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Department of the Treasury

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Person To Contact:

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PLR-129547-10

Date: January 12, 2011

Decedent =
Spouse 1 =
Family Trust =

Date 1 =
Spouse 2 =
Date 2 =
Date 3 =
Child 1 =
Child 2 =
Trustee =
Exempt Trust =
Marital Trust =
Descendants =
Trust =
Date 4 =
State Court =

State Statute =
Date 5 =
Date 6 =
Date 7 =
Retired Judge =
Date 8 =
Date 9 =
Date 10 =
Date 11 =

Dear :

This letter responds to your authorized representative's submission dated July 13, 2010, and subsequent correspondence, requesting a ruling on the gift tax consequences of a settlement agreement.

The facts and representations are as follows. Decedent and Spouse 1 established Family Trust, a revocable trust, on Date 1. After the death of Spouse 1 and Decedent's remarriage to Spouse 2, Decedent amended and restated Family Trust in its entirety on Date 2. Family Trust became irrevocable upon Decedent's death, on Date 3. Decedent was survived by Spouse 2, Child 1, Child 2, grandchildren and great-grandchildren. Child 1 and Child 2 are issue of Spouse 1.

Spouse 2 and Trustee (collectively, Trustees) currently serve as co-trustees of Family Trust as well as the trusts created thereunder upon the death of Decedent.

Pursuant to Article II(B)(5) and Article II(B)(6) of Family Trust, upon Decedent's death, Trustees of Family Trust created Exempt Trust and Marital Trust. Exempt Trust was funded with cash in an amount equal to Decedent's maximum generation-skipping transfer (GST) tax exemption remaining at death less the allocation of such exemption to property passing outside of Family Trust. Marital Trust was funded with cash, securities, and ownership interests in entities holding commercial real estate in an amount equal to the balance of the assets of Family Trust after certain mandatory distributions to individuals and Exempt Trust and after payment of taxes, expenses, and liabilities. The subject of this ruling request involves Marital Trust.

Article VII of Family Trust provides the terms of Marital Trust, in relevant part, as follows. If Spouse 2 survives Decedent, the trustees of Marital Trust shall pay the entire net income of Marital Trust to Spouse 2 during Spouse 2's lifetime, in quarterly or more frequent installments. Spouse 2 has the right to direct the trustees to sell the assets of Marital Trust that produce little or no income and to reinvest the proceeds in income-producing assets selected by the trustees. If at any time Spouse 2 is in need of additional funds for reasonable support, after taking into account Spouse 2's funds from other sources, then upon receipt of evidence satisfactory to the trustees, the trustees will pay all or any portion of the principal of Marital Trust as may be necessary to meet said need. Upon Spouse 2's death, Marital Trust shall terminate and the trustees will distribute the remaining balance of the trust estate, after payment of any taxes attributable to property of Marital Trust being included in Spouse 2's gross estate, to Decedent's Trust for the benefit of Decedent's living descendants.

Decedent's estate timely filed a United States Estate (and Generation-Skipping Transfer) Tax Return (Form 706). On Schedule M of Form 706, Decedent's estate made a qualified terminable interest property (QTIP) election under § 2056(b)(7) of the Internal Revenue Code for the assets distributed to Exempt Trust and for the assets distributed to Marital Trust. On Schedule R of Form 706, Decedent's estate made an

election under § 2652(a)(3), to treat the property in Exempt Trust as if the election under § 2056(b)(7) had not been made, and allocated Decedent's remaining GST exemption to the assets of Exempt Trust.

As noted above, along with cash and securities, Marital Trust was funded with ownership interests in entities holding commercial real estate. In nineteen of these entities, Marital Trust held only a partial interest, with the balance of ownership held or shared by Child 1, Child 2, and/or a trust for the benefit of Child 1. At the time of Decedent's death, Child 1 served as a manager, managing member, or general partner of at least eight of these entities.

On Date 4, more than two years after Decedent's death, Child 1 and Child 2 filed a "Petition for Order to Compel Accounting" in the matter of Family Trust. After a hearing, State Court ordered Family Trust to file a first and second accounting to cover the period from Decedent's death to the month in which the petition was filed. Family Trust timely filed the first accounting and, because Family Trust was deemed to be fully distributed as of the date of the second accounting, the second accounting ordered by State Court was filed instead as two first accountings, one for Exempt Trust and one for Marital Trust. Child 1 filed objections to the first accounting of Family Trust as well as to the first accounting for each of Exempt Trust and Marital Trust. Child 1 objected to various aspects of the report as well as to certain accounting methodologies adopted by the trusts, such as the apportionment of certain items to principal rather than to income.

Before the hearing on Child 1's objections, Trustees, on behalf of Marital Trust, filed a "Petition [under State Statute] to Establish Ownership Interests of Trust in Limited Liability Companies and to Enforce Management Rights of Trustees and Compel Delivery of Books and Records." Marital Trust, in its petition, requested an order confirming or determining the percentage of Marital Trust's ownership interest as well as the interests of the co-owners in nineteen named entities and one parcel of real property. In addition, Marital Trust requested an order declaring that the resignation executed by Child 1, in which Child 1 resigned and Spouse 2 consented to act as manager, managing member, or general partner of eight entities, was effective on the date of its execution. Finally, Marital Trust requested an order compelling Child 1 to turn over all books and records of the eight entities managed by Child 1 to Spouse 2.

On Date 5, Child 1 filed "Objections to Petition [under State Statute] to Establish Ownership Interests of Trust in Limited Liability Companies to Enforce Management Rights of Trustees and Compel Delivery of Books and Records." Child 1 disputed the percentage of Marital Trust's ownership interest, as set forth in Marital Trust's petition, in certain of the named entities and the real property. In addition, Child 1 claimed that Child 1's resignation as manager of the eight entities managed by Child 1 was procured under duress and false promises.

On Date 6, State Court consolidated for consideration the trust accounting and administration issues with the issues raised in Marital Trust's petition and set trial for Date 7. However, before trial commenced, State Court ordered the interested parties to participate in alternative dispute resolution to resolve their differences. Spouse 2, Trustee, Child 1 and Child 2 participated in a mediation proceeding presided over by Retired Judge. The parties were each represented by separate counsel.

On Date 8, Spouse 2, Trustee, Child 1, and Child 2 executed a "Settlement Agreement and Mutual General Release" (Agreement). Agreement resolves the trust accounting and administration issues raised in Child 1's objections to the accountings of Family Trust, Marital Trust, and Exempt Trust. In addition, Agreement proposes to effectuate a fair market value (FMV) exchange of interests in the subject entities and property in order to completely dissolve the co-ownership by and between Marital Trust and Child 1, Child 2, and trusts for the benefit of Child 1. The FMV exchange will be carried out as follows:

1. Marital Trust, by Trustees, will purchase interests in certain named entities currently owned in part by Marital Trust and in part by Child 1, Child 2, and/or a trust for the benefit of Child 1 or Child 2, so that Marital Trust's interest in these entities will equal 100 percent (the Marital Trust purchases).
2. Child 1 and Child 2 will purchase interests in certain named entities and the real property currently owned in part by Marital Trust and in part by Child 1, Child 2, and a trust for the benefit of Child 1 (the Child 1 and Child 2 purchases).
3. As selected by Retired Judge, Trustees shall engage two separate commercial appraisers whose firms or parent companies have at least 500 employees nationwide. The parties agree to rely on the average of the fair market values chosen by each of the two appraisers with respect to the subject entities and property in buying and/or selling their interests in the subject entities and property.
4. To the extent that the aggregate FMV of the Child 1 and Child 2 purchases exceeds the aggregate FMV of the Marital Trust purchases, Child 1 shall make an equalizing payment to Marital Trust in the excess amount within 60 days of the completion of the appraisal process.
5. To the extent that the aggregate FMV of the Marital Trust purchases exceeds the aggregate FMV of the Child 1 and Child 2 purchases, Marital Trust shall make an equalizing payment to Child 1 in the excess amount within 60 days of the completion of the appraisal process.

Agreement is contingent on a favorable ruling by the Internal Revenue Service on the gift tax aspects of the FMV exchange process. On Date 9, Trustees, on behalf of Family Trust and all trusts created thereunder, filed a "Petition for an Order Approving Settlement Agreement." A hearing was held on Date 10. On Date 11, State Court

issued "Order Approving Settlement Agreement," which is contingent on a favorable ruling by the Internal Revenue Service.

In State Court's Order, State Court determined that all notices had been given as required by law, including notice on behalf of minor and any unascertained beneficiaries. State Court further retained jurisdiction to enforce the terms and provisions of Agreement.

Trustees, on behalf of Marital Trust, request the following rulings:

1. The FMV exchange described in Agreement will result in transfers for full and adequate consideration and, as such, will not constitute gifts subject to tax under § 2511.
2. The FMV exchange described in Agreement will not be treated as a disposition under § 2519 and, therefore, § 2207A(b) will not apply.

LAW AND ANALYSIS

Section 2056(a) provides that, for purposes of the tax imposed by § 2001, the value of the taxable estate is to be determined by deducting from the value of the gross estate an amount equal to the value of any interest in property that passes or has passed from the decedent to the surviving spouse. Section 2056(b)(1) provides, in pertinent part, that no deduction shall be allowed under § 2056(a) 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.

Section 2056(b)(7) provides an exception to the rule of § 2056(b)(1) in the case of qualified terminable interest property. Under § 2056(b)(7)(A), qualified terminable interest property (QTIP) is treated as passing to the surviving spouse for purposes of § 2056(a), and no part of the property is 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 § 2056(b)(7)(B)(v) applies.

Section 2501 imposes a tax on the transfer of property by gift during the year by an individual, resident or nonresident. Section 2502(c) provides that the gift tax is the liability of the donor.

Section 2511(a) provides that the gift tax imposed by § 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 25.2511-1(g)(1) of the Gift Tax Regulations provides that for purposes of § 2511, the gift tax is not applicable to a transfer for full and adequate consideration in money or money's worth.

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 is deemed a gift. Section 25.2512-8 provides that transfers reached by the gift tax are not confined to those only which, being without a valuable consideration, accord with the common law concept of gifts, but embrace as well sales, exchanges, and other dispositions of property for a consideration to the extent that the value of the property transferred by the donor exceeds the value in money or money's worth of the consideration given therefor. However, a sale, exchange, or other transfer of property made in the ordinary course of business (a transaction which is bona fide, at arm's length, and free from any donative intent), will be considered as made for an adequate consideration in money or money's worth.

Section 2519(a) provides that for gift and estate tax purposes, any disposition of all or part of a qualifying income interest for life in any property to which this section applies shall be treated as a transfer of all interests in such property other than the qualifying income interest. Section 2519(b) provides that § 2519(a) applies to any property, if a deduction was allowed with respect to the transfer of such property to the donor under § 2056(b)(7).

Section 25.2519-1(a) provides that a transfer of all or a portion of the income interest of the surviving spouse in QTIP property is a transfer by the surviving spouse under § 2511. Section 25.2519-1(c) provides that the amount treated as a transfer under § 2519 upon a disposition of all or part of a qualifying income interest for life in QTIP 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 § 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 disposition. The gift tax consequences of the disposition of the qualifying income interest are determined under § 25.2511-2.

Section 25.2519-1(f) provides that the conversion of qualified terminable interest property into other property in which the donee spouse has a qualifying income interest for life is not, for purposes of this section, treated as a disposition of the qualifying income interest. Thus, the sale and reinvestment of assets of a trust holding qualified terminable interest property is not a disposition of the qualifying income interest, provided that the donee spouse continues to have a qualifying income interest for life in the trust after the sale and reinvestment. Similarly, the sale of real property in which the spouse possesses a legal life estate and thus meets the requirements of qualified terminable interest property, followed by the transfer of the proceeds into a trust which also meets the requirements of qualified terminable interest property, or by the reinvestment of the proceeds in income producing property in which the donee spouse has a qualifying income interest for life, is not considered a disposition of the qualifying

income interest. On the other hand, the sale of qualified terminable interest property, followed by the payment to the donee spouse of a portion of the proceeds equal to the value of the donee spouse's income interest, is considered a disposition of the qualifying income interest.

The term "disposition," as used in § 2519 applies broadly to circumstances in which the surviving spouse's right to receive the income is relinquished or otherwise terminated, by whatever means. See H.R. Rep. No. 97-201, at 161 (1981).

Section 2207A(b) provides that, if for any calendar year tax is paid under chapter 12 (gift tax) with respect to any person by reason of property treated as transferred by such person under § 2519, such person shall be entitled to recover from the person receiving the property the amount by which (1) the total tax for such year under chapter 12, exceeds (2) the total tax which would have been payable under such chapter for such year if the value of such property had not been taken into account for purposes of chapter 12. Under § 25.2207A-1(e), if the property is in trust at the time of the transfer, the "person receiving the property" is the trustee.

In the instant case, under the terms of Agreement, Marital Trust will purchase, at FMV, the interests of the other parties in certain named entities so that Marital Trust will own an interest of 100 percent in these entities. Similarly, Child 1 and Child 2 will purchase, at FMV, Marital Trust's interest in certain named entities so that Child 1 and Child 2 and any trust for the benefit of Child 1 will own an interest of 100 percent in these entities. Thenceforward, the entities previously-owned partially by Marital Trust and partially by Child 1, Child 2, and/or a trust for the benefit of Child 1 will be either wholly owned by Marital Trust or wholly owned by Child 1, Child 2, and/or a trust for the benefit of Child 1. To the extent there is any difference in the aggregate FMV of the Marital Trust purchases and the Child 1 and Child 2 purchases, an equalizing payment will be made. Fair market value will be determined impartially, by two commercial appraisers selected by Retired Judge.

The FMV exchange process described in Agreement was the product of a court-ordered mediation proceeding presided over by Retired Judge. The mediation proceeding was ordered to resolve the ongoing and, at times, contentious dispute between Trustees, Child 1, and Child 2 regarding (1) the administration of Family Trust and Marital Trust, (2) Marital Trust's management rights over certain properties, and (3) Marital Trust's ownership interest in entities owned partially by Marital Trust, Child 1, Child 2, and a trust for the benefit of Child 1. Based on the representations made and the facts presented, we conclude that the FMV exchange procedures set forth in Agreement were the result of a bona fide adversarial proceeding and arms-length negotiations. Therefore, to the extent the payments made and received in the FMV exchange process are distributed in accordance with each party's respective ownership interest, as properly determined under applicable local law, we conclude that the transfers occurring pursuant to the FMV exchange described in Agreement will be made for adequate and

full consideration in money or money's worth and will not be subject to the gift tax. Specifically with respect to the equalizing payment, we note that in order to avoid creating a transfer between Child 1 and Child 2, the equalizing payment to or by Child 1 must reflect the balance due or owed by Child 1 that is attributable to Child 1's proportionate ownership interest after completion of the Child 1 and Child 2 purchases and the Marital Trust purchases.

Furthermore, in the instant case, upon the conclusion of the FMV exchange process described in Agreement, Spouse 2 will continue to possess a qualifying income interest for life in the assets of Marital Trust and Spouse 2's right to income will not be diminished or relinquished. Thus, we conclude that under § 25.2519-1(f), the sale and purchase of ownership interests in various entities held by Marital Trust and the payment or receipt of an equalizing payment pursuant to the fair market value exchange process described in Agreement will not be treated as a disposition of a qualifying income interest life under § 2519. Consequently, we conclude that § 2207A(b) will not apply.

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. Specifically, we are not ruling on the income or gift tax consequences that may result from any aspect of Agreement outside the scope of this ruling.

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.

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

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.

Sincerely,

Leslie H. Finlow
Senior Technician Reviewer, Branch 4
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)