

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:9-PLR-112571-01
Date:

Re:

March 1, 2002

LEGEND:

Decedent =
Spouse =
Date 1 =
State =
Management Trust =
Date 2 =
Date 3 =
Date 4 =
Property 1 =

Property 2 =

Date 5 =
Court =
Date 6 =
Date 7 =
Citations =

Dear

This is in response to your letters dated February 23, 2001, July 26, 2001, September 20, 2001, and subsequent correspondence, in which you requested rulings under section 2056 of the Internal Revenue Code.

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FACTS:

The facts submitted and representations made are as follows:

Decedent was a widow with two adult children when she married Spouse, a widower with three adult children, on Date 1. Decedent and Spouse resided in State, a community property state, both before and during their marriage.

Shortly following their marriage, Decedent and Spouse executed a Marital Property Agreement, retroactive to the date of their marriage, in which they expressly stated their intent that each party would continue to own his or her separate property and the income and appreciation thereon, and each party would be separately liable for his or her debts and liabilities.

On Date 2, Decedent executed her will and a Management Trust Agreement (Management Trust). Decedent transferred cash, a life insurance policy, and personal property located at her personal residence and at her farm to the Management Trust. Decedent amended the Management Trust and executed a codicil to her will on Date 3. She died on Date 4. At the time of her death, Decedent owned Property 1 and Property 2.

In her will, Decedent made specific bequests to two of her relatives. She directed that all debts, claims, expenses of administration and taxes of her estate be paid from her residuary estate, and that the remaining portion pour over to the Management Trust.

Article 3 of the Management Trust is captioned, "Disposition of Trust Property at Death of Grantor or Spouse." Article 3 provides, in pertinent part, as follows:

3.2 Spouse Surviving. If the Grantor's Spouse survives the death of the Grantor, then upon the death of the Grantor, the trust estate shall be divided into three (3) portions to be designated the "Spouse's Fund," the "Marital Fund," and the "Credit Shelter Fund," each of which shall be subject to the right of my Spouse, if surviving, to use certain real estate and tangible personal property as set forth in Section 3.7, below....The Marital Fund will not entitle the deceased Grantor to qualify for the one hundred percent (100%) deferral from any federal estate tax thereon until after the death of the surviving Grantor under Section 2056 of the Code....

3.7 Spouse's Use of Assets. I hereby instruct the Trustee of the [Management Trust] that if my Spouse. . . survives me, that said Trustee shall allow him to use for his lifetime all the interest that I own at my death in all my real estate and all my personal property, furniture, equipment and tangible personal property associated with said real property, not otherwise disposed of under Section 6.1.1.1, so that he may have the

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exclusive right to use and enjoy said real estate and personal property for the remainder of his lifetime. My Executor and Trustee shall transfer and make available to my Spouse, if he survives me pursuant to these instructions, the real estate and related personal property for his sole use during his lifetime. If in the discretion of my Spouse, he wishes to give any of said real estate or personal property to my children or their descendants, then my Trustee after obtaining his consent shall make a distribution as he wishes. Upon his death, my interest in any said real property and all my personal property associated with said real property shall then be distributed by my Trustee in a manner consistent with the provisions as set forth in the disposition provisions of this my Trust, as provided for herein.

Article 4.8 of the Management Trust provides, in pertinent part, as follows:

4.8 Marital Trust. The trust estate of the Marital Trust shall be held, administered and distributed as follows:

4.8.1 Distributions to Surviving Spouse. During the surviving Spouse's lifetime, Trustee shall not pay any of the income of the Trust to the surviving Spouse. The Trustee may pay any or all of the income to the deceased Grantor's descendants as may be necessary to maintain their accustomed standard of living for said deceased Grantor's descendants and to provide for their health, education, maintenance and support in any manner with periodic installments not less frequently than annually. In addition the Surviving Spouse shall have the right to use any tangible assets held by the Trustee under these trusts, including personal property, real property, etc. as provided in Section 3.7, above, and shall not sell any part of said real estate or tangible personal property until after the death of my Spouse, unless necessary to pay debts or taxes of my estate. In addition, Trustee shall distribute to the deceased Grantor's descendants so much of the principal of the trust as Trustee, in Trustee's sole discretion, deems appropriate for their health, education, maintenance and support. In exercising this discretion, Trustee shall consider other income and resources available to the Grantor's descendants.

4.8.2 Statement of Intent. It is the deceased Grantor's intent that the marital deduction gift and the trust estate of the Marital Trust will not qualify for the marital deduction allowed by the federal estate tax law applicable to the deceased Grantor's estate except as to the portion of the Marital Trust the Executor does not elect to treat as qualified terminable interest property. All questions applicable to the marital deduction gift and to the Marital Trust shall be resolved accordingly. The powers and

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discretions of Trustee with respect to the administration of this trust during the surviving Spouse's lifetime shall not be exercised or exercisable except in a manner consistent with the deceased Grantor's intent as expressed in this Section.

Article 6 of the Management Trust is captioned, "Disposition of Trust Estate Upon Death of Trustor." Article 6 provides, in pertinent part, as follows:

6.1 Trust Division.

6.1.1 Upon the death of the Trustor and after payment of the pro rata portion of the administration expenses and taxes attributable to such Trust, the remainder of such Trust (including all assets transferred to the Trust upon the death of such Trustor) shall be distributed as follows:

6.1.1.1 Personal Property. My personal affects including our clothes, furniture, household affects [sic], books, pictures, automobile, and costume jewelry shall be held by the Trustee of this trust for the use and enjoyment of my Spouse, if he survives me, for his lifetime under the terms of this trust as set forth in Section 3.7, above. . . .

6.1.1.2 Balance of Trust. Prior to the death of my Spouse the assets in this trust shall be held and allocated pursuant to the provisions of Article 3, specifically including Section 3.7, then after the death of my Spouse, the remaining portion of my trust, including all remaining property, personal and real, cash funds, intangibles, etc. all of which shall be known as the Residue of my estate or trust shall be held or sold and converted into liquid funds in the Trustee's discretion and be divided into as many equal shares as there are persons surviving us from the following list of my Family or any of their surviving descendants, as follows:

1. [child of Decedent]; and
2. [child of Decedent].

On Date 5, Spouse, individually, as a beneficiary of the Marital Trust, as trustee of the Marital Trust, as successor trustee of the Management Trust, and as independent executor of the Decedent's estate, filed a petition with Court "to correct mistakes made by the scrivener" of the Management Trust and to reform, inter alia, Articles 3.2, 4.8.1 and 4.8.2 of the Marital Trust in order to conform the provisions with Decedent's intent that the Marital Trust qualify for the marital deduction under section 2056. Decedent's adult children joined in the petition, and Decedent's two minor grandchildren,

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represented by their father as next friend, also joined in the petition.

On Date 6, Court entered a final judgment, ordering the reformation of Articles 3.2, 4.8.1 and 4.8.2, retroactive to Date 2, in order to correct the scrivener's errors, to correct certain ambiguities, and to properly reflect the intentions of Decedent.

On Date 7, which is within 9 months of Decedent's death, Spouse, in his individual capacity as a beneficiary of the Management Trust, executed a valid disclaimer under State law of the limited power given to him under the terms of the Marital Trust to appoint any property comprising a part of the Marital Trust to Decedent's children or their descendants. Also within 9 months of Decedent's death, her two adult children and two minor grandchildren (represented by their temporary guardian) executed valid disclaimers under State law of any rights given to them under the terms of the Marital Trust to distributions of income or principal from that trust during the lifetime of Decedent's Spouse.

You have requested the following rulings:

1. Pursuant to the provisions of Article 3.7 of the Management Trust, Spouse has a qualifying income interest for life in all of Decedent's real estate and personal property, furniture, equipment and tangible personal property associated with said real property under section 2056(b)(7)(B)(ii).
2. Pursuant to the reformation by Court of the terms of the Management Trust and following Spouse's disclaimer of the limited power of appointment granted to him under Article 3.7 of the Management Trust and the disclaimers by Decedent's children and grandchildren of any rights to distribution of income or principal of the Marital Trust during the lifetime of Spouse, Spouse has a qualifying income interest in the Marital Trust under section 2056(b)(7)(B)(ii).

LAW and ANALYSIS:

Section 2001(a) provides that a tax is imposed 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, for purposes of the tax imposed by section 2001, the value of the taxable estate shall, except as limited by subsection (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 his surviving spouse, but only to the extent that such interest is included in determining the value of the gross estate.

Section 2056(b)(1) provides the general rule 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, an interest passing to the surviving spouse will terminate or fail, no deduction shall be allowed with respect to such interest – (A) if an interest in such property passes

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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 such surviving spouse (or the estate of such spouse); and (B) if by reason of such passing such person (or his heirs or assigns) may possess or enjoy any part of such property after such termination or failure of the interest so passing to the surviving spouse.

Section 2056(b)(7)(A) provides that in the case of qualified terminable interest property -- (i) for purposes of subsection (a), such property shall be treated as passing to the surviving spouse, and (ii) for purposes of paragraph (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) provides that the term "qualified terminable interest property" means 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 this paragraph 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 20.2056(b)-7(g) of the Estate Tax Regulations provides that the provisions of local law are taken into account in determining whether the conditions of section 2056(b)(7)(B)(ii)(I) are satisfied.

Section 20.2056(b)-7(h), Example 1, provides as follows: Decedent (D) owned a personal residence valued at \$250,000 for estate tax purposes. Under D's will, the exclusive and unrestricted right to use the residence (including the right to continue to occupy the property as a personal residence or to rent the property and receive the income) passes to Spouse (S) for life. At S's death, the property passes to D's children. Under applicable local law, S must consent to any sale of the property. If the executor elects to treat all of the personal residence as qualified terminable interest property, the deductible interest is \$250,000, the value of the residence for estate tax purposes.

Section 2046 provides that, for estate tax purposes, disclaimers of property interests passing upon death are treated as provided in section 2518.

Section 2518(a) provides that, if a person makes a qualified disclaimer with respect to any interest in property, then for purposes of the estate, gift, and generation-skipping transfer tax the disclaimed interest is treated as if it never passed to that person.

Section 2518(b) defines a qualified disclaimer as an irrevocable and unqualified refusal by a person to accept an interest in property but only if -- (1) such refusal is in writing, (2) such writing is received by the transferor of the interest, his legal representative, or

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the holder of the legal title to the property to which the interest relates not later than the date which is 9 months after the later of -- (A) the date on which the transfer creating the interest in such person is made, or (B) the day on which such person attains age 21, (3) such person has not accepted the interest or any of its benefits, and (4) as a result of such refusal, the interest passes without any direction on the part of the person making the disclaimer and passes either -- (A) to the spouse of the decedent, or (B) to a person other than the person making the disclaimer.

Section 25.2518-1(b) of the Gift Tax Regulations provides that, if a person makes a qualified disclaimer, for purposes of the federal estate, gift, and generation-skipping transfer tax provisions, the disclaimed interest in property is treated as if it had never been transferred to the disclaimant. Instead, it is considered as passing directly from the transferor of the property to the person entitled to receive the property as a result of the disclaimer. Accordingly, a person making a qualified disclaimer is not treated as making a gift.

Section 25.2518-2(c)(3)(i) provides that the 9-month period for making a disclaimer generally is to be determined with reference to the transfer creating the interest in the disclaimant.

Section 25.2518-2(d)(1) provides that a qualified disclaimer cannot be made with respect to an interest in property if the disclaimant has accepted the interest or any of its benefits, expressly or impliedly, prior to making the disclaimer. Acceptance is manifested by an affirmative act that is consistent with ownership of the interest in property.

Section 25.2518-2(d)(2) provides that, if a beneficiary who disclaims an interest in property is also a fiduciary, actions taken by the person in the exercise of fiduciary powers to preserve or maintain the disclaimed property are not treated as an acceptance of the property or its benefits. Thus, an executor who is also a beneficiary may direct the harvesting of a crop or the general maintenance of a home. However, a fiduciary cannot retain a wholly discretionary power to direct the enjoyment of the disclaimed interest. For example, a fiduciary's disclaimer of a beneficial interest does not meet the requirements of a qualified disclaimer if the fiduciary exercises or retains a discretionary power to allocate enjoyment of that interest among members of a designated class.

Section 25.2518-2(e)(1) provides that a disclaimer is not a qualified disclaimer unless the disclaimed interest passes without any direction on the part of the disclaimant to a person other than the disclaimant.

Ruling Request 1

Under Section 3.7 of the Management Trust, Decedent instructed the trustee to allow Spouse to use for his lifetime all the interest that she owned at her death in all her real estate [Property 1 and Property 2] and all her personal property, furniture, equipment

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and tangible personal property associated with said real property so that he may have the exclusive right to use and enjoy the real and personal property for the remainder of his lifetime.

Under State law, a life estate is created by words showing intent to give the right to possess, use, and enjoy the property during life. See Citation 1. While life estates in personal property are not favored, they are not prohibited. Life estates in personal property will be recognized and enforced if the intention of the testator to grant such life estate can be ascertained from the language used in the instrument of transfer. See Citation 2. Moreover, under State law, Spouse, as life tenant, is entitled to everything in the nature of income, rents, revenues and benefits accruing during his tenancy, absent a contrary restriction or limitation in the instrument of transfer. See Citation 3.

Spouse executed a valid disclaimer under State law of the limited power granted to him under Article 3.7 of the Management Trust to appoint the property in which he held a life estate to the Decedent's descendants. Spouse's disclaimer satisfies the requirements for a qualified disclaimer under section 2518.

Therefore, based on the facts submitted and representations made, we conclude that Spouse has a qualifying income interest for life within the meaning of section 2056(b)(7)(B)(ii) in Decedent's real property [Property 1 and Property 2] and personal property under Article 3.7 of the Management Trust.

Ruling Request 2

In the first sentence of Article 4.8.1 of the Management Trust, before the reformation by Court, Decedent expressly stated her intent that Spouse was not to be paid any income of the Marital Trust. We have determined that the word "not" was not an inadvertence because of the second sentence of Article 4.8.1 in which Decedent expressly stated her intent that the income be paid to her descendants to maintain them in their standard of living and to provide for their health, education, maintenance and support "with periodic installments not less frequently than annually." Decedent also instructed the trustee to distribute the principal of the Marital Trust to her descendants, but such distributions were expressly made subject to Spouse's life estate in Decedent's real and personal property.

While we look to local law in order to determine the nature of the interests provided under a trust document, we are not bound to give retroactive effect to a local court order for federal tax purposes. See Estate of Nicholson v. Commissioner, 94 T.C. 666, 671 (1990).

Therefore, based on the facts submitted and representations made, we conclude that Spouse does not have a qualifying income interest for life in any assets of the Marital Trust aside from his life estate in Decedent's real property [Property 1 and Property 2] and personal property as provided in Section 3.7 of the Management Trust.

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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 a ruling, it is subject to verification on examination.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,
Katherine A. Mellody
Senior Technician Reviewer, Branch 4
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure: Copy of this letter for section 6110 purposes

cc: