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Department of the Treasury
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Legend:

Trust =

Trust A =

Trust B =

Charity =

Faculty =

Fund =

A =

B =

D1 =

D2 =

State =

Judgment =

Agreement =

a =

b =

c =

Dear

This letter responds to a letter dated November 21, 2006, submitted on behalf of Trust by Trust's authorized representatives, requesting rulings concerning the division of Trust into two separate trusts, Trust A and Trust B.

According to the information submitted, on D1, A established Trust, a charitable remainder unitrust, described in § 664(d)(2) of the Internal Revenue Code under the laws of State. Charity is one of the beneficiaries of the remainder interest and the trustee of Trust.

Trust provides for an amount equal to a percent of the net fair market value of the trust assets determined as of the first business day of such taxable year to be paid to A during A's lifetime and after A's death to his wife, B, during her surviving lifetime. Trust further provides that upon the death of the survivor of A and B, the trust shall terminate and (1) b percent of the trust property shall be distributed to Charity for its Faculty, to be added to Fund and (2) c percent shall be distributed to such one or more organizations described in §§ 170(b)(1)(A), 170(c), 2055(a) and 2522(a).

On D2, A and B divorced under Judgment, which incorporated Agreement, an agreement for division of assets and liabilities. By the terms of Judgment, Trust's assets were divided in equal shares to Trust A and Trust B, both of which were intended to qualify as charitable remainder unitrusts under § 664(d)(2). A is the initial non-charitable beneficiary of Trust A and B is the initial non-charitable beneficiary of Trust B. A is the successor non-charitable beneficiary of Trust B if he survives B, and B is the successor non-charitable beneficiary of Trust A if she survives A. Charity remains as the trustee of both Trust A and Trust B. The other terms did not change for Trust A and Trust B.

Ruling 1

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

Section 664(d)(2), as effective at the time Trust was created, provides that a charitable remainder unitrust is a trust (A) from which a fixed percentage (which is not less than 5 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) 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.

Therefore, based solely on the facts and the representations submitted, the division of Trust into Trust A and Trust B did 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 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 the present 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 the unitrust income of Trust. That is, B would have a right to that interest only if A is the first to die. After the division of Trust, B's interest became immediate and possessory to a percent unitrust amount determined by reference to the fifty percent of the assets of Trust deposited into Trust B. Consequently, because after the division of Trust, A’s interest has declined significantly and B's interest has increased significantly, A and B 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).

For purposes of subtitle A, the Income Taxes, § 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 the application of § 1041's nonrecognition treatment to the facts of this case. Here, prior to divorce, A received annual income from Trust equal to a percent unitrust amount. B did not receive anything. Pursuant to Agreement, which constituted a divorce instrument, Trust was partitioned and divided into two equal trusts, one for A and one for B. A and B respectively each receive income equal to a percent unitrust amount determined as of the first day of the year from the fifty percent of the assets deposited into their respective trusts (while both are alive). Consequently, A, in essence, transferred incident to divorce one-half of his former interest in Trust to Trust B. Consistent with the above legislative history, we conclude that § 1041 applied to the transfer.

Therefore, for purposes of the income tax, no gain or loss was recognized by A on the transfer of one-half of his unitrust interest in Trust. B received that interest as a gift with a carryover basis from A pursuant to § 1041(b). In addition, the pro rata division of Trust into Trust A and Trust B did not result in the recognition of gain or loss to Trust, Trust A, or Trust B for purposes of § 1001.

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 the purpose 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.

Therefore, based on the information provided and the representations made, Trust A and Trust B 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 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 year by an individual.

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 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.

In this case, A and B divorced on D2. Trust was divided and Trust A and Trust B were established pursuant to the terms of Agreement that was executed on D2, as part of the divorce proceeding. Accordingly, the division of Trust and the establishment of Trust A and Trust B, constituted a transfer for full and adequate consideration under § 2516. Therefore, the division did not result in a transfer subject to gift tax.

Rulings 6, 7, 8, and 9

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 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 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 1.507-3(d) provides that unless a private foundation voluntarily gives notice pursuant to § 507(a)(1), a transfer of assets described in § 507(b)(2) will not constitute a termination of the transferor's private foundation status under § 507(a)(1).

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

Section 1.507-3(c)(1) provides 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 2 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 3(a)(2)(i) provide 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)(9)(i) provides that if a private foundation transfers all of its net assets to one or more private foundations that are effectively controlled, directly or indirectly, by the same person or persons that effectively controlled the transferor foundation, such transferee private foundation shall be treated as if it were the transferor private foundation for purposes of §§ 4940 through 4948 and §§ 507 through 509.

Section 1.507-3(b) provides, in pertinent part, that a transfer of assets pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization or reorganization to an organization that is treated as described in § 501(c)(3) by virtue of § 4947 is not a taxable expenditure under § 4945(d).

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.

As a charitable remainder unitrust under § 664(d)(2), Trust was a split-interest trust described in § 4947(a)(2) and, therefore, treated generally as if it had been a private foundation. Although split interest trusts are not § 501(c)(3) organizations or § 4947(a)(1) private foundations that are exclusively charitable, they are subject to § 507 termination rules that are appropriate. Section 507(b)(2) was applicable to the division of Trust. The transfer of all of Trust's assets, under Agreement, to Trust A and Trust B qualified as transfers meeting the requirements of §§ 1.507-3(c)(1) and (c)(2)(ii). Since Trust transferred all of its assets to Trust A and Trust B, under § 1.507-1(b)(6), Trust did not terminate its private foundation status as described in § 507(a). Accordingly, under § 1.507-3(a)(1), the two unitrusts were not treated as newly created private foundations. Also, there was no imposition of an excise tax under § 507(c) since the transferor trusts had not given notice of the intent to terminate.

Section 4941 does not apply to the income interest of both beneficiaries under § 53.4947-1(c)(2). Thus, no self-dealing will occur to the two new trusts for distribution of the correct and appropriate unitrust amount to A and B, since such distributions are defined by statute as not to be acts of self-dealing.

A transfer of assets pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization or reorganization to an organization that is treated as described in § 501(c)(3) by virtue of § 4947 is not a taxable expenditure under § 4945(d).

Following § 53.4945-6(b)(2), legal and other expenses incurred by Trust in preparation of this ruling request, assuming such expenses were incurred in the good faith belief that they were reasonable and consistent with ordinary care and prudence, did not constitute taxable expenditures. Accordingly, no self-dealing transaction or taxable expenditure occurred within the meaning of §§ 4941 and 4945 respectively, to the extent that the expenses were reasonable and proportionate to Trust's tax risk.

Accordingly, the division of Trust did not result in a tax under § 507(c). The division of Trust was not an act of self-dealing under § 4941 with respect to Trust. Distributions of the unitrust amounts from Trust A to A (or B) and distributions of the unitrust amount from Trust B to B (or A), will not be acts of self-dealing by and with respect to each trust under § 4941, provided that the unitrust amounts distributed are the correct amounts required under the terms of the trust document. The transfer of assets per the division of Trust was not a taxable expenditure under § 4945 and consequently there was no obligation on Trust to exercise expenditure responsibility under §§ 4945(d) and (h). With respect to the legal fees and filing fees incurred in the preparation of this ruling request, payment of the trustee of Trust of a portion of such fees that reasonably represents the portion of this ruling request that was intended to protect the trustees of Trust, Trust A, and Trust B, was not an act of self-dealing under § 4941 and was not taxable expenditures under § 4945.

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 qualified as a charitable remainder trust under § 664 or whether Trust A and Trust B each otherwise qualify as charitable remainder trusts under § 664.

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 representatives.

Sincerely,

/s/

Audrey W. Ellis
Senior Counsel, Branch 1
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

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