

Internal Revenue Service

Department of the Treasury

Index Number: 664.03-02

Washington, DC 20224

Number: **200035014**

Release Date: 9/1/2000

Person to Contact:

Telephone Number:

Refer Reply To:

CC:DOM:P&SI:2-PLR-118676-99

Date:

May 26, 2000

Trust =

Unitrust 1 =

Unitrust 2 =

A =

B =

Charity =

Court =

Dear :

This letter responds to a November 19, 1999 request and subsequent correspondence submitted by the authorized representatives of Trust concerning the federal tax consequences of a proposed division of Trust.

The information submitted states that A and B established Trust on December 14, 1993. Trust was intended to be a charitable remainder unitrust within the meaning of § 664(d)(2) of the Internal Revenue Code. A and B are co-trustees and were husband and wife when Trust was established. A and B have recently been involved in marital dissolution proceedings. In connection with the marital dissolution proceedings, a Stipulation, Consent, and Order was entered by Court which authorized the trustees to divide Trust into two separate and distinct unitrusts.

Paragraph 2.2 of Trust provides for annual unitrust payments to be made in equal proportions to A and B during their joint lifetimes, and, after the death of either of them, wholly to the survivor during his or her lifetime. The unitrust payment equals the smaller of (i) the trust income for the taxable year, and (ii) a fixed percentage amount equal to 15 percent of the net

fair market value of the trust assets as of the first business day of the first calendar month of the taxable year.

Paragraph 2.3 of Trust provides that any income for any taxable year in excess of the fixed percentage amount for such year shall be paid to the recipients to the extent that the aggregate of the yearly amounts paid in prior years to such person or persons was less than the aggregate of the fixed percentage amounts computed on the valuation dates. Any income of the trust for a taxable year shall be added to principal to the extent such income exceeds the sum of the fixed percentage amount for such year and any deficiency payable.

Paragraph 3.1 of Trust provides that upon the death of the last surviving unitrust recipient, all of the principal and income of the trust (other than any amount due to the last surviving recipient) must be distributed to Charity.

A and B now propose to divide Trust into two separate charitable remainder trusts each of which is intended to be a charitable remainder unitrust within the meaning of § 664(d)(2): Unitrust 1 and Unitrust 2. A will be the sole trustee of Unitrust 1 and B will be the sole trustee of Unitrust 2. Pursuant to the proposed division of Trust into two separate trusts, the trustees have agreed to an equitable allocation and division, on a pro rata basis, of the assets of Trust between the two separate and distinct trusts, with all of the other original terms of Trust to remain the same. Each of the new unitrusts will be allocated one-half of the assets of Trust.

In addition, since Trust was established, there are accumulated amounts in Trust representing the unpaid increment between the aggregate of the income actually paid in prior years and the aggregate amount determined by applying the fixed percentage to the value of Trust's assets each year. As part of the proposed division of Trust, the trustees have agreed to, and will request court approval to, equally allocate the make-up deficiency amount fifty percent to Unitrust 1 and fifty percent to Unitrust 2. This equitable allocation will allow each separate unitrust to have a make-up deficiency reserve for future payments of trust income.

Section 2.2 of Unitrust 1 provides that in each taxable year of the trust, the Trustee shall pay the unitrust amount to A during A's lifetime, and, after A's death, to B. Section 2.2 of Unitrust 2 provides that in each taxable year of the trust, the Trustee shall pay the unitrust amount to B during B's lifetime,

and, after B's death, to A. Both Unitrust 1 and Unitrust 2 will terminate upon the death of the last-surviving noncharitable recipient.

You have requested the following rulings:

1. That the proposed division of Trust into two separate and distinct unitrusts each of which is intended to comply with the requirements under § 664 of the Code, will not cause either trust to fail to qualify as a charitable remainder unitrust under § 664.
2. That the proposed division of Trust will not cause Trust, Unitrust 1, Unitrust 2, or the trustees to realize income or gain for federal income tax purposes, or have any other adverse federal income tax consequences.
3. That the equitable allocation between Unitrust 1 and Unitrust 2 of the aggregate of the make-up deficiency amounts that have accumulated will not cause the loss of any of the make-up deficiency amounts accumulated to date, or have any adverse federal income tax consequences for Trust, Unitrust 1, Unitrust 2, or the trustees.

Issue #1

Based upon the information provided and the representations made, we conclude that the division of Trust into two separate trusts will not cause either Trust or the resulting two trusts to fail to qualify as charitable remainder trusts under § 664 of the Code.

Issues #2 and 3

Section 61(a)(3) of the Code provides that gross income includes gains derived from dealings in property.

Section 1001(a) of the Code provides that the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in § 1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

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.

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 thereof. Thus, neither gain nor loss is realized on a partition. See Rev. Rul. 56-437, 1956-2 C.B. 507.

In Rev. Rul. 69-486, 1969-2 C.B. 159, distinguished by Rev. Rul. 83-61, 1983-1 C.B. 78, a non-pro rata distribution of trust property was made in kind by the trustee, although the trust instrument and local law did not convey authority to the trustee to make a non-pro rata distribution of property in kind. The distribution was effected as a result of a mutual agreement between the trustee and the beneficiaries. Because neither the trust instrument nor local law conveyed authority to the trustee to make a non-pro rata distribution, Rev. Rul. 69-486 held that the transaction was equivalent to a pro rata distribution followed by an exchange between the beneficiaries and was subject to the provisions of § 1001 and § 1002 of the Code.

The present case is distinguishable from Rev. Rul. 69-486 because it has been represented that the assets of Trust will be allocated among the two new unitrusts on a pro rata basis and each new unitrust will receive an equal share of the assets of Trust. Accordingly, the proposed transaction will not be treated as a pro rata distribution followed by an exchange of assets among the beneficiaries of Trust.

Cottage Savings Ass'n v. Commissioner, 499 U.S. 554 (1991), concerns the issue of when a sale or exchange has taken place that results in realization of gain or loss under § 1001 of the Code. In Cottage Savings, a financial institution exchanged its interests in one group of residential mortgage loans for another lender's interests in a different group of residential mortgage loans. The two groups of mortgages were considered "substantially identical" by the agency that regulated the financial institution.

The Supreme Court in Cottage Savings, 499 U.S. at 560-61, concluded that § 1.1001-1 of the regulations reasonably interprets § 1001(a) and stated that an exchange of property

gives rise to a realization event under § 1001(a) if the properties exchanged are "materially different."

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. Cottage Savings, 499 U.S. at 564-65. In Cottage Savings, 499 U.S. at 566, 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.

It is consistent with the Supreme Court's opinion in Cottage Savings to find that the interests of the beneficiaries of the two new unitrusts will not differ materially from their interests in Trust. The proposed transaction will not change the interests of the beneficiaries. Instead, the beneficiaries will be entitled to the same benefits after the proposed transaction as before. The proposed transaction is similar to the kinds of transactions discussed in Rev. Rul. 56-437, since Trust is to be partitioned, but all other provisions of Trust will remain unchanged. Further, the assets of Trust will be distributed among the two new unitrusts in proportions that are consistent with the share of the income of Trust to which each beneficiary is entitled under Trust. Under Trust, the income is to be paid in equal proportions to the two income beneficiaries, and each new unitrust will receive an equal share of the assets of Trust. Also the remainder beneficiary will receive the remainder on the same terms as under Trust. Thus, the proposed transaction will not result in a material difference in the kind or extent of the legal entitlements enjoyed by the beneficiaries.

The fact that under Trust, both income beneficiaries are trustees and under the new unitrusts, the sole income beneficiary will be the only trustee is not a material difference for purposes of § 1001 or Cottage Savings. This will be a change in the way that the new unitrusts are administered and will not otherwise change the legal entitlements of any beneficiary. During the term of the two new unitrusts, the amount that will be paid to the income beneficiaries will be controlled by the terms of the trust documents.

Therefore, the proposed division of Trust into two separate and distinct unitrusts, each of which is intended to comply with the requirements under § 664 of the Code, will not cause Trust,

the two new separate unitrusts, or the trustees to realize income or gain for federal income tax purposes under § 61(a)(3) or § 1001.

It is also consistent with the Supreme Court's decision in Cottage Savings to find that the equitable allocation of any make-up deficiency amounts that have accumulated in Trust will not cause the beneficiaries of Trust to have materially different interests in the two new unitrusts. Under Trust, at the time of the proposed partition, both income beneficiaries will be entitled to benefit equally from any make-up deficiency amounts that have accumulated. Upon the division of Trust, the accumulated make-up deficiency amounts will be divided equally between the two new unitrusts.

Therefore, the equitable allocation between the two new separate unitrusts of the aggregate of the make-up deficiency amounts that have accumulated in Trust will not cause the loss of any of such make-up deficiency amounts and will not cause Trust, the two new separate unitrusts, or the trustees to realize income or gain for federal income tax purposes under § 61(a)(3) or § 1001.

Except as specifically ruled on above, we express no opinion as to the federal tax consequences of the transaction described above. In particular we express no opinion on whether Trust, Unitrust 1, or Unitrust 2 is or will be a CRUT within the meaning of § 664(d)(2).

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent. Pursuant to the powers of attorney on file a copy of this letter will be sent to B and Trust's authorized representatives.

Sincerely,
H. GRACE KIM
Assistant to the Chief ,Branch 2
Office of the Assistant Chief Counsel
(Passthroughs and Special Industries)

Enclosures: (2)

Copy of this letter

Copy for § 6110 purposes