

under the parties' annuity payment arrangement will constitute transfers for "full and adequate consideration in money or money's worth" under § 2516; and (4) that in the event of Spouse's death prior to the full satisfaction of the payments under the settlement agreement, the payment of the outstanding amount will be deductible under § 2053. This letter ruling is being issued electronically in accordance with Rev. Proc. 2020-29, 2020-21, I.R.B. 859. A paper copy will not be mailed to Taxpayer.

FACTS

Taxpayer represents that the facts are as follows.

On Date 1, Taxpayer and Spouse entered into an agreement regarding their marital and property rights. Among other things, the parties intended that the agreement serve to effectuate a complete and total division of property between Taxpayer and Spouse under the equitable distribution provisions of State A law and except to the extent provided in the agreement, Taxpayer and Spouse mutually waived their rights and released each other from any claims for maintenance, distribution of marital property, distributive awards, and special relief or claims regarding separate property.

Pursuant to the agreement, Spouse agreed to pay Taxpayer \$X annually, with the first payment due on the anniversary date of the entry of the divorce decree, for a period of B Years. The agreement set forth the date and amount of each equal annual payment. The agreement also stated that Taxpayer could elect to receive a discounted lump sum prepayment of all remaining annual payments if Taxpayer made the election and gave E days' prior notice to Taxpayer. The agreement did not provide for stated interest on the annual payments or on any prepayment.

The agreement further provided that upon Spouse's death, prior to the payment of all amounts due to Taxpayer, the executor is required to promptly pay any annual payment then due plus any prepayment amount then reflected in the agreement within F days of the appointment of the legal representative of Spouse's estate, and such unpaid balance becomes a first charge and lien against Spouse's estate and any trust Spouse may create during the Spouse's lifetime. Similarly, in the case of Spouse's incompetence, Spouse's legal representative is obligated to pay any annual payment then due plus any prepayment amount then reflected in the agreement within F days of a determination of Spouse's incompetence. A reciprocal set of similar provisions apply in the case of Taxpayer's death or determination of incompetence.

On Date 2, a divorce decree was granted by the Court in State A. The Court ordered that all of the terms and provisions of the agreement are legally enforceable, and that Taxpayer and Spouse are directed to comply with all legally enforceable terms and provisions of the agreement. The Court retained jurisdiction for purposes of enforcing the settlement.

LAW AND ANALYSIS

Ruling 1

Section 1041(a) provides that no gain or loss is recognized on a transfer of property from an individual to a spouse or former spouse if the transfer is incident to a divorce. The purpose of § 1041 is to defer the tax consequences, recognition of gain or loss, until the transferee disposes of the property.

Section 1041(b)(1) and (2) provides that in the case of any transfer to which § 1041(a) applies, the property is treated as acquired by the transferee by gift for Federal income tax purposes, and further, that the transferee's basis is the transferor's adjusted basis immediately before the transfer.

Under § 1041(c)(2), in order for a transfer of property to be "incident to a divorce," the transfer must occur within one year after the date of divorce or must be related to the cessation of the marriage. Q&A7 of Temporary § 1.1041-IT(b) of the Income Tax Regulations provides that the 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 six years after the date on which the marriage ceases. Any transfer not pursuant to a divorce or separation instrument and any transfer occurring more than six 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 the 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.

Here, Taxpayer and Spouse entered into an agreement on Date 1 to effectuate a complete and total division of property in anticipation of divorce. Pursuant to the agreement, Spouse agreed to pay Taxpayer \$X annually for a period of B Years, with some payments extending past the six-year presumptive period. The agreement set forth the date and amount of each equal annual payment.

Since some of the payments extend past the six-year presumptive period, Taxpayer may rebut the presumption and show that the payments are being made to effect the division of property at the time of the divorce. Here, Taxpayer and Spouse have structured their agreement to extend the transfers beyond the six-year period for reasons we find reasonable in light of all the circumstances. Accordingly, under § 1041, we find the \$X annual payment for a period of B Years, as well as any lump sum

discounted prepayment, to be incident to the divorce. Therefore, no gain or loss is recognized on any periodic or lump sum payment made pursuant to the agreement.

Ruling 2

Sections 483 and 1274

Sections 483 and 1274 contain rules for partially recharacterizing as interest certain deferred payments made in connection with the sale or exchange of non-publicly traded property pursuant to a contract (§ 483) or debt instrument (§ 1274), whichever Code section is applicable. In general, §§ 483 and 1274 provide that the contract or debt instrument must provide for adequate stated interest. If the contract or debt instrument does not provide for adequate stated interest, a portion of each deferred payment may be recharacterized as interest for tax purposes under either § 483 or § 1274, whichever is applicable.

Sections 483 and 1274 do not apply to a contract or debt instrument that is related to a transfer of property subject to § 1041. See §§ 1.483-1(c)(3)(i) and 1.1274-1(b)(3)(iii). Because the agreement, pursuant to which the periodic payments and lump sum discounted prepayments are to be made, is related to a transfer of property subject to § 1041, §§ 483 and 1274 do not apply to characterize any portion of those payments as interest.

Section 7872

Section 7872 recharacterizes a below-market loan (a loan on which the interest rate charged is less than the applicable Federal rate) as two transactions. First, there is an arm's length transaction in which the lender makes a loan to the borrower in exchange for a note requiring the payment of interest at the applicable Federal rate; second, there is a transfer of funds by the lender to the borrower ("the imputed transfer"). The timing and characterization of the imputed transfer by the lender to the borrower are determined in accordance with the substance of the transaction.

The legislative history of § 7872 indicates that the term "loan" should be interpreted broadly. Any transfer of money that provides the transferor with a right to repayment may be a loan. For example, deposits of all kinds may be treated as loans. H.R. Conf. Rep. No. 861, 98th Cong., 2d Sess. 1018 (1984), 1984-3 (Vol. 2) C.B. 272.

Congress intended that § 7872 would apply only to the below-market loans enumerated in subparagraphs (A) through (F) of § 7872(c)(1), including gift loans and tax avoidance loans. Under § 7872(c)(1)(E), a loan that is not specifically enumerated may also be subject to § 7872 to the extent provided in regulations if the interest arrangement has significant effect on the tax liability of the borrower or the lender. H.R. Conf. Rep. No. 861 at 1018-19.

Section 7872(f)(3) provides that the term “gift loan” means any below-market loan where the foregone interest is in the nature of a gift. In general, there is a gift if property (including foregone interest) is transferred for less than full and adequate consideration under circumstances where the transfer is a gift for gift tax purposes. A sale, exchange, or other transfer made in the ordinary course of business (i.e., a transaction which is bona fide, at arm’s length and free from donative intent) generally is considered as made for full and adequate consideration. H.R. Conf. Rep. No. 861 at 1018.

Section 7872(c)(1)(D) states that § 7872 applies to any below-market loan which has as one of its principal purposes the avoidance of any Federal tax. The legislative history of § 7872 provides that a below-market loan is a tax-avoidance loan if one of the principal purposes of the interest arrangement of the loan is the avoidance of any Federal tax by either the borrower or the lender. Tax avoidance is a principal purpose of the interest arrangement if it is a principal factor in the decision to structure the transaction as a below-market loan, rather than a loan requiring the payment of interest at a rate that equals or exceeds the applicable Federal rate and a payment by the lender to the borrower. H.R. Conf. Rep. No. 861 at 1019.

Section 7872(f)(3) provides that, for purposes of § 7872, a husband and wife shall be treated as one person and, therefore, any loan between a husband and wife is ignored for purposes of § 7872. In addition, the transfers in the instant case were negotiated between a husband and wife at arm’s length in order to divide marital property incident to a divorce. Further, the transfers were not motivated by donative intent or with a principal purpose of the avoidance of any Federal tax. Based on the foregoing, we do not believe § 7872 was intended to apply to transactions such as the transaction in the instant case and, therefore, § 7872 does not apply to characterize any portion of the periodic or lump sum discounted prepayments as interest.

Ruling 3

Section 2501(a) imposes a gift tax for each calendar year on the transfer of property by gift during the calendar year. Section 2511 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 25.2512-8 of the Gift Tax Regulations provides, in relevant part, that a relinquishment or promised relinquishment of dower or curtesy, or of a statutory estate created in lieu of dower or curtesy, or other marital rights in the spouse's property or estate, shall not be considered to any extent a consideration “in money or money's worth.” However, § 25.2512-8 indicates that § 2516 and the regulations thereunder provide specific rules with respect to certain transfers incident to a divorce.

Section 2516 provides, in relevant part, that where a husband and wife enter into a written agreement relative to their marital and property rights and divorce occurs within the three-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 to either spouse in settlement of his or her marital or property rights shall be deemed to be transfers made for a full and adequate consideration in money or money's worth. Section 25.2516-1(a) 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 (whether or not the agreement is approved by a divorce decree), if the spouses obtain a final decree of divorce from each other within two years after entering the agreement.

Here, Taxpayer and Spouse entered into the agreement on Date 1. A final divorce decree was issued on Date 2, within the three-year period provided under § 2516. On these facts, we conclude that Spouse's payments to Taxpayer in settlement of Taxpayer's marital or property rights are treated as transfers made for a full and adequate consideration in money or money's worth and therefore will not be subject to gift tax under § 2501.

Ruling 4

Section 2053(a)(3) provides that the value of the taxable estate shall be determined by deducting from the value of the gross estate such amounts for claims against the estate as shall be allowable by the laws of the jurisdiction under which the estate is being administered. Under § 2053(c)(1), the deduction allowed for claims against the estate, when founded on a promise or agreement, is limited to the extent the claim was contracted bona fide and for an adequate consideration in money or money's worth. Section 2053(e) provides a cross-reference to § 2043(b)(2) treating certain relinquishments of marital rights as consideration in money or money's worth.

Section 2043(b)(1) provides a general rule that for estate tax purposes, a relinquishment or promised relinquishment of marital rights in a decedent's property or estate is not considered to any extent a consideration in "money or money's worth." However, § 2043(b)(2) provides that a transfer of property that satisfies the requirements of § 2516 relating to certain property settlements shall be considered to be made for an adequate and full consideration in money or money's worth.

Section 20.2053-1(d)(1) provides, in part, that to take into account properly events occurring after the date of a decedent's death in determining the amount deductible under § 2053, the deduction for any claim is limited to the total amount actually paid in settlement or satisfaction of that item.

Section 20.2053-4(a) provides, in part, that liabilities imposed by law or arising out of contracts or torts are deductible if they meet the applicable requirements set forth in §§ 20.2053-1 and 20.2053-4. To be deductible, a claim against a decedent's estate

must represent a personal obligation of the decedent existing at the time of the decedent's death. Except as otherwise provided in § 20.2053-4(b) and (c) and to the extent permitted by § 20.2053-1, the amounts that may be deducted as claims against a decedent's estate are limited to the amounts of bona fide claims that are enforceable against the decedent's estate (and are not unenforceable when paid) and claims that are actually paid by the estate in satisfaction of the claim. Events occurring after the date of a decedent's death shall be considered in determining whether and to what extent a deduction is allowable under § 2053. See § 20.2053-1(d)(2).

On Spouse's death prior to the payment of all amounts due to Taxpayer, Spouse's executor is required to promptly pay any annual payment then due plus any prepayment amount then reflected in the schedule of payments that is part of the agreement. The Court in State A has retained jurisdiction for purposes of enforcing the agreement, if need be. As discussed above, the agreement satisfies the requirements of § 2516 such that transfers made pursuant to it are considered to be made for an adequate and full consideration in money or money's worth within the meaning of § 2053(c)(1). Accordingly, we conclude that a deduction is allowable for the amounts actually and timely paid pursuant to the agreement in satisfaction of the schedule of payments.

Based on the facts and representations submitted by the Taxpayer, we rule as follows:

- (1) Section 1041 applies to the transfers made by Spouse to Taxpayer pursuant to the agreement and are nontaxable transfers pursuant to § 1041.
- (2) No portion of the transfers made by Spouse to Taxpayer pursuant to the agreement will be characterized as interest under § 483, 1274, or 7872.
- (3) Spouse's payments to Taxpayer in settlement of Taxpayer's marital or property rights are treated as transfers made for a full and adequate consideration in money or money's worth and therefore will not be subject to gift tax under § 2501.
- (4) A deduction is allowable for the amounts actually and timely paid pursuant to the agreement in satisfaction of the schedule of payments.

Pursuant to section 7.06 of Rev. Proc. 2021-1, 2021-1 I.R.B. 1, Taxpayer must attach a copy of this letter ruling to any Federal income tax return to which it is relevant. If Taxpayer files its returns electronically, it may satisfy this requirement by attaching a statement to the return that provides the date and control number of this letter ruling.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

The ruling contained in this letter is based upon information and representations submitted by Taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. However, this office has not verified any of the material submitted in support of the request for this ruling, and therefore it is subject to verification on examination.

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

Pursuant to the provisions of a power of attorney currently on file, we are sending a copy of this letter ruling to Taxpayer's authorized representative.

If you have any questions concerning this matter, please contact _____ at _____

Sincerely,

Ronald J. Goldstein
Senior Technician Reviewer
(Income Tax & Accounting)

cc: