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March 25, 1999

<u>A</u>	=
<u>B</u>	=
IRA X	=
Custodian	=
Trust	=
Decedent’s Trust	=
Residual Trust	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=
Date 5	=
Plan X	=
Plan Y	=

Dear :

This letter is in response to your letter of November 10, 1998, and previous correspondence, submitted on behalf of B, requesting rulings under sections 691, 1001, and 408 of the Internal Revenue Code.

The information submitted states that B is the surviving spouse of A. Prior to A's death on Date 1, A established an individual retirement account (IRA X). The owner and designated beneficiary of IRA X is Trust.

B represents that the original sources of the funds for IRA X were lump sum distributions to A from two defined benefit plans (Plan Y and Plan X) that qualified under section 401(a) of the Code and were exempt under section 501(a). These distributions were rolled over into IRA X, which is an IRA described in section 408(a) of the Code. B further represents that these lump sum distributions were made due to A's retirement and/or due to a termination of the defined benefit plans when A's employer's business was sold or liquidated. On Date 2, B signed a waiver to B's right to a joint and survivor annuity under Plan Y. On Date 3, B signed a waiver to B's right to a joint and survivor annuity under Plan X. B additionally represents that all requirements, under either the Internal Revenue Code or in the Income Tax Regulations, were satisfied in connection with the rollover of the lump sum distributions, and that these rollovers were completed within the 60 day time period found in section 402(c)(3) of the Code.

Trust is a revocable trust, executed on Date 4 and amended on Date 5. Under a community property agreement (Agreement) of Date 5, A and B agreed that all of their property, whether held in the name of one of them or both of them as joint tenants, was community property, including all property held in Trust. A and B were the co-settlors and co-trustees of Trust.

Article Six of Amendment No. One of Trust provides that if either of the settlors for any reason ceases to act as trustee, then the other of them will be the sole trustee. Thus, as a result of A's death, B is now the sole trustee of Trust.

Article Fifth of Trust provides that three successor trusts are created at the death of the first settlor to die: Survivor's Trust, Decedent's Trust, and Residual Trust.

Survivor's Trust will consist of property selected by the trustee from A and B's community property included in Trust, equal in value to B's interest in the community property included in Trust. Article Eight, paragraph C, of Trust provides that following the death of the deceased spouse, the surviving spouse has the power to amend, revoke, or terminate Survivor's Trust and that upon revocation of Survivor's Trust all of its assets will be delivered to the surviving spouse.

Decedent's Trust will be funded exclusively with the maximum amount that is exempt from federal estate tax. Residual Trust will consist of the balance of the trust estate.

Article Ninth, paragraph S of Trust grants the trustee the power to partition, allot, and distribute the trust estate, on any division or partial or final distribution of the trust estate, in individual interests, whether pro rata or otherwise, or in kind, or partly in money and partly in kind, at valuation determined by the trustee, and to sell such property as the trustee may deem necessary to make the division or distribution.

B, as trustee of Trust, intends, as part of an equal, non-pro rata partition of the former community property of A and B, to allocate the entire interest in IRA X to Survivor's Trust, and to allocate the entire interest in the other community property assets of equal value (with the values to be determined as of the date or dates of distribution) exclusively to A's one-half share of the former community property. A's partitioned share of the former community property will then be further partitioned and distributed non-pro rata to Decedent's Trust and Residual Trust.

B further intends to exercise B's power of revocation over Survivor's Trust and completely revoke Survivor's Trust. Thus, after IRA X has been allocated to Survivor's Trust, B, as trustee of Trust, will cause the IRA X proceeds to be distributed to herself as her separate property. Upon receipt of the IRA X proceeds, B will then contribute said proceeds into an IRA, set up and maintained in her name, within 60 days of the date of their distribution. B represents that the rollover IRA will meet the requirements of section 408(a) of the Code.

Ruling Request No. 1

Section 691(a)(1) of the Code provides that the amount of all items of gross income in respect of a decedent which are not properly includable in respect of the taxable period in which falls the date of his death or a prior period 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) of the Code provides that if a right, described in section 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 section 691(a)(2), 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 1001(c) of the Code provides that gain or loss generally must be recognized upon the sale or exchange of property. Section 1.1001-1(a) of the regulations provides that the gain or loss realized from the conversion of property into cash, or from the exchange of property for other property differing materially either in kind or in extent, is treated as income or as loss sustained.

Rev. Rul. 76-83, 1976-1 C.B. 213, holds that no gain or loss will be recognized from the approximately equal division of the fair market value of community property in a community property state under a divorce settlement agreement that provides for transfer of some assets in their entirety to one spouse or the other.

The non-pro rata partition into equal shares of A and B’s community property pursuant to the terms of the Trust is in substance the same as the division of the community property described in Rev. Rul. 76-83. Accordingly, the non-pro rata partition of A and B’s community property in Trust and the allocation of B’s share (the IRA X) to the Survivor’s Trust is neither a sale or exchange for purposes of section 1001, nor a transfer for purposes of section 691(a)(2).

Ruling Request No. 2

Section 676(a) of the Code provides that a grantor will be treated as the owner of a trust, where at any time the power to revest in the grantor title to such portion is exercisable by the grantor or a nonadverse party, or both.

Rev. Rul. 85-13, 1985-1 C.B. 184, holds that if a grantor is treated as the owner of an entire trust, the grantor is the owner of the trust’s assets for federal income tax purposes. Therefore, a transfer of trust assets to a grantor who owns the entire trust is not recognized as a sale for federal income tax purposes.

In this case, B is considered to be the grantor of Survivor’s Trust, the assets of which represent her partitioned share of Trust’s assets. Additionally, B holds a power to revoke Survivor’s Trust, and, therefore, will be treated as the owner of Survivor’s Trust under section 676(a). Therefore, because B is treated as the owner of the IRA X, the transfer of the IRA X to B is not a transfer for purposes of section 691(a)(2) and will not result in the recognition of gain under section 691(a)(2).

Ruling Request No. 3

Section 408(d)(1) of the Code provides the general rule that, except as otherwise provided in section 408(d), any amount paid or distributed out of an individual retirement plan shall be included in gross income by the payee or distributee, as the case may be, in the manner provided under section 72.

Section 408(d)(3)(A) of the Code provides that section 408(d)(1) does not apply to rollover contributions if such contributions satisfy the requirements of sections 408(d)(3)(A) and (d)(3)(B).

Section 408(d)(3)(A)(i) of the Code provides that section 408(d)(1) does not apply to any amount paid or distributed out of an IRA to the individual for whose benefit the IRA is maintained if the entire amount received (including money and any other property) is paid into an IRA (other than an endowment contract) for the benefit of such individual not later than the 60th day after the day on which he receives the payment or distribution.

Section 408(d)(3)(C)(i) of the Code provides that in the case of an inherited IRA, section 408(d)(3) (concerning tax-free rollover treatment) shall not apply to any amount received by an individual from such an account or annuity (and no amount transferred from such account or annuity to another IRA shall be excluded from gross income by reason of such transfer), and such inherited account or annuity shall not be treated as an IRA for purposes of determining whether any other amount is a rollover contribution.

Section 408(d)(3)(C)(ii) of the Code provides that an IRA shall be treated as inherited if the individual for whose benefit the account is maintained acquired such account by reason of the death of another individual, and such individual was not the surviving spouse of such other individual.

Thus, pursuant to section 408(d)(3(C)(ii) of the Code, a surviving spouse who acquires IRA proceeds from and by reason of the death of her spouse, may elect to treat those IRA proceeds as her own and roll them over into her own IRA.

Section 1.408-8 A-4(b) of the Proposed Income Tax Regulations provides that in the case of an individual dying after December 31, 1983, the only beneficiary of the individual who may elect to treat the beneficiary's entire interest in the trust (or in the remaining part of such interest if distribution thereof has commenced to the beneficiary) as the beneficiary's own account is the individual's surviving spouse. If the surviving spouse makes such an election, the spouse's interest in the account would then be subject to the distribution requirements of section 401(a)(9)(A), rather than those of section 401(a)(9)(B).

Section 1.408-8 A-6 of the proposed regulations asks: "What rules apply in the case of a rollover to an IRA of an amount distributed by a qualified plan or another IRA?" The answer, as provided in this section of the proposed regulations, states, in part, that if the surviving spouse of an employee rolls over a distribution from a qualified plan, such surviving spouse may elect to treat the IRA as the spouse's own IRA in accordance with the provisions in A-4.

In this case, B, the surviving spouse of A, became the sole trustee of Trust and, under the terms of Trust, had the "full power" to allocate the assets of Trust among Survivor's Trust, Decedent's Trust, and Residual Trust.

At his death, A held IRA X with Custodian which A and B classified as community property under the terms of the Agreement. B, as sole trustee of Trust, will allocate A's 50% interest in IRA X and B's 50% community property interest in IRA X to Survivor's Trust. B is empowered to revoke Trust 2, and B intends to do so. As a result, the assets of Survivor's Trust, including the proceeds of IRA X maintained in the name of A at his death, will pass to B. B then intends to request distribution from IRA X and, upon receipt, roll over the distribution into an IRA set up and maintained in B's name.

Generally, if a decedent's IRA proceeds pass through a third party, e.g., a trust, and then the proceeds are distributed to the decedent's surviving spouse, the spouse will be treated as acquiring them from the third party and not from the decedent. Thus, generally, the surviving spouse will not be eligible to roll over the IRA proceeds into her own IRA.

In this case, B, the surviving spouse of A, has the power under the provisions of Trust to allocate IRA X to Survivor's Trust. B intends to exercise that power. Upon allocation, B will terminate Survivor's Trust which will result in IRA X passing to B. B will then request a distribution of IRA X and roll over the IRA X proceeds into an IRA set up and maintained in her name. Thus, in this case, control over the assets of IRA X will at all times lie exclusively with B. As a result, the general rule does not apply.

Based on the foregoing, we hold that, for purposes of section 408(d)(3) of the Code, B will be treated as the beneficiary of IRA X. Thus, B will be treated, for purposes section 408(d)(3), as receiving the IRA funds from the decedent and not from the decedent's estate.

Accordingly, we conclude that IRA X does not constitute an "inherited IRA" within the meaning of section 408(d)(3)(C) of the Code, and pursuant to section 408(d)(3), B will not be required to include in B's taxable income the value of the IRA proceeds of IRA X which are distributed to her, so long as they are transferred into the rollover IRA within 60 days of their distribution.

We believe that the Employee Retirement Income Security Act of 1974 ("ERISA") preempts state community property laws with respect to qualified plans. See Boggs v. Boggs, 520 U.S. 833, 117 S. Ct. 1754, 138 L.Ed. 2d 45 (June 2, 1997). An ERISA preemption conflict occurs where compliance with both federal and state regulations is a physical impossibility or where state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress, in which case federal law will supersede and preempt state laws.

In this case, B's right to A's benefits under Plan Y or Plan Z consisted of B's right to receive a joint and survivor annuity under each plan. As noted above, B waived her right to joint and survivor annuities before A received lump sum distributions from qualified plans and rolled those distributions over into his IRA. There were no conflicting claims to the benefits under the qualified plans.

These statements are based on the assumptions that IRA X meets the requirements of section 408 of the Code at all times pertinent to the transactions described herein.

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

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

Pursuant to the power of attorney on file with this office a copy of this letter is being sent to B.

Sincerely yours,

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

Enclosures: 2
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