Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Index No.: 664.00-00; 691.00-00

Contact Person:

Telephone Number:

In Reference to:

CC:DOM:P&SI:2 - PLR-115845-97

Date: OCT 8 1998

199901023

X

Trust

D1

a

Foundation

Dear

This is in response to your letter dated June 8, 1998, and prior correspondence, submitted on behalf of X, in which rulings are requested on the income and estate tax consequences of a testamentary gift of an interest in a qualified retirement plan to an inter vivos charitable remainder unitrust.

The information submitted states that on D1, X executed an irrevocable declaration of trust (Trust). Trust is intended to qualify as a charitable remainder unitrust (CRUT) under § 664(d)(2) of the Internal Revenue Code. The unitrust will be funded upon X's death. X's two children will be the income beneficiaries of the a percent unitrust amount. Trust will terminate upon the earlier of the following dates: (a) the date of death of the last income beneficiary, or (b) the date which is exactly twenty years after the date of death of X. Upon the termination of Trust, all of its remaining assets will be distributed to Foundation. X represents that Foundation is a tax-exempt organization described in § 501(c)(3).

X is a participant in a qualified retirement plan described in § 401(a). X has designated Trust as the beneficiary of X's interest in the retirement plan. Thus, upon X's death the proceeds of this plan will be paid in a lump sum to Trust.

Section 61(a)(14) provides that gross income includes income in respect of a decedent (IRD).

Section 691(a)(1)(B) provides that the items of gross income in respect of a decedent that are not properly includible in respect of the taxable period in which the decedent's death occurs or a prior period shall be included in the gross income, for the taxable year when received, of 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.

Section 7701(a)(1) provides that the term "person" shall be construed to mean and include a trust.

Section 1.691(a)-1(b) of the Income Tax Regulations provides that the term "income in respect of a decedent" refers to those amounts to which a decedent was entitled as gross income but that were not properly includible in computing the decedent's taxable income for the taxable year ending with the date of death or for a previous taxable year under the method of accounting employed by the decedent.

Section 402(a) provides that generally all distributions from a qualified retirement plan are fully taxable as ordinary income to the recipient.

Section 691(a)(3) provides that the right to receive an amount of income in respect of a decedent shall be treated, in the hands of the person who acquired such right by reason of the death of the decedent, as if it had been acquired by such person in the transaction in which the right to receive the income was originally derived. In addition, the amount includible in gross income shall be considered in the hands of such person to have the character which it would have had in the hands of the decedent if the decedent had lived and received such amount.

The information submitted indicates that the distributions from the qualified plan to X would be ordinary income to X if X received the payments directly. Therefore, the distributions from the qualified plan to Trust will be IRD. Under § 691(a)(1)(B), Trust must include in gross income the proceeds from X's qualified retirement plan. Therefore, because the IRD is properly included in Trust's gross income, it is not included in the gross income of X's estate.

Section 691(c)(1)(A) provides that a person who includes IRD in gross income is entitled to a deduction in that year of an amount equal to that portion of the federal estate tax on

the decedent's estate that is attributable to the inclusion of the IRD items in the estate.

Section 1.691(c)-1(a) provides that the deduction described in section 691(c)(1)(A) is determined as follows:

(1) Ascertain the net value in the decedent's estate of the items which are included under section 691 in computing gross income. This is the excess of the value included in the gross estate on account of the items of gross income in respect of the decedent over the deduction from the gross estate for claims which represent the deductions and credit in respect of a decedent.

(2) Ascertain the portion of the estate tax attributable to the inclusion in the gross estate of such net value. This is the excess of the estate tax over the estate tax computed without including such net value in the gross estate. In computing the estate tax without including in the gross estate the net value of the IRD items, any estate tax deduction (such as the marital deduction) that may be based upon the gross estate shall be recomputed so as to take into account the exclusion of such net value from the gross estate.

The computation of the estate tax on X's estate includes a charitable deduction for the proceeds of the qualified retirement plan distributed to Trust. When recomputing the estate tax, § 1.691(c)-1(a)(2) provides that estate tax deductions shall also be recomputed based on the exclusion of the net value of IRD items from the gross estate. Therefore, because the IRD is excluded from the gross estate, the charitable deduction for the IRD contributed to Trust must also be excluded when recomputing the estate tax.

Section 664(a) provides that notwithstanding any other provision of subchapter J, the provisions of § 664, in accordance with regulations prescribed by the Secretary, apply in the case of a charitable remainder annuity trust and a charitable remainder unitrust.

Section 664(b) provides that amounts distributed by a charitable remainder unitrust shall be considered as having the following characteristics in the hands of the beneficiary to whom is paid the unitrust amount described in subsection (d)(2)(A):

(1) First, as amounts of income (other than gains, and amounts treated as gains, from the sale or other disposition of capital assets) includible in gross income to the extent of such income of the trust for the year and such undistributed income of the trust for prior years;

(2) Second, as a capital gain to the extent of the capital gain of the trust for the year and the undistributed capital gain of the trust for prior years;

(3) Third, as other income to the extent of such income of the trust for the year and such undistributed income of the trust for prior years; and

(4) Fourth, as a distribution of trust corpus.

Section 1.664-1(d)(1)(i)(a) provides that the order of unitrust distributions in the hands of the beneficiary is first ordinary income to the extent of the sum of the trust's ordinary income for the taxable year of the trust and its undistributed ordinary income for prior years.

In the hands of Trust and for purposes of § 664(b), the proceeds from X's qualified retirement plan will be IRD and will have the same character that it would have had in the hands of X had X lived and received such amounts. Under § 402(a) the qualified retirement plan proceeds would have been ordinary income to X. Therefore, provided that Trust is a qualified charitable remainder unitrust, the proceeds from the qualified retirement plan will be IRD to Trust and will be "first tier" ordinary income, as provided by § 664(b).

Section 664(c) provides that a charitable remainder unitrust is exempt from tax unless it has unrelated business taxable income within the meaning of § 512.

Section 691(a)(1)(B) provides that IRD is included in the gross income of the person who, by reason of the death of the decedent, acquires the right to receive the amount. Section 691(c)(1)(A) provides that the person required to include IRD in that person's gross income is entitled to a deduction for the amount of estate tax attributable to that IRD. Section 7701(a)(1) provides that the term person includes a trust.

X has asked how the deduction under § 691(c)(1)(A) is taken into consideration by Trust and whether the deduction is made available to the income beneficiaries of Trust as part of the first tier distributions under § 664(b).

Upon receiving the proceeds from the qualified retirement plan, § 691(a)(1)(B) requires Trust to include the IRD in its gross income (whether or not the trust is exempt from tax under § 664(c)). Under § 691(a)(3) the ordinary income character of the IRD is retained. Further, these amounts constitute ordinary income for purposes of § 664(b)(1). Under § 691(c)(1)(A) Trust is entitled to a deduction for the estate

tax attributable to the IRD. Therefore the IRD that constitutes ordinary income described in § 664(b)(1) is the amount of the IRD net of the deduction provided in § 691(c)(1)(A). This deduction is reported as an "other" deduction on line 11 of Form 5227. The § 691(c)(1)(A) deduction is not directly made available to the income beneficiaries under § 664(b).

Based on the information submitted and the representations made, we conclude as follows:

(1) Pursuant to section 4.01(39) of Rev. Proc. 98-3, 1998-1 I.R.B. 100, 108, the Internal Revenue Service has generally discontinued issuing rulings concerning whether a charitable remainder trust that provides for unitrust payments for one or two measuring lives satisfies the requirements described in section 664.

(2) Pursuant to section 4.01(44) of Rev. Proc. 98-3, 1998-1 I.R.B. 100, 108, the Internal Revenue Service has generally discontinued issuing rulings concerning whether a transfer to a charitable remainder trust described in § 664 that provides for annuity or unitrust payments for one or two measuring lives qualifies for a charitable deduction under §2055(e)(2)(A).

(3) When the proceeds from the qualified retirement plan are distributed to Trust, the proceeds will be included in the gross income of Trust under section 691(a)(1)(B), and will not be includible in the gross income of X's estate.

(4) Because the proceeds of the qualified retirement plan are IRD, they will be includible in the gross income of Trust for the taxable year the distribution is received by Trust as the designated beneficiary of X's qualified retirement plan. Provided Trust is a charitable remainder unitrust within the meaning of § 664(d)(2), Trust will not be taxable on its income for that year unless, for that year, it has unrelated business taxable income within the meaning of § 512.

(5) In computing the hypothetical estate tax (that is, excluding the IRD items) described in § 691(c)(2)(C), the estate must also exclude the charitable deduction resulting from the contribution of the qualified retirement plan amounts to Trust.

(6) Provided that Trust is a charitable remainder unitrust within the meaning of § 664(d)(2), the amounts from the qualified retirement plan that are IRD will be "first tier" income, described in § 664(b)(1).

(7) The deduction provided by § 691(c)(1)(A) reduces the amount of IRD that Trust includes in its first tier ordinary income. Therefore, the amount of first tier ordinary income from the IRD is the net of the IRD under § 691(a)(1)(B) less the deduction under § 691(c)(1)(A). The § 691(c)(1)(A) deduction is not directly made available to the income beneficiaries under § 664(b).

Except as specifically set forth above, we express no opinion concerning the federal tax consequences of the facts described above under any other provision of the Code.

This ruling is directed only to the taxpayer who requested it. Section 6110(j) provides that it may not be used or cited as precedent.

Pursuant to the power of attorney on file in this office, a copy of this letter will be sent to X.

Sincerely yours,

J. Thomas Hines

J. THOMAS HINES
Senior Technician Reviewer
Branch 2
Office of the Assistant
Chief Counsel
(Passthroughs and
Special Industries)

Enclosures: 2
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