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Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:2 - PLR-123934-02
Date:
April 30, 2003

Trust =

EIN:

Trust A =

Trust B =

A =

B =

State =

Charity =

D1 =

D2 =

D3 =

D4 =

Year 1 =

Dear :

This letter responds to your letter dated April 12, 2002, and subsequent correspondence, that you submitted on behalf of Trust as Trust's authorized representative. The trustees of Trust request rulings regarding the proposed division of Trust, a charitable remainder unitrust, into two separate trusts, Trust A and Trust B.

On D1, A and B, while married and residents of State (a community property state), established Trust, a charitable remainder unitrust described in § 664(d) of the Internal Revenue Code.

Trust provides for quarterly unitrust payments to be made to A and B in equal proportions during A's lifetime. After A's death, if B survives, the unitrust amount is to be paid to B for the lesser of her lifetime or a term of one year. After the earlier of B's death or the expiration of the one year term (or A's death if B predeceases him), Trust's assets are to be distributed to the Charity. Article 3.2 of the Trust instrument provides that A and B reserve the power, by will or written instrument, to change the charitable beneficiary (provided the charitable beneficiary selected is described in §§ 170, 2055, and 2522.) Article 3.3 of the Trust instrument provides that A and B reserve the power to accelerate the distribution of part or all of the trust corpus to the charitable remainder beneficiary.

In Year 1, A and B began the process of dissolving their marriage. A and B entered into a written property settlement agreement, dated D3, providing for the settlement of their marital property. A divorce decree for A and B was entered on D4. Under the property settlement agreement, Trust will be divided into two separate charitable remainder unitrusts: one trust for the benefit of A (Trust A) and another trust for the benefit of B (Trust B). The terms of Trust A and Trust B will be identical to the terms of Trust, except for the following:

a. Trust A and Trust B will each hold 50% of Trust's principal and 50% of Trust's undistributed income;

b. A will be the unitrust beneficiary of Trust A during his lifetime. After A's death, B, if living, will receive the unitrust payment for the shorter of B's life, or a term of 1 year. After the earlier of B's death or the expiration of the 1 year term (or on A's death, if B predeceases A), the corpus will be paid to the charitable remainder beneficiary. A will retain the power to change the charitable beneficiary of Trust A, and to accelerate payment of the trust corpus to the charitable remainder beneficiary. A will be the sole trustee of Trust A and will possess the power to remove and replace successor trustees; and

c. B will be the unitrust beneficiary of Trust B during the period both B and A are living. Upon A's death, if B survives, B will receive the unitrust payment for the shorter of B's life, or a term of 1 year. After the earlier of B's death or the expiration of the 1 year term (or on A's death, if B predeceases A), the corpus will be paid to the charitable remainder beneficiary. B will retain the power to change the charitable beneficiary of Trust B, and to accelerate payment of the trust corpus to the charitable remainder beneficiary. B will be the sole trustee of Trust B and will possess the power to remove and replace successor trustees.

Section 664(c) provides, generally, that a charitable remainder unitrust shall be exempt from federal income tax.

Section 664(d)(2) provides that a charitable remainder unitrust is a trust (A) from which a fixed percentage (which is not less than 5 percent nor more than 50 percent) of the net fair market value of its assets, valued annually, is to be paid, not less often than annually, to one or more persons (at least one of which is not an organization described in § 170(c) and, in the case of individuals, only to an individual who is living at the time of the creation of the trust) for a term of years (not in excess of 20 years) or for the life or lives of such individual or individuals, (B) from which no amount other than the payments described in § 664(d)(2)(A) and other than qualified gratuitous transfers described in § 664(d)(2)(C) may be paid to or for the use of any person other than an organization described in § 170(c), (C) following the termination of the payments described in § 664(d)(2)(A), the remainder interest in the trust is to be transferred to, or for the use of, an organization described in § 170(c) or is to be retained by the trust for such a use or, to the extent the remainder interest is in qualified employer securities (as defined in § 664(g)(4)), all or part of such securities are to be transferred to an employee stock ownership plan (as defined in § 4975(e)(7)) in a qualified gratuitous transfer (as defined by § 664(g)), and (D) with respect to each contribution of property to the trust, the value (determined under § 7520), of such remainder interest in such property is at least 10 percent of the net fair market value of such property as of the date such property is contributed to the trust.

Accordingly, based on the information provided and the representations made, the division of Trust into two separate trusts will not cause Trust, Trust A or Trust B to fail to qualify as charitable remainder trusts under § 664.

Section 2501(a) provides that a tax is imposed for each calendar year on the transfer of property by gift during the calendar year by any individual, resident or nonresident.

Section 2511(a) provides that the gift tax 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 2512(b) provides that where property is transferred for less than an adequate and full consideration in money or money's worth, then the amount by which the value of the property exceeded the value of the consideration shall be deemed a gift, and shall be included in computing the amount of gifts made during the calendar year.

Section 2516 provides that where a husband and wife enter into a written agreement relative to their marital and property rights and divorce occurs within the 3-year period beginning on the date one year before such agreement is entered into (whether or not such agreement is approved by the divorce decree), any transfers of property or interests in property made pursuant to such agreement (1) to either spouse in settlement of his or her marital or property rights, or (2) to provide a reasonable allowance for the support of issue of the marriage during minority, shall be deemed to be transfers made for a full and adequate consideration in money or money's worth.

Section 25.2516-1(a) of the Gift Tax Regulations provides that transfers of property or interests in property made under the terms of a written agreement between spouses in settlement of their marital or property rights are deemed to be for an adequate and full consideration in money or money's worth and, therefore, exempt from the gift tax (whether or not such agreement is approved by a divorce decree) if the spouses obtain a final decree within two years after entering into the agreement.

In this case, A and B entered into a written agreement in settlement of their marital property rights. Under the terms of the property settlement agreement, Trust will be divided as described above. Any transfer of property between A and B resulting from the division of Trust, will be deemed made for adequate and full consideration and, therefore, will not be subject to the gift tax.

Section 1041(a) provides that no gain or loss will be recognized on a transfer of property from an individual to (or in trust for the benefit of) (1) a spouse, or (2) a former spouse, but only if the transfer is incident to the divorce. Section 1041(c) provides that for purposes of § 1041(a)(2), a transfer of property is incident to the divorce if the transfer occurs (1) within one year after the date on which the marriage ceases, or (2) is related to the cessation of the marriage.

Section 1.1041-1T(b), Q&A-7 of the temporary Income Tax Regulations addresses when a transfer of property is “related to the cessation of the marriage.” Q&A-7 provides that a transfer of property is treated as related to the cessation of the marriage if the transfer is pursuant to a divorce or separation instrument, as defined in § 71(b)(2), and the transfer occurs not more than 6 years after the date on which the marriage ceases. A divorce or separation instrument includes a modification or amendment to such decree or instrument. Any transfer not pursuant to a divorce or separation instrument and any transfer occurring more than 6 years after the cessation of the marriage is presumed to be not related to the cessation of the marriage. This presumption may be rebutted only by showing that the transfer was made to effect the division of property owned by the former spouses at the time of the cessation of the marriage. For example, the presumption may be rebutted by showing that (a) the transfer was not made within one- and six-year periods described above because of factors which hampered an earlier transfer of the property, such as legal or business impediments to transfer or disputes concerning the value of the property owned at the time of the cessation of the marriage, and (b) the transfer is effected promptly after the impediment to transfer is removed.

Section 71(b)(2) defines the term “divorce or separation instrument” to mean (A) a decree of divorce or separate maintenance or a written instrument incident to such decree, (B) a written separation agreement, or (C) a decree (not described in § 71(b)(2)(A)) requiring a spouse to make payments for the support and maintenance of the other spouse.

Section 1.1041-1T(d), Q&A-10 provides that the transferor of property under § 1041 recognizes no gain or loss on the transfer even if the transfer was in exchange for the release of marital rights or other consideration. This rule applies regardless of whether the transfer is of property separately owned by the transferor or is a division (equal or unequal) of community property. Under § 1041(b), for purposes of subtitle A, the transferee is treated as having acquired the property by gift from the transferor with a carryover basis from the transferor.

Pursuant to the property settlement agreement, Trust will be divided into two equal charitable remainder unitrusts: one trust for the benefit of A and one trust for the benefit of B. Each charitable remainder unitrust will hold 50% of the principal and undistributed income of the original Trust. A and B will receive annual unitrust payments from their respective charitable remainder unitrusts (while both are alive) of the same percent of their respective trusts assets, as they were receiving under Trust. Consequently, A is transferring to B one-half of his unitrust interest in Trust, and B is transferring to A one-half of her unitrust interest in Trust, and both transfers are incident to the divorce. Assuming such an interest is "property," § 1041 will apply to the transfer. Therefore, for income tax purposes, no gain or loss is recognized by A on the transfer of his interest to B, and no gain or loss is recognized by B on the transfer of her interest to A.

Section 61(a)(3) provides that gross income includes gains derived from dealings in property.

Section 1001(a) provides that the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in § 1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in § 1011 for determining loss over the amount realized.

Section 1.1001-1(a) of the Income Tax Regulations provides that except as otherwise provided in subtitle A of the Code, the gain or loss realized from the exchange of property for other property differing materially either in kind or in extent, is treated as income or as loss sustained.

A pro rata partition of jointly owned property is not a sale or other disposition of property where the co-owners of the joint property sever their joint interests, but do not acquire a new or additional interest as a result thereof. Thus, neither gain nor loss is realized on a partition. See Rev. Rul. 56-437, 1956-2 C.B. 507.

In Rev. Rul. 69-486, 1969-2 C.B. 159, a non-pro rata distribution of trust property was made in kind by the trustee. The distribution was effected as a result of a mutual agreement between the trustee and the beneficiaries. Because neither the trust instrument nor local law conveyed authority to the trustee to make a non-pro rata distribution, Rev. Rul. 69-486 holds that the transaction was equivalent to a pro rata distribution followed by an exchange between the beneficiaries and was subject to the provisions of § 1001.

The present case is distinguishable from Rev. Rul. 69-486 because it has been represented that the assets of Trust will be allocated among the two separate trusts on a pro rata basis, and each account will receive an equal share of each asset in Trust. Accordingly, the proposed transaction will not be treated as a pro rata distribution followed by an exchange of assets among the beneficiaries of Trust.

Cottage Savings Ass'n v. Commissioner, 499 U.S. 554 (1991) concerns the issue of when a sale or exchange has taken place that results in realization of gain or loss under § 1001. In Cottage Savings, a financial institution exchanged its interests in one group of residential mortgage loans for another lender's interests in a different group of residential mortgage loans. The two groups of mortgages were considered "substantially identical" by the agency that regulated the financial institution.

The Supreme Court in Cottage Savings, 499 U.S. at 560-61, concluded that § 1.1001-1 reasonably interprets § 1001(a) and stated that an exchange of property gives rise to a realization event under § 1001(a) if the properties exchanged are "materially different."

In defining what constitutes a "material difference" for purposes of § 1001(a), the Court stated that properties are "different" in the sense that is "material" if their respective possessors enjoy legal entitlements that are different in kind or extent. Cottage Savings, 499 U.S. at 564-65. The Court held that mortgage loans made to different obligors and secured by different homes embodied distinct legal entitlements, and that the taxpayer realized losses when it exchanged interests in the loans.

It is consistent with the Supreme Court's opinion in Cottage Savings to find that the interests of Trust A and Trust B will not differ materially from their interests in Trust. The assets of Trust will be allocated among Trust A and Trust B in proportion to the current interests of Trust, and Trust A and Trust B will be entitled to the same benefits after the proposed transaction as before.

Therefore, the proposed division of Trust into Trust A and Trust B, and the proposed ratable allocation of Trust's assets among Trust A and Trust B will not be treated as a sale or disposition that would require Trust, Trust A, or Trust B to recognize gain or loss under § 1001.

Section 1015(b) provides that if property is acquired after December 31, 1920, by a transfer in trust (other than by a transfer in trust by gift, bequest, or devise), the basis is the same as it would be in the hands of the grantor increased in the amount of gain or decreased in the amount of loss recognized to the grantor on the transfer under the law applicable to the year in which the transfer is made.

Section 1.1015-2(a)(1) provides that in the case of property acquired after December 31, 1920, by transfer in trust (other than by transfer in trust by gift, bequest, or devise) the basis of property so acquired is the same as it would be in the hands of the grantor increased in the amount of gain or decreased in the amount of loss recognized to the grantor on the transfer under the law applicable to the year in which the transfer was made. If the taxpayer acquired the property by transfer in trust, this basis applies whether the property be in the hands of the trustee, or the beneficiary, and whether acquired prior to termination of the trust and distribution of the property, or thereafter.

Section 1223(2) provides that, in determining the period for which the taxpayer has held property however acquired, there shall be included the period for which the property was held by any other person, if under chapter 1 such property has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in the taxpayer's hands as it would be in the hands of such other person.

Accordingly, based on the information provided and the representations made, the basis and holding periods of the assets in Trust A and Trust B immediately after the division of Trust will be the same as they were in Trust immediately before the division.

Section 507(a) provides that except as provided in § 507(b), a private foundation may terminate its private foundation status only under the specific rules set forth in § 507(a).

Section 507(b)(2) provides that in the case of the transfer of assets of any private foundation to another private foundation pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization or reorganization, the transferee foundation shall not be treated as a new organization.

Section 507(c) imposes a termination tax equal to certain defined amounts, which are generally the lower of the aggregate tax benefit resulting from the tax-exempt status or the fair market value of the assets.

Section 507(d) defines the term "aggregate tax benefit," which term is used in § 507(c) as one means to measure the § 507(c) tax.

Section 4941(a)(1) imposes an excise tax on each act of self-dealing between a disqualified person and a private foundation.

Section 4941(d)(1)(E) provides that the term "self-dealing" means any direct or indirect transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation.

Section 4945 imposes an excise tax on a private foundation's making of any taxable expenditure under § 4945(d).

Section 4946(a) provides that the term "disqualified person" with respect to a private foundation includes a substantial contributor to the foundation (including the creator of a trust), a family member of a substantial contributor (including children), and a foundation.

Section 4946(a)(1)(D), together with § 4946(d), define the term "disqualified person" to include a spouse of a substantial contributor, among others.

Section 4947(a)(2) provides generally that split-interest trusts are subject to the provisions of §§ 507, 4941 and 4945 in the same manner as if such trusts were private foundations, but, under § 4947(a)(2)(A), not with respect to any amounts payable under the terms of such trust to income beneficiaries, unless a deduction was allowed under §§ 170(f)(B), 2055(e)(2)(B), 2522(e)(2)(B).

Section 1.507-1(b)(6) provides that if a private foundation transfers all or part of its assets to one or more other private foundations pursuant to a transfer described in § 507(b)(2), such transferor foundation will not have terminated its foundation status under § 507(a)(1).

Section 1.507-3(c)(1) provides, in part, that as used in § 507(b)(2), such transferor foundation will not have terminated its foundation status under § 507(a)(1).

Section 1.507-3(c)(2)(ii) provides, in part, that as used in § 507(b)(2), the term "other adjustments, organization or reorganization" shall include any partial liquidation or any other significant disposition of assets to one or more private foundations.

Sections 1.507-3(a)(1) and (2) provides, in substance, that in the transfer of assets from one private foundation to one or more private foundations in a § 507(b)(2) transfer, each transferee private foundation shall not be treated as a newly created organization, but shall succeed to the transferor's aggregate tax benefit within the meaning of § 507(d).

Section 1.507-4(b) provides that the excise tax on the termination of private foundation status under § 507(c) does not apply to a transfer of assets pursuant to § 507(b)(2), unless the provisions of § 507(a) become applicable.

Section 53.4945-6(b)(2) of the Foundation and Similar Excise Taxes Regulations (foundation regulations) provides that expenditures for unreasonable expenses, including compensation, consultant fees, and other fees for services rendered, will ordinarily be taxable expenditures under § 4945(d)(5) unless the foundation can demonstrate that such expenses were paid or incurred in the good faith belief that they were reasonable and that the payment or incurrence of such expenses in such amounts was consistent with ordinary care and prudence.

Section 53.4947-1(c)(2)(i) of the foundation regulations provides that under § 4947(a)(2)(A), § 4941 does not apply to any amounts payable under the terms of a split-interest trust to income beneficiaries unless a deduction was allowed under §§ 170(f)(2)(B), 2055(e)(2)(B), or 2522(e)(2)(B) with respect to the income interest of any such beneficiary.

Rev. Rul. 2002-28, 2002-20 I.R.B. 1, provides, in part, that when a private foundation distributes all of its assets to one or more other foundations under a plan of dissolution, the transferor foundation is not required to exercise expenditure responsibility under § 4945(h) with respect to the transfers.

As a charitable remainder unitrust under §664(d)(2), Trust is a split-interest trust described in § 4947(a)(2) and, therefore, subject to § 4941, which imposes an excise tax on acts of self-dealing. Although split-interest trusts are not § 501(c)(3) or § 4947(a)(1) private foundations that are exclusively charitable, they are subject to § 507 termination rules that are appropriate. Section 4947(a)(2) subjects split-interest trusts to the provisions of § 507. Section 507(b)(2) is applicable to the division of Trust. Since Trust will transfer all of its assets to Trust A and Trust B, under § 1.507-1(b)(6), Trust will not have terminated its private foundation status.

The transfer of all of Trust assets, under the prevailing divorce proceedings, to Trust A and Trust B will qualify as transfers meeting the requirements of §§ 1.507-3(c)(1) and (c)(2)(ii) of the regulations. Therefore, Trust A and Trust B will not be treated as newly created organizations, and the aggregate tax benefits of Trust under § 507(d) will carry over to Trust A and Trust B in proportion to the amount of Trust assets transferred to Trust A and Trust B, subject to any liability which Trust has under Chapter 42 of the Code to the extent not already satisfied by Trust.

A and B are disqualified persons with respect to Trust, under § 4946, because they are substantial contributors to Trust and are trustees. Because Trust is a split-interest trust, it is treated as a private foundation under § 4947(a)(2). The only interest that either A or B had in Trust was a payment of the unitrust amount under the provisions of § 664(d)(2). They each have exchanged a one-half interest in a unitrust payment in Trust for a full unitrust payment in a trust having fewer assets, one-half of the assets of Trust prior to its division. Thus, they are likely to receive more or less the same unitrust payment as before. However, it makes no difference for purposes of § 4941 whether either or both is receiving more or less of a unitrust payment after the division of Trust assets. Section 53.4947-1(c)(2) of the foundation regulations provides, in substance, that the amounts payable under charitable remainder split-interest trusts to the income beneficiaries are not subject to § 4941 (or § 507 or § 4945). Thus, the disqualified persons are insulated from self-dealing as far as each of their unitrust interests in Trust are concerned based on the fact that the unitrust payment is the same before and after the division of Trust. Since neither of the disqualified persons, A and B, receive any additional interest in the assets of the trust principal, no self-dealing transaction has occurred within the meaning of § 4941(d).

Trust principal remains preserved for charitable interests. There has been no increase in the unitrust amount at the expense of the charitable interest. Any expenses paid pursuant to the division of Trust, assuming such expenses are reasonable, are justified as necessary to facilitate the smooth functioning and operation of Trust which was likely not possible under the prevailing divorce proceedings. There are no other transactions with the income beneficiaries that affect Trust principal. Accordingly, again, no self dealing transaction will occur.

Based on the same analysis as applied in the two preceding paragraphs, no taxable expenditures have occurred under § 4945. Further, under § 1.507-3(a)(7) and (9), Trust will not be required to exercise "expenditure responsibility" under §§ 4945(d) and (h) with respect to the assets transferred to Trust A and Trust B. Trust will dispose of all of its assets within the meaning of § 1.507-3(a)(7) and Trust A and Trust B will be controlled by the same persons who controlled Trust within the meaning of § 1.507-3(a)(9).

After applying the relevant law to the information provided and the representations made, we conclude as follows:

1. The division of Trust into Trust A and Trust B will not cause Trust, Trust A, or Trust B to fail to qualify as charitable remainder trust under § 664.

2. Any transfer of property between A and B resulting from the division of Trust into Trust A and Trust B will not be subject to the gift tax as to A or B, because the division will be a transfer of property pursuant to a divorce under § 2516.

3. The proposed division of Trust into Trust A and Trust B will not be subject to income tax for A and B, because the division will be a transfer of property pursuant to a divorce agreement under the provisions of § 1041.

4. The proposed pro rata division of Trust into Trust A and Trust B will not cause recognition of income or create gain or loss to Trust, Trust A, or Trust B under § 61 or § 1001.

5. The basis and holding periods of the assets in Trust A and Trust B immediately after the division of Trust will be the same as they were in Trust immediately before the division.

6. The proposed division of Trust into Trust A and Trust B will not terminate Trust's status as a trust described in, and subject to, the private foundation provisions of § 4947(a)(2), and will not result in the imposition of an excise tax under § 507(c).

7. Trust A and Trust B will not be treated as newly created organizations. The aggregate tax benefits of Trust under § 507(d) will carry over to Trust A and Trust B in proportion to the amount of Trust assets transferred to Trust A and Trust B, subject to any liability which the Trust has under Chapter 42 of the Code to the extent not already satisfied by Trust.

8. The proposed division of Trust into Trust A and Trust B will not be an act of self-dealing under § 4941(d).

9. The proposed division of Trust into Trust A and Trust B will not be a taxable expenditure under § 4945.

10. If reasonable in amount, payment of the legal and other expenditures incurred by Trust to effect the proposed division out of the assets of Trust will not constitute an act of self-dealing under § 4941, or constitute a taxable expenditure under § 4945.

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts of the transaction described above under any other provision of the Code. We express no opinion on whether Trust, Trust A and Trust B otherwise qualify as charitable remainder trusts under § 664.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Pursuant to a power of attorney on file with this office, a copy of this letter is being sent to Trust and to Trust's other authorized representative.

Sincerely yours,
J. THOMAS HINES
Chief, Branch 2
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures: 2
Copy of this letter
Copy for § 6110 purposes