Estate of Kite v. Commissioner, Rule 155 Order and Decision (Cause No. 6772-08, unpublished opinion October 25, 2013)

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Planning for Surviving Spouse Who is Beneficiary of QTIP Trust; Kite I Held That Distribution to Spouse and Sale by Spouse of QTIP Assets for Deferred Annuity Triggered Section 2519; Gift Determined Without Regard to Any Consideration Received by Spouse for Deemed Transfer of Remainder Interest in QTIP Trust.

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Brief Synopsis

Mrs. Kite ("Wife") created a QTIP trust for Mr. Kite ("Husband") who died a week later, and under the terms of the trust the assets remained in the QTIP trust for Wife's benefit.

Subsequently, the assets of the QTIP trust as well as another QTIP trust and a general power of appointment marital trust were invested in a limited partnership. Eventually the trusts' interest in a restructured partnership was sold for notes and the notes were contributed a general partnership. In a three-day series of planned transactions, the trusts' assets (i.e., the interest in the general partnership) were distributed to Wife, the children contributed additional assets to the general partnership, and Wife (almost age 75) sold her partnership interests to her children for a deferred private annuity (annuity payments would not begin for 10 years). Wife died three years later before receiving any annuity payments.

The court's initial decision ("*Kite I*") ruled that the sale of assets for the private annuity was not a gift. T.C. Memo. 2013-43 (decision by Judge Paris). Using the IRS actuarial tables was appropriate, even though the annuity payments would not begin for 10 years and Wife had only a 12 1/2 year life expectancy, because Wife was not terminally ill at the time of the sale and she had at least a 50% chance of living more than one year. The sale was not illusory and was bona fide because the annuity agreement was enforceable and the parties demonstrated their intention to comply with the annuity agreement. "The annuity transaction was a bona fide sale for adequate and full consideration."

While the sale of assets for a deferred annuity was not a gift, the court in *Kite I* ruled that a deemed transfer occurred under §2519. Section 2519 provides that the transfer of any part of the qualifying income interest in a QTIP trust is treated as the transfer of the fair market value of the entire property less the value of the qualifying income interest, in effect, as the deemed transfer of the remainder interest in the trust. (The effect of the transfer of the income interest is determined under the general gift tax principles of §2511—the value of the portion of the income interest that is transferred less the consideration received for such transfer). However, the court accepted the government's argument that (1) the distribution of QTIP assets to Wife and (2) her sale of the assets for a 10-year deferred annuity were part of an integrated transaction that was deemed to be a disposition of her qualifying income interest that triggered §2519. The deemed transfer of the income interest was not a taxable gift under §2511 because Wife received full value. *Kite I* did not discuss what, if any, taxable gift resulted from the deemed transfer of the remainder interest.

In *Kite I*, apparently, the IRS did not argue that the contribution of QTIP assets to a limited partnership was a §2519 deemed transfer of the QTIP trust, even though some of the partnership interests were later transferred with a 34% discount. In addition, *Kite I* did not address an alleged estate tax deficiency other than rejecting a rather muddled §2036 argument because of Wife's failure to sign documents admitting a new partner of the limited partnership that received the contribution of assets from the QTIP trust.

Kite II is the court's Order and Decision regarding the Rule 155 computations of the gift tax as a result of the decision in *Kite I*. (Cause No. 6772-08, unpublished op. Oct. 25, 2013). The estate argued that no gift resulted from the deemed transfer of the remainder interest under §2519 because of the court's decision in *Kite I* that the Wife's sale of assets that she received from the QTIP trust in return for a deferred private annuity was a bona fide sale for adequate and

full consideration. Neither the statute nor regulations make clear whether the gift that results from a deemed transfer of the QTIP remainder interest under §2519 is the full value of the remainder interest or whether it is reduced by any amounts paid to the spouse to replace the value of the remainder interest in his or her estate. One sentence in the legislative history to §2519 suggests that the gift amount would be determined after subtracting any amounts paid to the spouse. However, the court in *Kite II* interpreted §2519 to mean that the full amount of the deemed transfer of the QTIP trust remainder interest is a gift, regardless of any consideration received by the surviving spouse. "[A] deemed transfer of a remainder interest under section 2519 cannot be made for adequate and full consideration or for any consideration."

KITE I

The rather complicated fact situation in Kite is summarized in the summary of *Kite I* available here or under Insights at http://www.bessemer.com/advisor.

Key facts for purposes of the court's decision on the Rule 155 computation in *Kite II* are as follows.

1. Assets from various QTIP trusts and in a general power of appointment marital trust created for Wife by her deceased husband ended up in a limited partnership as a result of various investment transactions by the trustee of the QTIP trusts and the marital trust.

2. On January 18, 2001, Wife's attorney and trust officer discussed a private annuity transaction with Wife's children. The gist of the transaction was that the trusts would distribute their assets to Wife and she would sell them to the children for a deferred private annuity. Payments under the annuity would not begin for 10 years, and at the time Wife (almost age 75) had a life expectancy of 12.5 years under the IRS's actuarial tables. Wife's physician signed a letter concluding that there was "at least a 50% probability that she will survive for 18 months or longer." This transaction was implemented in three steps over a planned three-day period in March 2001.

3. On March 28, 2001, Wife replaced the trustees of the marital trusts with her children as trustees, effective retroactive to January 1, 2001. (How a retroactive trustee change was made is not explained.) The children contemporaneously executed documents terminating the marital trusts effective January 1, 2001. The trusts' assets (consisting of the 99% interest in a limited partnership, "LP 2") were distributed to Wife's revocable trust. (Whether the trust distribution standards were broad enough to authorize the distribution of all of the trust assets to Wife was not addressed.)

4. On March 29, 2001, another partnership ("LP 1," then owned by Wife's children or their trusts) contributed additional assets to LP 2 in return for a substantial interest in LP 2.

5. On March 30, 2001, Wife's lifetime revocable trust sold its entire interest in LP 2 to Wife's children for the deferred unsecured private annuities. The annuities were valued taking into account the 10-year deferral before payments would begin, using the

procedure described in Rev. Rul. 72-438, Example 5. (Wife had a life expectancy, determined under the Treasury mortality tables used in §7520, of 12.5 years.)

6. Wife died about three years later on April 28, 2004, before receiving any payments under the deferred annuity. Her estate tax return did not include any interest in LP 2 that had been transferred to Wife's revocable trust from the marital trusts and that had been sold from the revocable trust to Wife's daughters in return for the deferred annuity.

The holdings in *Kite I* are as follows:

1. The transfer of assets in return for the private annuities was for full consideration, was not illusory, and did not lack economic substance.

2. The transfer of assets from the QTIP Trusts to LP 1 in return for limited partnership interests, the subsequent reorganization of LP 1, and the trusts' sale of the interests in LP 1 in return for 13-year secured notes did not constitute a disposition triggering §2519.

3. The liquidation of the QTIP trusts, the distribution of the QTIP trusts' assets (i.e., their interest in LP 2) to Wife's revocable trust, and the sale of the interests in LP 2 for the private annuities were an integrated transaction for purposes of section §2519, which constituted a deemed disposition of Wife's qualifying income interest for life, which in turn caused a deemed transfer of the remainder interests in the QTIP trusts. (The court did not address how much, if any, gift this would cause; that determination would be made in a subsequent ruling on the Rule 155 computations of the tax effects of the holdings in Kite I).

4. The transfer of assets from the general power of appointment marital trust to Wife was not a release of her general power of appointment causing a transfer under §2514 for gift tax purposes. The court only considered the termination of the marital trust and did not also consider the subsequent private annuity transaction as part of an integrated transaction in determining tax consequences of the transactions involving the general power of appointment marital trust.

KITE II ANALYSIS

1. *Separate Estate and Gift Tax Causes.* Docket No. 6772-08 was the gift tax case and Docket No. 6773-08 was the estate tax case. The two cases had been consolidated for trial, briefing and opinion. The court entered an Order on October 28, 2013 in Docket No. 6773-08 recognizing that there was no estate tax deficiency and that estate tax had been overpaid by $304,605. This followed the Order and Decision entered in Docket No. 6772-08 on October 25, 2013 approving the IRS's position in the gift tax case, and finding that there was a gift tax deficiency of $816,206.

2. *Section 2519; Statute and Regulations.* Section 2519(a) provides that for estate and gift tax purposes,

> "any disposition of all or part of a qualifying income interest for life in any property to which this section applies [i.e., property for which a QTIP election was made and a marital deduction was allowed under §2056(b)(7) or §2523(f)] shall be treated as a transfer of all interests in such property other than the qualifying income interest."

The regulations clarify what is deemed transferred when §2519 is triggered:

> "(c) *Amount treated as a transfer.*—(1) *In general.*—The amount treated as a transfer under the section upon a disposition of all or part of a qualifying income interest for life in qualified terminable interest 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 section 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 the disposition. The gift tax consequences of the disposition of the qualifying income interest are determined separately under §25.2511-2."

The effect is that if the spouse disposes of any portion of the qualifying income interest in a QTIP trust, the spouse is treated as having *transferred* the remainder interest in the trust. The statute and regulations do not directly address whether the amount of the deemed *gift* is reduced by the amount paid to the spouse that replaces the remainder value in the spouse's estate to be subject to gift or estate taxation in the future. There is one regulation referring to the spouse "as making a *gift* under section 2519 of the entire trust less the qualifying income interest...." Reg. §25.2519-1(a)(third sentence). However the statute and numerous other places in the regulations refer merely to the deemed "*transfer*" under §2519. §2519(a); Reg. §§ 25.2519-1(a)(first sentence and second sentence), 25.2519-1(c)(1), 25.2519-1(c)(2), 25.2519-1(c)(4), 25.2519-1(c)(5). There are various examples in Reg. §25.2519-1(g) that refer to the amount of the *gift* but no consideration was paid to the spouse in any of those examples to replace the remainder value in the spouse's estate.

3. *Estate's Position Regarding Gift Tax Effects.* The estate position was that the deemed transfer of the remainder interest under §2519 resulted in a zero gift. Section 2519 states that for gift 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." Under traditional gift tax principles, a transfer is subject to the gift tax to the extent that it is not made for an adequate and full consideration in money or money's worth. Commissioner v. Wemyss, 324 U.S. 303, 307 (1945); Reg. §25.2511-1(g) ("[t]he gift tax is not applicable to a transfer for a full and adequate consideration in money or money's worth"). Kite I viewed the termination of the QTIP trusts and the immediate sale of their assets as a single transaction that constituted a disposition of Wife's qualifying income interest, which caused a deemed transfer of the value of the QTIP assets less the value of the qualifying income interests in the trust. Because Kite I also determined that the sale of the assets for the annuity was a bona fide sale for adequate and full

consideration, the estate maintained that the deemed transfer of the remainder was completely offset by the value received by Wife in return, so no gift resulted.

4. *Government's Position Regarding Gift Tax Effects.* The government's position is that any consideration received by the surviving spouse in a transaction that triggers §2519 is irrelevant in determining the value of the deemed gift of the remainder interest in the QTIP trust.

5. *Kite II Analysis.*

   a. *Overview.* The estate incorrectly interpreted Kite I to mean the Wife "received full and adequate consideration for both the qualifying income interest and the remainder interest." Focusing on just the full consideration aspect of the annuity transaction "ignores the QTIP terminations that immediately preceded the annuity transaction."

   b. *Rev. Rul. 98-8.* Revenue Ruling 98-8 considered the gift tax consequences to a surviving spouse upon purchasing the remainder interest in a QTIP trust by conveying to the trust a note equal to the remainder value. The trust would then distribute the QTIP trust assets to the spouse who would pay off the promissory note with the QTIP trust assets. The effect was a commutation—the spouse ended up owning assets equal in value to the income interest. The ruling concluded that a commutation results in a deemed transfer of the remainder interest under §2519. [Observation: Under the fact situation addressed in Rev. Rul. 98-8, the spouse did not end up owning assets equal to the value of the remainder interest.]

   c. *Termination of QTIP Trusts Alone Can Trigger §2519.* Without further analysis, the court reaches this conclusion in applying the reasoning of Rev. Rul. 98-8 to this case:

      > "Under the reasoning provided in Rev. Rul. 98-8, the termination of the QTIP trusts alone triggered section 2519 …."

      The court stated that it did not need to determine whether the termination of the QTIP trusts alone triggered §2519. Instead, Kite I found that the termination of the QTIP and the annuity transaction were a single transaction resulting in the disposition of the income interest. Even so, the estate's focus on the annuity transaction without also considering the termination of the QTIP trusts "is misguided because the termination of a QTIP trust can result in a transfer of a qualifying income interest for purposes of section 2519." [Observation: Consider the broad implications of that statement if it is true. If the termination of a QTIP trust can trigger §2519, do principal distributions constitute a deemed disposition of part of the qualifying income interest—thus also triggering a §2519 deemed transfer of the remainder interest?]

d. *Replacement of Income Interest Value Does Not Avoid §2519 Trigger.* The receipt of value by the spouse of value equal to the value of the qualifying income interest does not prevent a disposition of the income interest from triggering §2519. Reg. §25.2519-1(f). [Observation: The point of that regulation presumably is to keep the remainder value in the QTIP trust from being excluded from the estate—by merely receiving consideration equal to the value of the income interest.]

e. *Basic Statement of Court's Position.* After citing that regulation (and for some reason also citing legislative history pointing out that qualifying income interests do not necessarily have to be in trust) the court states its ultimate position:

> "In fact, a deemed transfer of a remainder interest under section 2519 cannot be made for adequate and full consideration or for any consideration."

f. *Reg. §25.2519-1(a); Remainder Interest is Not Owned by Spouse So Spouse Cannot Receive Consideration For It.* One sentence in Reg. § 25.2519-1(a) states that "the donee spouse is treated as making a gift under section 2519 of the entire trust less the qualifying income interest...." (Emphasis added). The court says "the term 'gift' is not an accident." The reason the court gives for this statement is that

> "[t]he remainder interest is a future interest held by the remainderman and not the donee spouse. Accordingly, the donee spouse cannot receive full and adequate consideration, or indeed any consideration, in exchange of the remainder interest."

Observation: The court's reference to this one sentence in the regulations as saying the "gift" is the entire trust less the qualifying income interest" seems somewhat disingenuous without also mentioning that numerous other places in the regulations and the statute itself (see paragraph 2 above) refers to the entire trust less the qualifying income interest as being the amount "transferred" rather than referring to it as the amount of the "gift." If it is merely the amount "transferred," traditional gift principles would suggest that any consideration received by the deemed transferor would be subtracted to determine the amount of the "gift."]

g. *Policy; Intent of QTIP Regime.* The court reasons that its conclusion is supported by the policy of the marital deduction and QTIP regime, which is merely to defer the tax by including the asset transferred to the QTIP trust in the done-spouse's gross estate for estate tax purposes. [Observation: If the spouse receives consideration equal to the full value of assets in the QTIP trust, the policy of merely deferring transfer tax is achieved. The consideration received by the spouse will be included in the spouse's gross estate. There was no amount to include in the spouse's estate in this case not because of the sale of the QTIP assets by the surviving spouse for its full value, but because the spouse made a terrible investment decision in the sale transaction, with the sale proceeds ultimately becoming worthless.]

h. *Rebuttal of Legislative History Supporting Taxpayer's Position.* The estate argued that there is a statement in the legislative history to §2519 supporting that the amount of the gift resulting from a §2519 transfer is the entire value of the trust less amounts received by the spouse. Indeed, the legislative history states that almost verbatim:

> "If the property is subject to tax as a result of the spouse's lifetime transfer of the qualifying income interest, the entire value of the property, less amounts received by the spouse upon disposition, will be treated as a taxable gift by the spouse under new Code sec. 2519." H.R. Rept. No. 97-201 at 161, 1981-2 C.B. at 378.

The court agrees that "when read in isolation this statement from the House report seems to support petitioner's position…." The court says, however, that the statement must be read in the context of the entire report. The "first sentence" (immediately preceding the sentence stating that the gift is determined after subtracting any amounts received by the spouse) says that property subject to a QTIP election will eventually be subject to a gift or estate tax. The sentence that follows the sentence quoted above (i.e., the "third sentence") is that the deemed gift of the remainder interest under §2519 is not a present interest qualifying for the annual exclusion but the gift of the income interest is a present interest gift that qualifies for the annual exclusion. The court draws the conclusion from these two sentences, despite the middle sentence saying that the gift under §2519 is determined after subtracting "amounts received by the spouse upon disposition," that "the deemed transfer of a remainder interest under section 2519 is a gift." [Observation: The court's analysis from the surrounding sentences is not persuasive. The first sentence is actually consistent with saying that the deemed gift is reduced by a consideration received by the spouse because that consideration will be subject to a transfer tax in the future. The third sentence merely states the obvious that a gift of a remainder interest is a future interest that does not qualify for the annual exclusion. The court reasons that the third sentence supports the finding that the remainder interest is held by the remainderman and not the surviving spouse so the spouse cannot transfer it for consideration. However, the third sentence merely says that the deemed transfer of the remainder interest is a future interest—not that the fiction of a deemed gift of that interest would be determined ignoring traditional principles of subtracting any consideration received in return for that deemed gift.]

i. *Procedural Issue.* The government also argued that the taxpayer's objections (i.e., that the gift should be calculated after subtracting consideration received by the donor) were new issues that were waived because they were not raised in briefs. The court (in footnote 4) observed that it addressed the estate's objections without making a determination as to whether the estate raised new issues.

OBSERVATIONS

1. *Surprising Result.* The result of this Rule 155 Order, following the court's reasoning in T.C. Memo. 2013-43, is surprising. Most planners and commentators have believed that a zero gift would result, based on the court's prior determination that there was a deemed transfer of the QTIP remainder interest under §2519 combined with the court's determination that the Wife received full value when she transferred the assets of the QTIP trust. *See e.g.,* Jeffrey Pennell, *Jeff Pennell on Estate of Kite: Will It Fly?* Leimberg Est. Pl. Email Newsletter, Archive Message #2062 (February 11, 2013). Instead, the court determines, as a matter of law, that a deemed transfer under §2519 results in a taxable gift of the full actuarial value of the remainder interest regardless of any consideration received by the spouse. This is particularly poignant when the very event that triggered §2519 was the *sale* of the QTIP trust assets in connection with the termination of the QTIP trust for the full value of those assets.

2. *Mere Termination of QTIP Trust Triggers §2519.* The Order states in dictum that "the termination of the QTIP trusts alone triggered section 2519," and in the following paragraph again reiterates that "the termination of a QTIP trust can result in a transfer of a qualifying income interest for purposes of section 2519." These statements are quite troubling. This means that if a trustee distributes all of the QTIP trust assets to the spouse, either a distribution under the trust distribution standard or under a small trust termination provision, the surviving spouse is automatically treated as making a gift of the actuarial value (immediately prior to the termination) of the remainder interest. Having all of the trust assets distributed to the trust beneficiary is not necessarily unusual; does the surviving spouse really risk being treated as making a large taxable gift (i.e., the full value of the remainder interest) upon merely receiving the assets of the QTIP trust?

   If the termination of the QTIP trust results in a disposition of the qualifying income interest, it would seem that any principal distribution from the QTIP trust to the spouse would constitute a disposition of a portion of the qualifying income interest—which by itself triggers a deemed transfer of *all* of the remainder interest under §2519. This is a quite surprising notion.

   The court's reasoning to treat a termination of a QTIP trust as triggering §2519 is suspect. The court reasons that result follows from Rev. Rul. 98-8. However that revenue ruling merely addresses an indirect commutation of a QTIP trust. (The factual scenario considered in Rev. Rul. 98-8 was (i) the purchase of the remainder interest by the spouse for a note, (ii) the distribution of all trust assets to the surviving spouse, followed by (iii) the spouse paying off the note with a portion of the trust assets. The net result was that the spouse ended up with assets equal to the value of the income interest.) The key result of the transaction considered in Rev. Rul. 98-8 was that the value of the remainder interest was not owned by the spouse and was no longer in a QTIP trust subject to taxation at the spouse's subsequent death under §2044. Therefore, the remainder value would escape gift and estate taxation. Despite this key distinction, the court draws the conclusion that "[u]nder the reasoning provided in Rev. Rul. 98-8, the termination of the QTIP trusts alone triggered section 2519."

3. *Termination of QTIP Trust (or Perhaps Distribution of QTIP Assets) Followed by Sale of Assets by Spouse.* The court's reasoning indicates that a sale of assets by a spouse upon receiving a terminating distribution from a QTIP trust, in and of itself, triggers §2519. (The court's Order [on page 2] states that "the termination of the QTIP trusts and the immediate sale of their assets" was a single transaction that triggered §2519.) If a terminating distribution has that effect, a principal distribution (i.e., a partial termination) may have the same result. Planners previously have not been concerned with a spouse selling assets that the spouse receives from the QTIP trust, as long as it is a bona fide legitimate sale.

4. *Policy; Intent of Marital Deduction.* The court's reasoning that the policy and intent of the marital deduction supports its conclusion is quite ironic. The court correctly observes that the purpose of the marital deduction is merely to defer the transfer tax until a subsequent lifetime transfer or the death of the done-spouse. But in this case the spouse received back assets, directly owned by the spouse, equal in value to the full value of assets in the QTIP trust. Those assets would later be subject to gift or estate tax. It so happened that the assets received by Wife later plummeted in value, but at the time of the transaction that triggered §2519 Wife received back assets equal to the full value of the QTIP assets. The policy and intent of the marital deduction seems to support (indeed to require) that replenishment of the value to the surviving spouse must be considered in determining the amount of gift that is made under §2519. Otherwise, as discussed immediately below, there is a double inclusion of assets subject to the gift and estate tax.

5. *Double Inclusion.* The court never once addressed the distinct possibility of taxing the same value twice as a result of its ruling—once as a gift equal to the value of the remainder interest under §2519 and the second time at the spouse's death when the assets that the spouse received as consideration are subject to estate tax. In this case, the assets happened to fall in value to zero, but the court's reasoning is not so limiting. The court interprets §2519 as resulting in a taxable gift of the full actuarial value of the remainder interest, even if that value is replenished in the wife's direct ownership of assets. (It was merely the gamble of the private annuity transaction that caused the value to vanish in Wife's estate. Alternatively, the value in Wife's gross estate could have been multiplied several times if Wife had lived beyond her actuarial life expectancy. That same scenario could also happen if the spouse invests the QTIP assets in a single volatile stock—it could explode in value or it could fall to zero. It is the investment decision that causes the asset value to vanish—not the deemed disposition of the income interest and the deemed transfer of the remainder interest under §2519.)

   Perhaps the double inclusion would be avoided by the provision in §2001(b) that any gifts that are also included in the decedent's gross estate will not be added back into the estate tax calculation as adjusted taxable gifts. However, would a tracing analysis be required and would the estate be able to satisfy that tracing requirement to prove that amounts that were included in the deemed gift under §2519 remain (possibly through many permutations) at the spouse's death?

6. *Legislative History.* The legislative history to §2519 seems to make clear that in determining the amount of the *gift*, as opposed to the amount of the *transfer*, resulting under §2519, any consideration received by the spouse should be considered:

> "If the property is subject to tax as a result of the spouse's lifetime transfer of the qualifying income interest, the entire value of the property, *less amount received by the spouse upon disposition*, will be treated as a taxable *gift* by the spouse under new Code sec. 2519." H.R. Rept. No. 97-201, at 161, 1981-2 C.B. at 378.

The court attempts (feebly) to rebut what seems to be the clear intent of that sentence by immediately preceding and following sentences in the House Report. (See the discussion in Paragraph 4. h above regarding the *Kite II* Analysis.)

7. *Visceral Reaction.* The court's attempt to find some reason to keep the estate from being able to avoid estate taxation is understandable (and laudable to protect the integrity of the marital deduction system). However, the court's reasoning creates very troubling concerns. As discussed above, what caused the removal of asset value from the transfer tax base was the private annuity transaction, not the distribution of assets from the QTIP trust. But under the court's reasoning, the termination of a QTIP trust and subsequent sale of assets by the spouse triggers 2519, even if assets do not "disappear" from the transfer tax system.

8. *Planning For Surviving Spouses' Interests in QTIP Trusts.* Planning for surviving spouses who are beneficiaries of substantial QTIP trusts is complicated. This case is an example of clients entering into complicated transactions in planning with QTIP trusts. For an outstanding detailed discussion of planning by a surviving spouse with QTIP trusts, see Read Moore, Neil Kawashima & Joy Miyasaki, *Estate Planning for QTIP Trust Assets*, 44th U. MIAMI HECKERLING INST. ON EST. PLAN. ch. 12 1202.3 (2010).

One possible alternative is for the QTIP trust to invest in assets that may result in discounted values. In *Kite I*, interestingly the IRS did not argue that the investment of QTIP assets in limited partnerships constituted a disposition that triggered §2519. In FSA 199920016 the IRS suggested that the investment of QTIP trust assets in a family limited partnership might trigger a §2519 disposition if the conversion of the trust assets limited the spouse's right to income. This issue has also been raised in at least several gift and estate tax audits. In that FSA, the IRS National Office ultimately advised the Examination Division not to pursue litigation. *See* Read Moore, Neil Kawashima & Joy Miyasaki, *Estate Planning for QTIP Trust Assets*, 44th U. Miami Heckerling Inst. on Est. Plan. ch. 12 1202.3 (2010). Under the facts of the FSA, the surviving spouse continued to received distributions in approximately the same amounts she would have received had the partnership not been created.

Another planning alternative is for the trust to distribute sizable assets to the surviving spouse so the spouse can subsequently enter into estate planning transactions with the assets. A common problem is how to justify making large distributions to the spouse. The Kite children as trustees terminated the marital trusts despite the lack of authority to do

so under the trust agreements. Apparently, the IRS did not argue that the subsequent transactions should not be recognized because of the unauthorized termination of the trusts. Finding the authority to make distributions from a QTIP trust to a surviving spouse so that the spouse can enter into estate planning transactions is a recurring complexity in

planning with QTIP trust interests. *See* Read Moore, Neil Kawashima & Joy Miyasaki, *Estate Planning for QTIP Trust Assets*, 44th U. MIAMI HECKERLING INST. ON EST. PLAN. ch. 12 1201.1-1201.5 (2010).

If some subsequent transaction by the spouse is treated as an integrated transaction that triggers §2519, the *Kite II* Rule 155 Order raises the considerable complexity that the deemed gift may be the full amount of the QTIP remainder trust value even if the subsequent transaction is a sale for full consideration. Query, what if the subsequent transaction is a gift of the assets? If that is somehow treated as an integrated transaction that is a deemed disposition of the income interest, would there be a direct gift of the assets under §2511 and also a deemed gift of the remainder interest under §2519? (Presumably the integrated transaction theory would not apply in that circumstance to trigger §2519.)