Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:

Telephone Number:

Refer Reply To:
CC:PSI:B04
PLR-116467-16

Date:
October 31, 2016

Legend

Husband
Wife
Date
Year
Company
a
b

Dear :

This letter responds to your authorized representative's letter dated May 12, 2016, requesting income, gift, estate, and generation-skipping transfer (GST) tax rulings with respect to a transfer from a trust.

The facts and representations submitted are summarized as follows:

Husband and Wife were married on Date. Husband and Wife separated in Year, and later that year, Husband filed for divorce.

Husband and Wife negotiated a proposed settlement agreement regarding marital support obligations and property rights. The proposed settlement agreement provides for the establishment of a trust for the benefit of Wife. The trust will be initially funded with half of Husband's shares in Company. Wife will receive all of the net income of the trust annually. The trustee has the discretion to make distributions of principal to Wife, but is prohibited from distributing Company shares to her or from selling Company shares in order to make such principal distributions. In addition, when the trust holds assets other than Company stock, Wife will have the right to withdraw the

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greater of $a or b percent of the principal for the trust each year. Trust does not grant Wife any powers to appoint trust property either during her life or upon death. In exchange, Wife will relinquish all marital rights and property claims that she might have acquired while married to Husband. Upon Wife's death, the remaining trust principal will revert to Husband, or Husband's estate if Husband predeceases Wife. The proposed settlement agreement does not become final or binding upon Husband and Wife until the receipt of a favorable private letter ruling from the Internal Revenue Service.

You have requested the following rulings:

1. Wife will not recognize any income tax gain or loss upon the creation of the trust pursuant to § 1041.

2. Sections 2501 and 2702(c) will not apply to cause Wife to be treated as having made a gift of an interest in the trust to any other person or persons, and she is not deemed to be a transferor for purposes of the federal gift tax.

3. Except to the extent of any unexercised withdrawal right held by Wife at her death, none of the assets of the trust will be included in Wife's gross estate for federal estate tax purposes under §§ 2036, 2038, 2039, or 2041 or any other applicable provisions of the Internal Revenue Code.

LAW AND ANALYSIS

Ruling 1

Section 1001(a) provides that the gain from the "sale or disposition of property" is "the excess of the amount realized therefrom over the adjusted basis provided in § 1011 for determining gain," and the loss is "the excess of the adjusted basis provided in such section for determining loss over the amount realized." Section 1001(c) provides that, except as otherwise provided, "the entire amount of the gain or loss, determined under this section, on the sale of exchange of property shall be recognized."

Section 1041(a) provides that no gain or loss shall be recognized on a transfer of property from an individual to (or in trust for the benefit of) (1) a spouse, or (2) a former spouse, but only if the transfer is incident to a divorce.

Section 1041(b) provides that, in the case of any transfer of property described in § 1041(a), the property shall be treated as acquired by the transferee by gift, and the basis of the transferee in the property shall be the adjusted basis of the transferor.

Section 1041(c) provides that for purposes of § 1041(a)(2), a transfer of property is incident to the divorce if the transfer occurs (1) within one year after the date on which the marriage ceases, or (2) is related to the cessation of the marriage.

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Section 1.1041-1T(b), Q&A-7, of the Temporary Income Tax Regulations provides that a transfer of property is related to the cessation of the marriage if the transfer is pursuant to a divorce or separation instrument, as defined in § 71(b)(2), and the transfer occurs not more than six years after the date on which the marriage ceases. A divorce or separation instrument includes a modification or amendment to such decree or instrument.

Husband proposes to transfer Company shares to an irrevocable trust for the benefit of Wife. Under the terms of the trust, Wife will receive all net income from the trust during life and may, at the discretion of the trustee, receive distributions of principal. The trustee may not, however, distribute shares to Wife nor sell such shares in order to make cash distributions to Wife. At the death of Wife, any remaining trust principal will be distributed to Husband, or, should Husband predecease Wife, Husband's estate.

Husband will transfer the shares of Company to the trust within six years after the entry of the final judgment of divorce. In return, Wife will relinquish all marital rights and property claims that she acquired while married to Husband. This arrangement is to be formalized in a legally binding property settlement agreement between Husband and Wife prior to the transfer of Company shares to the trust.

Accordingly, based on the facts submitted and representations made, provided that the transfer of Company shares to the trust occurs within six years of the entry of final judgment of divorce and the terms of the trust and the proposed settlement agreement as executed by Husband and Wife remain materially identical to those submitted as part of Husband's ruling request, we conclude that Wife will not recognize gain or loss on the transfer of Company shares to the trust.

Ruling 2

Section 2501(a)(1) imposes a tax for each calendar year on the transfer of property by gift during the calendar year by any individual.

Section 2511(a) provides that the gift tax 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 2512(b) provides that where property is transferred for less than an adequate and full consideration in money or money's worth, the amount by which the value of the property exceeds the value of the consideration shall be deemed a gift.

Section 2702(a)(1) provides, in general, that solely for purposes of determining whether a transfer in trust to (or for the benefit of) a member of the transferor's family is

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a gift (and the value of such transfer), the value of any interest in such trust retained by the transferor or by any applicable member of the transferor's family (as defined in § 2701(e)(2)) shall be determined as provided in paragraph (2).

Section 2702(a)(2)(A) provides that the value of any retained interest which is not a qualified interest shall be treated as zero.

Section 25.2702-2(a)(3) of the Gift Tax Regulations provides that the term "retained" means held by the same individual both before and after the transfer in trust. In the case of the creation of a term interest, any interest in the property held by the transferor immediately after the transfer is treated as held both before and after the transfer.

Section 2702(e) provides that the term "member of the family" has the meaning given such term by § 2704(c)(2). Section 2704(c)(2) defines "member of the family" to mean, with respect to an individual, (A) such individual's spouse, (B) any ancestor or lineal descendant of such individual or such individual's spouse, (C) any brother or sister of the individual, and (D) any spouse of any individual described in clause (B) or (C).

Section 2702(c)(1) provides that for purposes of this section, the transfer of an interest in property with respect to which there is one or more term interests shall be treated as a transfer of an interest in trust. Section 2702(c)(3) provides that the term "term interest" means either a life interest in property, or an interest in property for a term of years.

Section 2702(a)(3)(A)(iii) provides that § 2702(a)(2) shall not apply to any transfer to the extent that regulations provide that such transfer is not inconsistent with the purposes of this section.

Section 25.2702-1(c)(7) provides that § 2702 does not apply to a transfer in trust if the transfer of an interest to a spouse is deemed to be for full and adequate consideration by reason of § 2516 (relating to certain property settlements) and the remaining interests in the trust are retained by the other spouse.

Section 25.2702-4(d), Example 5, considers a situation where H and W enter into a written agreement relative to their marital and property rights that requires W to transfer property to an irrevocable trust, the terms of which provide that the income of the trust will be paid to H for 10 years. On the expiration of the 10-year term, the trust is to terminate and the trust corpus is to be paid to W. H and W divorce within two years after the agreement is entered into. Pursuant to § 2516, the transfer to H would otherwise be deemed to be for full and adequate consideration. Section 2702 does not apply to the acquisition of the term interest by H because no member of H's family acquired an interest in the property in the same transaction or series of transactions.

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The result would not be the same if, on the termination of H's interest in the trust, the trust corpus were distributable to the children of H and W rather than W.

In this case, under the terms of the proposed settlement agreement, Husband is transferring property to the trust in exchange for Wife's relinquishment of her marital support and property rights. As mentioned above, the transfer will constitute a transfer for full and adequate consideration under § 2516. Husband will retain the entire remainder interest in Trust by reason of the reversion. Accordingly, based on the facts submitted and representations made, we conclude that §§ 2501 and 2702(c) will not apply to cause Wife to be treated as having made a gift of an interest in the trust to any other person or persons, and she is not deemed to be a transferor for purposes of the federal gift tax.

Ruling 3

Section 2031(a) provides that the value of the gross estate of the decedent shall be determined by including to the extent provided for in this part, the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated.

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 his 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 a case of a bona fide sale for adequate and full 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 that 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(a)(1) provides that the value of the gross estate includes 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 the case of a bona fide sale for adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of death to any change through the exercise of a power by the decedent to alter, amend, revoke, or terminate the interest in the property or where the decedent relinquished such power within the three-year period ending on the date of the decedent's death.

Section 2039(a) provides that the gross estate shall include the value of an annuity payment or other payment receivable by any beneficiary by reason of surviving the decedent under any form of contract or agreement entered into after March 1, 1931

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(other than as insurance under policies of the life of the decedent), if, under such contract or agreement, an annuity or other payment was payable to the decedent, or the decedent possessed the right to receive such annuity or payment, either alone or in conjunction with another for his or her 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.

Section 2039(b) provides that § 2039(a) applies to only such part of the value of the payment receivable under an agreement as is proportionate to that part of the purchase price therefor contributed by the decedent.

Section 2041(a)(2) provides that the value of the gross estate shall include the value of all property to the extent of any property with respect to which the decedent has at the time of his death a general power of appointment created after October 21, 1942, or with respect to which the decedent has at any time exercised or released such a power of appointment by a disposition which is of such nature that if it were a transfer of property owned by the decedent, such property would be includible in the decedent's gross estate under sections 2035 to 2038, inclusive. For purposes of section 2041(a)(2), the power of appointment shall be considered to exist on the date of the decedent's death even though the exercise of the power is subject to a precedent giving of notice or even though the exercise of the power takes effect only on the expiration of a stated period after its exercise, whether or not on or before the date of the decedent's death notice has been given or the power has been exercised.

In this case, Husband is the transferor of the trust, not Wife. Wife did not retain any power to alter, amend, revoke, or terminate any interest in the proposed transfer. Accordingly, §§ 2036 and 2038 do not apply. Section 2039(a) does not apply because Wife has not paid any part of the purchase price for her interest in Trust as contemplated by § 2039(b). Wife will receive all of the net income of the trust annually and discretionary principal under certain conditions. Trust does not grant Wife any powers to appoint trust property either during her life or upon her death. Upon Wife's death, her interest in the trust will terminate and the trust property will revert to Husband or Husband's estate. Therefore, § 2041 does not apply to cause the trust property to be includible in Wife's gross estate. However, if Wife predeceases Husband, and if Trust holds assets other than Company shares, at that time, in addition to any trust income payable to Wife upon her death, an amount equal to the greater of $a or b percent of the non-Company share principal less any non-Company principal actually withdrawn by Wife in the year of her death, will be includible in Wife's gross estate.

Accordingly, based on the facts submitted and representations made, we conclude that except to the extent of any unexercised withdrawal right held by Wife at her death, none of the assets of the trust will be included in Wife's gross estate for federal estate tax purposes under §§ 2036, 2038, 2039, or 2041.

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In accordance with the Power of Attorney on file with this office, we have sent a copy of this letter to your authorized representatives.

Except as expressly provided herein, we neither express nor imply any opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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 rulings, it is subject to verification on examination.

This ruling is directed only to the Taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

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

Enclosures
Copy for § 6110 purposes
Copy of this letter

cc:

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