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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
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Person To Contact:
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Refer Reply To:
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Date: May 6, 2008

Legend:

Trust =

Trust A =

Trust B =

Foundation =

Foundation A=

Foundation B=

A =

B =

D1 =

D2 =

State =

Judgment =

Agreement =

a =

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 pursuant to the laws of State. A and B were married at the time that Trust was created.

Trust provides for an amount equal to a percent of the net fair market value of the trust assets valued as of the first business day of such taxable year to be paid to A annually during A's lifetime and after A's death to B during her surviving lifetime. The life time unitrust interest of B will take effect following the death of A only if B furnishes the funds for payment of any federal estate taxes or state death taxes for which the trustee may be liable upon the death of A. Trust further provides that upon the death of the survivor of A and B, the trust shall terminate and its remaining principal shall be distributed to such one or more organizations described in §§ 170(c), 2055(a) and 2522(a) ("qualified charities") as A shall designate in writing during his lifetime and to the extent he does not effectively designate the distribution of all of the remaining trust principal, it shall be distributed to the trustees of Foundation, if it is a qualified charity under the terms of Trust, otherwise to one or more qualified charities as the trustee of Trust shall determine.

Prior to D2, A irrevocably designated charitable remainder beneficiaries. On D2, A and B divorced under Judgment, which incorporated Agreement, an agreement for the 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.

During his lifetime, A will possess and retain the sole power to designate the charitable remainder beneficiary or beneficiaries of Trust A. B is the successor non-charitable beneficiary of Trust A if she survives A and furnishes the funds for payment of any federal estate taxes and state death taxes for which the trustee may be liable upon the death of A. If the funds are not furnished by B by the due date for payment of such taxes, the unitrust period shall terminate on the death of A, notwithstanding any other provision in Trust A.

During her lifetime, B will possess and retain the sole power to designate the charitable remainder beneficiary or beneficiaries of Trust B. A is the successor non-charitable beneficiary of Trust B if he survives B and furnishes the funds for payment of any federal estate taxes and state death taxes for which the trustee may be liable upon the death of B. If the funds are not furnished by A by the due date for payment of such taxes, the unitrust period shall terminate on the death of B, notwithstanding any other provision in Trust B.

Upon the death of the survivor of A and B, the remainder of Trust A shall be distributed to satisfy 50 percent of the irrevocable designated charitable remainder distributions that A designated prior to the severance of Trust. The balance of the remainder of Trust A shall be distributed to one or more qualified charities as A shall designate. To the extent this power of appointment is not effectively exercised, the balance of the remainder of Trust A shall be distributed and paid over to the trustee or trustees of Foundation A, if it shall then be a qualified charity, or if it shall not be a qualified charity, to such one or more qualified charities and in such proportions as the trustees shall select in their sole discretion.

Upon the death of the survivor of A and B, the remainder of Trust B shall be distributed to satisfy 50 percent of the irrevocable designated charitable remainder distributions that A has so designated prior to the severance of Trust. The balance of the remainder of Trust B shall be distributed to one or more qualified charities as B shall designate. To the extent this power of appointment is not effectively exercised, the balance of the remainder of Trust B shall be distributed and paid over to the trustee or trustees of Foundation B, if it shall then be a qualified charity, or if it shall not be a qualified charity, to such one or more qualified charities and in such proportions as the trustees shall select in their sole discretion.

Ruling 1

Section 664(c) 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.

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 in enacting § 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).

With respect to 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 the nonrecognition treatment of § 1041 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.

Under § 1015(a), if property is acquired by gift, 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 is acquired 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 entered into Agreement on D2. In addition, A and B's divorce became final on D2 within the three year period beginning on the date one year before D2. Accordingly, under § 2516, the termination of Trust and the transfer of property interests in Trust to Trust A and Trust B pursuant to Agreement will be deemed to be transfers made for full and adequate consideration in money or money's worth and therefore, 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 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,

Audrey W. Ellis

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