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Department of the Treasury
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Trust =

Trust A=

Trust B=

A =

B =

n =

D1 =

D2 =

D3 =

Trustee =

Foundation =

Foundation B=

State =

Dear :

This letter responds to a letter dated May 3, 2005, submitted on behalf of Trust requesting the following rulings regarding a proposed division of Trust, a charitable remainder unitrust, into two separate trusts, Trust A and Trust B:

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 a charitable remainder trust under § 664 of the Internal Revenue Code.

2. The proposed division of Trust pursuant to divorce into Trust A and Trust B will not result in taxable income to A or B under §1041.

3. The proposed division of Trust into Trust A and Trust B will not cause the recognition of taxable gain or loss to Trust, Trust A, Trust B, or the Trustee of the respective trusts under §1001.

4. The division of the interests of A and B in Trust into Trust A and Trust B will not be subject to gift tax as to A or B, because the division is a transfer of property pursuant to a divorce under § 2516.

5. 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's assets transferred to Trust A and Trust B, subject to any liability Trust has under Chapter 42 of the Code to the extent not already satisfied by Trust.

6. If reasonable in amount, payment from Trust assets of legal fees and other expenditures incurred by Trust to effectuate the division of Trust will not constitute an act of self-dealing under § 4941, nor will it constitute taxable expenditures under § 4945.

FACTS

According to the information submitted, on D1, during her marriage to B, A established Trust, a charitable remainder unitrust described in § 664(d)(2). Trust is irrevocable and governed by the laws of State. Trustee is Trust's trustee.

Trust provides that in each taxable year of Trust a unitrust amount equal to n percent of the net fair market value of Trust's assets as determined on the first day of each taxable year is to be made to A during her lifetime, and after her death to B, for his lifetime. After the death of the survivor of A or B, Trust's assets will be distributed to Foundation. Under Article II (A) of the Trust instrument, A reserves the power exercisable only by her will to revoke B's interest in Trust. Under Article II (C) of the Trust instrument, A reserves the power, by will or written instrument, to change the charitable beneficiary (provided the charitable beneficiary selected is described in §§ 170, 2055(a), and 2522(a)).

On or about D2, A commenced an action to dissolve the marriage. The divorce became final under a Judgment of Dissolution of Marriage on D3. By the terms of the Marital Settlement Agreement, A and B propose to divide Trust into two separate trusts, Trust A and Trust B, each of which is intended to qualify as a charitable remainder unitrust under § 664(d)(2). As proposed, there will be a pro rata division of all the assets in Trust, with 50 percent of each asset being transferred into each of Trust A and Trust B. A will be the sole income beneficiary of Trust A, and Foundation will be the designated charitable remainder beneficiary of Trust A. B will be the sole income beneficiary of Trust B, and Foundation B will be the designated charitable remainder beneficiary of Trust B. Payments will be made to the beneficiaries from each trust in an amount equal to n percent of the net fair market value of the trust assets determined as of the first day of each taxable year. Trust A and Trust B will make payments to their respective income beneficiary for each beneficiary's lifetime and on the death of the respective income beneficiary the trust assets will be distributed to the designated charitable beneficiary. Neither A nor B will retain a survivorship interest in the other person's trust. A and B reserve the power to change the charitable remainder beneficiary of their respective trusts. Trustee will be the trustee of Trust A and Trust B.

RULING 1

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.

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.

RULING 2

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 is the excess of the amount realized over the adjusted basis provided in §1011 for determining gain, and the loss is the excess of the adjusted basis provided in §1011 for determining loss over the amount realized. Under §1001(c), the entire amount of gain or loss must be recognized, except as otherwise provided.

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.

An exchange of property results in the realization of gain or loss under §1001 of the Code if the properties exchanged are materially different. Cottage Savings Association v. Commissioner, 499 U.S. 554 (1991). Properties exchanged are materially different if the properties embody legal entitlements "different in kind or extent" or if the properties confer "different rights and powers." Id. at 565. In Cottage Savings, the Court held that mortgage loans made to different obligors and secured by different homes did embody distinct legal entitlements, and that the taxpayer realized losses when it exchanged interests in the loans. Id. at 566. 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" to the Code so long as their respective possessors enjoy legal entitlements that are different in kind or extent. Id. at 564-65.

In this case, prior to the divorce, A owned the entire unitrust income interest in Trust and B had no present interest in either the income or corpus of Trust. B had at most a future contingent interest in Trust. That is, B would have a right to an interest only if A dies without exercising her testamentary power to terminate B's interest in Trust. After the partition of Trust pursuant to the Marital Settlement Agreement, A's interest decreases to a n percent unitrust amount determined by reference to the 50 percent of the assets of Trust deposited into Trust A; and B's interest becomes immediate and possessory equal to a n percent unitrust amount determined by reference to the 50 percent of the assets of Trust deposited into Trust B. Consequently, because after the partition of Trust, A's interest declines significantly and B's interest increases significantly, A and B will enjoy legal entitlements that are materially different in kind or extent from those enjoyed prior to the division of Trust. Accordingly, gain or loss would be realized and recognized to A and B under §1001 unless another section of the Code provides for nonrecognition in such case. See § 1.1001-1(a).

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) a spouse, or former spouse if the transfer is incident to the divorce. 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.

Section 1041 was added to the Code by § 421 of the Tax Reform Act of 1984 (1984 Act), Pub. L. No. 98-369. It provides a broad non-recognition rule for transfers of property between spouses and former spouses. The House Report accompanying the 1984 Act expresses the intent of Congress behind § 1041:

> Furthermore, in divorce cases, the government often gets whipsawed. The transferor will not report any gain on the transfer, while the recipient spouse, when he or she sells, is entitled under the [United States v. Davis, 370 U.S. 65 (1962)] rule to compute gain or loss by reference to a basis equal to the fair market value of the property at the time received.
>
> The committee believes that to correct these problems and make the tax laws as unintrusive as possible with respect to relations between spouses, the tax laws governing transfers between spouses and between former spouses should be changed.
>
> . . .
>
> The bill provides that the transfer of property to a spouse incident to a divorce will be treated, for income tax purposes, in the same manner as a gift. Gain (including recapture income) or loss will not be recognized to the transferor, and the transferee will receive the property at the transferor's basis. ... Thus,

> uniform Federal income tax consequences will apply to these transfers notwithstanding that the property may be subject to differing state property laws.

H. R. Rep. No. 432, 98th Cong., 2d Sess., Part 2, at 1491-92 (1984) ("House Report").

We note that for purposes of subtitle A, the Income Tax, §1041 specifically provides for the nonrecognition of gain or loss on any transfer of property incident to divorce. The broad application of §1041 is consistent with the above legislative history and applies nonrecognition principles to transfers of property between divorcing spouses if related to the divorce.

Specifically with respect to the divorce-related transfers of annuities and beneficial interests in trusts, the above legislative history states: "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 contract (under sec. 72), or the usual treatment as the beneficiary of a trust (by reason of sec. 682),... ." Id.

In our view, this statement of Congressional intent supports nonrecognition treatment to the facts of this case under §1041. Prior to divorce, A received annual unitrust payments from Trust. B did not receive anything. Pursuant to the Settlement Agreement, Trust will be partitioned into two equal trusts, one for the benefit of A and one for the benefit of B. Consequently, A in essence is transferring incident to divorce one-half of A's former interest in Trust to B. Consistent with the above legislative history, we conclude that §1041 will apply to the transfer. Therefore, for purposes of the income tax, no gain or loss will be recognized by A on the transfer of one-half of A's interest in Trust to B, and B receives that interest as a gift with a carryover basis from A pursuant to §1041(b).

RULING 3

A 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 of the transaction. Thus, neither gain nor loss is realized on the partition. See Rev. Rul. 56-437, 1956-2 C.B. 507.

Accordingly, the pro rata partition of Trust into Trust A and Trust B will not result in the recognition of gain or loss to Trust, Trust A, Trust B, or the Trustee of the respective trusts under §1001.

RULING 4

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 shall apply 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, the amount by which the value of the property exceeded the value of the consideration shall be deemed a gift.

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 1 year before such agreement is entered into (whether or not such agreement is approved by the divorce decree), any transfers of property 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.

In this case, A and B entered into a Marital Settlement Agreement relative to their marital and property rights on D2. On D3, A and B’s divorce became final under a Judgment of Dissolution of Marriage. D3 is a date less than 3 years after D2. Accordingly, based on the facts submitted and representations made, we conclude that the transfer of property interests in Trust upon its division into Trust A and Trust B made pursuant to the Marital Settlement Agreement will be deemed to be transfers made for full and adequate consideration in money or money’s worth and, therefore, will not be subject to gift tax.

RULINGS 5 AND 6

Under § 4947(a)(2), § 507 applies to certain “split interest” trusts (trusts with both charitable and non-charitable beneficiaries) as if they were private foundations. Accordingly, since Trust, Trust A, and Trust B are split-interest trusts, they are subject to the rules of §§ 507, 4941, and 4945.

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(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(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 newly created organization.

Section 1.507-3(c)(1) provides, in part, that as used in § 507(b)(2) the term "other adjustment, organization or reorganization" shall include any partial liquidation or any other "significant disposition of assets" to one or more private foundations.

Section 1.507-3(c)(2)(ii) provides that the term "significant disposition of assets" means the transfer of 25 percent or more of the net assets of the foundation at the beginning of the year, which disposition may be made in a single year or in a series of related dispositions over more than one year.

Section 1.507-3(a)(1) and (2)(i) 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) in proportion to the assets transferred to each.

Section 1.507-3(a)(4) provides that if a private foundation incurs liability for one or more of the taxes imposed under Chapter 42 (or any penalty resulting therefrom) prior to, or as a result of, making a transfer of assets described in § 507(b)(2) to one or more private foundations, in any case where transferee liability applies each transferee foundation shall be treated as receiving the transferred assets subject to such liability to the extent that the transferor foundation does not satisfy such liability.

Under § 1.507-3(a)(9)(1), if a private foundation transfers all of its assets to one or more private foundations effectively controlled by the same persons that effectively control the transferor, the transferee foundations are treated as though they were the transferor for purposes of § 4945.

Section 4941(a) 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 for the 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).

Under § 4945(d)(4), the term "taxable expenditure" includes a grant to a private foundation unless the grantor exercises expenditure responsibility in accordance with § 4945(h).

Section 4946(a) provides the term "disqualified person" with respect to a private foundation includes a substantial contributor to the foundation (including the creator of a trust), the foundation manager (including a trustee) and the members of the family of those individuals.

Section 53.4945-6(b)(2) of the Foundation and Similar Excise Taxes Regulations provides that expenditures for unreasonable administrative 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 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 business care and prudence.

Rev. Rul. 2002-28, 2002-1 C.B. 941 provides that when a private foundation transfers all of its assets to other foundations in a § 507(b)(2) transfer there are no expenditure responsibility requirements under § 4945(d)(4) or (h) with respect to the transfers because the transferee foundations are treated as the transferor.

Trust is a split-interest trust described in § 4947(a)(2) and, therefore, treated generally as if it were a private foundation and subject to § 507 termination rules. The proposed transfer of 100 percent of Trust's 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 (2)(ii).

Accordingly, under § 1.507-3(a)(1), Trust A and Trust B will not be treated as newly created private foundations. Further, these trusts shall, under § 1.507-3(a)(2)(i), succeed to the aggregate tax benefit of the transferor organization, Trust, on a pro rata basis determined by the fair market value of the assets. Under § 1.507-3(a)(4), the assets will be subject to any liability that Trust may have under Chapter 42.

A and B are disqualified persons with respect to Trust. The only interest that either A or B had in Trust was the payment of the unitrust amount under the provisions of § 664(d)(2). A and B have exchanged a unitrust (and a contingent survivor's unitrust interest) payment in Trust for a full unitrust payment in a trust having fewer assets, namely 50 percent of the assets of Trust prior to its division. Thus, they are in the aggregate, likely to receive the same unitrust payment as before. Therefore, no self-dealing transaction occurs under § 4941.

Since the transferee trusts are treated as the transferor Trust rather than recipients of expenditure responsibility grants, there are no expenditure responsibility requirements that must be exercised by Trust under § 4945(d)(4) or (h) with respect to the transfers. See Rev. Rul. 2002-28. Under § 53.4945-6(b)(2), legal and other expenses incurred by Trust to implement the division of the assets of Trust, assuming such expenses are incurred in the good faith belief that they are reasonable and consistent with ordinary care and prudence, will not constitute taxable expenditures under § 4945.

Therefore, if reasonable in amount, payment from Trust assets of legal fees and other expenditures incurred by Trust to effectuate the division of Trust will not constitute an act of self-dealing under § 4941, nor will it constitute taxable expenditures under § 4945.

CAVEATS

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under any other provision of the Code, in particular § 61. Specifically, no opinion is expressed concerning whether Trust qualifies as a charitable remainder trust under § 664 or whether Trust A or Trust B each will qualify as a charitable remainder trust under § 664.

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

Pursuant to a power of attorney on file with this office, we are sending a copy of this letter to Trust's authorized representative.

Sincerely,

/s/

Mary Beth Collins
Senior Technician Reviewer, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)
A copy of this letter
A copy for § 6110 purposes

cc: