Office of Chief Counsel
Internal Revenue Service
Memorandum

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to:
Senior Attorney (Jacksonville, Group 1)
(Small Business/Self-Employed)

from:
Chief, Branch 4
(Passthroughs and Special Industries)

Subject:

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

LEGEND

Decedent	=
Child	=
Spouse	=
Trust	=
Trustee	=
State	=
Country A	=
Country B	=
Country C	=
Country D	=
Date 1	=

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Date 2 =
Date 3 =
Date 4 =
a =
b =
c =
x =
State Statute 1 =

State Statute 2 =
State Statute 3 =

Country A Statute 1 =
Country A Statute 2 =
Country A Statute 3 =
Country A Statute 4 =
Country A Statute 5 =

ISSUE

Is a marital deduction allowable under § 2056(a) for the full amount of the surviving spouse's elective share as provided under State law?

CONCLUSION

A marital deduction is not allowable to the extent the elective share was to be satisfied with assets in a trust in Country A held for the benefit of the decedent's child.

FACTS

On Date 1, Decedent created an irrevocable trust (Trust) to be administered in Country A. Under the trust agreement, Trust will be governed by the laws of Country A and administered by the courts of Country A. A corporate fiduciary situated in Country A (Trustee) is designated as the trustee, and Trustee has continuously served as trustee from the inception of Trust. Decedent designated himself and his adult child (Child) as the beneficiaries.

Also on Date 1, Decedent transferred to Trust the entire issued share capital of a company situated in Country A. On Date 2, Decedent transferred to Trust the entire issued share capital of companies situated in Country A, Country B, Country C, and Country D. In general, neither Trustee nor any company whose shares are held in Trust is subject to the jurisdiction or laws of the United States or a state of the United States.

Decedent died on Date 3, a resident of State. He was survived by his spouse (Spouse). Spouse asserted her right under State law to x percent (the Elective Share) of the sum total of certain property (the Elective Estate) owned by Decedent or subject to certain

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rights of Decedent at his death. See State Statute 1. The property held in Trust was computed as a part of the Elective Estate.[1]

State law designates certain classes of Decedent's property, in order of priority, to satisfy the Elective Share. See State Statute 2. In general, the first class of property to satisfy the Elective Share includes assets otherwise passing to Spouse. The second class of property to be used to satisfy the Elective Share includes the assets of Decedent's probate estate and revocable trusts. Finally, if the Elective Share is not fully satisfied with the first and second classes of property, the Elective Share is to be satisfied with Trust assets. See State Statute 3.

On the Form 706 (United States Estate (and Generation-Skipping Transfer) Tax Return) filed for Decedent's estate (the Estate), the executor included the Trust assets with a reported value of $a. On Schedule M of the return, the executor claimed a marital deduction of $c as the amount of the Elective Share passing to Spouse. The executor computed the Elective Share under the above-described State law formula. According to the executor's computation, the assets in the first and second classes of Decedent's property were entirely consumed in satisfying the Elective Share, but there still remained an unsatisfied balance (Shortfall) of $b. The computation indicates that the assets of Trust will be used to satisfy the Shortfall.[2] Based on that premise, the marital deduction of $c claimed for the Elective Share included the Shortfall amount of $b.

LAW AND ANALYSIS

Country A Law

Country A Statute 1 provides, in part, that any question concerning the validity or interpretation of a trust, the validity or effect of any transfer to a trust, the administration of the trust, the existence and extent of powers, the exercise or purported exercise by a foreign court of any power to vary the terms of a trust or the beneficial rights or interests in the property shall be determined in accordance with the law of Country A and no rule of foreign law shall affect such question.

Country A Statute 2 provides that, without prejudice to the generality of Country A Statute 1, any question mentioned in that paragraph shall be determined without consideration of whether or not the trust avoids or defeats rights, claims, or interests conferred by foreign law upon any person by reason of a personal relationship or by way of heirship rights, or contravenes any rule of foreign law or any foreign judicial or administrative order or action intended to recognize, protect, enforce or give effect to any such rights, claims or interests.

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[1] The Elective Estate also included a revocable trust that Decedent had created.

[2] Trust has an indefinite term. Trustee has complete discretion in making or withholding distributions of Trust income and principal to the beneficiaries.

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Under Country A Statute 3, no judgment of a foreign court or decision of any other foreign tribunal with respect to a trust shall be enforceable, or given effect, to the extent that it is inconsistent with Country A law, irrespective of any applicable law relating to conflicts of law.

Country A Statute 4 provides, subject to certain exceptions not relevant here, that a trust shall be valid and enforceable in accordance with its terms.

Under Country A Statute 5, unless its terms provide otherwise, a trust may continue in existence for an unlimited period. No rule against perpetuities or excessive accumulations shall apply to a trust or to any advancement, appointment, payment or application of assets from a trust.

A trust established and administered in Country A is generally fully valid and enforceable in Country A even though the settlor may have reserved certain powers. Country A Statute 1. Non-Country A forced heirship rules of the settlor's domicile (such as State laws governing spousal inheritance) have no effect on the continuation of such a trust. Country A Statute 2. Moreover, a state court judgment purporting to alter or vary the terms of a Country A trust generally is not recognized and is unenforceable in a Country A court. Country A Statute 2 and Country A Statute 3. See Michael A. Spielman, U.S. International Estate Planning ¶ 16.10[11] (2012); Keith S. Baker & Edward Davenport, Asset Protection: Domestic and International Law Tactics § 39.69; Mark E. Osborne, Asset Protection Trust Planning, SU002 ALI-CLE 1 (2013).

State Law

The nature, extent, and character of property interests passing from a decedent to the surviving spouse are determined by State law. Commissioner v. Bosch, 387 U.S. 456 (1967); Heim v. Commissioner, 914 F.2d 1322 (9th Cir. 1990). In this case, the pecuniary amount of the Elective Share passing to Spouse was determined under State law by taking into account the value of the Trust assets. Under the State law formula, any part of the Elective Share that could not be satisfied by other classes of property is to be paid with Trust assets as a last resort.

Nevertheless, at the time of Decedent's death, the Trust assets were held in Country A, were discretely subject to the laws of Country A, and were under the sole jurisdiction of the Country A courts. Under the terms of Trust, Child was the sole remaining beneficiary of the Trust income and principal. Regardless of the pecuniary amount of the Elective Share and State law determining the Trust assets as satisfying the Shortfall of the Elective Share, under Country A law, Child – not Spouse – was the beneficial owner of the Trust assets at the time of Decedent's death.

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Marital Deduction

Section 2056(a) of the Internal Revenue Code provides that the value of the taxable estate shall, except as limited by § 2056(b) (relating to life estates and terminable interests), 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.

Under § 2056(c)(3) and § 20.2056(c)-1(a)(3) of the Estate Tax Regulations, a surviving spouse's dower or curtesy interest (or statutory interest in lieu thereof) is treated as passing from the decedent to the surviving spouse for purposes of § 2056.

Section 20.2056(c)-1(a)(5) provides, in part, that any property interest transferred during life is considered as having passed to the person to whom the decedent transferred the interest.

Section 20.2056(c)-2(a) provides, in part, that a property interest is treated as passing to the surviving spouse only if it passes to the spouse as beneficial owner. For this purpose, where a property interest passed from the decedent in trust, such interest is considered to have passed from the decedent to the surviving spouse to the extent of the surviving spouse's beneficial interest therein.

The Tax Court in Estate of Turner v. Commissioner, 138 T.C. 306 (2012) (Turner II),[3] addressed the issue of whether a surviving spouse's interest pursuant to a bequest in the decedent's will is considered as having passed to the spouse when the spouse is not the beneficial owner of the property available to satisfy the bequest.

Under the facts of Turner II, as relevant, the decedent and his spouse formed a limited partnership, each receiving in exchange for their respective contributions a 0.5 percent general partnership interest and a 49.5 percent limited partnership interest. The decedent thereafter transferred a 21.7446 percent limited partnership interest to family members other than his spouse. Upon the death of the decedent, the estate included in the decedent's gross estate the value of the decedent's 0.5 percent general partnership interest and 27.7554 percent limited partnership interest. In Turner I, the Tax Court found that the partnership interests the decedent transferred during his life to family members were includible in the decedent's gross estate under § 2036. Under the formula marital deduction clause of the decedent's will (the "spousal bequest"), the decedent's spouse was to receive an amount of property equal in value to the amount necessary to result in the smallest, if any, federal estate tax being imposed on the estate. A portion of those assets receivable by the spouse pursuant to the spousal

[3] The Tax Court's opinion in Turner II is a supplemental opinion in response to petitioner's motion for reconsideration of the court's holding in a memorandum opinion that the estate was subject to § 2036. See Estate of Turner v. Comm'r, T.C. Memo. 2011-209 (Turner I).

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bequest in the decedent's will related to the 21.7446 percent limited partnership interest that the decedent transferred during life which was beneficially owned by family members (other than the spouse) at the decedent's death.

The estate contended in Turner II that pursuant to the spousal bequest in the decedent's will, the estate could recalculate the amount passing to the spouse using the includible value of the assets underlying the transferred limited partnership interest. The estate argued that a marital deduction should be allowed for this increase to the spousal bequest.[4]

The court, in Turner II, held that, although the assets underlying the transferred limited partnership interest were includible in the gross estate, neither those assets nor the corresponding transferred partnership interest passed to the spouse at the decedent's death. After noting the broad definition of the term "passing" in § 2056(c), which includes interests in property received by bequest, the court stated:

> Under the regulations, "[a] property interest is considered as passing to the surviving spouse *only if it passes to the spouse as beneficial owner*". [Section 20.2056(c)-1] (emphasis added). Neither the partnership interest that [the decedent] transferred by gift nor the underlying assets passed or could pass to [the spouse] as a beneficial owner, and under [§ 20.2056(c)-2(a)], such property interests are not considered as passing to the surviving spouse. Accordingly, under [§ 2056(a)] the estate may not deduct from the value of the gross estate an amount equal to the value of either the transferred partnership interest or the underlying assets.

Turner II at 316.

The court concluded that, because the decedent transferred the underlying assets to the partnership and then gifted the portions of the limited partnership interest to others, a property interest in either the transferred partnership interest or the assets underlying that interest could not pass to the spouse at the decedent's death, despite the language in the will. Therefore, the marital deduction could not be recalculated to include the transferred partnership interest or the underlying assets.

In arriving at its conclusion, the court considered the policy behind the marital deduction rule. The court noted that the rule did not eliminate tax on the transfer of marital assets, but rather deferred tax until the death of or gift by the surviving spouse. See also Estate of Letts v. Commissioner, 109 T.C. 290 (1997), aff'd without published opinion, 212 F.3d

[4] The Commissioner allowed an increased marital deduction based on the value of assets transferred in exchange for the partnership interests that the decedent held at death to the extent that they passed to the spouse.

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600 (11th Cir. 2000). The court in Turner II determined that, with regard to the limited partnership interests that were transferred during the decedent's life, the spouse could not consume the assets or transfer the assets by gift and the assets would not be includible in the spouse's estate upon her death. Thus, the court noted:

> Allowing a marital deduction for the transferred partnership interest or the assets would allow them to leave the marital unit without a transfer tax either at the death of the first spouse or upon the transfer by gift or at the death of the second spouse.

Turner II at 318.

Based on all of the above, a marital deduction is allowable under § 2056(a) only for interests in property that pass from a decedent to his or her spouse as beneficial owner and is not allowable for an interest in property passing from the decedent to someone other than the surviving spouse as the beneficial owner. Cf. Ahmanson Found. v. U.S., 674 F.2d 761, 775 (9th Cir. 1981) (finding that marital deduction limited to the amount of the decedent's property to which the surviving spouse had an enforceable right).

In this case, as in Turner II, it was not possible for beneficial ownership of any of the Trust assets to pass from Decedent to Spouse. Further, Decedent had transferred during his lifetime the trust assets to Trust for himself and Child as beneficial owners. At his death, Child became the sole beneficial owner of Trust assets. Despite Spouse's rights under State law to a statutory share of Decedent's estate, Spouse cannot acquire the beneficial ownership necessary for any portion of the trust property to be considered as passing from Decedent to Spouse because Spouse's statutory interest in Decedent's estate is not enforceable against Trust under the laws of Country A. Accordingly, a marital deduction under § 2056(a) is not allowable for $b, the portion of the Elective Share relating to property held in Trust.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call Deborah Ryan if you have any further questions.

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