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Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:B09 / PLR-119049-02

Date:

September 26, 2002

Re:

LEGEND

Date 1 =
Husband =
Wife =
Original Trust =
State =
Date 2 =
State Court =
X =
Bank =
CRUT 1 =

CRUT 2 =

Dear :

In a letter dated March 14, 2002, the taxpayer requested rulings concerning the tax consequences of a judicial division and modification of an irrevocable charitable remainder unitrust into two separate and equal successor trusts. This letter responds to your request.

The information submitted and the representations made are summarized as follows: On Date 1, Husband and Wife created Original Trust, an irrevocable charitable remainder unitrust, under the laws of State. Husband and Wife are the co-trustees and sole beneficiaries of Original Trust during their joint lifetimes.

Original Trust was initially structured as a net income with makeup charitable remainder unitrust. However, on Date 2, Husband and Wife obtained an order from State Court to restructure Original Trust as a straight unitrust.

Article 2(A) of Original Trust, as amended by the Date 2 court order, provides, in part, that during the joint lifetimes of Husband and Wife, the trustee shall pay to them jointly, and then to the survivor for life, in each taxable year of the trust, a unitrust amount equal to $x\%$ of the net fair market value of the trust assets valued as of the first day of such taxable year. Article 2(A) further provides that no amount other than the unitrust amount may be paid to or for the use of any person other than an organization described in each of §§ 170(b)(1)(A), 170(c), 2055(a) and 2522(a) of the Internal Revenue Code ("Code").

Article 2(F) provides that upon the death of the survivor of Husband and Wife the trust estate is to be distributed to certain enumerated charitable organizations. This provision further provides that Husband and Wife, acting jointly during their lifetime, and thereafter the survivor of Husband and Wife during the remainder of his or her lifetime, shall have the power to add or substitute as remaindermen one or more charitable organizations described in §§ 170(b)(1)(A), 170(c), 2055(a) and 2522.

Article 6 provides that upon the death, resignation or incapacity of either the initial co-trustees, the remaining co-trustee shall become the sole trustee of the trust. Thereafter, upon the death, resignation or incapacity of the surviving trustee, then Bank is designated to become the sole trustee.

Husband and Wife are in the process of dissolving their marriage and seek to divide Original Trust into two separate and distinct unitrusts, CRUT 1 and CRUT 2. The assets of Original Trust will be allocated and divided equally, on a pro rata basis, between CRUT 1 and CRUT 2. In addition, CRUT 1 and CRUT 2 will have terms identical to those of Original Trust, with the following exceptions:

1. Husband shall be the sole unitrust beneficiary of CRUT 1 during his lifetime, and after his death, Wife will become the unitrust beneficiary. Wife shall be the sole unitrust beneficiary of CRUT 2 during her lifetime, and after her death, Husband will become the unitrust beneficiary. Both CRUT 1 and CRUT 2 shall terminate upon the death of the survivor of Husband and Wife.

2. Husband shall have the right to designate the charitable remainder beneficiaries of CRUT 1 and Wife shall have the right to designate the charitable remainder beneficiaries of CRUT 2.
3. With regard to the trustee provisions, Husband will be the sole trustee of CRUT 1 during his lifetime. Upon husband's death, Wife will serve as successor trustee of CRUT 1. If Wife is unable to serve, Bank is designated to serve as successor trustee of CRUT 1. If Husband resigns as trustee of CRUT 1 or becomes incapacitated during his lifetime, Bank is designated to serve as successor trustee and it shall continue to serve as successor trustee even after Husband's death. Similarly, Wife will be the sole trustee of CRUT 2 during her lifetime. Upon Wife's death, Husband will serve as successor trustee of CRUT 2. If Husband is unable to serve, Bank is designated to serve as successor trustee of CRUT 2. If Wife resigns as trustee of CRUT 2 or becomes incapacitated during her lifetime, Bank is designated to serve as successor trustee and it shall continue to serve as successor trustee even after Wife's death.

Based on the foregoing facts and representations, you have requested the following rulings:

1. The division of Original Trust and the distribution of the assets of Original Trust to CRUT 1 and CRUT 2 will not cause either CRUT 1 or CRUT 2 to fail to qualify as charitable remainder unitrusts under § 664.
2. The division of Original Trust and the distribution of assets to CRUT 1 and CRUT 2 will not cause Original Trust, CRUT 1, CRUT 2 or the beneficiaries to realize income or gain under § 61(a)(3) or § 1001.
3. The basis and holding period of the assets in CRUT 1 and CRUT 2 immediately after the division of Original Trust will remain the same as they were immediately before the division of Original Trust.
4. The proposed division of Original Trust into CRUT 1 and CRUT 2 will not terminate Original 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).
5. CRUT 1 and CRUT 2 will not be treated as newly created organizations, and that the aggregate tax benefits of Original Trust under § 507(d) will carry over to CRUT 1 and CRUT 2 in proportion to the amount of Original Trust's assets transferred to CRUT 1 and CRUT 2, subject to any liability that Original Trust has incurred under chapter 42 to the extent not already satisfied by Original Trust.

6. The proposed division of Original Trust into CRUT 1 and CRUT 2 will not be an act of self-dealing under § 4941.
7. The proposed division of Original Trust into two CRUT 1 and CRUT 2 will not be a taxable expenditure under § 4945.
8. If reasonable in amount, payment of the legal and other expenditures incurred by Original Trust to effect the proposed division out of the assets of Original Trust will not constitute an act of self-dealing under § 4941 or a taxable expenditure under § 4945.

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.

Section 1.664-1(a)(4) of the Income Tax Regulations provides, in part, that in order for a trust to be a charitable remainder trust, it must meet the definition of and function exclusively as a charitable remainder trust from the creation of the trust.

Based on the information provided and the representations made, the division of Original Trust and the distribution of the assets of Original Trust to CRUT 1 and CRUT 2 will not cause any of Original Trust, CRUT 1 or CRUT 2 to fail to qualify as charitable remainder unitrusts under § 664.

RULINGS 2 AND 3

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

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

Section 1.1001-1(a) states that, except as otherwise provided in subtitle A of the Code, a taxpayer's income includes gain realized from the exchange of property differing materially either in kind or in extent.

Section 1015(b) provides that if property is acquired by gift or transfer in trust on or after December 31, 1920, by a transfer in trust (other than a transfer in trust by a gift, bequest, or devise), the basis shall be 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 such transfer under the law applicable to the year in which the transfer was made.

Section 1.1015-2(a)(1) provides that in the case of property acquired on or 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 such 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) states 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 another person, if under chapter 1 the property has, for the purpose of determining gain or loss from an exchange, the same basis in whole or in part in the taxpayer's hands as it would have in the hands of the other person.

The Supreme Court of the United States has affirmed that a taxpayer realizes taxable income from a property exchange under § 1001 only if the properties exchanged are materially different. Cottage Savings Association v. Commissioner, 499 U.S. 554, 560-562 (1991). In Cottage Savings, the Supreme Court concluded that properties are materially different if their respective possessors enjoy legal entitlements that are different in kind or extent. Id. at 565.

Based on the information submitted and the representations made, we conclude that the proposed division of Original Trust into CRUT 1 and CRUT 2 will not cause Original Trust, CRUT 1, CRUT 2 or the beneficiaries to realize income under §§ 1001 and 61(a)(3). We also conclude that under §§ 1015(b) and 1223(2), the basis and holding period of the assets in CRUT 1 and CRUT 2 will be the same as they were immediately before the division of Original Trust.

RULINGS 4, 5, 6, 7 AND 8

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 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).

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), a family member of a substantial contributor (including children), and a foundation manager (including a trustee).

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)(2)(B), 2055(e)(2)(B) or 2522(e)(2)(B).

Section 1.507-1(b)(6) provides, in part, 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 private foundation status under § 507(a)(1).

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 a “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.

Sections 1.507-3(a)(1) and (2) 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 organizations, 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 termination of private foundation status under § 507(c) does not apply to a transfer of assets pursuant to § 507(b)(2).

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.

Section 53.4947-1(c)(2)(i) 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. 942, 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), Original 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 Original Trust. Since Original Trust will transfer all of its net assets to CRUT 1 and CRUT 2, under § 1.507-1(b)(6), Original Trust will not have terminated its private foundation status under § 507(a)(1). Accordingly, the excise tax imposed under § 507(c) is not applicable to it.

The transfer of all of Original Trust's assets, under the prevailing divorce proceedings, to CRUT 1 and CRUT 2 will qualify as transfers meeting the requirements of §§ 1.507-3(c)(1) and (c)(2)(ii). Accordingly, under § 1.507-3(a)(1), CRUT 1 and CRUT 2 will not be treated as newly created private foundations. Further, such trusts shall, under § 1.507-3(a)(2)(i), succeed to the aggregate tax benefit of the transferor organization, Original Trust, on a pro rata basis determined by the fair market value of the assets.

Husband and Wife are disqualified persons with respect to Original Trust, under § 4946, because they are substantial contributors to Original Trust and are trustees. Because Original Trust is a split interest trust, it is treated as a private foundation under § 4947(a)(2).

The only interest that either Husband or Wife had in Original 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 Original Trust for a full unitrust payment in a trust having one-half of the assets of Original Trust prior to its division. Thus, Husband and Wife are likely to receive more or less the same unitrust payment as before. However, it makes no difference for purposes of § 4941 whether either one or both is receiving more or less of a unitrust payment after the division of Original Trust assets. Section 53.4947-1(c)(2), in substance, provides that the amounts payable to the income beneficiaries under the terms of a charitable remainder split-interest trust are not subject to § 4941 (or § 507 or § 4945). Thus, the disqualified persons are insulated from self-dealing as far as each of their income interests in Original Trust are concerned based on the fact that the unitrust payment is the same before and after the division of Original Trust. Since neither of the disqualified persons, Husband and Wife, receive any additional interest in the assets of the trust principal, no self-dealing transaction has occurred within the meaning of § 4941(d).

Original 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 Original Trust, assuming such expenses are reasonable, are justified as necessary to carry out the trust purpose to facilitate the smooth functioning and operation of the trust which was not possible under the prevailing divorce proceedings. There are no other transactions with the income beneficiaries that affect the principal of Original Trust. Accordingly, no self-dealing transaction occurred.

Based on the same analysis as applied in the two preceding paragraphs, no taxable expenditures have occurred under § 4945. See also § 53.4945-6(b)(2). Further, under §§ 1.507-3(a)(7) and (9), Original Trust will not be required to exercise “expenditure responsibility” under §§ 4945(d) and (h) with respect to the assets transferred to CRUT 1 and CRUT 2. Original Trust will dispose of all of its assets within the meaning of § 1.507-3(a)(7) and CRUT 1 and CRUT 2 will be controlled by the same persons who controlled the Original Trust within the meaning of § 1.507-3(a)(9). See also, Rev. Rul. 2002-28, 2002-20 I.R.B. 942.

Based on the foregoing, we conclude that the proposed division of Original Trust into CRUT 1 and CRUT 2 will not terminate Original 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).

CRUT 1 and CRUT 2 will not be treated as newly created organizations, and the aggregate tax benefits of Original Trust under § 507(d) will carry over to CRUT 1 and CRUT 2 in proportion to the amount of Original Trust’s assets transferred to CRUT 1 and CRUT 2, subject to any liability that Original Trust has incurred under chapter 42 to the extent not already satisfied by Original Trust.

The proposed division of Original Trust into CRUT 1 and CRUT 2 will not be an act of self-dealing under § 4941.

The proposed division of Original Trust into CRUT 1 and CRUT 2 will not be a taxable expenditure under § 4945.

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

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

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer.

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

Sincerely,

James F. Hogan

James F. Hogan
Senior Technician Reviewer
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure

Copy for 6110 purposes