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Person To Contact:  
, ID No.

Telephone Number:

RE:

Refer Reply To:  
CC:PSI:B04 – PLR-165283-02  
Date: DECEMBER 03, 2003

Legend

Taxpayer	=
Spouse	=
Trust	=
Agreement	=
State Statute	=

Dear :

This letter is in response to the November 7, 2003, letter submitted by your authorized representative on your behalf, and prior submissions, in which you request rulings as to the qualification of a transfer to a trust for a marital deduction under section 2523(f) of the Internal Revenue Code and the subsequent includibility of the transferred property in the gross estate of Taxpayer or Spouse at their deaths.

The facts and representations submitted are summarized as follows: Taxpayer and Spouse are currently married. Taxpayer proposes to create and enter into Trust. Taxpayer intends to transfer his separately-owned property to Trust.

Article II of Trust provides that Taxpayer shall retain the power to appoint all the income or principal of Trust. The power of appointment shall cease to apply to any property which is distributed to a beneficiary pursuant to other provisions of Trust. The power of appointment shall terminate on the first to occur of: (1) Taxpayer's death, (2) Spouse's death, (3) Taxpayer's written release of the power of appointment which is signed by Taxpayer and delivered to the trustee, or (4) the expiration of 20 years and 2 months from the date of Trust. In no event shall the power of appointment be exercised in favor of Taxpayer, Taxpayer's creditors, Taxpayer's estate or the creditors of Taxpayer's estate.

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Pursuant to Article IV, subject to Article II, during Taxpayer's lifetime, the trustee shall pay all of the net income from Trust, at least annually, to or for the benefit of Spouse. After Taxpayer's death, the trustee shall pay all the net income from Trust, at least quarter-annually, to or for the benefit of Spouse. The trustee shall distribute to or for the benefit of Spouse, so much of the principal of Trust as the trustee from time to time, in its sole discretion, may consider necessary or advisable for Spouse's health, support, maintenance and education. Upon written demand by Spouse, unproductive property shall be made reasonably productive.

Pursuant to Article V, subject to Article II, on the death of Spouse, the trustee shall distribute the income for the period between the last income distribution date and the death of Spouse to the estate of Spouse. The remaining principal of Trust shall be held and administered as provided in Article VI.

Pursuant to Article VI, if Spouse is survived by Taxpayer, on the death of Spouse the remaining unappointed trust estate shall be divided into a "Marital Trust" and "Family Trust". The Marital Trust shall consist of a fractional share of the property of the trust estate known as the marital deduction fractional share. During Taxpayer's lifetime, the trustee shall pay all the net income from the Marital Trust, at least quarter-annually, to Taxpayer. The trustee may distribute to or for the benefit of Taxpayer, from time to time, so much of the principal of the Marital Trust as the trustee, in its sole discretion, shall consider necessary or advisable to supplement said income distribution to adequately provide for Taxpayer's health, support, maintenance and education. Upon Taxpayer's death, the trustee shall distribute the remaining principal as appointed by Taxpayer's will. This power may not be exercised in favor of Taxpayer, Taxpayer's creditors, Taxpayer's estate, or the creditors of Taxpayer's estate. To the extent Taxpayer does not exercise the power to appoint, the remainder shall be paid to the Family Trust and administered as provided in Article VIII.

Pursuant to the terms of Trust, if Taxpayer survives Spouse, the Family Trust shall consist of the remainder of the trust after funding the Marital Trust. During Taxpayer's lifetime, the trustee shall distribute so much of the net income and principal of the Family Trust to or for the benefit of Taxpayer, in such amounts as is necessary for his health, education, support, maintenance, and education. However, in the event that Spouse survives Taxpayer, then the Family Trust shall consist of all of the trust.

Pursuant to Article VIII, upon the last to die of Taxpayer and Spouse, the trustee shall divide the Family Trust into separate shares to benefit various individuals and charities.

Article IX, section 4, provides that notwithstanding anything in Trust to the contrary, a trustee shall not participate in the exercise of any discretion with respect to

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the distribution of income or principal which would discharge an obligation of any person, including an obligation of support; or participate in the amendment or termination of any trust created under Trust, if such participation would cause any portion of the trust estate to be included in the gross estate of any person.

Pursuant to Article X, the trusts created under Trust shall terminate at such time as Taxpayer and Spouse agree to such termination. In the event of such termination, the trust principal shall be distributed to Spouse. In addition to this provision, within 30 days after the entry of a decree of dissolution or a decree of legal separation of the marriage of Taxpayer and Spouse, Spouse shall elect to terminate any trust created under Trust by delivering written notice of such election to the trustee. In the event of such termination, the Trust principal and any accumulated income will be distributed to Spouse within 60 days of the trustee's receipt of such notice and distributed pursuant to Agreement (described below).

Pursuant to Article X, section 5, the initial trustee shall be Taxpayer and Spouse. If Spouse survives Taxpayer, then upon Taxpayer's death, the trustee will be Spouse and another party. If Taxpayer survives Spouse, Taxpayer will be the sole trustee.

Taxpayer and Spouse also intend to enter into an Agreement regarding the disposition of their property in the event of divorce. Taxpayer and Spouse agree that for purposes of State Statute 1, the property transferred to Trust shall retain the characterization (marital property or separate property) it had prior to the transfer. Furthermore the property transferred to Trust shall be divided upon divorce as provided in a prenuptial agreement. In the event of divorce, the court having jurisdiction shall determine the portion, if any, of the property transferred to Trust that Taxpayer is to receive incident to the divorce. Upon the court's determination, Spouse shall take all actions necessary to terminate Trust pursuant to Article X of Trust. Upon termination of Trust, Spouse shall convey Taxpayer's portion to Taxpayer. Agreement shall be null and void upon the first to occur of the following: (i) Taxpayer signing a document expressly and specifically nullifying Agreement, or (ii) the expiration of 20 years from the date of Agreement.

You have asked that we rule as follows:

1. Taxpayer's transfers of assets to Trust while Taxpayer retains the power to appoint income and principal of Trust will not constitute gifts for purposes of section 2501.
2. Distributions of income and principal from Trust will constitute gifts for purposes of section 2501 and each distribution of income and principal to Spouse from Trust will qualify for the gift tax marital deduction under section 2523.

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3. When Taxpayer's power of appointment is terminated pursuant to Trust and Agreement is nullified, and if Taxpayer makes a valid QTIP election pursuant to section 2523(f) with respect to the Trust assets held in Trust at that time, then:
  - a. the Trust assets will qualify for the gift tax marital deduction under section 2523(a).
  - b. If Spouse survives Taxpayer, then no part of Trust will be includible in Taxpayer's gross estate and if Spouse does not dispose of the income interest in a disposition subject to section 2519, then upon Spouse's subsequent death, the Trust assets will be includible in Spouse's gross estate under section 2044.
  - c. If Taxpayer survives Spouse and if Spouse does not dispose of the income interests in a disposition subject to section 2519, then upon Spouse's death, the Trust assets will be includible in Spouse's gross estate under section 2044.
    - i. To the extent the personal representative of Spouse's estate does not make a QTIP election under section 2056(b)(7) with respect to a portion of Trust, those Trust assets will not be includible in Taxpayer's estate upon Taxpayer's subsequent death.
    - ii. To the extent the personal representative of Spouse's estate elects to qualify a portion or all of Trust under section 2056(b)(7), then only that portion of the Trust assets for which the election is made will be includible in Taxpayer's gross estate under section 2044.
4. Taxpayer's position as co-trustee or sole trustee will not cause inclusion of the Trust assets in Taxpayer's gross estate under section 2036 or section 2038.

Section 2501(a)(1) imposes a tax on the transfer of property by gift during the calendar year by any individual, resident or nonresident.

Section 2511 provides that the gift tax imposed by section 2501 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 25.2511-2(b) of the Gift Tax Regulations provides that as to any property, or part therein, of which the donor has so parted with dominion and control as to leave in him no power to change its disposition, whether for his own benefit or for the benefit of another, the gift is complete. Section 25.2511-2(c) provides, in part, that a gift is incomplete if and to the extent that a reserved power gives the donor the power to name new beneficiaries or to change the interests of the beneficiaries as between themselves unless the power is a fiduciary power limited by a fixed or ascertainable

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standard. Thus, if an estate for life is transferred but, by an exercise of a power, the estate may be terminated or cut down by the donor to one of less value, and without restriction upon the extent to which the estate may be so cut down, the transfer constitutes an incomplete gift.

Section 25.2511-2(f) provides that the relinquishment or termination of a power to change beneficiaries of transferred property, occurring otherwise than by the death of the donor (the statute being confined to transfers by living donors), is regarded as the event which completes the gift and causes the gift tax to apply.

Section 2523(a) provides that where a donor transfers during the calendar year by gift an interest in property to a donee who at the time of the gift is the donor's spouse, there shall be allowed as a deduction in computing taxable gifts for the calendar year an amount with respect to such interest equal to its value.

Section 2523(b) provides, in part, that 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, such interest transferred to the spouse will terminate or fail, no deduction shall be allowed with respect to such interest if the donor retains in himself, or transfers or has transferred (for less than an adequate and full consideration in money or money's worth) to any person other than such donee spouse (or the estate of such spouse), an interest in such property, and if by reason of such retention or transfer the donor (or his heirs or assigns) or such person (or his heirs or assigns) may possess or enjoy any part of such property after such termination or failure of the interest transferred to the donee spouse.

Section 2523(f)(1) provides that, in the case of qualified terminable interest property, for purposes of section 2523(a), such property shall be treated as transferred to the donee spouse, and for purposes of section 2523(b)(1), no part of such property shall be considered as retained in the donor or transferred to any person other than the donee spouse.

Section 2523(f)(2) defines the term "qualified terminable interest property" as any property which is transferred by the donor, in which the donee has a qualifying income interest for life, and to which an election under this subsection applies.

Section 2523(f)(3) provides that, for purposes of this subsection, rules similar to the rules of clauses (ii), (iii), and (iv) of section 2056(b)(7)(B) shall apply.

Section 2523(f)(4)(A) provides that an election under section 2523(f) with respect to any property shall be made on or before the date prescribed by section 6075(b) for filing a gift tax return with respect to the transfer (determined without regard to section 6019(2)) and shall be made in such manner as the Secretary shall by regulations prescribe.

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Section 2523(f)(4)(B) provides that an election under this subsection, once made, shall be irrevocable.

Section 2523(f)(5)(A) provides that, in the case of any qualified terminable interest property, such property shall not be includible in the gross estate of the donor spouse, and any subsequent transfer by the donor of an interest in such property shall not be treated as a transfer for purposes of the gift tax.

Section 2523(f)(5)(B) provides that section 2523(f)(5)(A) shall not apply with respect to any property after the donee spouse is treated as having transferred such property under section 2519, or such property is includible in the donee spouse's gross estate under section 2044.

Section 25.2523(f)-1(f), Example 5 provides a situation where D transfers assets to a trust and gives S a power exercisable annually to require distribution to S of only 50 percent of the trust income for life. Trust also provides that if S and D divorce, S's interest in Trust will pass to C. In such situations, S's income interest is not a qualifying income interest for life because it is terminable upon S's divorce. Therefore, no portion of the trust is deductible under section 2523(f).

Section 25.2523(f)-1(f), Example 10 provides a situation where the donor spouse retains an income interest in property. In 1994, D transfers property to an irrevocable trust under the terms of which trust income is to be paid to S for life, then to D for life and, on D's death, the trust corpus is to be paid to D's children. D elects under section 2523(f) to treat the property as qualified terminable interest property. D dies in 1996, survived by S. S subsequently dies in 1998. Under section 25.2523(f)-1(d)(1), because D elected to treat the transfer as qualified terminable interest property, no part of the trust corpus is includible in D's gross estate because of D's retained interest in the trust corpus. On S's subsequent death in 1998, the trust corpus is includible in S's gross estate under section 2044.

Section 25.2523(f)-1(f) Example 11 provides that the facts are the same as in Example 10 except that S dies in 1996, survived by D, who subsequently dies in 1998. Because D made an election under section 2523(f) with respect to the trust, on S's death the trust corpus is includible in S's gross estate under section 2044. Accordingly, under section 2044(c), S is treated as the transferor of the property for estate and gift tax purposes. Upon D's subsequent death in 1998, because the property was subject to inclusion in S's gross estate under section 2044, the exclusion rule in section 25.2523(f)-1(d)(1) does not apply under section 25.2523(f)-1(d)(2). However, because S is treated as the transferor of the property, the property is not subject to inclusion in D's gross estate under section 2036 or section 2038. If the executor of S's estate made a section 2056(b)(7) election with respect to the trust, the trust is includible in D's gross estate under section 2044 upon D's later death.

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Section 2519(a) provides that any disposition of all or part of a qualifying income interest for life in any property (if a deduction was allowed with respect to the transfer of such property to the donor under section 2056(b)(7) or section 2523(f)) shall be treated as a transfer of all interests in such property other than the qualifying income interest.

Section 2056(a) provides that, for purposes of the tax imposed by section 2001, 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, but only to the extent that such interest is included in determining the value of the gross estate.

Section 2056(b)(7)(A) provides that, in the case of qualified terminable interest property, for purposes of section 2056(a), such property shall be treated as passing to the surviving spouse, and for purposes of section 2056(b)(1)(A), no part of such property shall be treated as passing to any person other than the surviving spouse.

Section 2056(b)(7)(B)(i) defines the term "qualified terminable interest property" (QTIP) as property: (I) which passes from the decedent; (II) in which the surviving spouse has a qualifying income interest for life; and (III) to which an election under section 2056(b)(7) applies.

Section 2056(b)(7)(B)(ii) provides that the surviving spouse has a qualifying income interest for life if: (I) the surviving spouse is entitled to all the income from the property, payable annually or at more frequent intervals, or has a usufruct interest for life in the property; and (II) no person has a power to appoint any part of the property to any person other than the surviving spouse.

Section 2044(a) provides that the value of the gross estate shall include the value of any property to which this section applies in which the decedent had a qualifying income interest for life. Section 2044(b) provides that this section applies to any property if a deduction was allowed with respect to the transfer of such property to the decedent under section 2056 by reason of subsection (b)(7) thereof, or under section 2523 by reason of subsection (f) thereof, and section 2519 (relating to dispositions of certain life estates) did not apply with respect to a disposition by the decedent of part or all of such property.

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.

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Section 2033 provides that the value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of the decedent death.

Section 2036(a) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death (1) the possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

Section 2038 provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has any time made a transfer (except in the case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at his death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power), to alter, amend, revoke, or terminate, or where any such power is relinquished during the 3-year period ending on the date of the decedent's death.

### Ruling Requests 1 and 2

Taxpayer proposes to make transfers of his separately owned property to Trust. Taxpayer will retain the power to appoint the income and principal of Trust. Accordingly, we conclude that any transfer to Trust by Taxpayer while Taxpayer retains the power of appointment will not constitute completed gifts by Taxpayer under section 25.2511-2(c). Further, if Taxpayer does not exercise his power to appointment over the income and/or principal of Trust, the trustee of Trust is required to pay all of the net income to Spouse during her lifetime and the trustee may distribute principal to Spouse, if in the trustee's discretion, the trustee considers it necessary for Spouse's health, support, maintenance and education. Accordingly, we conclude that each payment of income and principal to Spouse will constitute a completed gift under section 2501 and each gift will qualify for the gift tax marital deduction under section 2523.

### Ruling Request 3

In this case, Trust provides that the trustee is required to pay all of the net income to Spouse for her life and so much of the principal that the trustee, in its



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discretion, consider necessary for Spouse's health, support, maintenance, and education. However, Spouse's right to all of the net income is subject to Taxpayer's power to appoint income and principal. Further, Taxpayer and Spouse retained the power to terminate Trust in the event of divorce pursuant to Article X and Agreement. Upon divorce, Trust will be terminated and Taxpayer and Spouse will each receive a portion of the Trust assets based upon a court's determination of the character (marital or separate property) of the Trust assets. Accordingly, Spouse's interest does not constitute a qualifying income interest for purposes of section 2523.

However, Taxpayer's power of appointment shall terminate on the first to occur of: (1) Taxpayer's death, (2) Spouse's death, (3) Taxpayer's written release of the power of appointment which is signed by Taxpayer and delivered to the trustee, or (4) the expiration of 20 years and 2 months from the date of Trust. Agreement shall be null and void upon the first to occur of the following: (i) Taxpayer signing a document expressly and specifically nullifying this Agreement, or (ii) the expiration of 20 years from the date of Agreement. Accordingly, when the power of appointment is terminated and the Agreement is nullified pursuant to Trust and Agreement, Spouse's income interest will constitute a qualifying income interest for purposes of section 2523.

Therefore, we rule as follows:

1. Upon the termination of Taxpayer's power of appointment pursuant to Trust and the nullification of Agreement, if Taxpayer makes a valid QTIP election pursuant to section 2523(f) with respect to the Trust assets held in Trust at that time, then the Trust assets will qualify for the gift tax marital deduction under section 2523.
  - i. Further, subsequent to making a valid section 2523(f) election, if Spouse survives Taxpayer, then no part of Trust will be includible in Taxpayer's gross estate. If Spouse does not dispose of the income interest in a disposition subject to section 2519, then upon Spouse's subsequent death, the Trust assets will be includible in Spouse's gross estate under section 2044.
  - ii. Further, subsequent to Taxpayer making a valid section 2523(f) election, if Taxpayer survives Spouse and Spouse does not dispose of the income interests in a disposition subject to section 2519, then upon Spouse's death, the Trust assets will be includible in Spouse's gross estate under section 2044.
    1. To the extent the personal representative of Spouse's estate does not make a QTIP election under section 2056(b)(7) with respect to a portion of Trust, those Trust assets will not be includible in Taxpayer's estate upon Taxpayer's subsequent death.

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2. To the extent the personal representative of Spouse's estate elects to qualify a portion or all of Trust under section 2056(b)(7), then only that portion of the Trust assets for which the election is made will be includible in Taxpayer's gross estate under section 2044.

#### Ruling Request 4

Under the terms of Trust, Taxpayer's powers as trustee are restricted by definite ascertainable standards. Therefore, Taxpayer, as trustee, has not retained any right to alter, amend, revoke, or terminate Trust within the meaning of section 2038, or the right, "to designate the persons who shall possess or enjoy the property or the income therefrom" within the meaning of section 2036.

The ruling contained in this letter is 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.

Except as specifically ruled herein, we express or imply no opinion on the federal tax consequences of the transaction under the cited provisions or under any other provisions of the Code.

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

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,

Lorraine E. Gardner  
Senior Counsel, Branch 4  
Office of Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosure

Copy for § 6110 purposes  
Copy of this letter