

§ 1.1041-1T Treatment of transfer of property between spouses or incident to divorce (temporary).

Q-1: How is the transfer of property between spouses treated under section 1041?

A-1: Generally, no gain or loss is recognized on a transfer of property from an individual to (or in trust for the benefit of) a spouse or, if the transfer is incident to a divorce, a former spouse. The following questions and answers describe more fully the scope, tax consequences and other rules which apply to transfers of property under section 1041.

(a) *Scope of section 1041 in general.*

Q-2: Does section 1041 apply only to transfers of property incident to divorce?

A-2: No. Section 1041 is not limited to transfers of property incident to divorce. Section 1041 applies to any transfer of property between spouses regardless of whether the transfer is a gift or is a sale or exchange between spouses acting at arm's length (including a transfer in exchange for the relinquishment of property or marital rights or an exchange otherwise governed by another nonrecognition provision of the Code). A divorce or legal separation need not be contemplated between the spouses at the time of the transfer nor must a divorce or legal separation ever occur.

Example 1. A and B are married and file a joint return. A is the sole owner of a condominium unit. A sale or gift of the condominium from A to B is a transfer which is subject to the rules of section 1041.

Example 2. A and B are married and file separate returns. A is the owner of an independent sole proprietorship, X Company. In the ordinary course of business, X Company makes a sale of property to B. This sale is a transfer of property between spouses and is subject to the rules of section 1041.

Example 3. Assume the same facts as in example (2), except that X Company is a corporation wholly owned by A. This sale is not a sale between spouses subject to the rules of section 1041. However, in appropriate circumstances, general tax principles, including the step-transaction doctrine, may be applicable in recharacterizing the transaction.

Q-3: Do the rules of section 1041 apply to a transfer between spouses if the transferee spouse is a nonresident alien?

A-3: No. Gain or loss (if any) is recognized (assuming no other nonrecognition provision applies) at the time of a transfer of property if the property is transferred to a spouse who is a nonresident alien.

Q-4: What kinds of transfers are governed by section 1041?

A-4: Only transfers of property (whether real or personal, tangible or intangible) are governed by section 1041. Transfers of services are not subject to the rules of section 1041.

Q-5: Must the property transferred to a former spouse have been owned by the transferor spouse during the marriage?

A-5: No. A transfer of property acquired after the marriage ceases may be governed by section 1041.

(b) *Transfer incident to the divorce.*

Q-6: When is a transfer of property incident to the divorce?

A-6: A transfer of property is *incident to the divorce* in either of the following 2 circumstances—

(1) The transfer occurs not more than one year after the date on which the marriage ceases, or

(2) The transfer is related to the cessation of the marriage.

Thus, a transfer of property occurring not more than one year after the date on which the marriage ceases need not be related to the cessation of the marriage to qualify for section 1041 treatment. (See A-7 for transfers occurring more than one year after the cessation of the marriage.)

Q-7: When is a transfer of property related to the cessation of the marriage?

A-7: 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 section 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.

Q-8: Do annulments and the cessations of marriages that are void *ab initio* due to violations of state law constitute divorces for purposes of section 1041?

A-8: Yes.

(c) *Transfers on behalf of a spouse.*

Q-9: May transfers of property to third parties on behalf of a spouse (or former spouse) qualify under section 1041?

A-9: Yes. There are three situations in which a transfer of property to a third party on behalf of a spouse (or former spouse) will qualify under section 1041, provided all other requirements of the section are satisfied. The first situation is where the transfer to the third party is required by a divorce or separation instrument. The second situation is where the transfer to the third party is pursuant to the written request of the other spouse (or former spouse). The third situation is where the transferor receives from the other spouse (or former spouse) a written consent or ratification of the transfer to the third party. Such consent or ratification must state that the parties intend the transfer to be treated as a transfer to the nontransferring spouse (or former spouse) subject to the rules of section 1041 and must be received by the transferor prior to the date of filing of the transferor's first return of tax for the taxable year in which the transfer was made. In the three situations described above, the transfer of property will be treated as made directly to the nontransferring spouse (or former spouse) and the nontransferring spouse will be treated as immediately transferring the property to the third party. The deemed transfer from

the nontransferring spouse (or former spouse) to the third party is not a transaction that qualifies for nonrecognition of gain under section 1041.

(d) *Tax consequences of transfers subject to section 1041.*

Q-10: How is the transferor of property under section 1041 treated for income tax purposes?

A-10: The transferor of property under section 1041 recognizes no gain or loss on the transfer even if the transfer was in exchange for the release of marital rights or other consideration. This rule applies regardless of whether the transfer is of property separately owned by the transferor or is a division (equal or unequal) of community property. Thus, the result under section 1041 differs from the result in *United States v. Davis*, 370 U.S. 65 (1962).

Q-11: How is the transferee of property under section 1041 treated for income tax purposes?

A-11: The transferee of property under section 1041 recognizes no gain or loss upon receipt of the transferred property. In all cases, the basis of the transferred property in the hands of the transferee is the adjusted basis of such property in the hands of the transferor immediately before the transfer. Even if the transfer is a bona fide sale, the transferee does not acquire a basis in the transferred property equal to the transferee's cost (the fair market value). This carryover basis rule applies whether the adjusted basis of the transferred property is less than, equal to, or greater than its fair market value at the time of transfer (or the value of any consideration provided by the transferee) and applies for purposes of determining loss as well as gain upon the subsequent disposition of the property by the transferee. Thus, this rule is different from the rule applied in section 1015(a) for determining the basis of property acquired by gift.

Q-12: Do the rules described in A-10 and A-11 apply even if the transferred property is subject to liabilities which exceed the adjusted basis of the property?

A-12: Yes. For example, assume A owns property having a fair market value of \$10,000 and an adjusted basis of \$1,000. In contemplation of making a transfer of this property incident to a

divorce from B, A borrows \$5,000 from a bank, using the property as security for the borrowing. A then transfers the property to B and B assumes, or takes the property subject to, the liability to pay the \$5,000 debt. Under section 1041, A recognizes no gain or loss upon the transfer of the property, and the adjusted basis of the property in the hands of B is \$1,000.

Q-13: Will a transfer under section 1041 result in a recapture of investment tax credits with respect to the property transferred?

A-13: In general, no. Property transferred under section 1041 will not be treated as being disposed of by, or ceasing to be section 38 property with respect to, the transferor. However, the transferee will be subject to investment tax credit recapture if, upon or after the transfer, the property is disposed of by, or ceases to be section 38 property with respect to, the transferee. For example, as part of a divorce property settlement, B receives a car from A that has been used in A's business for two years and for which an investment tax credit was taken by A. No part of A's business is transferred to B and B's use of the car is solely personal. B is subject to recapture of the investment tax credit previously taken by A.

(e) *Notice and recordkeeping requirement with respect to transactions under section 1041.*

Q-14: Does the transferor of property in a transaction described in section 1041 have to supply, at the time of the transfer, the transferee with records sufficient to determine the adjusted basis and holding period of the property at the time of the transfer and (if applicable) with notice that the property transferred under section 1041 is potentially subject to recapture of the investment tax credit?

A-14: Yes. A transferor of property under section 1041 must, at the time of the transfer, supply the transferee with records sufficient to determine the adjusted basis and holding period of the property as of the date of the transfer. In addition, in the case of a transfer of property which carries with it a potential liability for investment tax credit recapture, the transferor must, at the time of the transfer, supply the trans-

feree with records sufficient to determine the amount and period of such potential liability. Such records must be preserved and kept accessible by the transferee.

(f) *Property settlements—effective dates, transitional periods and elections.*

Q-15: When does section 1041 become effective?

A-15: Generally, section 1041 applies to all transfers after July 18, 1984. However, it does not apply to transfers after July 18, 1984 pursuant to instruments in effect on or before July 18, 1984. (See A-16 with respect to exceptions to the general rule.)

Q-16: Are there any exceptions to the general rule stated in A-15 above?

A-16: Yes. Two transitional rules provide exceptions to the general rule stated in A-15. First, section 1041 will apply to transfers after July 18, 1984 under instruments that were in effect on or before July 18, 1984 if both spouses (or former spouses) elect to have section 1041 apply to such transfers. Second, section 1041 will apply to all transfers after December 31, 1983 (including transfers under instruments in effect on or before July 18, 1984) if both spouses (or former spouses) elect to have section 1041 apply. (See A-18 relating to the time and manner of making the elections under the first or second transitional rule.)

Q-17: Can an election be made to have section 1041 apply to some, but not all, transfers made after December 31, 1983, or some but not all, transfers made after July 18, 1984 under instruments in effect on or before July 18, 1984?

A-17: No. Partial elections are not allowed. An election under either of the two elective transitional rules applies to all transfers governed by that election whether before or after the election is made, and is irrevocable.

(g) *Property settlements—time and manner of making the elections under section 1041.*

Q-18: How do spouses (or former spouses) elect to have section 1041 apply to transfers after December 31, 1983, or to transfers after July 18, 1984 under instruments in effect on or before July 18, 1984?

A-18: In order to make an election under section 1041 for property transfers after December 31, 1983, or property transfers under instruments that were in effect on or before July 18, 1984, both spouses (or former spouses) must elect the application of the rules of section 1041 by attaching to the transferor's first filed income tax return for the taxable year in which the first transfer occurs, a statement signed by both spouses (or former spouses) which includes each spouse's social security number and is in substantially the form set forth at the end of this answer.

In addition, the transferor must attach a copy of such statement to his or her return for each subsequent taxable year in which a transfer is made that is governed by the transitional election. A copy of the signed statement must be kept by both parties.

The election statements shall be in substantially the following form:

In the case of an election regarding transfers after 1983:

SECTION 1041 ELECTION

The undersigned hereby elect to have the provisions of section 1041 of the Internal Revenue Code apply to all qualifying transfers of property after December 31, 1983. The undersigned understand that section 1041 applies to all property transferred between spouses, or former spouses incident to divorce. The parties further understand that the effects for Federal income tax purposes of having section 1041 apply are that (1) no gain or loss is recognized by the transferor spouse or former spouse as a result of this transfer; and (2) the basis of the transferred property in the hands of the transferee is the adjusted basis of the property in the hands of the transferor immediately before the transfer, whether or not the adjusted basis of the transferred property is less than, equal to, or greater than its fair market value at the time of the transfer. The undersigned understand that if the transferee spouse or former spouse disposes of the property in a transaction in which gain is recognized, the amount of gain which is taxable may be larger than it would have been if this election had not been made.

In the case of an election regarding preexisting decrees:

SECTION 1041 ELECTION

The undersigned hereby elect to have the provisions of section 1041 of the Internal Revenue Code apply to all qualifying trans-

fers of property after July 18, 1984 under any instrument in effect on or before July 18, 1984. The undersigned understand that section 1041 applies to all property transferred between spouses, or former spouses incident to the divorce. The parties further understand that the effects for Federal income tax purposes of having section 1041 apply are that (1) no gain or loss is recognized by the transferor spouse or former spouse as a result of this transfer; and (2) the basis of the transferred property in the hands of the transferee is the adjusted basis of the property in the hands of the transferor immediately before the transfer, whether or not the adjusted basis of the transferred property is less than, equal to, or greater than its fair market value at the time of the transfer. The undersigned understand that if the transferee spouse or former spouse disposes of the property in a transaction in which gain is recognized, the amount of gain which is taxable may be larger than it would have been if this election had not been made.

(Secs. 1041(d)(4), (98 Stat. 798, 26 U.S.C. 1041(d)(4)), 152(e)(2)(A) (98 Stat. 802, 26 U.S.C. 152(e)(2)(A)), 215(c) (98 Stat. 800, 26 U.S.C. 215(c)) and 7805 (68A Stat. 917, 26 U.S.C. 7805) of the Internal Revenue Code of 1954))

[T.D. 7973, 49 FR 34452, Aug. 31, 1984]

§ 1.1042-1T Questions and answers relating to the sales of stock to employee stock ownership plans or certain cooperatives (temporary).

Q-1: What does section 1042 provide?

A-1: (a) Section 1042 provides rules under which a taxpayer may elect not to recognize gain in certain cases where *qualified securities* are sold to a qualifying employee stock ownership plan or worker-owned cooperative in taxable years of the seller beginning after July 18, 1984, and *qualified replacement property* is purchased by the taxpayer within the *replacement period*. If the requirements of Q&A-2 of this section are met, and if the taxpayer makes an election under section 1042(a) in accordance with Q&A-3 of this section, the gain realized by the taxpayer on the sale of the qualified securities is recognized only to the extent that the amount realized on such sale exceeds the cost to the taxpayer of the qualified replacement property.

(b) Under section 1042, the term *qualified securities* means employer securities (as defined in section 409(1)) with respect to which each of the following