Internal Revenue Service

Number: **201438014**
Release Date: 9/19/2014

Index Number: 691.01-00, 642.03-02

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:03
PLR-147375-13

Date:
May 5, 2014

LEGEND

Trust =

Decedent =

Date 1 =

Date 2 =

Date 3 =

a =

b =

c =

d =

Charity1 =

Charity2 =

State =

Dear :

This letter responds to a letter dated October 1, 2013, and subsequent correspondence, submitted on behalf of Trust by its authorized representative, requesting a ruling under § 691 and § 642 of the Internal Revenue Code.

FACTS

The information submitted states that Decedent created Trust on Date1 and died on Date2. Decedent owned an individual retirement account (IRA) at the time of his death, of which the designated beneficiary was Trust. Trust provides for the distribution of Decedent's estate, including the payment of pecuniary bequests of $a and $b to Charity1 and Charity2, respectively. At the time of Decedent's death, Trust's assets totaled $c, $d of which was in the IRA. The pecuniary bequests to Charity1 and Charity2 exceeded the amount of Trust's non-IRA assets.

On Date3, a court order in State reformed Trust. The purpose of the reformation was to ensure that Trust's distribution of IRA assets to Charity1 and Charity2 would be treated as direct bequests to the charities rather than as income in respect to Trust of a decedent under § 691. Alternatively, the purpose of the reformation was to qualify the Trust for a charitable deduction under § 642(c).

Trust requests the following rulings:

1. that the payment of pecuniary bequests to Charity1 and Charity2 from IRA assets will not cause Trust to recognize income in respect of a decedent (IRD) under § 691(a);

2. that if Trust does recognize IRD on the payments, it can claim a deduction under § 642(c); and

3. that the Internal Revenue Service will respect Trust's reformation.

LAW

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)).

Section 1.642(c)-1(a)(1) provides that any part of the gross income of a trust which, pursuant to the terms of the governing instrument, is paid during a taxable year for a charitable purpose shall be allowed as a deduction to the trust.

Section 691(a)(1) provides that the amount of all items of gross income in respect of a decedent which are not properly includible in respect of the taxable period in which falls the date of his 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.

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

Section 1.691(a)-4(a) provides that in general, the transferor must include in his gross income for the taxable period in which the transfer occurs the amount of the consideration, if any, received for the right or the fair market value of the right at the time of the transfer, whichever is greater.

Section 1.691(a)-4(b) provides that if the estate of a decedent or any person transmits the right to IRD to another who would be required by § 691(a)(1) to include such income when received in his gross income, only the transferee will include such income when received in his gross income.

Section 1.691(a)-4(b)(2) provides that if a right to IRD is transferred by an estate to a specific or residuary legatee, only the specific or residuary legatee must include such income in gross income when received.

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.

Kenan v. Commissioner, 114 F.2d 217 (2d Cir. 1940), holds that if a trust or estate satisfies a pecuniary legacy with property, the payment is treated as a sale or exchange of the property.

In Commissioner v. Estate of Bosch, 387 U.S. 456 (1967), the Supreme Court considered whether a state trial court's characterization of property rights conclusively binds a federal court or agency in a federal estate tax controversy. The Court concluded that the decision of a state trial court as to an underlying issue of state law should not be controlling when applied to a federal statute. Rather, the highest court of the state is the best authority on the underlying substantive rule of state law to be applied in the federal matter. If there is no decision by that court, then the federal authority must apply what it finds to be state law after giving "proper regard" to the state trial court's determination and to relevant rulings of other courts of the state. In this respect, the federal agency may be said, in effect, to be sitting as a state court.

In Crown Income Charitable Fund v. Commissioner, 8 F.3d 571, 573 (7th Cir. 1993), aff'g98 T.C. 327 (1992), the Seventh Circuit addressed the issue of commutation. The trust at issue in Crown Income Charitable Fund contained a provision permitting the trustees to commute the charitable interest only if, as a matter of law, it was clear that doing so would not adversely affect the maximum charitable deduction otherwise available. The trustees of the Crown Income Charitable Fund distributed trust assets in excess of the annuity amount to the charitable beneficiary over a number of years and deducted, under § 642(c), the full amount distributed to the charitable beneficiaries. Both the Seventh Circuit and the Tax Court held that the excess distributions were not deductible under § 642(c) because those instruments were not made pursuant to the terms of the governing instrument.

In Brownstone v. United States, 465 F.3d 525 (2nd Cir. 2006), a deceased husband's will created a marital deduction trust, which granted the husband's surviving wife a general testamentary power of appointment. When the wife died, she exercised her power in favor of her estate, the residue of which passed to charitable organizations. The trustee of the marital deduction trust distributed $1 million to the wife's estate and claimed a charitable contribution deduction under § 642(c), because the $1 million distribution passed entirely to the charitable beneficiaries under the wife's will.

The Second Circuit in Brownstone held that the distribution to the charities was made pursuant to the wife's power of appointment and not pursuant to the governing instrument, the deceased husband's will. The Second Circuit interpreted the definition of governing instrument narrowly, stating that an instrument subject to the creating instrument (the wife's will) could not combine with the creating instrument (the husband's will) and qualify as the governing instrument. The sole governing instrument in Brownstone is the husband's original will; therefore, the marital deduction trust is not entitled to a deduction under § 642(c) since the distribution was made pursuant to the wife's will.

Rev. Rul. 59-15, 1959-1 C.B. 164, citing Emanuelson v. United States, 159 F. Supp 34 (Conn. 1958), held that a settlement agreement arising from a will contest qualifies as a governing instrument for purposes of § 642(c).

ANALYSIS AND CONCLUSION

In reforming the trust instrument in this case, the state court did not resolve a conflict with respect to Trust. The original Trust instrument entitled Charity1 and Charity2 to $a and $b, respectively, of Trust property. The purpose of the court order was to obtain the tax benefits that would ensue if Trust's transfers to Charity1 and Charity2 were treated as direct bequests of the IRD amounts to the charities under § 691(a)(1) or considered to be made out of the trust's gross income pursuant to the terms of the governing instrument under § 642(c). Neither Rev. Rul. 59-15 nor Emanuelson hold that a modification to a governing instrument will be construed to be the governing instrument in situations where the modification does not stem from a conflict. Additionally, both Crown Income Charitable Fund and Brownstone have a narrow interpretation of what qualifies as pursuant to a governing instrument.

Accordingly, based solely on the facts and representations submitted, we conclude the following:

1. because Trust will use IRA assets 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 the IRA which is IRD to the extent the IRA was used to satisfy the pecuniary legacies.

2. 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 the IRA in satisfaction of the pecuniary legacies does not entitle Trust to a deduction under § 642(c)(1); and

3. because the purpose of the court order reforming Trust was to obtain tax benefits rather than resolve a conflict, the Internal Revenue Service will not respect Trust's reformation.

Except as specifically ruled above, we express or imply no opinion concerning the federal tax consequences of the transactions described above under any of the provisions of the Code or regulations.

This ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

____

James A. Quinn
Senior Counsel, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)
Copy of this letter
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cc: