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Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:ITA:4 – PLR-143891-01

Date:

February 15, 2002

LEGEND:

A =

B =

v =

w =

y =

Year 1 =

Year 2 =

Company =

Court =

Dear

This letter responds to your request for a letter ruling, on behalf of A and B, regarding the change in title of B's stock certificates. You request rulings that (1) no gain or loss will be recognized to A or B as a result of the change in title, and (2) the change in title does not constitute a gift for gift tax purposes.

FACTS

As a result of marital difficulties, A and B divorced. A divorce decree ("order") was issued by the Court in Year 1. The order resolved all legal issues arising from the marital relationship, including apportionment of the marital property.

At the time of the divorce proceeding, A's and B's marital assets included y shares of Company, a closely held business. The shares were titled in A's name. Under state

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law, however, the shares of Company, regardless of how title is held, constitute marital property subject to division between the parties.

In order to equalize the marital property, the order allocated v percent of the shares to A and w percent of the shares to B. B's w percent interest in Company, combined with other assets she received, gave her one-half of the marital estate. Although the stock certificates for B's w percent interest in Company were never titled in her name, the order stated that the "true ownership" of that interest is "apportioned" to her. A and B represent that the record ownership of the w percent interest was left in A's name to protect the value of the stock, encourage investment in Company, and enhance the future marketability of the stock. Further, it is represented that A and B did not enter into a written agreement relative to their marital property rights prior to Year 1, the year of the divorce.

In Year 2, B filed a lawsuit asking the Court to direct that the w percent interest in Company be titled in her name. As a result of mediation of the issues raised in the lawsuit, the parties submitted this request for a private letter ruling.

LAW AND ANALYSIS

Section 1041(a) of the Internal Revenue Code provides that no gain or loss shall be recognized on a 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) provides that in the case of any § 1041(a) transfer of property, (1) for purposes of subtitle A, the property shall be treated as acquired by the transferee by gift, and (2) the basis of the transferee in the property shall be the adjusted basis of the transferor.

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

Section 1.1041-1T(b), Q&A-7, of 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), and the transfer occurs not more than 6 years after the date on which the marriage ceases. A divorce or separation instrument includes a modification or amendment to such decree or instrument. Any transfer not pursuant to a divorce or separation instrument and any transfer occurring more than 6 years after the cessation of the marriage is presumed to be not related to the cessation of the marriage. This presumption may be rebutted only 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. For example, the presumption may be rebutted by showing that (a) the transfer was not made within the one- and six-year periods described above because of factors which hampered an earlier transfer of the property, such as legal or business impediments to transfer or disputes concerning the value of the property owned at the time of the cessation of the marriage, and (b) the transfer is effected promptly after the impediment to transfer is removed.

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

In the present case, B has sought an order from the Court directing that B’s w percent interest in Company be titled in her name. If granted, the change in title will represent a transfer pursuant to a “divorce or separation instrument” within the meaning of §71(b)(2).

The transfer, however, will not be made before the expiration of 6 years from the date the marriage ended. Thus, under § 1.1041-1T(b), Q&A-7 of the temporary regulations, there is a rebuttable presumption that the transfer is not related to the cessation of the marriage. Notwithstanding the presumption, it is our position that the transfer in title of the shares of Company is related to the cessation of the marriage of A and B.

First, it is clear that the transfer of Company stock from A to B is being made to effect the division of property owned by A and B at the time of the divorce. The Company stock was marital property owned by A and B at divorce, and the order issued by the Court at the time of the divorce allocated w percent of the shares to B. A and B have simply chosen to delay the transfer of title of such shares for more than six years after the cessation of the marriage. Second, A and B have represented that there are compelling business reasons concerning why the transfer will occur more than 6 years from the date the marriage ended. These reasons include maintaining investor confidence in Company, enhancing the marketability of the stock, and facilitating future growth. Thus, valid business reasons exist to explain the delay in the transfer. Accordingly, the transfer is related to the cessation of the marriage under § 1041(c)(2) even if it occurs more than six years after the cessation of A’s and B’s marriage.

With respect to the issue relating to the applicability of the gift tax provisions, § 2501(a) imposes a tax for each calendar year on the transfer of property by gift during the calendar year by an individual.

Section 2511(a) provides that the gift tax applies 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, then the amount by which the value of the property exceeded the value of the consideration shall be deemed a gift.

Under § 25.2511-2(b) of the Gift Tax Regulations, as to any property, or part thereof or interest therein, of which the donor has so parted with dominion and control as to leave in him no power to change its disposition, whether for his own benefit or the benefit of another, the gift is complete. But if upon a transfer of property (whether in trust or otherwise) the donor reserves any power over its disposition, the gift may be wholly incomplete, or may be partially complete and partially incomplete, depending upon all

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the facts in the particular case. Accordingly, if a transfer of property is subject to a reserved power, the terms of the power must be examined and its scope determined.

Section 25.2511-2(c) provides that a gift is incomplete in every instance in which the donor reserves the power to revest the beneficial title to the property to himself.

Section 2516 provides that where a husband and wife enter into a written agreement relative to their marital 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 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 the present case, it is represented that A and B did not enter into a written agreement relative to their marital property rights prior to Year 1, the year A and B were divorced. The determination of A's and B's respective marital property rights were delineated in the Court's order. Under the order, the Court directed that the parties divide the y shares of Company so that the stock remains titled in the name of A, but the true ownership is apportioned between the parties v% to A and w% to B. B is to be treated as and considered a shareholder and is to receive her proportionate share of any dividends, stock splits, or other matters affecting the structure and/or value of the stock. The parties are to share in the proceeds/benefits/consideration resulting from the sale of the stock in the same percentages as they hold ownership. A is not permitted to sell, pledge, or otherwise transfer, directly or indirectly, any stock that he owns in Company without prior written consent of B.

The order irrevocably assigned w% of Company stock to B in Year 2. A cannot revoke the order and revest B's interest in the w% to himself. In addition, he is required to take all necessary steps to protect B's interest. Although legal title of the stock has remained on the books of Company in the name of A since the time of the order, B has received all the benefits of any sales of the stock as well as other economic benefits such as appreciation in the stock's value (no dividends have been paid on the stock).

Under § 2516, where a husband and wife enter into a written agreement relative to their marital property rights and divorce occurs within the 3-year period beginning on the date which is one year before the agreement is entered into, any transfers of property interests made pursuant to such agreement to either spouse, in settlement of his or her marital rights, is deemed to be a transfer made for a full and adequate consideration in money or money's worth. Based upon the requirements of § 2516, we conclude that the transfer of w% of the y shares to B is a transfer made for adequate consideration in money or money's worth within the meaning of § 2516. Accordingly, the proposed change in title of Company stock from A's name to B's name will not result in the application of the federal gift tax under § 2501 of the Internal Revenue Code.

HOLDINGS:

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(1) The transfer of title to be made between A and B pursuant to the order and the amended order will qualify for nonrecognition of gain under § 1041.

(2) The proposed change in title of B's w% of Company stock from A's name to B's name will not result in the application of the federal gift tax under § 2501.

CAVEATS

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any item discussed or referenced in this letter. 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 Internal Revenue Code.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the power of attorney on file, we are sending a copy of this letter to both of the taxpayers.

Sincerely,
Stephen J. Toomey
Assistant to Branch Chief, Branch 4
Office of Associate Chief Counsel
(Income Tax & Accounting)

cc: