



## Charitable Remainder Trusts Can Be Divided Upon Divorce Without Risks Of Self-Dealing Or A Termination Tax

By: Brad Dewan, Esq.



When divorces occur a division of the assets takes place. But what happens when the spouses each have rights to payments from a charitable remainder unitrust? The divorcing spouses would likely want to “split” the CRT (and its assets) in half so that each spouse could receive payments from his or her own CRT and have the sole right to select the charitable organization to receive the payments upon his or her death. A recent private letter ruling, PLR 200824022, immediately followed by Revenue Ruling 2008-41, demonstrates that such a division of an existing CRT can be done without unfavorable tax consequences. In addition, these rulings are instructive since they point out the rules affecting private foundations that also apply to charitable remainder trusts.

The Revenue Ruling presented two situations.

In Situation 1, either a charitable remainder annuity trust (CRAT) or a charitable remainder unitrust (CRUT) was assumed to exist (the “Trust”). The Trust had two or more individual beneficiaries (“recipients”) with equal shares of the annuity or unitrust distributions.

The share of a recipient who died would be split equally between or among the surviving recipients. The last surviving recipient would have rights to the entire annuity or unitrust payouts. The assets of the Trust would be paid to a charitable organization described in IRC section 170(c) upon the death of the surviving recipient. A state court then approves a pro rata division of the Trust assets among separate but equal trusts and each new separate trust qualifies as the same CRAT or CRUT as the Trust. Importantly each asset of the Trust is equally divided among the separate trusts. Each new separate trust has the same governing provisions as the Trust but there are significant differences. First, each separate trust has only one recipient (i.e. non-charitable beneficiary).

Second, each separate trust is administered and invested independently by its own independent trustee. Third, and very interestingly, upon the death of a recipient, the assets of that respective separate trust, instead of going to a charity, is split equally and distributed to the remaining separate

trust(s), resulting in an increase in the distributions to the surviving recipient of each respective separate trust. Only upon the death of the last surviving recipient are the assets distributed to the remainder beneficiary, the charity (“Charity”). This Charity (whether one or more) is the same for the Trust and each of the separate trusts. Thus a recipient of a separate trust does not have the right to change the remainder charity. Each recipient is to receive the same annuity or unitrust amount that was to be distributed to that recipient by the Trust. In essence then, “the recipients and the remainder beneficiaries are entitled to the same benefits after the division of the Trust as before.” Finally, but importantly, all costs associated with this division of the Trust, and the creation and funding of the separate trusts, will be paid by the recipients only. The trustee(s) will pay none of these costs.

In Situation 2, the facts are the same as in Situation 1 except the Trust has only two recipients, a married couple, who are obtaining a divorce. In addition, upon the death of a recipient, the assets of that recipient’s separate trust will be distributed to the remainder beneficiary as is typical. But similar to Situation 1, each recipient (spouse) will receive the same annuity or unitrust amount as would have been received under the Trust. However, any “survivorship rights” that may have existed with the Trust are relinquished upon the division into separate trusts.

These facts differ in a couple of interesting ways from the facts in the PLR. First, the PLR only dealt with the split of the CRT upon the divorce of Husband and Wife. Second, under the CRT in the PLR, the Husband was the sole current beneficiary and the Wife’s rights arose only upon the death of the Husband. Third, each spouse retained a survivorship interest in the other’s unitrust amount from the separate trust. Fourth, each spouse could name and then change the remainder beneficiary of his or her own separate trust but could not change the remainder beneficiary of the other spouse’s separate trust. Finally, the trustee of Trust paid a portion of the legal fees and filing fees incurred with respect to the PLR.

The Ruling addressed several issues but because of space limitations only a few are discussed.

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The first issue asked if the division of the Trust would result in the separate trusts failing to qualify under IRC section 664(d). The conclusion was no since each asset was going to be divided on a pro rata basis among the separate trusts; each separate trust would have the same governing provisions, same recipients and same charitable beneficiaries.

Another issue asked was whether the creation of the separate trusts by a pro rata division of the Trust results in a termination under Section 507(a)(1) of the trust status of the Trust as a trust described in the private foundation provisions of Section 4947(a)(2) and thus generate the imposition of an excise tax under Section 507(c)? The answer was no because the IRS determined that the transfer of assets from the Trust to the separate trusts constituted a “significant disposition of assets” as defined in the regulations under Section 507 and such transfer did not satisfy the requirements for a “termination” under Section 507(a). The next issue discussed was whether the division of the original CRT into separate trusts constituted an act of self-dealing under Section 4941? In determining that no act of self-dealing would occur, the IRS noted that since the assets of the CRT were being equally divided among the separate trusts, no possible disqualified person would receive a disproportionate interest in the trust assets; and no self dealing transaction actually would occur since such a transaction is comprised of a sale or exchange of assets between the subject organization and a disqualified person and the proposed division was not such a “sale or exchange.” The IRS also stressed that the remainder interests of the named charities would not be diminished by the division.

The last issue to be mentioned was whether the division of the CRT constituted a “taxable expenditure” under Section 4945. In ruling in the negative, the Ruling again pointed to Section 507(b)(2) and related regulations which state that certain transactions like a merger, redemption or other reorganization involving another organization treated as a private foundation under Section 4947 are not “taxable expenditures” under Section 4945(d).

In summary, this Ruling presents an interesting solution to a likely intractable problem when the noncharitable beneficiaries wish to separate. Also, it highlights how CRTs are subject to the private foundation rules as a result of Section 4947(a)(2).

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