

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:4-PLR-118595-00

Date:

February 27, 2001

Re:

LEGEND:

Decedent =

Spouse =

Date =

Trust A =

Trust B =

Marital Trust =

Trust C =

Marital Trust 1 =

Marital Trust 2 =

Company =

Business =

Charity =

State Statute =

Cite 1 =

Cite 2 =

Dear :

This is in response to your November 14, 2000 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

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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 was likewise distributable to Trust B.

Trust B provides that 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 the terms of the Marital Trust, 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 its assets, including interests in Company, to Trust B. Company 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.

It is proposed that Spouse, as trustee of the Marital Trust, will petition the local probate court for an order dividing the Marital Trust pursuant to State Statute into two trusts, Marital Trust 1 and Marital Trust 2. In all respects, the terms of Marital Trust 1 and Marital Trust 2 will be identical to the terms of the Marital Trust. Marital Trust 1 will receive all tangible personal property, all of Business, and possibly some cash and marketable securities.

Marital Trust 2 will receive only publicly traded securities and cash. No fractional interest in any asset will be transferred to Marital Trust 2. An election will be made under section 2056(b)(7) to treat all of the property in Marital Trust 1 and Marital Trust 2 as qualified terminable interest property.

The court order will provide that, if Spouse transfers his income interest in Marital Trust 2 to Charity, then Marital Trust 2 will terminate and the Marital Trust 2 property will be distributed outright to Charity. This determination is consistent with applicable State

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law. Cite 1 and Cite 2. Spouse will thereupon make a gift of his income 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 funded with specific assets will not cause either Marital Trust 1 or Marital Trust 2 to be ineligible for the election under section 2056(b)(7) ("QTIP election").

(2) For estate tax purposes, both Marital Trust 1 and Marital Trust 2 are eligible for the QTIP election and do not lose eligibility as a result of the court order authorizing Spouse to make a gift of his income interest in Marital Trust 2 to Charity.

(3) For gift tax purposes, Spouse's gift of his income 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 result in 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.

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.

Section 2056(b)(1) denies a marital deduction 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

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spouse.

Section 2056(b)(7) provides an exception to the terminable interest rule in the case of qualified terminable interest property. 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 paragraph (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

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(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.

Situation 2 of Rev. Rul. 86-60, 1986-1 C.B. 302, considers whether a transfer to charity by a secondary life annuitant of a charitable remainder annuity trust of his entire secondary life annuity interest qualifies for the gift tax charitable deduction. Following the transfer, the secondary life annuitant did not retain any interest in the trust, and at no time had he made a transfer of an interest in the trust for a private purpose. Consequently, there is no requirement that the transfer to charity be in a form described in § 25.2522(c)-3(c)(2), and the secondary life annuitant's transfer of his annuity interest to charity qualifies for a deduction under section 2522(a).

In this case, the Marital Trust is eligible for the QTIP election under section 2056(b)(7). The proposed funding of the Marital Trust as two separate trusts, as permitted by state law, and the order authorizing Spouse's assignment of his income interest, will have no effect on eligibility of Marital Trust 1 and Marital Trust 2 for the election under section 2056(b)(7).

When Spouse assigns his income interest in Marital Trust 2, he will make a gift under section 2511 of his qualifying income interest for life in Marital Trust 2. Under the court order, which is consistent with applicable local law, upon Spouse's assignment of his income interest, the property held in Marital Trust 2 will pass outright to Charity pursuant to the court order consistent with applicable state law. Charity is an organization described in section 2522(a). In accordance with Situation 2 of Rev. Rul. 86-60, Spouse's transfer of his income interest will qualify for a gift tax charitable deduction under section 2522(a).

In addition, Spouse will be deemed to make a transfer under section 2519 of all interests in the Marital Trust 2 property other than his qualifying income interest, and a gift tax deduction under section 2522 will be allowable for the amount Spouse is

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treated as transferring to Charity under section 2519.

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.

Rev. Rul. 86-60 holds that the transfer by A, the grantor and life-interest beneficiary of a charitable remainder annuity trust, of A's annuity interest to the charitable beneficiary 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, his 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). Accordingly, 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 factional 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 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

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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

Copy for section 6110 purposes