Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:2 - PLR-100187-02
Date:
December 31, 2002

Legend

Executor =

Decedent =

Wife =

IRA 1 =

IRA 2 =

Trust 1 =

Trust 2 =

D1 =

D2 =

D3 =

State =

$a =

$x =

$y =

$z =

$s =

$w =

$t =

$u =

Year =

Dear :

This letter responds to a letter dated December 20, 2002, submitted on behalf of Executor by Executor's authorized representative, requesting rulings under § 691(c) of the Internal Revenue Code.

The information submitted states that Decedent died on D1. At death, the value of Decedent's gross estate was $a. As of D1, Decedent maintained two Individual Retirement Accounts (IRAs), IRA 1 and IRA 2. On D1, the value of IRA 1 was $x. The beneficiary of IRA 1 was Trust 1. On D1, the value of IRA 2 was $y. The beneficiary of IRA 2 was Trust 2. IRA 1 and IRA 2 were included in Decedent's gross estate.

On D2, Wife, Decedent's spouse, exercised her personal right of election to receive her elective share pursuant to the laws of State. Under State's elective share statute, Wife was entitled to receive one-third of the estate (after certain expenses, but before taxes). State law permits distributions in kind to satisfy an elective share. Under an agreement approved by the probate court, Wife's elective share was to be funded with $z from IRA 1, $s from IRA 2, and $w in other assets that do not constitute income in respect of a decedent under § 691(a) (non IRD assets). As a partial payment of her share, IRA 2 paid $t to Trust 2 in Year. In Year, Wife received $t from Trust 2. Wife died on D3.

The receipt of $t was reported as gross income to Wife in Year. For the Year taxable year, no deduction under § 691(c) was taken for Wife. Wife's estate will receive Wife's share of Decedent's estate that was not paid to Wife prior to Wife's death .

Decedent's estate reported a taxable estate of $u on its Form 706, United States Estate Tax Return.

Section 691(a) provides that all items of IRD shall be included in the income of the decedent's estate or in the income of the person who acquires by bequest or otherwise the right to receive the items.

Section 691(c)(1)(A) provides that a person who includes an amount in gross income under § 691(a) shall be allowed, for the same taxable year, as a deduction, an amount which bears the same ratio to the estate tax attributable to the net value for estate tax purposes of all the items described in § 691(a)(1) as the value for estate tax

purposes of the items of gross income or portions thereof in respect of which such person included the amount in gross income (or the amount included in gross income, whichever is lower) bears to the value for estate tax purposes of all the items described in § 691(a).

Section 691(c)(2) provides the method of calculating the § 691(c) deduction. First, it is necessary to determine the net value for estate tax purposes of all items of IRD relating to the decedent. This net value is the value in the gross estate of the IRD, less the claims deductible for Federal estate tax purposes which represent the deductions and credits in respect of the decedent described in § 691(b). Second, the estate tax attributable to the net value of the IRD items is determined. Under § 691(c)(2)(C), the estate tax attributable to the net value of all IRD items (and, therefore, the deduction allowable) is an amount equal to the excess of the actual estate tax over the estate tax computed without including the IRD items in the gross estate.

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

Section 1.691(a)-1(c) provides that the term IRD also includes the amount of all items of gross income in respect of a prior decedent, if (1) the right to receive such amount was acquired by the decedent by reason of the death of the prior decedent or by bequest, devise, or inheritance from the prior decedent and if (2) the amount of gross income in respect of the prior decedent was not properly includible in computing the decedent's taxable income for the taxable year ending with the date of his death or for a previous taxable year.

Section 1.691(c)-1(a) provides that a person who is required to include in gross income for any taxable year an amount of IRD, may deduct for the same taxable year that portion of the estate tax imposed upon the decedent's estate which is attributable to the inclusion in the decedent's estate of the right to receive such amount.

Section 1.691(c)-1(a)(2) provides that in computing the tax on the estate determined without inclusion of IRD (hypothetical estate) any estate tax deduction (such as the marital deduction) which may be based upon the gross estate shall be recomputed.

Section 1.691(c)-1(a)(2) does not describe the method under which the marital deduction is recomputed in the hypothetical estate.

Rev. Rul. 67-242, 1967-2 C.B. 227, describes the following facts. At the time of his death, A was entitled to fees for professional services rendered, to dividends declared before his death, but payable and paid to the record owners of the stock as of a date following his death, and to accrued bond interest, in the respective amounts of $30x, $10x, and $5x, and having values in the gross estate respectively of $29x, $10x and $5x. The right to the fees for professional services rendered, $29x, along with certain other properties totaling $171x (i.e., total bequest of $200x), was specifically bequeathed by A to his surviving spouse. The gross estate was valued at $415x and after the allowance of deductions of $15x, a marital deduction of $200x[1], and a specific exemption of $60x[2], the taxable estate was $140x. The Federal estate tax on this amount was $32.7x from which was subtracted $1.2x as a credit for State death taxes paid, leaving a net estate tax liability of $31.5x. The Revenue Ruling states that the surviving spouse is entitled to a § 691(c) deduction with respect to her portion of the total IRD of the estate.

The computation in Rev. Rul. 67-242, involves a situation where the spouse receives a specific bequest of IRD property. The computation illustrates that in determining the estate tax on the hypothetical estate, the marital bequest (and thus, the allowable marital deduction) is reduced by the IRD items specifically bequeathed to the spouse.

In Kincaid v. Commissioner, 85 T.C. 25 (1985), under the terms of the decedent's revocable trust, the surviving spouse was to receive property equal in value to the maximum marital deduction allowable to the estate (at the time of decedent's death, 50% of the adjusted gross estate) less the value of property includible in the gross estate that passed to the spouse outside of the trust. The decedent's gross estate included the value of certain annual bonus payments that were to continue after his death, and that became payable to the spouse as the designated beneficiary. The right to these payments (which constituted IRD) passed to the spouse outside of the trust, and therefore, under the formula bequest in the trust, the portion of the trust assets passing to the spouse was reduced by the value of the right to these payments. The Tax Court concluded that in determining the hypothetical estate tax, the marital deduction should be recomputed on the basis that the surviving spouse was entitled to one-half of the adjusted gross estate as provided by the formula bequest. Since the IRD was not a specific bequest to the surviving spouse, it was necessary to recompute

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[1] At the time this revenue ruling was issued, the maximum estate tax marital deduction allowable was 50% of the "adjusted gross estate" (the gross estate less deductions for funeral and administration expenses and claims). Since the property passing to the spouse was 50% of the adjusted gross estate, the entire bequest was deductible.

[2]Also at the time the revenue ruling was issued, an estate was allowed a specific exemption in the amount of $60,000.

the marital deduction (a formula bequest equal to one-half of the adjusted gross estate) by applying the formula to the hypothetical estate. Accordingly, in computing the hypothetical taxable estate, the court determined that the marital deduction should be equal to one-half the adjusted gross hypothetical estate, to reflect the marital bequest the spouse would have received under the terms of the trust.

In the present case, neither IRA 1 nor IRA 2 were specific bequests to Wife. Wife exercised her personal right of election and became entitled to one-third of the decedent's estate. Thus, in computing the estate tax for the hypothetical estate, the marital deduction is recomputed on the basis that Wife was entitled to one-third of the hypothetical estate as determined under State law. Accordingly, the estate tax on the hypothetical estate is calculated by deducting as a marital deduction, the value of one-third of the hypothetical estate as determined under State law. Kincaid v. Commissioner, 85 T.C. 25 (1985).

IRA 1 and IRA 2 are items of IRD. As such, the portion of Wife's elective share comprised of IRA 1 and IRA 2 represents IRD. Therefore, as Wife received IRD and Wife's estate and its beneficiaries have received and will receive IRD in the future, Wife and Wife's estate and its beneficiaries are entitled to a § 691(c) deduction for the estate tax attributable to the inclusion of the IRD items in the Decedent's gross estate and also in Wife's gross estate.

Furthermore, the amount, $t, paid to Wife through Trust 2 in Year from IRA 2 is gross income to Wife for Year. Therefore, under § 691(c), Wife is entitled to a deduction for Year for a portion of the Federal estate tax paid by Decedent's estate that is attributable to Wife's share of IRA 2 received by Wife in Year. Wife's deduction is calculated using the ratio described in § 691(c)(1) multiplied by the Federal estate tax attributable to the net value of the items of IRD.

Wife's interest in her portion of IRA 1 and IRA 2 is includible in the gross estate of Wife. As Wife's interest in IRA 1 and IRA 2 are amounts to which Wife was entitled as gross income, but which were not properly included in computing her taxable income for the taxable year ending with the date of her death or for a previous taxable year, Wife's interest in IRA 1 and IRA 2 is IRD to Wife's estate. Under § 691(c), Wife's estate and/or the beneficiaries of Wife's estate may deduct a portion of Federal estate tax paid by Decedent's estate that is attributable to Wife's interest in her portion of IRA 1 and IRA 2. To the extent the Federal estate tax on Wife's estate is attributable to IRA 1 and IRA 2, then the estate tax paid by Wife's estate attributable to IRA 1 and IRA 2 will also be deductible as provided in § 691(c). Thus, the recipients of such portions of IRA 1 and IRA 2 that were payable to Wife are entitled to a deduction under § 691(c) for the portion of the Federal estate tax attributable to the inclusion of IRA 1 and IRA 2 in Decedent's estate, and in addition, they are entitled to a deduction under § 691(c) for the portion of the Federal estate tax attributable to the inclusion of IRA 1 and IRA 2 in Wife's estate.

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 a power of attorney on file with this office, a copy of this letter is being sent to Executor's authorized representative.

Sincerely,

J. THOMAS HINES
Chief, Branch 2
Associate Chief Counsel
(Passthroughs and
Special Industries)

Enclosures: 2
Copy of this letter
Copy for § 6110 purposes