

**Office of Chief Counsel
Internal Revenue Service
Memorandum**

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date: December 31, 2008

to: DARCY PARKER
Appeals Officer
Plantation Florida

from: JOHN P. MORIARTY
Chief, Branch 1
(Income Tax & Accounting)

Subject:

This Chief Counsel Advice responds to your request for assistance of September 9, 2008. This advice may not be used or cited as precedent. Please contact Renay France at 202-622-5020 if you have any questions concerning this memorandum or its conclusions.

LEGEND

H =

W =

C =

D1 =

D2 =

D3 =

D4 =

D5 =

a = \$

b = \$

c = \$

d = \$

f = \$

T =

Y =

ISSUE

May H claim an alimony deduction under §§ 71 and 215 of the Internal Revenue Code for funds paid by T, a third-party, court-appointed trustee, to W, H's ex-wife, under the terms of their divorce decree with funds attached from the taxpayer's assets? Does § 682 apply to the trust?

CONCLUSION

Section 682 does not apply to the transfer of \$c by Y to T. Additional factual development is needed to determine whether the amounts held by T are held in a grantor trust for the benefit of H. If the funds are held in a grantor trust, additional information is also needed to determine whether § 682 applies to payments from T to W and whether the payments by T to W are deductible by H as alimony under § 71.

FACTS

H and W were previously married. Faced with irreconcilable differences, H and W obtained a final divorce. The terms of H and W's separation are set forth in the divorce decree. Paragraph 10 of the decree requires H to pay \$a to W as alimony beginning on D1 and ending at the time specified in Paragraph 10. Paragraph 11 of the divorce decree requires H to pay \$b to W as child support beginning on D1 and ending at the time specified in Paragraph 11.

In D2, W became aware that H intended to take up residence abroad, remove assets from the United States, and stop paying the alimony and child support required by the divorce decree. At that time, H owned a house and maintained an Individual Retirement Account (IRA).

In response, on D3, W filed a motion to, among other things, attach H's IRA. The Court granted the motion and issued an Order that Y, the trustee of H's IRA, liquidate the IRA and transfer the net amount of \$c into a new account, held in the name of T, named trustee on

behalf of W. The Order requires, T, as trustee, to make periodic payments to W pursuant to H and W's divorce decree, including, but not limited to, payments of \$d for the support of W and C. We understand that you are treating the transfer of \$c by Y to T as a taxable IRA distribution to H.

On D 4, W filed a motion to attach the sale proceeds from the sale of the house owned by H. The motion was granted but limited to \$f of the proceeds. The \$f proceeds were transferred to T in trust for W.

During D 5, H claimed that the distributions of \$a from the trust to support W, constituted H's payment of alimony as described in §71, and on this basis, deducted the payments from H's gross income pursuant to § 215.

LAW AND ANALYSIS.

Section 71 provides for the income tax treatment of alimony or separate maintenance payments. It provides that gross income includes amounts received as alimony or separate maintenance.

Section 71 (b)(1) provides that the term "alimony or separate maintenance payment" means any payment in cash if: (A) such payment is received by (or on behalf of) a spouse under a divorce or separation instrument; (B) the divorce or separation instrument does not designate such payment as a payment which is not includable in gross income under § 71 and not allowable as a deduction under section 215; (C) in the case of an individual legally separated from his spouse under a decree of divorce or of separate maintenance, the payee spouse and the payor spouse are not members of the same household at the time such payment is made, and (D) there is no liability to make any such payment after the death of the payee spouse and there is no liability to make any payment (in cash or property) as a substitute for such payments after the death of the payee spouse.

Section 71(g) cross references § 682 for the taxable status of the income of an estate or trust in the case of divorce.

Section 671 provides, in general, that if the grantor of a trust or another person is treated as the owner of any portion of the trust, that person's taxable income and credits shall include the income, deductions, and credits of the trust attributable to that portion of the trust to the extent that such items would be considered in computing the taxable income, or credits of an individual. Sections 673 through 678 specify the circumstances under which the grantor or other person will be regarded as the owner of a trust.

Section 677 provides, in part, that the grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such owner under 674, whose income without approval or consent of any adverse party is, or, in the discretion of the grantor or a nonadverse party, or both, may be distributed to the grantor or the grantor's spouse or held or accumulated for future distribution to the grantor or the grantor's spouse.

Section 682(a) provides that there shall be included in the gross income of a wife who is divorced or legally separated under a decree of divorce or of separate maintenance (or who is separated from her husband under a written separation agreement) the amount of the income of any trust which such wife is entitled to receive and which, except for this section, would be includible in the gross income of her husband, and such amount shall not, despite any other provision of subtitle A of the Code, be includible in the gross income of such husband.

Section 682(b) provides that for purposes of computing the taxable income of the estate or trust and the taxable income of a wife to whom section 682(a) applies, such wife shall be considered as the beneficiary specified in part I of subchapter J of chapter 1 of the Code.

Prior to 1984, the section 682 regulations provided that §71 would govern trusts formed in contemplation of divorce such as the one at issue here. However, in the Deficit Reduction Act of 1984, P.L. 98-369, Congress amended §§ 71 and 682. The legislative history shows that the changes were intended to have § 682 apply to grantor trusts in the case of divorce, regardless of whether they were formed in contemplation of divorce. The legislative history in this connection is as follows:

Where an annuity is transferred, or a beneficial interest in a trust is transferred or created, incident to divorce or separation, the transferee will be entitled to the usual annuity treatment, including recovery of the transferor's investment in the contracts (under section 72), or the usual treatment as the beneficiary of a trust (by reason of section 682), notwithstanding that the annuity payments or payments by the trust qualify as alimony or otherwise discharge a support obligation.

H.R. Rept. No. 98-432, Pt. 2, at 1492 (1984). In this case, you are treating Y's distribution of \$c from the IRA to T as a taxable distribution to H. Assuming that this distribution is taxable to H, the distribution is not also taxable income of the trust. Rather, H is considered to use this amount to settle the trust; therefore this amount is corpus, not income, of the trust. Accordingly, § 682 does not apply to the transfer of \$c by Y to T.

Section 682 might apply, however, to the weekly payments of \$d from T to W if the amounts held by T are held in a grantor trust in which T invests the corpus of the trust on behalf of W, and the corpus earns income. This would be the case only if, under normal tax rules, W was entitled to receive the income and H was required to include the trust income in his gross income. This could happen, for example, if H were to be treated as the owner of the trust under the grantor trust rules even though W was the beneficiary of the trust. As discussed below, we would need further factual development to determine whether the grantor trust rules apply. Further, until we know how the grantor trust rules operate in this case, we are unable to advise you whether the weekly payments of \$a by T to W are deductible by H as alimony under § 71.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

Our analysis is premised on the facts provided to us, including the characterization of the \$c distribution as being a taxable IRA distribution to H. While we have no reason to doubt this characterization, you may wish to confirm it (if you have not done so already) with TEGE.

Sections 673-678 specify the circumstances under which the grantor or another person will be regarded as the owner of a portion of the trust. The only description of the trust that we have is the one page order from the court and the ex parte motion. Additional development is needed to determine whether the grantor trust rules apply. For example, it would help to know how and whether the corpus would be returned to H if he no longer had to make the payments (e.g., if W were to die).

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.