Internal Revenue Service

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Date:
March 2, 2005

Trust =

Trust A =

Trust B =

A =

B =

C =

D =

E =

State =

Court =

D1 =

D2 =

Dear :

This letter responds to a letter dated August 31, 2004, and subsequent correspondence, 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, who are husband and wife, are the grantors, donors and unitrust beneficiaries of Trust. Trust was created pursuant to a Trust Agreement dated D1. The trustees of Trust are A, B, C, D, and E. Trust operates as a charitable remainder unitrust (CRUT) under § 664 of the Internal Revenue Code.

Article I of the Trust Agreement provides that Trust is intended to provide the donors during their joint lifetimes with an annual income interest equal to ten percent of the net fair market value of the trust assets for such taxable year as determined on the first business day of January of each year. This amount is to be paid in equal quarterly installments in equal shares at the end of each calendar quarter to the donors for the remainder of their lifetimes. The payments will be paid from Trust's income unless such income in a given year is insufficient, in which case the payments will be made from principal. Any income in excess of the annual payment is to be added to the Trust's principal. Upon the death of a donor, the trustees will thereafter pay and distribute the unitrust amount to the surviving donor in each taxable year of the Trust.

Article II provides that upon the death of the surviving donor, all remaining assets of Trust shall be paid and distributed to any one or more charitable organizations selected by the trustees, each of which is at the time of such payment and distribution an organization described in §§ 170(b)(1)(A), 170(c), 501(c)(3), 2055(a) and 2522(a) in such amounts and proportions as the trustees shall determine in the sole discretion of the trustees. Notwithstanding this provision, the donors or the surviving donor reserve the power, exercisable by written instrument to select such charitable organization or organizations which shall be the recipients of any distribution under Article II in such amounts and in such proportions as the donors, or surviving donor, shall determine, provided that such organizations must be described in the above Code sections.

Article VII provides that no estate, inheritance or other death taxes with respect to Trust shall be allocated to or recoverable from Trust, and the donors agree not to make any inconsistent directions in their wills. Article IV provides that Trust is irrevocable. Article VIII provides that Trust is subject to State law.

For a variety of reasons, A and B have proposed a division of Trust into two separate CRUTs: Trust A and Trust B, one for each donor. Trust's assets will be divided equally and on a pro rata basis betweens Trust A and Trust B.

Trust A and Trust B will be identical to Trust in all terms other than: (1) A will be the only non-charitable beneficiary of Trust A and B will be the only non-charitable beneficiary of Trust B; (2) Each spouse retains a survivorship interest in the other's unitrust's annual payout; (3) The surviving spouse cannot appoint or change the charitable remainder beneficiaries of the other spouse's new trust. This designation will have been determined by the deceased donor or in the absence of such donor designation, by the trustees for his or her new trust; (4) Trust, Trust A, and Trust B will have the same trustees, except that A and E will not be trustees of Trust B, and B and D will not be trustees of Trust A; and (5) Trust A and Trust B will incorporate certain additional mandated administrative provisions contained in the Income Tax Regulations issued after creation of Trust that must be included so that Trust A and Trust B will qualify as charitable remainder trusts.

On D2, Court of State tentatively approved the division of Trust into Trust A and Trust B as described above. The final dissolution of Trust and its division into Trust A and Trust B is contingent upon receiving a favorable ruling letter from the Service.

LAW AND ANALYSIS

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.

Rulings 2

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) 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.

In the present case, prior to the division of Trust, the two spouses together received annual income from Trust equal to a 10 percent unitrust amount. Following the division, Trust will be partitioned and divided into two equal trusts, one for A and one for B. Each new trust will have 50 percent of the assets of Trust. A and B will each receive income equal to a 10 percent unitrust amount determined from only the 50 percent of the assets deposited into his or her respective new trust. Consequently, A in essence is transferring one-half of A's former interest in Trust to B and B is transferring one-half of B's former interest in Trust to A. Even if this change in their respective rights to the full

amount of the unitrust income from Trust, and the other changes in rights listed in the facts (e.g., each spouse is giving up his or her right to name the ultimate charitable beneficiary of the other spouse's new trust), were to constitute a material change in legal entitlements for purposes of Cottage Savings and § 1001, we conclude that § 1041 applies to the transfer. Therefore, for purposes of the income tax, no gain or loss will be recognized by A on the transfer of one-half of A's unitrust interest in Trust to B, and B receives that interest as a gift with a carryover basis from A under § 1041(b). Similarly, no gain or loss will be recognized by B on the transfer of one-half of B's unitrust interest in Trust to A, and A receives that interest as a gift with a carryover basis from B under to § 1041(b).

Ruling 3 through 6

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 an excise tax on any private foundation which voluntarily terminates its private foundation status under § 507(a)(1).

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 tranferor's private foundation status under § 507(a)(1).

Section 1.507-3(c)(1) provides, in pertinent part, that as used in § 507(b)(2), the term "other adjustment, organization or reorganization" includes any partial liquidation or any other significant disposition of assets to one or more private foundations, other than transfers for full and adequate consideration or distributions out of current income.

Section 1.507-3(c)(2)(ii) provides that the term "significant disposition of assets" means the transfer of 25% 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.

Section 1.507-3(a)(3) provides, in general, that in the event of a transfer of assets described in § 507(b)(2), any person who is a substantial contributor (within the meaning of § 507(d)(2)) with respect the transferor foundation shall be treated as a substantial contributor with respect to the transferee foundation.

Section 1.507-1(b)(6) provides that if a private foundation transfers all or part of its asset 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(a)(9)(i) provides that if a private foundation transfers all of its net assets to one or more private foundations which are effectively controlled, directly or indirectly, by the same person or persons which effectively controlled the transferor private foundation, such a 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 liquidations, merger, redemption, recapitalization, or other adjustment, organization or reorganization to an organization that is described in § 4947 is a not a taxable expenditure under § 4945(d).

Section 4941(a)(1) imposes an excise tax on each act of self-dealing between a disqualified person and a private foundation.

Section 4945 imposes an excise tax on a private foundation's making of any 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 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 53.4947-1(c)(1)(ii) provides that a split-interest trust is subject to the provisions of § 507 (except as provided in §§ 53.4947-1(e)), 508(e) (to the extent applicable to a split-interest trust), 4941, 4943 (except as provided in § 4947(b)(3)), 4944 (except as provided in § 4947(b)(3)), and 4945 in the same manner as if such trust were a private foundation.

Section 53.4947-1(c)(2)(i) provides, in general, 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 split-interest trust, Trust is treated as if it were a private foundation. Thus, except as provided in § 53.4947-1(c)(2)(i), it is subject to §§ 507, 4941 and 4945.

The proposed transfers of all of Trust's assets to Trust A and Trust B will constitute a significant dispositions of Trust's assets. The proposed transfers will not be for full and adequate consideration and will not be distributions out of current income. Thus, the proposed transfers will be § 507(b)(2) transfers.

A transfer of assets described in § 507(b)(2) does not constitute a termination of the transferor's private foundation status under § 507(a)(1) unless the transferor voluntarily gives notice pursuant to § 507(a)(1). Since Trust has not given notice of its intent to terminate, it will retain its private foundation status and the tax imposed by § 507(c) will not apply.

Since Trust A and Trust B will be treated as if they were Trust for purposes of § 4941, transfers between the Trust and Trust A and Trust B will not be acts of self-dealing.

Assuming no deduction was allowed, payments to the unitrust beneficiaries named will not be acts of self-dealing under § 4941. See § 53.4947-1(c)(2)(i).

A transfer of assets pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization or reorganization to an organization that is described in § 4947 is not a taxable expenditure under § 4945(d). Accordingly, Trust's proposed transfer of all of its assets to Trust A and Trust B will not be a taxable expenditure.

Section 53.4945-6(b)(2) 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. Trust represents that the fees related to the proposed transfer of assets will be reasonable and will be consistent with ordinary business care and prudence. Thus, the payment of the fees will not be a taxable expenditure.

CONCLUSIONS

Based solely on the representations made and the information submitted, we have reached the following conclusions:

1. The division of Trust into Trust A and Trust B will not cause either Trust, Trust A or Trust B to fail to qualify as charitable remainder trusts under ' 664.

2. The partition of Trust into Trust A and Trust B will not cause gain or loss to be recognized by A or B under § 1001.

3. The proposed transfers of assets will not terminate the Trust's status as a private foundation or result in the imposition of taxes under § 507.

4. The proposed transfers of the Trust's assets will not result in self-dealing under § 4941.

5. The proposed transfers of the Trust's assets will not be a taxable expenditure under § 4945.

6. If reasonable in amount, payment of the legal and other expenditures incurred to effect the proposed transfer of the Trust's assets will not constitute a taxable expenditure 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 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.

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