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Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:3 PLR-168973-02
Date:
June 25, 2003

Trust:

A:

B:

Trust A:

Trust B:

State:

Court:

Foundation:

Charity:

a:

b:

c:

d:

e:

f:

Dear :

This letter responds to your letter received December 18, 2002, as well as additional correspondence, submitted on behalf of the Trust, requesting the following rulings regarding the proposed division of the Trust into Trust A and Trust B:

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

2. The division of the community property interest of A and B in the 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.

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

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

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

FACTS

A and B, as husband and wife, created the Trust on a. Both are the grantors, initial trustees, and beneficiaries of the Trust. The Trust was drafted to qualify as a charitable remainder unitrust (CRUT) within the meaning of § 644(d)(2). The Trust is irrevocable and governed by the laws of State. Trust assets were valued at approximately b as of c.

By the terms of the Trust instrument, A and B receive, in equal monthly installments, an amount equal to d percent of the net fair market value of Trust assets measured as of the first day of the tax year, with any Trust income exceeding this amount being added to principal. Payments from the Trust are to continue as long as A or B is alive. Upon the death of the second of A or B, Trust corpus is to be distributed to the Foundation or other public charities described in § 170(c), § 2055(a), and § 2522(a). A and B reserve the power to change the charitable remainder beneficiary.

On e, B commenced an action in the Court to dissolve the marriage. The divorce decree was entered on f. By the terms of the property settlement agreement, the parties propose to divide the Trust into two separate trusts, Trust A and Trust B, each of which is intended to qualify as a CRUT under § 664(d)(2). As proposed, there will be a pro rata division of all the assets in the Trust, with 50% of each asset being transferred into each of Trust A and Trust B. A will be the sole trustee and income beneficiary of Trust A, and B will be the sole trustee and income beneficiary of Trust B. Payments will be made to the beneficiaries from each trust in an amount equal to 8% of the net fair market value of trust assets measured as of the first day of each tax year. A and B, after the division, will receive the same amounts in the aggregate they would have received before the division. Trusts A and B will make payments to their respective income beneficiary for each beneficiary's lifetime. Neither A nor B will retain a survivorship interest in the other's trust. On termination of each trust, on the death of the income beneficiary, the trustee shall distribute the remaining principal and income to the designated charitable remainder beneficiary (the Foundation for Trust A and the Charity for Trust B) or to other public charities described in §§ 170(c), 2055(a), and 2522(a). A and B will reserve the power to change the charitable remainder beneficiary of their respective trusts.

LAW AND ANALYSIS

Issue 1

Section 664(d)(2) provides that a charitable remainder unitrust (CRUT) is a trust: (A) from which a fixed percentage (which is not less than 5% nor more than 50%) 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 trust for such use; 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% of the net fair market value of such property as of the date such property is contributed to the trust.

Section 170(f)(2)A) allows a deduction for a contribution of a remainder interest in property transferred in trust if the trust is a charitable remainder annuity trust or

unitrust described in § 664. Under § 1.664-1(a)(4) of the Income Tax Regulations, a charitable remainder trust must meet the definition of and function exclusively as a charitable remainder trust from the creation of the trust. Sections 170(f) and 664 are intended to make sure that charitable beneficiaries of charitable remainder trusts receive remainders equal to the amount claimed as a charitable deduction by the creator of the trust. See S. Rep. No. 552, 91st Cong., 1st Sess. 87 (1969).

After the division of Trust into Trust A and Trust B, the total unitrust amount to be paid annually will not change. A and B will receive the same aggregate amount after the division as they receive currently. As a result, the charitable remainder beneficiaries will receive what they were entitled to receive before the Trust was divided.

Issue 2

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 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 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.

Issues 3 & 5

Under § 4947(a)(2), §§ 507, 4941 and 4945 apply to certain “split interest” trusts (trusts with both charitable and non-charitable beneficiaries) as if they were private foundations.

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 newly created 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 the term "disqualified person" with respect to a private foundation includes a substantial contributor to the foundation (including the creator of a trust), and a foundation manager (including a trustee).

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% 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.

Sections 1.507-3(a)(1) and (2)(i) provide, 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.

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 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 business care and prudence.

As a CRUT under § 664(d)(2), the Trust is a split-interest trust described in § 4947(a)(2) and, therefore, treated generally as if it were a private foundation. 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 507(b)(2) is applicable to the division of the Trust. The transfer of all of the 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 (c)(2)(ii) of the regulations. Accordingly, under § 1.507-3(a)(1), the two unitrusts 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, the 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 the Trust may have under chapter 42.

A and B are disqualified persons with respect to the Trust, under § 4946, because they are substantial contributors to the Trusts and are trustees. The only interest that either A or B had in the Trust was the payment of the unitrust amount under the provisions of § 664(d)(2). They have each exchanged a one-half interest in a unitrust payment in the Trust for a full unitrust payment in a trust having fewer assets, one-half of the assets of the Trust prior to its division. Thus, they are likely to receive more or less the same unitrust payment as before. The 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 the Trust, assuming such expenses are reasonable, are justified as necessary to facilitate the smooth functioning and operation of the trust which was likely not possible under the prevailing divorce proceedings. There are no other transactions with the income beneficiaries that affect the Trust principal. Accordingly, no self-dealing

transaction will occur within the meaning of § 4941.

Based on the same analysis as applied in the preceding paragraph, no taxable expenditures have occurred under § 4945. See also § 53.4945-6(b)(2) of the foundation regulations.

Issue 4

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. With respect to such a transfer, § 1041(b) provides that (1) for purposes of subtitle A, the property shall be treated as acquired by the transferee by gift, and (2) the basis of the transferee in the property shall be the adjusted basis of 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”).

For purposes of subtitle A, § 1041 specifically provides for the nonrecognition of gain or loss on any transfer of property incident to divorce. The broad application of this provision is consistent with the legislative history.

With respect to the divorce-related transfers of annuities and beneficial interests in trusts, the legislative history states that “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 § 72), or the usual treatment as the beneficiary of a trust (by reason of § 682),... .” Id.

This statement of Congressional intent supports the application of § 1041's nonrecognition treatment to the facts of this case. By dividing the Trust into two equal charitable remainder trusts, one for the benefit of each, A and B essentially are transferring incident to divorce one-half of their interests in the Trust to the other spouse. Thus, for purposes of the income tax, no gain or loss will be recognized by either A or B on the transfer of any interest in the Trust to the other spouse, which will constitute the corpus of their respective trusts.

By its terms, § 1041 shields taxpayers from the recognition of “gain or loss” with respect to certain transfers. We make no determination regarding the inclusion in gross income of any item of income, as opposed to “gain”, by A or B or the Trust as a result of the proposed division.

CONCLUSIONS

Based solely on the facts and representations submitted by Company, we conclude that–

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

2. The division of the community property interest of A and B in the 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.

3. Trust A and Trust B will not be treated as newly created organizations. The aggregate tax benefits of the Trust under § 507(d) will carry over to Trusts A and B in proportion to the amount of the Trust’s assets transferred to Trusts A and B. The assets will be subject to any liability that the Trust has under chapter 42 of

the Code to the extent not already satisfied by the Trust.

4. No gain or loss will be recognized by A or B on the division of the Trust

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

Except for the specific rulings above, we express or imply no opinion concerning the federal income tax consequences of the facts of this case under any other provision of the Code. Specifically, we express or imply no opinion regarding: (1) whether the Trust qualifies as a charitable remainder trust under § 664 or whether Trusts A and B will qualify as charitable remainder trusts under § 664; (2) whether the division of the Trust will result in any income being subject to income tax (§ 1041 is limited by its terms to the nonrecognition of gain or loss); or (3) whether the legal or other expenditures incurred by the Trust were paid or incurred in the good faith belief that they were reasonable and that the payment or incurrence of these expenses was consistent with ordinary business care and prudence.

These rulings are directed only to the taxpayer who requested them. Section 6110(k)(3) provides that they may not be used or cited as precedents.

Under a power of attorney on file with this office, we are sending the original of this letter to you and a copy to the Trust.

This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3), this ruling may not be used or cited as precedent.

Sincerely,
CHRISTINE ELLISON
Chief, Branch 3
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

enclosures: copy for § 6110 purposes

cc: