

Internal Revenue Service

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Date: MAY 12, 2004

Re:

LEGEND:

Decedent =

Spouse =

Date 1 =

Date 2 =

Trust A =

Trust B =

Trust C =

Charity =

State Statute =

Cite 1 =

Cite 2 =

Dear :

This is in response to your September 26, 2003 letter and other communications requesting rulings on the application of the income, gift, and estate tax to a proposed transaction.

Decedent died on Date, survived by Spouse. During her life, Decedent and Spouse transferred their respective 50-percent interests in certain community property to a revocable trust, Trust A, which terminated on Decedent's death. On termination of Trust A, Decedent's 50-percent interest in the Trust A property passed to Trust B, a trust created by Decedent during her lifetime. Under Decedent's will, the residue of her estate also passed to Trust B.

Under Article 3.1.5 of Trust B, the trust residue is to be distributed to a "Marital Trust." However, if the trustee elects under section 2056(b)(7) to treat only part of the Marital Trust property as qualified terminable interest property, then the property for which an election is not made will be distributed to Trust C.

Under Article 3.2.1, Spouse is to receive, for his life, the net income quarterly and as much principal as, in the discretion of the trustee, is necessary for his support and medical care, after taking into consideration, to the extent the trustee may deem advisable, his resources. On Spouse's death, certain specific tangible assets will be distributed to designated persons and organizations. The balance of the Marital Trust property will be distributed to Charity, an organization exempt from tax under sections 501(c)(3) and 170(c)(2).

Spouse is designated as trustee of the Marital Trust. He is also the executor of Decedent's estate.

In accordance with the terms of Trust A, the trustee of Trust A will distribute 50-percent of the trusts assets, including interests in a limited liability company (LLC), and interests in other limited liability companies and real estate holding partnerships (collectively referred to as Business) to Trust B. The LLC will be liquidated and Trust B will receive marketable securities and certain other assets in a liquidating distribution. The trustee of Trust B will then distribute assets to the Marital Trust, consisting of marketable securities, tangible personal property, cash and Business.

On the federal estate tax return filed for decedent's estate, the executor elected to treat the entire Marital Trust as qualified terminable interest property (QTIP) under section 2056(b)(7).

Subsequently, on Date 2, Court issued an order pursuant to a petition filed by Spouse, as trustee of the Marital Trust. Pursuant to the court's order, Marital Trust is to be divided into two trusts, Marital Trust 1 and Marital Trust 2. Marital Trust 1 and Marital Trust 2 are to be administered in accordance with the terms of Marital Trust. Marital Trust 1 is to be funded with all tangible personal property, all of Business, and possibly some cash and marketable securities. Marital Trust 2 will be funded only with publicly traded securities and cash. Marital Trust 2 will not be funded with any fractional interest in any asset.

The court order further provides that if Spouse assigns all of his beneficial interest in any Marital Trust created under the terms of Trust B to the remainder beneficiary of that Marital Trust, then upon assignment, the Marital Trust subject to the assignment shall terminate and the trust property is to be distributed outright to the remainder beneficiary of the trust.

The court order dividing the Marital Trust is authorized under state law. State Statute. Further, the court's determination regarding the termination and distribution of the trust on Spouse's assignment of his entire interest in the trust to the remainder beneficiary is consistent with applicable state law. Cite1; Cite2.

In accordance with the court order, Spouse proposes to assign his entire interest in Marital Trust 2 to Charity.

Rulings requested

You have asked for the following rulings:

- (1) For estate tax purposes, the division of the Marital Trust into two trusts (Marital Trust 1 and Marital Trust 2), funded with specific assets, will not invalidate the QTIP election which was made with respect to the Marital Trust.
- (2) For estate tax purposes, the court order which authorizes Spouse to assign his entire interest in Marital Trust 2 and terminates Marital Trust 2 upon the gift by Taxpayer of his interest therein will not invalidate the QTIP election made with respect to the Marital Trust.
- (3) For gift tax purposes, Spouse's gift of his entire interest in Marital Trust 2 qualifies for the gift tax charitable deduction.
- (4) For gift tax purposes, Spouse will be treated under section 2519 as making a gift of the remainder interest in Marital Trust 2 when he makes a gift of his income interest in Marital Trust 2, and Spouse's gift of the remainder interest will qualify for the gift tax charitable deduction.
- (5) For gift tax purposes, Spouse's gift of his income interest in Marital Trust 2 does not trigger gift tax treatment of any part of Marital Trust 1.
- (6) For income tax purposes, Spouse's gift of his income interest in Marital Trust 2 qualifies for an income tax charitable deduction based on the actuarial value of the income interest.

Ruling requests 1 through 5

Section 2056(a) provides that the value of the taxable estate shall, except as limited by section 2056(b), be determined by deducting from the value of the gross estate an amount equal to the value of any interest in property which passes or has passed from the decedent to the surviving spouse.

Under section 2056(b)(1) a marital deduction is not allowed for interests passing to the surviving spouse that are “terminable interests”; that is, interests in property passing to the surviving spouse that 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, where on termination, an interest in the property passes to someone other than the surviving spouse.

Section 2056(b)(7) provides an exception to the terminable interest rule in the case of qualified terminable interest property (QTIP). Under section 2056(b)(7), for purposes of section 2056(a), qualified terminable interest property 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.

Under section 2056(b)(7)(B)(i) and (ii), “qualified terminable interest property” means property which passes from the decedent, in which the surviving spouse is entitled for life 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 2501 provides that a tax is imposed on the transfer of property by gift by any individual.

Section 2519(a) provides that 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 section 2519 (a) applies to any property if a deduction was allowed with respect to the transfer of such property to the donor under section 2056(b)(7).

Section 25.2519-1(a) of the Gift Tax Regulations provides that a transfer of all or a portion of the income interest of the spouse in qualified terminable interest property is a transfer by the spouse under section 2511.

Section 25.2519-1(c) provides that the amount treated as a transfer under section 2519 upon a 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 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 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 during such year to or for the use of charitable organizations described in section 2522(a). However, under section 2522(c)(2) and § 25.2522-3(c)(1) and (2) of the Gift Tax Regulations, where a donor transfers an interest property (other than an interest described in section 170(f)(3)(B)) to a person, or for a use described in section 2522(a) or (b) and an interest in the same property is retained by the donor, is transferred, or has been transferred (for less than an adequate and full consideration in money or money's worth) from the donor to a person, or for a use, not described in section 2522(a) or (b), no deduction is allowed for the interest that is or has been transferred to the person, or for the use, described in section 2522(a) or (b), unless the charitable interest is:

- (A) an undivided portion (not in trust) of the donor's entire interest;
- (B) a remainder interest (not in trust) in a personal residence or farm;
- (D) a remainder interest in a charitable remainder annuity trust or a charitable remainder unitrust (described in section 664) or a pooled income fund (described in section 642(c)(5));
- (E) a guaranteed annuity interest or a unitrust interest; or
- (G) a qualified conservation contribution.

In Situation 2 of Rev. Rul. 86-60, 1986-1 C. B. 302, the secondary life annuitant of a charitable remainder trust transfers the annuitant's entire annuity interest to the charitable remainder beneficiary. The ruling concludes that the transfer qualifies for the gift tax charitable deduction. Following the transfer, the secondary life annuitant did not retain any interest in the trust. Further, and at no time had the annuitant made a transfer of an interest in the trust for a private purpose. Consequently, the transfer to charity need not be in the form described in § 25.2522(c)-(3)(c)(2). Accordingly, the annuitant's transfer to charity qualifies for the deduction under section 2522(a).

In this case, the estate has elected to treat the Marital Trust as qualified terminable interest property under section 2056(b)(7). The division, pursuant to the court order, of the Marital Trust into Marital Trust 1 and Marital Trust 2, to be funded as described above, will not invalidate the election under section 2056(b)(7) with respect to

the Marital Trust, or Marital Trust 1 and Marital Trust 2. In addition, the court order as it pertains to the effect of Spouse's assignment of his entire interest in Marital Trust 2 to Charity, will not invalidate the election under section 2056(b)(7) with respect to the Marital Trust, or Marital Trust 1 and Marital Trust 2.

Further, when Spouse assigns his entire interest in Marital Trust 2 to Charity, he will make a gift to Charity under section 2511 of his qualifying income interest for life in Marital Trust 2. Charity is an organization described in section 2522(a). In accordance with Situation 2 of Rev. Rul. 86-60, Spouse's transfer of his entire interest in Marital Trust 2 will qualify for the gift tax charitable deduction under section 2522(a).

In addition, under section 2519, upon Spouse's assignment of his interest in Marital Trust 2, Spouse will be treated as making a transfer of all interests in Marital Trust 2 other than his qualifying income interest. Under the court order, which is consistent with applicable state law, upon Spouse's assignment of his entire interest in Marital Trust 2 to Charity, the trust will terminate and the trust corpus will pass outright to Charity. Accordingly, a gift tax charitable deduction under section 2522 will be allowed for the amount Spouse is deemed to transfer to Charity under section 2519. In addition, for gift tax purposes, Spouse's gift of his entire interest in Marital Trust 2, will not otherwise cause Spouse to be treated as making a gift under section 2519 with respect to any portion of Marital Trust 1.

Ruling request 6

Section 170(a)(1) allows as a deduction any charitable contribution to an organization described in section 170(c), payment of which is made within the taxable year.

Section 170(f)(3)(A) disallows a charitable contribution deduction for a contribution of a partial interest in property. Section 170(f)(3)(B)(ii) provides an exception in the case of a contribution of an undivided portion of the taxpayer's entire interest in the property.

Section 1.170A-7(b)(1)(i) of the Income Tax Regulations defines an undivided portion of a taxpayer's entire interest in property as "a fraction or percentage of each and every substantial interest or right owned by the donor in such property" that extends "over the entire term of the donor's interest" in the property.

Section 1.170-7(a)(2)(i) allows a deduction for a contribution of a partial interest in property if the interest is the taxpayer's entire interest in the property such as an income interest or a remainder interest. If, however, the property in which the partial interest exists was divided in order to create the partial interest and avoid section 170(f)(3)(A), the deduction will not be allowed.

In Situation 1 of Rev. Rul. 86-60, A, the grantor and life-interest beneficiary of a charitable remainder annuity trust, transfers A's annuity interest to the charitable beneficiary. The ruling concludes that the transfer qualifies for a charitable deduction under section 170. The rationale is that A is contributing A's entire interest in the property, and, although A had previously divided the property, the property was not divided in order to avoid the rules of sections 170(f)(2) and (f)(3)(A).

In the present case, Spouse did not divide the interests in the Marital Trust. Instead, Spouse's income interest and right to principal, and the charitable beneficiary's remainder interest were created by Decedent. By contributing his entire interest in Marital Trust 2, Spouse will contribute an undivided portion of his entire interest in the Marital Trust under section 170(f)(3)(B)(ii). Spouse represents that in the course of the property division of the Marital Trust, he will not divide any assets in the Marital Trust into fractional interests. Thus, section 170(f)(3)(A) does not apply to the contribution of Spouse's interest in Marital Trust 2, and Spouse's transfer of his entire interest in Marital Trust 2 will qualify as a charitable contribution under section 170 limited to the fair market value of the interest at the time of the transfer.

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under the cited provisions or any other provisions of the Code.

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.

Sincerely yours,

George L. Masnik
Chief, Branch 4
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure

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