**Internal Revenue Service**

Number: **200539008**
Release Date: 9/30/2005
Index Number: 664.00-00

Department of the Treasury
Washington, DC 20224

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Refer Reply To:
CC:PSI:B02 – PLR-115223-05
Date:
June 13, 2005

Trust =

Trust A =

Trust B =

A =

B =

State =

Court 1 =

Court 2 =

D1 =

D2 =

D3 =

x% =

Dear :

This letter responds to a letter dated February 17, 2005, submitted on behalf of Trust, requesting rulings concerning the proposed division of Trust into two separate trusts, Trust A and Trust B.

FACTS

A and B, husband and wife, are the grantors, trustees, and unitrust beneficiaries of Trust. Trust was created pursuant to a Trust Agreement dated D1. A and B funded Trust with community property. Trust operates as a charitable remainder unitrust (CRUT) under § 664 of the Internal Revenue Code. Trust is irrevocable and governed by the laws of State, a community property state.

By the terms of Trust, A and B receive, on the last day of each calendar quarter, an amount equal to x% 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. If either A or B dies during the term of Trust, then the unitrust amount will be paid entirely to the survivor of A or B. The payments of the unitrust amount will continue until the earlier of (1) the expiration of the 20-year period commencing with the date A and B transferred the property to Trust, or (2) the death of the later of A and B. Upon the earlier of the expiration of the 20-year period or the death of the later of A or B, Trust corpus is to be distributed to one or more charitable organizations described in §170(c), §2055(a), and §2522(a) as designated by A and B, or the survivor of them in a signed writing. Any designation by A, B, or the survivor of them, unless otherwise stated, may be amended or revoked by a later written instrument signed by A or B, or the survivor of them, and delivered to the trustee. Under the terms of Trust, if either A or B ceases to act as co-trustee for any reason, the other spouse shall act as the sole trustee of Trust. A and B, or the survivor of them, retained the right to designate a successor trustee in the event that both A and B cease to act as Trustee. Trust provides that if either A or B dies prior to the expiration of the Unitrust term, the survivor's right to succeed to the deceased's share of the unitrust payments will become effective only if the survivor furnishes the funds for payment of any federal estate taxes or state death taxes for which Trustee may be liable upon the first of A or B to die.

On D2, Court 1 entered a judgment dissolving the marriage of A and B. As part of the marital dissolution, A and B entered into a "Memorandum of Understanding" setting forth the terms of the Martial Settlement Agreement. The Marital Settlement Agreement is in the process of being finalized. By the terms of the Memorandum of Understanding, the parties propose to divide 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, the assets of Trust will be divided equally in kind between 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. If A predeceases the 20-year period, then B will become the sole beneficiary of Trust A for the remainder of the trust term. If B predeceases the 20-year period, then A will become the sole beneficiary of Trust B for the remainder of the trust term.

A will have the right to designate the charitable remainder beneficiaries of Trust A. B will have the right to designate the charitable remainder beneficiaries of Trust B. If either A or B predeceases the 20-year period, the survivor will not have the right to designate or change the charitable remainder beneficiaries designated by the deceased.

A will be the sole trustee of Trust A during his lifetime. If A shall for any reason cease to act as trustee of Trust A, he will retain the right to appoint a successor trustee for Trust A. Similarly, B will be the sole trustee of Trust B during her lifetime and will retain the right to appoint a successor trustee for Trust B.

On D3, Court 2 approved a petition by A and B to divide Trust into Trust A and Trust B. Court 2's order is conditioned upon the receipt of a favorable letter ruling from the Service.

LAW AND ANALYSIS

Ruling 1

Section 664(c) of the Internal Revenue Code provides, generally, that a charitable remainder unitrust shall be exempt from federal income tax.

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 solely on the facts and representations submitted, we conclude that the division of Trust into Trust A and Trust B will not cause Trust, Trust A, or Trust B to fail to qualify as charitable remainder trusts under § 664.

Rulings 2 and 3

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 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 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.

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. Pursuant to § 1041(c), a transfer of property is incident to the divorce if the transfer occurs (1) within one year after the date on which the marriage ceases, or (2) is related to the cessation of the marriage.

Section 1.1041-1T(b), Q&A-7 of the temporary Income Tax Regulations provides that a transfer of property is "related to the cessation of the marriage" if the transfer is pursuant to a divorce or separation instrument, as defined in § 71(b)(2) of the Code, and the transfer occurs not more than six years after the date on which the marriage ceases. A divorce or separation instrument includes a modification or amendment to such decree or instrument.

Section 1041 was added to the Code by § 421 of the Tax Reform Act of 1984 (1984 Act), Pub. L. No. 98-369. The House Report accompanying the 1984 Act expresses the intent of Congress behind section 1041:

> 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").

Concerning transfers between spouses of annuities and beneficial interests in trusts, the above legislative history specifically 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 sec. 72), or the usual treatment as the beneficiary of a trust (by reason of sec. 682)... . Id.

For purposes of subtitle A, § 1041(a) provides a broad rule of nonrecognition of gain or loss for any transfer of property between present spouses and between divorcing spouses if the transfer is incident to divorce. In our view, a broad application of § 1041 is consistent with the language of the statute and the above statement of Congressional intent.

Here, A and B together currently receive annual Trust payments equal to an x% unitrust amount. Under the facts of this case, Trust will be divided into two equal charitable remainder unitrusts, Trust A and Trust B, each of which will have 50 percent of the assets of the Trust. A and B, as the sole beneficiary of Trust A and Trust B respectively, will each receive payments equal to an x% unitrust amount determined from only the 50 percent of the assets deposited into his or her respective trust. A, in essence, is transferring one-half of his former interest in Trust to B, and B, in essence, is transferring one-half of her former interest in Trust to A. Assuming the completed and

signed Marriage Settlement Agreement will constitute a divorce or separation instrument within the meaning of § 71(b)(2), we conclude § 1041 applies to the beneficiary level in the instant case because Trust's division is a property transfer between spouses or former spouses incident to divorce.

Even if this change in their respective rights to the full amount of the unitrust payments from Trust were to result in legal entitlements "different in kind or extent", under Cottage Savings (and thus were to constitute a taxable event under § 1001), § 1041 would shield A and B from the recognition of gain or loss on the transfer. Therefore, no gain or loss will be recognized by A on the transfer of his one-half unitrust interest in Trust to B, and B receives that interest with a carryover basis from A under § 1041(b). Similarly, no gain or loss will be recognized by B on the transfer of her one-half unitrust interest in Trust to A, and A receives that interest with a carryover basis from B under to § 1041(b).

The pro rata division or partition of an asset is a nontaxable event for purposes of §§ 61(a)(3) and 1001. For instance, 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 a partition. See Rev. Rul. 56-437, 1956-2 C.B. 507.

The division of the assets in Trust and the distribution of those assets to Trust A and Trust B will be equal in kind (i.e., pro rata). Accordingly, for purposes of §§ 61(a)(3) and 1001, no gain or loss will recognized by Trust, Trust A, or Trust B on the division of Trust into Trust A and Trust B.

Ruling 4

Section 1223(2) provides that, in determining the period for which the taxpayer has held property however acquired, there shall be included the period for which such property was held by any other person, if under chapter 1 of the Code such property has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in the taxpayer's hands as it would have in the hands of such other person.

Section 1015(a) provides, that if property was acquired by gift after December 31, 1920, the basis shall be the same as it would be in the hands of the donor or the last preceding owner by whom it was not acquired by gift, except that if such basis (adjusted for the period before the date of the gift as provided in § 1016) is greater than the fair market value of the property at the time of the gift, then for purposes of determining loss the basis shall be such fair market value.

Section 1015(b) provides that, if the property was acquired after December 31, 1920, by a transfer in trust (other than by 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 the transfer.

Based solely on the facts and representations submitted, we conclude that Trust A and Trust B will determine their basis in the assets by reference to the basis of the assets in the hands of Trust under § 1015(a) or (b), and the holding periods of the assets held by Trust A and Trust B will include the period for which the assets were held by Trust.

Ruling 5

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 were divorced pursuant to a judgment of dissolution on D2. A and B entered into a Memorandum of Understanding relative to their marital and property rights. The terms of the Memorandum of Understanding were included in Court 2's order dividing Trust into Trust A and Trust B. Accordingly, based on the facts submitted and representations made, we conclude that to the extent the division of Trust into Trust A and Trust B results in transfers of property between A and B, pursuant to the provisions of § 2516, the transfers will not be subject to gift tax.

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts of the transaction described above under any

other provision of the Code, in particular § 61. We express no opinion on whether Trust otherwise qualifies as a charitable remainder trust under § 664 or whether Trust A and Trust B each will otherwise qualify as charitable remainder trusts under § 664. Additionally, this ruling is contingent upon the finalization of the Marriage Settlement Agreement reflecting the terms described above.

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

Pursuant to a power of attorney on file with this office, a copy of this letter is being sent to Trust's authorized representative.

Sincerely,

Beverly Katz
Senior Technician Reviewer, Branch 2
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures: 2
Copy of this letter
Copy for § 6110 purposes