent that such interest is included in determining the value of the gross estate.

Under § 2056(b)(1), a marital deduction is not allowable for an interest in property passing to the surviving spouse that is a "terminable interest." An interest passing to the surviving spouse is a terminable interest if it will terminate or fail on the lapse of time or on the occurrence of an event or contingency, or on the failure of an event or

contingency to occur and, on termination, an interest in the property passes to someone other than the surviving spouse.

Section 2056(b)(7) allows an estate tax marital deduction for QTIP. Under § 2056(b)(7)(B)(i), the term “qualified terminable interest property” means property that passes from the decedent, in which the surviving spouse has a qualifying income interest for life, and to which the qualified terminable interest 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.

In this case, after the judicial severance of Marital Trust into Marital Trust 1 and Marital Trust 2, Spouse will continue to be entitled to all the income from the property in Marital Trust 1 and Marital Trust 2, payable in quarterly or more frequent intervals. Further, no person will have a power to appoint any part of the property in Marital Trust 1 and Marital Trust 2 to any person other than the surviving spouse. Accordingly, Spouse will continue to have a qualifying income interest in Marital Trust 1 and Marital Trust 2 after the judicial severance of Marital Trust. Further, after Spouse’s renunciations of her interests in Marital Trust 1 and Disclaimer Trust, Spouse will continue to have a qualifying income interest in Marital Trust 2. Based upon the facts submitted and the representations made, we conclude that the judicial severance of Marital Trust into Marital Trust 1 and Marital Trust 2 will not disqualify Marital Trust 1 or Marital Trust 2 as QTIP trusts under § 2056 and that Spouse’s renunciations of her interests in Marital Trust 1 and Disclaimer Trust will not cause Marital Trust 2 to fail to be qualified as a QTIP trust under § 2056.

Rulings 4, 5 and 6

Section 2501 imposes a tax on the transfer of property by gift by an individual. Under § 2502(c), the gift tax imposed under § 2501 is the liability of the donor.

Section 2511(a) 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 25.2511-1(c)(1) of the Gift Tax Regulations provides that the gift tax applies to gifts indirectly made. Thus, any transaction in which an interest in property is gratuitously passed or conferred upon another, regardless of the means or device employed, constitutes a gift subject to tax.

Section 25.2511-2(a) provides that the gift tax is a primary and personal liability of the donor, is an excise upon his 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.

Section 2519(a) provides that any disposition of all or part of a qualifying income interest for life in any property to which § 2519 applies is treated as a transfer of all interests in the property other than the qualifying income interest. Section 2519(b) provides that § 2519 applies to any property if a deduction was allowed with respect to the transfer of such property to the donor under § 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 § 2056(b)(7), the donee spouse is treated for purposes of chapters 11 and 12 as transferring all interests in property other than the qualifying income interest. A transfer of all or a portion of the income interest of the spouse is a transfer by the spouse under § 2511.

Section 25.2519-1(c)(1) 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 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 25.2519-1(c)(4) provides that the amount treated as a transfer under § 25.2519-1(c)(1) is further reduced by the amount the donee spouse is entitled to recover under § 2207A(b). If the donee spouse is entitled to recover gift tax under § 2207A(b), the amount of the gift tax recoverable and the value of the remainder interest treated as transferred under § 2519 are determined by using the same interrelated computation applicable for other transfers in which the transferee assumes the gift tax liability. The gift tax consequences of failing to exercise the right of recovery are determined separately under § 25.2207A-1(b).

Under § 2207A(b) and § 25.2207A-1(a), if an individual is treated as transferring an interest in property by reason of § 2519, the individual is entitled to recover from the “person receiving the property” (as defined in § 25.2207A-1(e)) the amount of gift tax attributable to that property. Under § 25.2207A-1(e), if the property is in trust at the time of the transfer, the “person receiving the property” is the trustee, and any person who has received a distribution of the property prior to the expiration of the right of recovery if the property does not remain in trust. Under § 25.2207A-1(b), the failure of a person to exercise a right of recovery provided by § 2207A(b) is treated as a transfer for federal gift tax purposes of the unrecovered amounts to the persons from whom the recovery could have been obtained.

Rev. Rul. 75-72, 1975-1 C.B. 310, holds that if, at the time of the transfer, a 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 the fair market value of the property passing from the donor less the amount of the gift tax to be paid by the donee or from the property itself.

Rev. Rul. 81-223, 1981-2 C.B. 189, holds that, in determining the amount of the gift tax liability that is to be subtracted from the value of the transferred property, the donor's available unified credit must be used to reduce the gift tax liability that the donee has assumed to the extent unified credit is available.

As stated above, pursuant to Court order dated Date 8 and applicable State law, after the division of Marital Trust, Spouse's interest in Marital Trust 1 will be separate and distinct from her interest in Marital Trust 2. Therefore, based upon the facts submitted and the representations made, after the renunciations of Spouse's interests in Marital Trust 1 and Disclaimer Trust, Spouse will be deemed to have made a gift by Spouse of Spouse's qualifying income interest in Marital Trust 1 under § 2511 and a gift of all of the other property and other interests in property then owned by Marital Trust 1, other than Spouse's qualifying income interest in Marital Trust 1, under § 2519. Moreover, after the renunciations Spouse will not be deemed to have made a gift of the property held in Marital Trust 2 under § 2519.

As a condition of the gift that will result from Spouse's renunciations of her interests in Marital Trust 1 and Disclaimer Trust, Child 1 and Child 2 agreed in a net gift agreement, dated Date 7, that any and all gift tax imposed on Spouse's gift of Spouse's qualifying income interest under § 2511 will be paid by Child 1 and Child 2, and Child 1 and Child 2 will be personally and solely responsible for any such gift tax liability. Thus, based on the facts submitted and the representations made, after the renunciations, the amount of the gift will be reduced by the gift taxes paid or to be paid by or recovered from Child 1 and Child 2.

Ruling 7

Section 2702(a)(1) provides that solely for the purpose of determining 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 (as defined in § 2701(e)(2)) shall be determined as provided in § 2702(a)(2). Section 2702(a)(2) provides that the value of any retained interest which is not a qualified interest (as defined in § 2702(b)) shall be treated as being zero and the value of any retained interest that is a qualified interest shall be determined under § 7520. Under § 25.2702-2(a)(3), the term "retained" means held by the same individual both before and after the transfer in trust.

Pursuant to the order of Court, Marital Trust 1 and Marital Trust 2 will be separate trusts for all purposes. As a result, Spouse's interest in Marital Trust 1 will be separate and distinct from her interest in Marital Trust 2. Therefore, when Spouse renounces her entire interest in Marital Trust 1 and Disclaimer Trust, Spouse's interest in Marital Trust 2 is not treated as a retained interest for purposes of § 2702(a)(1). Accordingly, based on the facts submitted and the representations made, Spouse's renunciations of her interests in Marital Trust 1 and Disclaimer Trust will not result in Spouse's interest in Marital Trust 2 being valued at zero under § 2702.

Ruling 8

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) provides that § 2044(a) applies to any property if--(1) a deduction was allowed with respect to the transfer of such property to the decedent under § 2056(b)(7), and (2) section 2519 did not apply with respect to a disposition by the decedent of part or all of such property.

When Spouse renounces her entire interests in Marital Trust 1 and Disclaimer Trust, Spouse will be deemed to have made a transfer of all of the property of Marital Trust 1, other than her qualifying income interest therein, under § 2519. Therefore, based on the facts submitted and the representations made, after Spouse's renunciations of her interests in Marital Trust 1 and Disclaimer Trust, no part of the property deemed transferred under § 2519 will be includible in Spouse's gross estate under § 2044(a) because of the application of § 2044(b)(2).

Except as expressly provided herein, no opinion is expressed or implied concerning the federal tax consequences of any aspect of any transaction or item discussed or referenced in this letter, including the judicial modification of Trust or the effect of the net gift agreement as to any other beneficiary of Trust. Further, we express or imply no opinion on the federal tax consequences under § 61 or 1001 of any aspect of any transaction or item discussed or referenced in this letter, other than the judicial severance of Marital Trust into Marital Trust 1 and Marital Trust 2.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

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

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Karlene M. Lesho
Senior Technician Reviewer, Branch 4
(Passthroughs & Special Industries)

Enclosures (2)

cc: