

Part I

Section 2056.-- Bequests, Etc., to Surviving Spouse

26 CFR 20.2056(a)-1: Qualified terminable interest property elections.

Rev. Rul. 2000-2

ISSUE

May an executor elect under § 2056(b)(7) of the Internal Revenue Code to treat an individual retirement account (IRA) and a trust as qualified terminable interest property (QTIP) if the trustee of the trust is the named beneficiary of decedent's IRA and the surviving spouse can compel the trustee to withdraw from the IRA an amount equal to all the income earned on the IRA assets at least annually and to distribute that amount to the spouse?

FACTS

A died in 1999 at the age of 55, survived by spouse, B, who was 50 years old. Prior to death, A established an IRA described in § 408(a). The IRA is invested only in productive assets. A named the trustee of a testamentary trust established under A's will as the beneficiary of all amounts payable from the IRA after A's death. A copy of the testamentary trust and a list of the trust beneficiaries were provided to the custodian of A's IRA within nine months after A's death. As of the date of A's death, the

testamentary trust was irrevocable and was a valid trust under the laws of the state of A's domicile. The IRA was includible in A's gross estate under § 2039.

Under the terms of the testatmentary trust, all trust income is payable annually to B, and no one has the power to appoint trust principal to any person other than B. A's children, who are all younger than B, are the sole remainder beneficiaries of the trust. No other person has a beneficial interest in the trust. Under the terms of the trust, B has the power, exercisable annually, to compel the trustee to withdraw from the IRA an amount equal to the income earned on the assets held by the IRA during the year and to distribute that amount through the trust to B. The IRA document contains no prohibition on withdrawal from the IRA of amounts in excess of the annual minimum required distributions under § 408(a)(6).

In accordance with the terms of the IRA instrument, the trustee of the testamentary trust elects, in order to satisfy § 408(a)(6), to receive annual minimum required distributions using the exception to the five year rule in § 401(a)(9)(B)(iii) for distributions over a distribution period equal to a designated beneficiary's life expectancy. Because B's life expectancy is the shortest of all the potential beneficiaries of the testamentary trust's interest in the IRA (including remainder beneficiaries), the distribution period for purposes of § 401(a)(9)(B)(iii) is B's life expectancy. Because B is not the sole beneficiary of the testamentary trust's interest in the IRA, the trustee elected to have the annual minimum required distributions from the IRA to the testamentary trust begin no later than December 31 of the year immediately following the year of A's death. The amount of the annual minimum required

distribution for each year is calculated by dividing the account balance of the IRA as of the December 31 immediately preceding the year by the remaining distribution period. On B's death, any undistributed balance of the IRA will be distributed to the testamentary trust over the remaining distribution period.

LAW AND ANALYSIS

Section 2056(a) provides that the value of the taxable estate is, except as limited by § 2056(b), determined by deducting from the value of the gross estate an amount equal to the value of any interest in property that passes from the decedent to the surviving spouse.

Under § 2056(b)(1), if an interest passing to the surviving spouse will terminate, no deduction is allowed with respect to the interest if, after termination of the spouse's interest, an interest in the property passes or has passed from the decedent to any person other than the surviving spouse (or the estate of the spouse).

Section 2056(b)(7) provides that QTIP, for purposes of § 2056(a), is treated as passing to the surviving spouse and no part of the property shall be treated as passing to any person other than the surviving spouse. Section 2056(b)(7)(B)(i) defines QTIP as property that passes from the decedent, in which the surviving spouse has a qualifying income interest for life, and to which an election applies. Under § 2056(b)(7)(B)(ii), the surviving spouse has a qualifying income interest for life if (I) the surviving spouse is entitled to all the income from the property, payable annually or at more frequent intervals, or has a usufruct interest for life in the property, and (II) no

person has a power to appoint any part of the property to any person other than the surviving spouse.

Section 20.2056(b)-7(d)(2) of the Estate Tax Regulations provides that the principles of § 20.2056(b)-5(f), relating to whether the spouse is entitled for life to all of the income from the entire interest, apply in determining whether the surviving spouse is entitled for life to all of the income from the property for QTIP purposes.

Section 20.2056(b)-5(f)(1) provides that, if an interest is transferred in trust, the surviving spouse is entitled for life to all of the income from the entire interest, if the effect of the trust is to give the surviving spouse substantially that degree of beneficial enjoyment of the trust property during the surviving spouse's life which the principles of the law of trusts accord to a person who is unqualifiedly designated as the life beneficiary of a trust.

Section 20.2056(b)-5(f)(8) provides that the terms "entitled for life" and "payable annually or at more frequent intervals" require that under the terms of the trust the income referred to must be currently (at least annually) distributable to the spouse or that the spouse must have such command over the income so that it is virtually the spouse's. Thus, the surviving spouse will be entitled for life to all of the income from the interest, payable annually, if, under the terms of the trust instrument, the spouse has the right exercisable annually (or more frequently) to require distribution to the spouse of the trust income, and otherwise the trust income is to be accumulated and added to corpus.

In the present situation, the IRA is payable to a trust the terms of which entitle B to receive all trust income, payable annually. In addition, no one has a power to appoint any part of the property in the trust or the IRA to any person other than B. Therefore, whether A's executor can elect to treat the trust and the IRA as QTIP depends on whether B is entitled to all the income for life from the IRA, payable annually.

Under the terms of the testamentary trust, B is given the power, exercisable annually, to compel the trustee to withdraw from the IRA an amount equal to all the income earned on the assets held in the IRA and pay that amount to B. If B exercises this power, the trustee must withdraw from the IRA the greater of the amount of income earned on the IRA assets during the year or the annual minimum required distribution. Nothing in the IRA instrument prohibits the trustee from withdrawing such amount from the IRA. If B does not exercise this power, the trustee must withdraw from the IRA only the annual minimum required distribution.

B's power to compel the trustee's action meets the standard set forth in § 20.2056(b)-5(f)(8) for the surviving spouse to be entitled to all the income for life payable annually. Thus, B has a qualifying income interest for life within the meaning of § 2056(b)(7) in both the IRA and the testamentary trust. Furthermore, B has a qualifying income interest for life in the IRA and the testamentary trust for purposes of §§ 2519 and 2044. Because the trust is a conduit for payments equal to income from the IRA to B, A's executor needs to make the QTIP election under § 2056(b)(7) for both the IRA and the testamentary trust.

The result would be the same if the terms of the testamentary trust require the trustee to withdraw from the IRA annually an amount equal to all the income earned on the IRA assets and pay that amount to the surviving spouse.

HOLDING

An executor may elect under § 2056(b)(7) to treat an IRA and a trust as QTIP when the trustee of the trust is the named beneficiary of the decedent's IRA, the surviving spouse can compel the trustee to withdraw from the IRA an amount equal to all the income earned on the IRA assets at least annually and to distribute that amount to the spouse, and no person has a power to appoint any part of the trust property to any person other than the spouse.

EFFECT ON OTHER REVENUE RULING(S)

Rev. Rul. 89-89, 1989-2 C.B. 231, is obsoleted.

DRAFTING INFORMATION

The principal author of this revenue ruling is Donna L. Mucha of the Office of Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling contact Donna L. Mucha on (202) 622-3120 (not a toll-free call).