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IRS RULES ON TAX CONSEQUENCES ASSOCIATED WITH EARLY TERMINATION OF A GENERATION-SKIPPING TAXABLE MARITAL TRUST

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Andrew M. Nerney and Andrew Brett Seiken, associates in Cummings & Lockwood's Private Clients Group, published an article entitled "IRS Rules on Tax Consequences Associated with Early Termination of Generation-Skipping Taxable Marital Trust" which appeared in *Trusts & Estates* magazine website on April 25, 2016.

For a link to this article, please, click here.

IRS RULES ON TAX CONSEQUENCES ASSOCIATED WITH EARLY TERMINATION OF A GENERATION-SKIPPING TAXABLE MARITAL TRUST

A surviving spouse was the beneficiary of two marital trusts established under her late husband's revocable trust agreement: one generation-skipping transfer (GST) tax exempt and the other GST taxable. The provisions of each marital trust provided for the surviving spouse to receive all income during life and granted to the surviving spouse a testamentary general power of appointment (POA) over the assets in the GST taxable trust.

State law allowed for the early termination of non-charitable irrevocable trusts, conditioned on all beneficiaries consenting to such early termination and the court concluding that continuance of the trust isn't necessary to achieve any material purpose of the trust.

By agreement, the surviving spouse and the remaindermen beneficiaries agreed to terminate both marital trusts and successfully petitioned the local probate court for an order of termination. By agreeing to terminate the marital trusts, the surviving spouse surrendered her income interest and released her general POA over the balance of the assets in the GST taxable marital trust. In exchange, the agreement provided that the surviving spouse shall receive cash, securities and payment by the trustee of any income taxes or gift taxes payable with respect to the distribution. The balance of the assets would then be distributed to a trust for the benefit of the remaindermen. The court approved the termination of the two marital trusts.

The taxpayers sought guidance from the Internal Revenue Service as to potential tax consequences of the transaction. Specifically the taxpayers were interested in the tax consequences flowing from the termination of the GST taxable marital trust. In PLR 201615004 (released April 8, 2016), the IRS made three rulings with respect to these facts.

QTIP Election Null and Void

In Revenue Procedure 2001-38, the IRS set forth a rule that a qualified terminable interest property (QTIP) election is treated as null and void when the election isn't necessary to reduce the estate tax liability to zero. In the present case, the estate tax liability would have been zero even if the executor failed to make a QTIP election for the GST taxable trust because the surviving spouse had an income interest and testamentary general POA sufficient for her spouse's estate to receive a deduction under Internal Revenue Code Section 2056(b)(5). Reaffirming the rule in the Revenue Procedure and finding the QTIP election was null and void, the IRS concluded in the PLR that the property held in the GST taxable marital trust isn't includible in the gross estate of the surviving spouse under IRC Section 2044. Thus, because there's no valid QTIP election and no "qualifying income interest," the surviving spouse isn't treated as making a gift under IRC Section 2519 by disposing of the income interest with respect to the property. No GST tax consequences resulted from the release of the income interest, as there was no deemed gift under Section 2519.

Release of General POA Results in Gift

Though no gift resulted under Section 2519 as the result of a release of a "qualifying income interest," the release of a general POA creates a taxable gift under IRC Section 2514(b). When a donor transfers an interest in property for less than adequate consideration, Treasury Regulations Section 25.2512-8 values the gift as equal to the value of the property transferred by the donor that exceeds the value in money or money's worth of the consideration given therefor. Accordingly, when the surviving spouse released her POA and transferred the assets of the GST taxable trust for less than an adequate and full consideration, the surviving spouse is deemed to have made a gift. While the IRS declined to make a factual determination as to the value of any gift, it indicated that only the excess value of the fair market value of the GST taxable marital trust assets at the time of the release over the value of the consideration received by the surviving spouse in exchange for those trust assets would deemed a taxable gift.

Same Transferor for Gift and GST Purposes

IRC Section 2652(a) deems the donor of any gift to be the transferor. To the extent a taxable gift was made when the general POA was released over the assets held in the GST taxable trust, the IRS concluded that the surviving spouse was also deemed to have been the transferor for GST tax purposes.