Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:ITA:B04
PLR-125724-06
Date:
November 16, 2006

LEGEND:

Husband	=
Wife	=
Corporation	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=
X	=
Y	=
Z	=
Court	=

Dear :

This responds to your joint request dated May 8, 2006, for a private letter ruling regarding §§ 1041 and 2512 of the Internal Revenue Code (Code). Specifically, you request whether § 1041 will apply to the proposed transfer by Husband to Wife of certain shares in Corporation and whether § 2512 will apply to the proposed transfer.

FACTS:

On Date 1, Husband and Wife executed a Separation and Property Settlement Agreement (First Agreement) providing for a division of property in settlement of their

marital and property rights. On Date 2, the First Agreement was approved by the Court, and Husband and Wife were granted a divorce on that date.

At the time of the divorce, Husband was President and Chief Executive Officer of Corporation, a publicly traded company, and he owned approximately 24% of the outstanding shares of Corporation. Paragraph 6(f) of the First Agreement obligates Husband to include in his Last Will and Testament a provision that, if Wife survives Husband, then Wife is to receive a certain number of shares of common stock in Corporation, determined on a formula described in Paragraph 6(f). Paragraph 6(f) provides an alternative bequest of cash or other property if Husband does not own any Corporation shares at his death.

Husband now wishes to eliminate the obligation regarding the transfer of Corporation stock at his death. On Date 3, he began negotiations with Wife regarding the transfer of Corporation stock during his lifetime. On Date 4, Husband and Wife executed a document entitled “Agreement in Partial Satisfaction of Contingent Claim” (Second Agreement). Under the Second Agreement, when the Second Agreement becomes effective, Husband will transfer to Wife 25% of the number of shares in Corporation that would be payable under Paragraph 6(f) of the First Agreement if Husband died on the effective date of the Second Agreement. In exchange, Wife agrees to release and extinguish one-half of her claim under Paragraph 6(f), such that, if she survives Husband, the number of Corporation shares that Husband’s estate would be obligated to pay Wife under Paragraph 6(f) would be reduced by one-half.

The Second Agreement is conditioned on receipt of a favorable ruling from the Internal Revenue Service on the rulings requested in this private letter ruling request. The Second Agreement provides that, in the event the Service issues a favorable ruling, the parties will submit the Second Agreement to the Court for approval to amend First Agreement.

Husband is currently age 72, and Wife is currently age 71. It has been represented that, on the date the Second Agreement was executed, Husband and Wife were in good health; that Husband and Wife have been negotiating at arm’s length in arriving at the terms of the Second Agreement; that each has been represented by independent legal counsel of his or her own selection; and that there is no agreement, express or implied, regarding how Wife will use the property transferred to her pursuant to the Second Agreement.

Husband and Wife request two rulings: (1) that the proposed transfer of Corporation stock will not result in taxable income or gain to either Husband or to Wife, and (2) that the proposed transfer of Corporation stock will not result in a taxable gift by either Husband or Wife.

LAW AND ANALYSIS:

Issue 1—Income Tax Consequences on Transfer of Corporation Stock

Section 1041(a) of the Code provides that no gain of loss is recognized on the 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.

Section 1041(b) of the Code provides that, in the case of any transfer of property described in § 1041(a), the property shall be treated as acquired by the transferee by gift, and the basis of the transferee in the property shall be the adjusted basis of the transferor.

Section 1041(c) of the Code provides that, for purposes of § 1041(a)(2), a transfer of property is incident to the divorce if the transfer: (1) occurs within 1 year after the date on which the marriage ceases, or (2) is related to the cessation of the marriage.

Q&A-7 of section 1.1041-1Tof the Temporary Income Tax Regulations provides that a 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) of the Code, and the transfer occurs not more than six years after the date the marriage ceases. The regulations provide that a divorce or separation instrument includes a modification or amendment to the decree or instrument. The regulations further provide that 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. The regulations allow a taxpayer to rebut the presumption 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.

Section 71(b)(2) of the Code provides that the term “divorce or separation instrument” means: (1) a decree of divorce or separate maintenance or a written instrument incident to such a decree, (2) a written separation agreement, or (3) a decree (not described in subparagraph (1)) requiring a spouse to make payments for the support or maintenance of the other spouse.

In the present case, it has been represented that the parties will elect to have the provisions § 1041 apply. Under the First Agreement, the parties originally contemplated that Husband would make a testamentary gift of Corporation stock, not an inter vivos gift of Corporation stock, to Wife. The facts submitted and the representations made indicate that the parties will modify the First Agreement to effectuate the transfer of property owned at the time of the cessation of the marriage with Court approval. Under the temporary regulations, a divorce or separation instrument includes a modification or amendment to such decree or instrument. Consequently, any order from the divorce court that modifies an original divorce or separation instrument must be considered

related to the cessation of the marriage, even if the order occurs years after the divorce. In addition, under the regulations, a transfer made to effect the division of property owned by the former spouses at the time of the cessation of the marriage is considered related to the cessation of the marriage.

Accordingly, based on facts of the case and the representation made, we conclude that the proposed transfer by Husband to Wife of Corporation stock owned by the parties at the time of the cessation of the marriage will qualify for non-recognition under § 1041 as a transfer of property incident to divorce. Thus, the proposed transfer of Corporation stock will not result in taxable income or gain to either Husband or to Wife.

Issue 2—Gift Tax Consequences of Transfer of Corporation Stock

Section 2511 of the Code 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) of the Code 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 exceeds the value of the consideration shall be deemed a gift.

Section 2516 of the Code provides 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 the agreement is entered into (whether or not the agreement is approved by the divorce decree), any transfers of property or interests in property made pursuant to the 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.

Prior to amendment by § 425(b) of the Deficit Reduction Act of 1984 (the "Act"), and effective before July 18, 1984, § 2516 of the Code provided that where a husband and wife enter into a written agreement relative to their marital and property rights and divorce occurs within two years thereafter (whether or not such agreement is approved by the divorce decree), any transfers of property or interests in property made pursuant to the 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. The Act expanded the application of § 2516 to include agreements entered into within one year after the divorce occurs.

Section 25.2516-1(a) of the Gift Tax Regulations 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.

Section 2053(a)(3) of the Code 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 moneys worth.

Section 2043(b)(1) of the Code provides a general rule that for estate tax purposes, the 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, effective in the case of estates of decedents dying after July 18, 1984, that for purposes of § 2053, a transfer of property that satisfies the requirements of § 2516(1) shall be considered to be made for an adequate consideration in money or money's worth. *See also* Rev. Rul. 60-160, 1960-1 C.B. 374, regarding the deduction of amounts paid pursuant to a property settlement agreement to which § 2516 does not apply.

In the present case, Husband and Wife executed the First Agreement relative to their marital and property rights on Date 1, and on Date 2, the Court issued the decree of divorce. Therefore, Husband's obligation to make the testamentary transfer under the Agreement is within the purview of § 2516 of the Code. Further, under § 2043(b)(2), the transfer of stock to be made to Wife at Husband's death pursuant to Paragraph 6(f) of the Settlement Agreement would be treated as made for adequate and full consideration in money or money's worth for purposes of § 2053(c)(1). Thus, if Husband were to die survived by Wife, the value of the stock subject to the transfer required under Paragraph 6(f) would be deductible under § 2053 as a claim against the estate for estate tax purposes.

As discussed above, under the terms of Second Agreement, Husband agrees to transfer currently to Wife 25% of the number of shares in Corporation that would otherwise be payable under Paragraph 6(f) if Husband died on the agreement effective date. In exchange, Wife is relinquishing her right to receive, on Husband’s death provided she is then living, one-half of the number of shares otherwise payable pursuant to Paragraph 6(f). As noted above, the payments to be made pursuant to Paragraph 6(f) of Settlement Agreement come within the purview of § 2516 and, therefore, would be treated as made for adequate and full consideration for gift and estate tax purposes.

Husband is aged 72 and Wife is aged 71, and it has been represented that both were in good health on the date the Second Agreement was executed; that the Second Agreement was the product of arm's length negotiation; and that both parties have been represented by counsel.

According, in view of the terms of the settlement and based on the facts submitted and representation made, we conclude that the proposed transaction will constitute transfers by Husband and Wife for adequate consideration that will not result in a taxable gift by either Husband or Wife. (*Compare* Rev. Rul. 79-118, 1979-1 C.B. 315, concluding, under the circumstances presented, that additional amounts paid pursuant to the donor's voluntary agreement to increase support payments made under a separation agreement constituted taxable gifts by the donor.)

The rulings contained in this letter are based upon information and representations submitted by the taxpayers 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.

CAVEATS:

A copy of this letter must be attached to any income tax return to which it is relevant. We enclose a copy of the letter for this purpose. Also enclosed is a copy of the letter ruling showing the deletions proposed to be made in the letter when it is disclosed under § 6110 of the Code.

Except as specifically ruled herein, we express or imply no opinion on the federal tax consequences of the transaction under the cited provisions or under any other provisions of the Code.

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

Sincerely,

DONNA WELCH
Senior Technician Reviewer, Branch 4
Office of Associate Chief Counsel
(Income Tax & Accounting)