PURCHASE AND SALE OF MARITAL TRUST ASSETS DID NOT TRIGGER ANY TRANSFER TAX CONSEQUENCES

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Trust and estate litigation often involves issues regarding a QTIP marital trust for which a deduction was taken under Code §2057(b)(7) for estate tax purposes. This comes up often, since such litigation often arises between a surviving spouse who is beneficiary of the QTIP trust, and children of the decedent who are remaindermen and may not be children of the surviving spouse.

Care must be undertaken in dealing with such trusts and their assets in crafting settlements of such disputes. Transfers of interests in such trusts, terminations of such trusts, and other transactions can trigger gift tax consequences, including under Code §2519 (creating a gift tax upon disposition by a surviving spouse of all or part of such spouse's mandatory income interest in the QTIP).

Not all settlement transactions give rise to adverse transfer tax consequences. In a recent private letter ruling, a QTIP trust purchased ownership interests in entities owned by the children/remaindermen and trusts for their benefit. The children/remaindermen also purchased interests in other entities that were owned by the QTIP trust. The taxpayers sought confirmation that such transfers did not trigger Code §2519 or other gift tax consequences.

Since there was no effective or deemed disposition of the spouse's income interest in the QTIP trust, the IRS confirmed that Code §2519 was not triggered. Further, no other taxable gift was deemed to occur.

Central to the ruling was that the prices for the various purchases were determined by independent third party appraisals – thus, there were no underpayments or overpayments for the assets. If the remaindermen had been able to purchase QTIP trust assets at a discounted value, or if the QTIP trust overpayed for the assets it bought, this might otherwise have been construed as a disposition of the spouse's income interest under Code §2519. Underpayments or overpayments for the assets may have also given rise to other gift tax consequences, although if undertaken in context of litigation settlement it probably could still be argued that other consideration was exchanged for the assets (such as releases of rights under the purported claims) as to avoid a gift element.

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