

Office of Chief Counsel
Internal Revenue Service
Memorandum

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POSTU-159830-05

Third Party Communication: None
Date of Communication: Not Applicable

UILC: 691.01-02, 642.03-02

date: December 15, 2005

to: Territory Director, Midwest Area
(Examination, PSP)

from: Branch Chief, Branch 2
(Passthroughs & Special Industries)

subject:

This Chief Counsel Advice may not be used or cited as precedent.

LEGEND

Trust =

Decedent =

IRA =

Charity 1 =

Charity 2 =

Charity 3 =

Year 1 =

D1 =

x =

y =

z =

ISSUES

1. Did Trust have gross income under § 691(a)(2) on the assignment of a portion of Decedent's IRA to the Charities in satisfaction of a pecuniary legacy?
2. If Trust had gross income under § 691(a)(2), was it entitled to a deduction under § 642(c)(1) for the portion of Decedent's IRA assigned to the Charities?

CONCLUSIONS

1. Trust had gross income under § 691(a)(2) on the assignment of a portion of Decedent's IRA to the Charities.
2. Trust was not entitled to a deduction under § 642(c)(1) for the portion of Decedent's IRA assigned to the Charities.

FACTS

Decedent died on D1. At the time of Decedent's death, Decedent owned an individual retirement account (IRA), of which the designated beneficiary was Decedent's revocable trust (Trust).

Article I(B), section (1), of Trust provides that upon the death of Decedent, the sum of \$100,000 shall be distributed "in cash or in kind" as follows: \$x to Charity 1, \$y to Charity 2, and \$z to Charity 3 (collectively, the Charities).

Article I(B), sections (2), (3), and (4), provide that the residue of the Trust property shall be distributed to Decedent's children outright or in trust as provided therein.

Article II(A)(12) provides that the trustee shall possess the discretion and power to make distributions or divisions of principal in cash or in kind, or both, at fair market values current at a date of distribution fixed by the trustee, without any requirement that each item be distributed or divided ratably.

Trust completed the distribution of IRA in Year 1, by instructing the IRA custodian to divide IRA into shares, each titled in the name of a beneficiary under Trust. Thus, each of the Charities became the owner and beneficiary of an IRA equal in value, at the time of division, to the dollar amount it was entitled to under Trust.

LAW AND ANALYSIS

Section 691(a)(1) of the Code provides that the amount of all items of gross income in respect of a decedent (IRD) which are not properly includible in respect of the taxable period in which falls the date of the decedent's death or a prior period (including the amount of all items of gross income in respect of a prior decedent, if the right to receive such amount was acquired by reason of the death of the prior decedent or by bequest, devise, or inheritance from the prior decedent) shall be included in the gross income, for the taxable year when received, of: (A) the estate of the decedent, if the right to receive the amount is acquired by the decedent's estate from the decedent; (B) the person who, by reason of the death of the decedent, acquires the right to receive the amount, if the right to receive the amount is not acquired by the decedent's estate from the decedent; or (C) the person who acquires from the decedent the right to receive the amount by bequest, devise, or inheritance, if the amount is received after a distribution by the decedent's estate of such right.

Section 691(a)(2) provides that if a right, described in § 691(a)(1), to receive an amount is transferred by the estate of the decedent or a person who received such right by reason of the death of the decedent or by bequest, devise, or inheritance from the decedent, there shall be included in the gross income of the estate or such person, as the case may be, for the taxable period in which the transfer occurs, the fair market value of such right at the time of such transfer plus the amount by which any consideration for the transfer exceeds such fair market value. For purposes of this paragraph, the term "transfer" includes sale, exchange, or other disposition, or the satisfaction of an installment obligation at other than face value, but does not include transmission at death to the estate of the decedent or a transfer to a person pursuant to the right of such person to receive such amount by reason of the death of the decedent or by bequest, devise, or inheritance from the decedent.

Rev. Rul. 92-47, 1992-1 C.B. 198, holds that a distribution to the beneficiary of a decedent's IRA that equals the amount of the balance in the IRA at the decedent's death, less any nondeductible contributions, is IRD under § 691(a)(1) that is includable in the gross income of the beneficiary for the taxable year the distribution is received.

Section 642(c)(1) provides that in the case of an estate or trust (other than a trust meeting the specifications of subpart B of part I of subchapter J of chapter 1), there shall be allowed as a deduction in computing its taxable income (in lieu of the deduction allowed by § 170(a), relating to deduction for charitable, etc., contributions and gifts) any amount of the gross income, without limitation, which pursuant to the terms of the governing instrument is, during the taxable year, paid for a purpose specified in § 170(c) (determined without regard to § 170(c)(2)(A)).

The amount of the balance in IRA at Decedent's death, less any nondeductible contributions, is IRD under § 691(a)(1). If an estate or trust satisfies a pecuniary legacy with property, the payment is treated as a sale or exchange. See Kenan v.

Commissioner, 114 F.2d 217 (2d Cir.1940). Because Trust used IRA to satisfy its pecuniary legacies, Trust must treat the payments as sales or exchanges. Therefore, under § 691(a)(2), the payments are transfers of the rights to receive the IRD and Trust must include in its gross income the value of the portion of IRA which is IRD to the extent IRA was used to satisfy the pecuniary legacies.

The terms of Trust do not direct or require that the trustee pay the pecuniary legacies from Trust's gross income. Accordingly, the transfer of a portion of IRA in satisfaction of the pecuniary legacies does not entitle Trust to a deduction under § 642(c)(1).

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

This memorandum responds to a private letter ruling request from Trust, requesting various rulings regarding the rollover of IRA to the beneficiaries of Trust and the amendment of Trust to provide for a disabled child of Decedent. These rulings, involving issues under the jurisdiction of T:EP:RA, were granted in a letter dated November 30, 2005, which has not yet been publicly released. After we informed the taxpayer that this office was adverse to the taxpayer on the § 691 issue described above, the taxpayer withdrew that portion of their original ruling request. Because the adverse determination on this issue was not included in the letter issued by T:EP:RA, this memorandum is necessary to inform your office of our position on the transaction.

The taxpayer does not agree that the partial assignment of IRA to the Charities results in a sale or exchange of the IRD element of IRA (and thus gross income under § 691(a)(2), with no allowable § 642(c) deduction for the reasons described above). The taxpayer argues that this conclusion is preempted by the application of § 408(d)(1), which provides that "any amount paid or distributed out of an IRA shall be included in gross income by the payee or distributee." The taxpayer maintains that this rule, requiring actual payment or distribution, prevents the application of the Kenan principle and § 691(a)(2) to currently tax Trust since it has not received payments or distributions from IRA.

We disagree with this interpretation. We believe that under Kenan, Trust has received an immediate economic benefit by satisfying its pecuniary obligation to the Charities with property on which neither Trust nor Decedent have previously paid income tax which is a disposition for § 691(a)(2) purposes. We further believe that the language of § 408(d)(1) simply prevents the immediate taxation of IRA recipients on amounts in an IRA which are not currently payable under a theory of "constructive receipt." T:EP:RA, which has jurisdiction over § 408, does not object to our conclusion on this issue.

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

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Please call
questions.

of this office at

if you have any further