

PLR 201119003 No Gifts Triggered by Trust Transfers to Resolve Family Discord

Erskine Summary: The IRS has privately ruled that transactions between a marital trust and a decedent's children from his first marriage to resolve discord between his surviving spouse and her stepchildren over the management of real estate holdings won't trigger gifts and won't result in a deemed transfer of the remainder interest in the marital trust. Drafting in a provision to allow such a Fair Market Value Exchange process without having to go through the time and costs of court mediation is required when trusts will hold fractional interests in real estate and other significant unique assets (such as art collections).

The Decedent was married to Spouse 1, with whom he had two children, Child 1 and Child 2. After the death of Spouse 1, Decedent remarried to Spouse 2, and Decedent subsequently amended and restated his Living Trust. Decedent was survived by Spouse 2, Child 1, Child 2, grandchildren and great-grandchildren. Spouse 2 and Trustee (together, Trustees) serve as co-trustees of Decedent's Trust as well as the trusts (including the Marital Trust) created thereunder upon the death of Decedent. Along with cash and securities, the Marital Trust was funded with ownership interests in entities holding commercial real estate. In 19 of these entities, the 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.

In order to resolve disputes over the management of the real estate, a Fair Market Value exchange Agreement (the product of a court ordered mediation proceeding presided over by a retired judge) was entered into by the Trusts and the various beneficiaries. Under the terms of the Agreement, the Marital Trust will purchase, at fair market value (FMV), the interests of the other parties in certain named entities so that the Marital Trust will own an interest of 100% in these entities. 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.

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, IRS concluded that the transfers occurring pursuant to the FMV exchange will be made for adequate and full consideration in money or money's worth and will not be subject to the gift tax.

The Agreement may then operate to settle the dispute in a satisfactory manner without adverse gift tax costs.