RECENT DEVELOPMENTS IN FIDUCIARY INCOME TAX

ABA SECTION OF TAXATION
2019 MAY MEETING
FIDUCIARY INCOME TAX COMMITTEE

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1. LEGISLATIVE & TREASURY UPDATE

a. IRS Section 199A Final Regulations

On January 18, 2019, the U.S. Treasury Department and the IRS released a version of final regulations under section 199A, which was enacted as part of the Tax Cuts and Jobs Act. The final regulations were posted on the IRS website in advance of being published in the Federal Register. The release finalized versions of the regulations that were proposed in August 2018. The final regulations generally apply to tax years after February 8, 2019, the date on which they were published in the Federal Register, but taxpayers may rely on either the proposed regulations in their entirety or the final regulations in their entirety for taxable years ending in 2018.

Changes by the final regulations include, but are not limited to, the following:

- “Net capital gain” includes qualified dividend income. This is important because the QBI deduction is limited to the amount of the taxpayer’s taxable income less net capital gains.

- The computations of the QBI deduction for taxpayers with taxable income in the phase-in range are clarified for the treatment of QBI from an SSTB, and SSTB limitations apply to income from a PTP.

- Trade or business conducted by a disregarded entity will be treated as conducted directly by the entity’s owner for purposes of § 199A.

- Property contributed to a partnership or S corporation will have a UBIA based on the transferee’s adjusted basis in the contributed property, less money received by the transferee or plus money paid by the transferee in the transaction.

- A taxpayer who transfers his or her interest in an RPE prior to the close of the RPE’s taxable year is not entitled to a share of UBIA from the RPE.

- The UBIA of property acquired from a decedent will be the fair market value of the property on the date of the decedent’s death and the depreciable period will begin on the decedent’s date of death.

- Aggregation will be allowable only if 50% common ownership exists on the last day of the taxable year, as well as for a majority of the taxable year.
The attribution rule for the common ownership test in the aggregation requirements will be under § 267(b) or § 707.

An RPE can elect to aggregate separate trades or businesses that are operated directly or through lower tier RPEs.

A taxpayer’s failure to aggregate certain businesses will not preclude later aggregation of those businesses.

If a business has SSTB activities and if the SSTB activities do not satisfy the de minimis rule, the entire business is treated as an SSTB.

The 80% test of the “anti-cracking and packing” rule is eliminated. Instead if a business provides property or services to a 50% or more commonly owned SSTB, the portion of the business provided property or services to the SSTB will be treated as a separate SSTB with respect to related parties.

The “incidental to an SSTB” rule is eliminated.

All of an RPE’s items related to a § 199A will not be presumed to be zero because of a failure to report one item. Instead, only the unreported item of positive QBI, wages or UBIA is presumed to be zero. Items may be reported on an amended or late return as long as the limitations period remains open.

ESBTs may continue to qualify for the § 199A deduction but the separate S and non-S portions of the ESBT are not treated as two separate trusts for purposes of applying the income threshold test.

For purposes of determining whether a trust’s taxable income exceeds the threshold amount, the trust’s taxable income is calculated after deducting any distribution deduction under § 651 or § 661.

The § 199A “anti-abuse” rule applies if a trust was created with a principal (as opposed to a significant) purpose of avoiding or using more than one threshold amount, and the effect is that the trust will be aggregated with the grantor or other trusts for purposes of determining the threshold amount.

b. Treasury Decision 9847

On February 8, 2019, the IRS issued Treasury Decision 9847 which contained the final regulations concerning the deduction for qualified business income under § 199A. These regulations are effective on February 8, 2019. Sections 1.199A-1 through 1.199A-6 are generally applicable to taxable years ending after February 8, 2019. However, taxpayers may rely on the rules set forth in §§ 1.199A-1 through 1.199A-6, in their entirety, or on the proposed regulations under §§ 1.199A-1 through 1.199A-6 issued on August 16, 2018, in their entirety, for taxable years.
ending in calendar year 2018. On April 17, 2019, the IRS issued corrections to Treasury Decision 9847 to correct certain errors that the IRS believed might prove to be misleading.

c. **Policy Statement on the Tax Regulatory Process, March 5, 2019**

IRS and Treasury Department announced that they are making changes to their guidelines for issuing tax guidance.

First, Treasury Department and the IRS previously have interpreted the Code to permit issuance of temporary regulations with immediate effect without including a statement of good cause. Treasury Department and the IRS now will include a statement of good cause in the preamble when issuing any future temporary regulations, except in certain exceptional circumstances.

Second, Treasury Department and the IRS will not argue that sub-regulatory guidance (e.g., revenue rulings, revenue procedures, notices and announcements) has the force and effect of law. In litigation before the U.S. Tax Court, as a matter of policy, the IRS will not seek judicial deference under *Auer v. Robbins*, 519 U.S. 452 (1997) or *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984) to interpretations only set forth in sub-regulatory guidance.

Third, prior to the issuance of proposed regulations, Treasury Department and the IRS sometimes publish a notice announcing their intention to issue proposed regulations. To limit uncertainty, Treasury Department and the IRS will include a statement in each future notice of intent to issue proposed regulations stating that if no proposed regulation or other guidance is released within 18 months after the notice is published, taxpayers may continue to rely on the guidance in the notice until additional guidance is issued, and Treasury Department and the IRS will not assert an adverse position.

d. **IRS Notice 2019-25**

Due to the large changes to the Internal Revenue Code made by the 2017 Tax Cuts and Jobs Acts, the addition to tax under section 6654 for failure to make estimated income tax payments for the 2018 taxable year otherwise required to be made on or before January 15, 2019, is waived for any individual whose total withholding and estimated tax payments made on or before January 15, 2019, equal or exceed eighty percent of the tax shown on that individual’s return for the 2018 taxable year. This Notice provides instructions on how to request this waiver or to claim a refund of the waived amount if it has already been paid.


Part 1: Implementation of Tax Cuts and Jobs Act
- Guidance clarifying the deductibility of certain expenses described in §67(b) and (e) that are incurred by estates and non-grantor trusts.
Guidance under §§101 and 1016 and new §6050Y regarding reportable policy sales of life insurance contracts. Notice 2018-41 was published on May 14, 2018.

Final regulations on computational, definitional, and anti-avoidance rules under new §199A and §643(f). Proposed regulations on computational, definitional, and anti-avoidance guidance under new §199A and §643(f) published on August 16, 2018 in FR as REG-107892-18 (NPRM) (Released on August 8, 2018).

Guidance implementing changes made to §529 by sections 11025 and 11032 of the TCJA and section 302 of the Protecting Americans from Tax Hikes (PATH) Act of 2015.

Notice on the increased contribution limit to §529A ABLE accounts, as added by section 11024 of the TCJA.

Guidance implementing changes to §1361 regarding electing small business trusts.

Regulations under § 2010 addressing the computation of the estate tax in the event of a difference between the basic exclusion amount applicable to gifts and that applicable at the donor’s date of death.

Part 3: Burden Reduction

Final regulations under §§1014(f) and 6035 regarding basis consistency between estate and person acquiring property from decedent. Proposed and temporary regulations were published on March 4, 2016.

Guidance under §170(e)(3) regarding charitable contributions of inventory.

Final regulations under §2642(g) describing the circumstances and procedures under which an extension of time will be granted to allocate GST exemption.

Final regulations streamlining the §754 election statement. Proposed regulations were published on October 12, 2017.

Guidance under §1362(f) regarding the validity or continuation of an S corporation election in certain situations involving disproportionate distributions, inconsistent tax return filings, or omissions on Form 2553, Election by a Small Business Corporation.

Part 5: General Guidance; Gifts and Estates and Trusts

Guidance on basis of grantor trust assets at death under §1014.

Final regulations under §2032(a) regarding imposition of restrictions on estate assets during the six month alternate valuation period. Proposed regulations were published on November 18, 2011.

Regulations under §2053 regarding personal guarantees and the application of present value concepts in determining the deductible amount of expenses and claims against the estate.

Regulations under §7520 regarding the use of actuarial tables in valuing annuities, interests for life or terms of years, and remainder or reversionary interests.
f. Prop Reg. Section 1.641(c)-1

The IRS has issued proposed regulations regarding the treatment of the income of an ESBT that is a grantor trust for income tax purposes when the grantor is a non-resident alien (NRA). The 2017 Tax Cuts and Jobs Act made a change to existing law and allowed NRAs as potential current beneficiaries of ESBTs. The proposed regulations would ensure that, with respect to situations in which an NRA is a deemed owner of a grantor trust that has elected to be an ESBT, the S corporation income of the ESBT would continue to be subject to U.S. Federal income tax. Specifically, the proposed regulations would modify the allocation rules under Reg. §1.641(c)-1 to require that the S corporation income of the ESBT be included in the S portion of the ESBT if that income otherwise would have been allocated to an NRA deemed owner under the grantor trust rules.

g. IRS Notice 2018-61 (ACTEC Comments)

On July 13, 2018, Notice 2018-61 became effective which stated that Regulations are to be issued clarifying that estates and non-grantor trusts may continue to deduct expenses described in tax code Section 67(e)(1) and amounts allowable as deductions under Section 642(b), Section 651 or Section 661, including the appropriate portion of a bundled fee, in determining the estate or non-grantor trust's adjusted gross income during taxable years, for which the application of Section 67(a) is suspended pursuant to Section 67(g). Additionally, the regulations will clarify that deductions enumerated in Section 67(b) and Section 67(e) continue to remain outside the definition of “miscellaneous itemized deductions” and thus are unaffected by Section 67(g), the IRS explained.

The IRS intends to also issue regulations regarding the interaction of Section 67(g) and Section 642(h).

ACTEC submitted comments to the IRS on February 19, 2019, which provided as follows:

- Request to address the treatment of expenses and deductions described in section 67(e)(1) and (2) for purposes of determining a trust’s or estate’s alternative minimum taxable income (as calculated under Section 56).
- Despite the fact that costs may be deductible by an estate or trust, either as non-miscellaneous itemized deductions or as deductions allowed in computing adjusted gross income, Treasury Reg. § 1.642(h)-2 aggregates the costs comprising the excess in the year of the estate’s or trust’s termination, and treats the aggregate excess as a single itemized deduction. ACTEC believes the Treasury Department and the IRS have the authority to separate these deductible items. More specifically, ACTEC recommends that regulations first require the fiduciary to divide any excess deduction in the final year of administration into separate amounts. At a minimum, the excess should be divided into at least three categories: (1) amounts allowed in computing adjusted gross income; (2) nonmiscellaneous itemized deductions (as defined by sections 63(d) and 67(b), but not including deductions allowed in computing adjusted gross income under section 67(e)); and (3) miscellaneous itemized deductions. The regulations should then provide that these amounts are carried out, without change in character, to the beneficiaries succeeding to the section 642(h)(2) excess deduction.
Finally, ACTEC recommends that the Treasury Department and the IRS address the treatment of suspended deductions on the termination of a trust. Suspended deductions include investment interest under section 163(d).23 The treatment of suspended passive activity losses is already addressed in section 469(j)(12). Other suspended deductions such as section 163(d) investment interest did not exist in 1954 when section 642(h) was enacted and guidance is needed in the case of such deductions. ACTEC recommends that such suspended deductions be treated in the same manner as excess deductions.

2. CASE LAW


   Background of Case: The Joseph Lee Rice, III Family 1992 Trust (later divided into separate trusts, one being The Kimberley Rice Kaestner 1992 Family Trust (the “Trust”)) was created in New York in 1992 for the benefit of the children of the settlor Joseph Lee Rice, III pursuant to a trust agreement between Rice and the initial trustee, William B. Matteson. In 2005 Matteson was replaced as trustee by David Bernstein, who was a resident of Connecticut. Bernstein remained in the position of trustee and remained a Connecticut resident during the entire period of time relevant to this case. The trust was and is governed by the laws of the State of New York, of which Rice was a resident. No party to the trust resided in North Carolina until Rice’s daughter and a primary beneficiary of the trust, Kimberley Rice Kaestner, moved to North Carolina in 1997.

   During the tax years at issue, the assets held by the Trust consisted of various financial investments, and the custodians of those assets were located in Boston, Massachusetts. Documents related to the Trust such as ownership documents, financial books and records, and legal records were all kept in New York. All of the Trust’s tax returns and accountings were prepared in New York.

   During tax years 2005 through 2008, North Carolina taxed the Trust on income accumulated each year, regardless of whether any of that income was distributed to any of the North Carolina beneficiaries. The Trust sought a refund of those taxes totaling more than $1.3 million, including $79,634.00 paid for 2005, $106,637.00 paid for 2006, $1,099,660.00 paid for 2007, and $17,241.00 paid for 2008. North Carolina denied the refund request on 11 February 2011.

   The relevant provision of N.C.G.S. section 105-160.2 has remained substantively unchanged since the tax years at issue and states that income tax on an estate or trust “is computed on the amount of the taxable income of the estate or trust that is for the benefit of a resident of this State.” Id. § 105-160.2 (2017). When applied to taxation, “[t]he Due Process Clause ‘requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax.’ ” Quill, 504 U.S. at 303, 112 S. Ct. at 1909 (quoting Miller Bros. Co. v. Maryland, 347 U.S. 340, 344-45, 74 S. Ct. 535, 539 (1954)). Due process also requires that “the ‘income attributed to the State for tax purposes must be rationally related to values connected with the taxing State,’ ” id. at 306, 112 S. Ct. at 1909-10 (internal quotation marks omitted)
That the Trust and its North Carolina beneficiaries have legally separate, taxable existences is critical to the outcome because a taxed entity’s minimum contacts with the taxing state cannot be established by a third party’s minimum contacts with the taxing state. Here it was the Trust’s beneficiaries, not the Trust, who reaped the benefits and protections of North Carolina’s laws by residing here. Because the Trust and the Trust’s beneficiaries are separate legal entities, due process was not satisfied solely from the beneficiaries’ contacts with North Carolina.

For taxation of a foreign trust to satisfy the due process guarantee of the Fourteenth Amendment and the similar pledge in Article I, Section 19 of our state constitution, the Trust must have some minimum contacts with the State of North Carolina such that the Trust enjoys the benefits and protections of the State. When, as here, the income of a foreign trust is subject to taxation solely based on its beneficiaries’ availing themselves of the benefits of our economy and the protections afforded by our laws, those guarantees are violated. Therefore, the North Carolina Supreme Court held that N.C.G.S. § 105-160.2 was unconstitutional as applied to collect income taxes from plaintiff for tax years 2005 through 2008.

The N.C. Department of Revenue petitioned for certiorari, which was granted by the Supreme Court on January 11, 2019. Oral argument for each side was held before the Supreme Court on April 16, 2019. During oral argument, the N.C. Department of Revenue maintained throughout that the beneficiaries of a trust are the true owners of the trust property and should be taxed on the trust’s income pro rata, regardless of whether a distribution is actually made to the beneficiary. The beneficiary’s right to enjoy the services, benefits, and protections of state residency is sufficient minimum contacts with the trust to support taxing the accumulated and undistributed trust income. Kaesnter, the Respondent, maintained that the income was never received by the beneficiary, who had no absolute right to receive it during the tax year or in future years. Further, it is the trustee, not the beneficiary, who has control over the trust property. A transcript of the oral argument can be found here:


b. **Dieringer v. Commissioner, 917 F.3d 1135**

i. **Facts.**

This case involved the estate of Victoria E. Dierenger (the “Estate”). Victoria and her late husband Robert E. Dieringer (“Robert”) had twelve children together, including Eugene Dieringer (“Eugene”), Patrick Dieringer (“Patrick”), and Timothy Dieringer (“Timothy”).

The Dieringer family owns Dieringer Properties, Inc. (“DPI”), a closely held corporation that manages commercial and residential properties. After Robert passed away and before Victoria’s death, Eugene was the president of DPI, Patrick was the executive vice-president and secretary, Victoria was the vice-president, and Timothy was the office manager. DPI's Board of
Directors ("Board") consisted of Victoria as chairperson, and Eugene, Patrick, Timothy, and Thomas Keepes ("Keepes"), who is unrelated to the Dieringers, as directors.

Before Victoria's death, the only shareholders of DPI were Victoria, Eugene, and Patrick. Victoria owned 425 out of 525 voting shares and 7,736.5 out of 9,220.5 nonvoting shares. Eugene owned the remaining 100 voting shares, and Eugene and Patrick each owned 742 nonvoting shares.

According to Victoria's will, which was dated November 10, 2000, upon her death all of the Estate would pass to the Victoria Evelyn Dieringer Trust ("Trust"). The Trust, as amended on April 22, 2005, provided for Victoria's children to receive some personal effects, but no other proceeds from her estate. The Trust also provided for $600,000 in donations to various charitable organizations. Any assets remaining in the Estate would then pass to the Bob and Evelyn Dieringer Family Foundation ("Foundation"), an I.R.C. § 501(c)(3) organization, as a charitable contribution. Under Victoria's estate plan, Eugene was appointed as the sole trustee of both the Trust and the Foundation. Patrick and Keepes served as advisory trustees of the Foundation.

Prior to Victoria's death, the DPI Board had preliminary discussions about purchasing Victoria's DPI shares as part of ongoing succession planning. A November 24, 2008 Board resolution reported that the issue had been discussed and that the Board resolved to “periodically purchase” Victoria’s shares based on terms acceptable to all parties. At a February 13, 2009 Board meeting, Victoria reiterated her potential interest in having DPI purchase her shares. In anticipation of entering a purchase agreement for Victoria's shares, DPI paid the Trust $45,000 prior to Victoria's death. When Victoria unexpectedly died on April 14, 2009, there were no specific redemption agreements in place.

When Victoria died, Eugene was appointed executor of the Estate. To determine the value of Victoria’s DPI shares for Estate administration purposes, the Estate’s law firm requested an independent appraisal of the net asset value of DPI. The appraisal determined that the value of DPI as of the date of Victoria’s death was $17,777,626 and that Victoria's shares in DPI were worth $14,182,471.

Effective November 20, 2009, DPI's Board converted the corporate structure from a C corporation to an S corporation on the advice of Keepes. The DPI Board made this change in corporate structure to accomplish its long-term tax planning goals and to avoid certain adverse tax consequences under I.R.C. § 1374. As a result of electing S corporation status, the DPI Board decided that it should also redeem Victoria's DPI shares that were to pass to the Foundation.

The Board entered into an agreement with the Trust to redeem Victoria’s shares, prior to the shares “pouring over” into the Foundation. Initially, DPI agreed to redeem all of Victoria's shares for $6,071,558, effective November 30, 2009. This amount was based on a 2002 appraisal, since the date-of-death appraisal had not yet been completed. As a result, the redemption agreement provided that the stated price would be "reconciled and adjusted retroactively" to reflect the fair market value of the shares as of November 30, 2009. DPI executed two promissory notes payable to the Trust in exchange for the DPI shares. Eugene, Patrick, and Timothy entered into separate subscription agreements to purchase additional DPI shares, in order to provide funding for DPI to meet the required payments on the promissory notes.
At the direction of DPI, an appraisal was obtained for the value of Victoria’s DPI shares as of November 30, 2009, for the purpose of redemption (“redemption appraisal”). The redemption appraisal valued Victoria’s DPI shares at $916 per voting share and $870 per nonvoting share. The appraiser testified that Eugene (through his lawyer) instructed him to value Victoria’s DPI shares as if they were a minority interest in DPI for the purposes of this appraisal, and that he would not have done so without these instructions. The redemption appraisal therefore included a 15-percent discount for lack of control and a 35-percent discount for lack of marketability. As a result, Victoria's DPI shares were valued significantly less in the redemption appraisal than in the date-of-death appraisal.

DPI determined that it could not afford to redeem all of Victoria’s shares at the new valuation price. The redemption agreement was then amended, and consequently DPI redeemed all 425 voting shares and 5,600.5 nonvoting shares for a total purchase price of $5,263,462. The balance on the long-term promissory note was amended to reflect the changes in the number and price of shares under the amended redemption agreement. After the redemption agreement was implemented, the distribution of DPI shares was as follows: (1) the Trust owned 2,136 nonvoting shares; (2) Eugene owned 200 voting shares and 2,932 nonvoting shares; (3) Patrick owned 65 voting shares and 893 nonvoting shares; and (4) Timothy owned 25 voting shares and 108 nonvoting shares.

In January 2011, the Trust distributed the promissory notes and the remaining DPI shares to the Foundation. The state probate court approved the redemption agreement and indicated that the redemption agreement and promissory notes would not be prohibited self-dealing under I.R.C. § 4941. For the 2011 tax year, the Foundation reported the following contributions on its Form 990-PF, Return of Private Foundation: (1) a noncash contribution of DPI shares with a fair market value of $1,858,961; (2) a long-term note receivable with a fair market value of $2,921,312; and (3) a short-term note receivable with a fair market value of $2,250,000. The Trust reported a capital loss of $385,934 for the sale of the 425 voting shares and $4,831,439 for the sale of 5,600.5 nonvoting shares for the taxable year ending on December 31, 2009, on its Form 1041 Tax Return.

In June 2013, the Internal Revenue Service (“IRS”) issued a notice of deficiency to the Estate based on its July 2010 tax return (Form 706). The notice stated that there was a deficiency of $4,124,717 and imposed an accuracy-related penalty of $824,943 under I.R.C. § 6662 for error and negligence in using the date-of-death appraisal as the value of the charitable contribution of Victoria’s DPI shares.

Upon receiving the notice of deficiency, the Estate filed a timely petition in the Tax Court challenging the Commissioner's deficiency notice and penalty assessment. The Estate argued that it correctly used the date-of-death appraisal to determine the value of Victoria’s DPI shares for the purpose of the charitable contribution deduction. The IRS responded that post-death events should be considered in determining the value of the charitable contribution, as the actions by Eugene, Patrick, and Timothy reduced the value of Victoria’s contribution to the Foundation.
Following trial, the Tax Court issued a decision upholding the IRS’s reduction of the Estate's charitable deduction and the deficiency assessment. The Tax Court found that the redemption was not part of Victoria’s estate plan and there were valid business reasons for many of the transactions that took place after her death. The Tax Court also concluded, however, that post-death events—primarily Eugene's decision to apply a minority interest discount to the redemption value of Victoria’s DPI shares—reduced the value of the contribution to the Foundation and therefore reduced the value of the Estate’s charitable deduction. Further, the Tax Court affirmed the Commissioner's determination that the Estate was liable for a penalty under I.R.C. § 6662(a). After denying the Estate's motion for reconsideration, the Tax Court entered a final decision in favor of the IRS, which sustained an estate tax deficiency of $4,124,717 and an accuracy-related penalty of $824,943. The Estate timely appealed.

ii. Ruling.

Relying on Ahmanson Foundation v. United States, 674 F.2d 761, 772 (9th Cir. 1981), the Court of Appeals affirmed the Tax Court’s ruling regarding the deficiency assessment. The Court of Appeals found that Victoria structured her estate plan in a manner that enabled Eugene to commit almost unchecked abuse of the Estate by setting him up to be executor of the Estate, trustee of the Trust, and trustee of the Foundation, in addition to his roles as president, director, and majority shareholder of DPI. The Court of Appeals also found that, by improperly directing the appraiser to determine the redemption value of the DPI shares by applying a minority interest valuation, Eugene manipulated the charitable deduction so that the Foundation only received a fraction of the charitable deduction claimed by the Estate.

The Court of Appeals also held that the record supported the assessment of a penalty under I.R.C. § 6662(a) as the redemption appraisal was inaccurate because of instructions from Eugene on behalf of the Estate, which meant the Estate “knew” that Eugene and his brothers were acquiring the DPI stock at a discount. Further, the Court of Appeals found that the appraiser's credible testimony that he was instructed to undertake a minority interest valuation, which he ordinarily would not have done in this situation, demonstrated the Estate’s lack of good faith.


i. Facts.


In 2014 Jill received the following distributions: (1) a $174,832 annuity from National Financial Services, LLC; (2) $44,705 from an individual retirement account (“IRA”) from UBS Financial Services, Inc. (“UBS”); and (3) $50,000 from an IRA from First Clearing, LLC (“First Clearing”). Jill reported these amounts on her 2014 Form 1040, U.S. Individual Income Tax
Return. Jill’s Forms 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc., for UBS and First Clearing list her as Robert’s beneficiary.

On her 2014 Schedule A, Itemized Deductions, Jill claimed a miscellaneous deduction for Federal estate tax of $156,789 attributable to Albert. On February 27, 2017, the Internal Revenue Service (“IRS”) issued a notice of deficiency to Jill disallowing the deduction.

ii. Ruling.

The Tax Court held that Jill provided no evidence that any of the three distributions to her were included in either Robert’s or Albert’s estate, or that any estate tax was paid for any of the three distributions in either Robert’s or Albert’s estate. As a result, the Tax Court held that Jill did not meet her burden of showing that she was entitled to a deduction for federal estate tax attributable to IRD.


Lawrence and Linda Mann ("the Manns") filed a tax refund suit against the United States of America to challenge the disallowance by the Internal Revenue Service ("IRS") on their 2011 joint tax return of three claimed charitable deductions: (1) $675,000 for the donation of a house; (2) $24,206 for the donation of personal property in that house, and (3) $10,000 in cash to Second Chance, Inc. ("Second Chance"), a non-profit property deconstruction organization.

In April 2011, the Manns purchased real property located at 5300 Moorland Lane in Bethesda, Maryland ("the Property"). At the time the Manns purchased the Property, it included a remodeled colonial-style house ("the House") in good condition. However, the Manns later discovered that the House had a wet basement, and decided to have the House demolished and to build a new home on the Property. At no point before the demolition did the Manns reside in the House. The Manns hired Potomac Valley Builders to demolish the House and to build a new residence on the Property. Prior to the demolition, the Manns contacted Second Chance about donating the House. Second Chance is a charitable organization under section 501(c)(3) of the Internal Revenue Code that engages in property "deconstruction," the salvaging of building materials, fixtures, and furniture from properties.

On December 1, 2011, Linda Mann signed an agreement with Second Chance to donate the House for deconstruction. That same day, Linda Mann signed an agreement with Second Chance conveying all of her rights, title, and interest in "the improvements, building and fixtures located on the Premises" located at 5300 Moorland Lane, Bethesda, Maryland, excluding a shed located on the Property. I.R.494. There is no evidence that this agreement was recorded in the Montgomery County land records.

As to the tax implications of Second Chance's deconstruction services, in a December 20, 2011 email to Lawrence Mann, a deconstruction sales manager for Second Chance explained that generally, donors could claim a tax deduction for all material that "crosses the threshold of [the Second Chance] warehouse." The manager stated that Second Chance expected deconstruction of
the House to yield items with a fair market value of at least $150,000 at a "conservative minimum," which would translate to a tax savings of approximately $45,000.

Using a sales comparison methodology, which relies on comparable home sales in the same neighborhood, the first House appraisal ("House Appraisal A") valued the entirety of the Property at $1,875,000, the Property without the House at $1,200,000, and thus the House specifically at $675,000. The Personal Property appraisal included an itemized list of 40 pieces of furniture or home decoration, individually valued and photographed. The total appraised value of those items was $24,206. On their 2011 tax return, the Manns claimed charitable donations in the amount of $675,000 for the value of the House, $24,206 for the value of the Personal Property, and $10,000 for the cash donation to Second Chance. In June 2014, the IRS disallowed all of these claimed donations. In an effort to avoid litigating the 2011 deductions, the Manns filed an amended 2011 tax return in August 2016. In that amended return, they adjusted the claimed deduction for the donation of the House from $675,000 to $313,353, the value of the deconstructed House as determined in House Appraisal B, and accordingly sought a refund of $92,837. House Appraisal B specifically states that it seeks to "determine the fair market value of the donated structure's used building components when sold on the 2nd hand market" by taking the value of new versions of the building materials comprising the House and depreciating those materials based on the age of the House.

The IRS now maintains that the Manns are not entitled under Section 170 to either the original $675,000 fair market value deduction or the amended $313,353 deconstructed value deduction. The IRS asserts that in donating the value of the House, the Manns donated only a part of their interest in the Property, and that such partial-interest donations are impermissible under Section 170. In opposition, the Manns assert that they had a discrete interest in the House that could be and was properly and separately donated pursuant to S 170.

"The Code generally restricts a taxpayer's ability to claim a charitable deduction for the donation of an interest in property which consists of less than the taxpayer's entire interest in such property," except in certain circumstances not present here. Belk v. Comm'r of Internal Revenue, 774 F.3d 221,224 (4th Cir. 2014)(citing 26 U.S.C. S 170(f)(3)(A)). See 26 C.F.R. S 1.170A7(a)(l) (providing that "[i]n case of a charitable contribution ... of any interest in property which consists of less than the donor's entire interest in such property, no deduction is allowed under section 170" except in certain limited circumstances). Whether a claimed donation of a property interest is of an entire interest, and thus properly deductible, or of a partial interest, and thus not properly deductible, is "ultimately a question of federal law," but "[t]he answer to this federal question ... largely depends upon state law" property rights. United States v. Craft, 535 U.S. 273, 278 (2002). In Maryland, real property for tax purposes can consist of "land or improvements to land." Md. Code Ann. Tax-Property SI-101(gg)(l) (West 2002). Improvements to land include "buildings and structures of every kind." Supervisor of Assessments of Bait. Cty. v. Greater Bait. Med. Ctr., 32 A,3d 174, 180 (Md. Ct. Spec. App. 2011) ("GBMC").

In Maryland, then, it is possible to sever the property interest in improvements to real property from the land itself, such that it would have been possible for a donation of the House to be a conveyance of an entire property interest rather than a partial interest in the overall Property. However, Maryland law is equally clear that the severance of the House from the Property and the
transfer of the entire interest in the separated House would be valid for tax purposes only if that transaction is separately recorded in the land records. In Townsend Baltimore Garage, LLC v. Supervisor of Assessments of Baltimore City, 79 A.3d 960 (Md. Ct. Spec. App. 2009). Here, the Manns sought to convey a separate interest in the House to Second Chance through a private contract, but they never recorded that transaction in the land records. As a result, for tax purposes under Maryland law, the Manns have not properly severed the House from the Property and transferred ownership of it to Second Chance. As a result, the Manns' donation was comparable to granting a license to Second Chance to access and use the House for salvage and training purposes.

The Manns assert that the Maryland case law on which this conclusion rests is inapt because it involves a tax assessment, rather than a tax deduction. However, the Manns point to no case or statute establishing any salient distinction between tax assessments and tax deductions in this context. Likewise, the cases cited by the Manns in support of the undisputed point that, under Maryland law, improvements to land can be severed from real property do not alter the Court's conclusion. None address the question of the specific requirements under Maryland law for properly severing ownership interests in real property from ownership interests in improvements to land for tax purposes. The Court thus determines that, as a matter of law, the Manns' donation of the House to Second Chance was not a proper conveyance of an undivided interest in property. Accordingly, the House donation was not a qualifying charitable contribution under S 170 and was not deductible.

Even if the Court were to find that the Manns had properly severed their interest in the real property from their interest in the House and had properly donated the latter to Second Chance, the Manns would still not be entitled to their original claimed deduction of $675,000 or their amended claimed deduction of $313,353. Charitable contributions of property for which a deduction of more than $5,000 is claimed must be accompanied by a qualified appraisal of the donated property. 26 U.S.C. Section 170(f)(11). Because neither House Appraisal A nor House Appraisal B was a qualified appraisal that properly substantiated the Manns' claimed deductions, and the Manns have not otherwise met their burden to justify those deductions, the Court granted summary judgment to the IRS on the issue of the donation of the House.


By way of background, the Dille Family Trust purports or alleges that it owns copyrights, trademarks and other intellectual property rights relative to the fictional comic character known as the 25th century space explorer "Buck Rogers" (also known as "Anthony Rogers"). The intellectual property rights claimed by the Dille Family Trust include the rights relating to a novella entitled Armageddon 2419 A.D., where the character "Anthony Rogers" first appeared. This novella was allegedly written by Phillip Francis Nowlan in 1928 or 1929 while he was under contract with either John F. Dille or his companies. A lawsuit regarding the public domain rights over the intellectual property was filed by Team Angry Filmworks and was ultimately transferred to the Western District of Pennsylvania because the non-bankruptcy trustee for the Dille Family Trust, Louise A. Geer, resides in New Castle, Pa.
With the trial looming in the Eastern District, the Dille Family Trust's ability to fund payment of the fees and expenses of its legal counsel ended. The beneficiaries of the Dille Family Trust are the surviving children of Robert C. Dille (i.e., Robert Nichols Flint Dille and Lorraine Dille Williams). The latter, Lorraine Dille Williams, was lending the trust monies enabling the Dille Family Trust to mount its litigation efforts, despite the fact that the trust on its own was not generating enough income to pay for such expenses. Without funding for the litigation, the Dille Family Trust filed for Chapter 11 relief on November 28, 2017. The effect of the filing was that all litigation was stayed and, instead, the parties sharpened their litigation arrows before this Court.

A hearing on the Motion to Dismiss was held on January 7, 2019. At that hearing, argument was spirited by all parties including the Chapter 11 Trustee and Team Angry Filmworks. In addition, Lorraine Dille Williams appeared pro se and counsel for Robert Nichols Flint Dille appeared. At the hearing, these beneficiaries reported to the Court that they lost confidence in Ms. Geer and are concerned that no estate fiduciary is looking out for the interests of the beneficiaries. The gist of these motions is that given all of the acrimony, and the costs attendant to litigation, the Trustee believes that a reorganization is neither possible nor likely. The Trustee would therefore like to sell the intellectual property and other assets for the benefit of creditors and convert this case to a Chapter 7 liquidation.

Turning to the relevant statutes that guide this Court's rule of decision, 11 U.S.C. § 109(d) provides, in pertinent part, that only "a person . . . may be a debtor" under Chapter 11. The term "person" is further defined in the Bankruptcy Code as including an "individual, partnership, and corporation . . . ." See 11 U.S.C. § 101(41). Also, the term "corporation" is limited to certain business entities including a "business trust."

A fair reading or synthesis of the case law is that the riddle of whether a trust constitutes a valid "business trust" turns upon two generally required elements. The first is whether the trust itself was created for the purpose of transacting business for a profit (as opposed to merely preserving a res for beneficiaries). The second is whether the trust in-fact has all of the indicia of a corporate entity. If both of these items are present, then the trust at issue is more than a gratuitous or ordinary trust and is a business trust. If any one of these two characteristics is not present, then the trust is not a "business trust" and is ineligible for bankruptcy relief under Chapter 11 pursuant to 11 U.S.C. § 109(d).

Turning to the plain language of the relevant trust documents, there is no question that the purpose of the Dille Family Trust is to create an estate-planning vehicle or otherwise preserve the res for family beneficiaries. The text of the governing documents supports this conclusion.

It is true that the Dille Family Trust has from time to time licensed certain "Buck Rogers" related intellectual property. The extent and magnitude of these affairs is hardly clear in the record. In addition, the 2012 tax returns filed by Ms. Geer reflect no net income as all royalties were consumed by the professional expenses and management fees of the trustee. Given the foregoing, the Court found that the primary purpose of the Dille Family Trust was to protect and preserve the res for the benefit of the family beneficiaries under the trust, and not primarily for transacting business for a profit. For this reason alone, the Dille Family Trust does not qualify as a "business trust" and is therefore ineligible for bankruptcy relief by operation of 11 U.S.C. §§ 101(9), 101(41),
and 109(d). As to indicia of corporateness, the Court found that the weight of the record supports a finding that the Dille Family Trust lacks sufficient characteristics of a corporate entity and was therefore determined to be an ordinary trust not eligible for bankruptcy.

3. OTHER GUIDANCE

a. PLR 201908008 - Section 2501 - Imposition of tax.

i. Facts.

Grantor created an irrevocable trust (“Trust”) for the benefit of two individuals and a foundation (“Foundation”). The Trust had an Independent Trustee and an Administrative Trustee.

Article I(1) of the Trust provides that during the Grantor’s life, the Trustees shall pay so much, if any, of the net income from the Trust to or for the benefit of any one or more of the beneficiaries, in such equal or unequal shares and to the exclusion of any one or more of the other beneficiaries, as the Distribution Committee shall, at any time or from time to time by written instrument delivered to the Trustees, direct; provided, however, that the Trustees shall not distribute any amount to any of the beneficiaries pursuant to any direction of the Distribution Committee unless and until the Grantor shall, acting individually and in a nonfiduciary capacity, consent in writing to such direction.

Article I(2) of the Trust further provided that the Trustees are authorized to distribute all or any part of the net income of the Trust not distributed pursuant to Article I(1) to any one or more of the beneficiaries, in such equal or unequal shares and to the exclusion of any one or more of the other beneficiaries, as the Independent Trustee shall, at any time or from time to time in the absolute discretion of the Independent Trustee, determines for any purpose.

Article I(3) of the Trust provides that the Trustees shall pay so much, if any, of the principal of the Trust to or for the benefit of any one or more charitable organizations, and in such equal or unequal shares, as Grantor shall, at any time or from time to time by written instrument, direct and appoint; provided, however, that this power of appointment is not exercisable to any extent in favor of Grantor, Grantor’s estate, the creditors of Grantor, or the creditors of Grantor’s estate.

Any net income not paid pursuant to Article I is accumulated and added to principal of the Trust.

Article II of the Trust provides that following Grantor’s death, the Trustees shall distribute the trust estate to one or more charitable organizations, and in such equal or unequal shares, as Grantor shall direct and appoint; provided, however, that this power of appointment is not exercisable to any extent in favor of Grantor, Grantor’s estate, the creditors of Grantor, or the creditors of Grantor’s estate. To the extent Trust property is not effectively appointed, the Trustees shall distribute such property to such one or more charitable organizations, and in such equal or unequal shares, as the Independent Trustee shall determine in the absolute discretion of the Independent Trustee.
The Trust provides that during the Grantor’s lifetime the Distribution Committee shall have the power to direct the Trustees as provided in Article I of the Trust. Following the Grantor’s death the Distribution Committee will cease to exist. The initial members of the Distribution Committee are the Independent Trustee and the two individual beneficiaries of the Trust. Grantor, or if she is unable to act, the members of the Distribution Committee may appoint successor members to the Distribution Committee. The Independent Trust also has the power to appoint members to the committee. The Distribution Committee will act by majority decision at all times there is more than one member of the Distribution Committee. The Trust requires that there be at least one member of the Distribution Committee at all times during the Grantor’s life and that a majority of the members of the Distribution Committee must consist of beneficiaries.

The Trust also provides that there shall not be more than three individuals, or more than two individuals and one corporation in office as Trustees of Trust, and neither the Grantor, Grantor’s spouse, nor any individual or corporation who is related or subordinate to Grantor or Grantor’s husband (within the meaning of § 672(c)) is eligible to serve as trustee of the Trust.

Grantor requested 7 rulings:

(1) The contribution of property by Grantor to the Trust will not be a completed gift.

(2) Any distribution of income to any one of the beneficiaries pursuant to Article I(1) of the Trust will not be a completed gift by any member of the Distribution Committee.

(3) If Settlor exercises her inter vivos limited power of appointment and appoints all or any part of the principal of the Trust to one or more charitable organizations, any such distribution pursuant to the appointment will be a completed gift by Grantor and, in such event, a gift tax charitable deduction would be allowed to Grantor for the amount of such gift.

(4) The members of the Distribution Committee do not possess a general power of appointment within the meaning of § 2041.

(5) For as long as the Distribution Committee is serving, neither Grantor nor any member of the Distribution Committee shall be treated as the owner of any portion of the Trust under §§ 671 through 678 and, accordingly, no portion of the items of income, gain, deductions and credits of the Trust will be included under § 671 in computing the taxable income of Grantor or of any member of the Distribution Committee.

(6) Except to the extent that the Trust has “unrelated business income” within the meaning of § 681(a), the Trust will be allowed a charitable deduction in any taxable year in accordance with § 642(c)(1) against any gross income, including capital gains and ordinary income, otherwise taxable to the Trust for the full amount paid during such taxable year (or by the close of the following taxable year, if the Trustees shall so elect) to charitable organizations pursuant to Grantor’s exercise of her inter vivos limited power of appointment.

(7) Grantor will not be a disqualified person with respect to the Trust because the Trust will not be treated as a split-interest trust within the meaning of § 4947(a)(2) and Treas. Reg. § 53.4947-1(c)(1)(i).
ii. **Ruling.**

First, the IRS determined that a transfer of property to the Trust by the Grantor would not be a completed gift for income purposes because the Grantor retained a right to consent to distributions of income under Article I(1) of the Trust. However, the IRS did note that if the Grantor failed to exercise her consent right that she would be treated as making a gift if the Independent Trustee makes a distribution to a beneficiary. Additionally the IRS determined that a transfer of property to the Trust by the Grantor would be incomplete with respect to the remainder because Grantor held a limited power of appointment over the Trust.

With respect to the second and fourth requested ruling, the IRS determined that the members of the Distribution Committee did not possess general powers of appointment because their powers were exercisable only in conjunction with the Grantor.

With respect to the third requested ruling, the IRS determined that any transfer to a charitable organization pursuant to the exercise of Grantor’s limited power of appointment would be a completed gift, to which a charitable deduction would be allowable.

Regarding the fifth requested ruling, the IRS concluded that the Trust included none of the circumstances that would cause Grantor to be treated as the owner of any portion of the Trust under §§ 673, 674, 676, or 677 as long as the Distribution Committee is serving. Further, because none of the members of the Distribution Committee have a power exercisable by himself to vest trust income or corpus in himself, the IRS determined that none of the members of the Distribution Committee would be treated as the owner of the Trust under § 678(a). The IRS also noted that an examination of the Trust revealed none of the circumstances that would cause administrative controls to be considered exercisable primarily for the benefit of the Grantor under § 675, but stated that the circumstances attendant on the operation of the Trust will be what determines whether the Grantor will be treated as the owner of any portion of the Trust under § 675 and therefore the determination of whether Grantor is treated as owner of the Trust under § 675 would be deferred until the federal income tax returns of all parties involved have been examined.

Regarding the sixth and seventh rulings requested, the IRS determined that except to the extent the Trust has any “unrelated business income” the trust would be entitled to a charitable deduction for amounts passing to a charitable organization and that the Grantor would not be a disqualified person because the Trust would not be treated as a split-interest trust.

b. **PLR 201907004 - Section 4941 - Taxes on self-dealing.**

i. **Facts.**

Grantor transferred certain business interests to trusts established for the benefit of Grantor’s descendants (“Beneficiary Trusts”) in exchange for promissory notes that pay interest only for a term of 30 years, with the total principal amount for the notes due at the end of the term. The sole beneficiary or all of the beneficiaries of each Beneficiary Trust are the Grantor’s descendants.
Grantor assigned the promissory notes to a limited liability company (“LLC”). The members of LLC are Grantor, who holds all of the nonvoting interests in LLC, and another limited liability company (“LLC 2”), which holds all of the voting interests in LLC. The members of LLC 2 are the Grantor’s descendants and each holds interests as individuals.

LLC will hold and administer the promissory notes and receive payments of interest and principal on the promissory notes. Aside from the cash initially contributed by LLC 2 for the voting interests in LLC, LLC’s sole assets and source of income will be the promissory notes.

Power to manage the affairs of LLC is vested in the manager, who is selected and may be removed by a vote of the members holding at least a majority of the voting interests in LLC (currently LLC 2, which holds 100 percent of such voting interests). Grantor’s daughter (“Daughter”), who is also the Trustee of a charitable lead annuity trust (“Trust”), is the initial manager of LLC. Daughter holds interests in LLC only in an individual capacity indirectly through her interests in LLC 2, not in her capacity as Trustee of Trust.

The members holding nonvoting interests (currently Trustor, who holds 100 percent of such nonvoting interests) possess no management rights or rights to vote on who will be the manager of LLC. LLC may be dissolved only with written approval of all members, whether holding voting or nonvoting interests.

The remainder interests in Trust benefit the Grantor’s descendants. Grantor proposes to fund Trust by transferring Grantor’s nonvoting interests in LLC to Trust. The annuity amount shall be paid from Trust’s income, including distributions from LLC, and, to the extent income is insufficient, from Trust’s principal. Trust is subject to section 4941 under section 4947(a)(2). The Grantor requests a ruling that his transfer of his interests in LLC to Trust will not violate the prohibition against self-dealing.

**ii. Ruling.**

The IRS determined that Trust would have no management rights or right to vote on the manager of LLC. Further, Trust would have a right to receive distributions only if LLC dissolved or chose to make current distributions, but the timing and amount of such distributions would be uncertain and could not be compelled by Trust. Additionally, Trust would not have the power to compel dissolution of LLC since LLC may only be dissolved with written approval of all members, including LLC 2. Accordingly, the IRS ruled that Trust’s receipt of nonvoting interests in LLC from the Grantor would not constitute a loan or extension of credit between a “private foundation” and a “disqualified person” within the meaning of section 4941(d)(1)(B) and Treas. Reg. §53.4941(d)-2(c) because Trust would not acquire an interest in the promissory note; instead, Trust would acquire nonvoting interests in LLC, with respect to which it would not have any management rights or control over distributions.
c. PLR 201909005 - Section 1361 - S corporation defined.

See also:
- PLR 201908012 - Section 1361 - S corporation defined
- PLR 201905002 - Section 1361 - S corporation defined.

i. Facts.

X was incorporated under the laws of State on Date 1, and elected to be an S corporation effective Date 2. On Date 3, A transferred a shares of X stock to Trust 1. X represents that Trust 1 was treated as a wholly-owned grantor trust under §§ 671 and 676. On Date 4, A died and Trust 1 ceased to be a grantor trust with respect to A’s interests, but would have continued to qualify as an eligible S corporation shareholder under § 1361(c)(2)(A)(ii) for the two year period beginning on the day of the deemed owner’s death. On Date 5, before the end of the two year period, Trust 1 transferred a shares of X stock to Trust 2. X represents that Trust 2 qualified to elect to be treated as an electing small business trust (ESBT), however, the trustee failed to make a timely ESBT election within the meaning of § 1361(e)(1)(A)(v) thereby causing X’s S corporation election to terminate on Date 5. On Date 6, Trust 2 distributed a shares of stock in X to Trust 3. X represents that Trust 3 qualified to elect to be treated as a qualified subchapter S trust (QSST) but the beneficiary failed to make a timely QSST election within the meaning of § 1361(d)(2). The failure to make the QSST election Date 6, would have terminated X’s S corporation election had it not already been terminated Date 5.

X represents that the circumstances resulting in the termination of their respective S corporation elections were inadvertent and not motivated by tax avoidance. X further represent that it filed returns consistent with its status as an S corporation. X and its shareholders agree to make such adjustments (consistent with the treatment of X as an S corporation) as may be required by the Secretary.

ii. Analysis.

Section 1361(a)(1) provides that the term “S corporation” means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1)(B) provides that, for purposes of subchapter S, the term “small business corporation” means a domestic corporation which is not an ineligible corporation and which does not have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual.

Section 1361(c)(2)(A)(i) provides that, for purposes of § 1361(b)(1)(B), a trust all of which is treated (under subpart E of part 1 of subchapter J of chapter 1) as owned by an individual who is a citizen or resident of the United States may be an S corporation shareholder.

Section 1361(c)(2)(A)(ii) and § 1.1361-1(b)(1)(ii) provide that, for purposes of § 1361(b)(1)(B), a trust that is described in § 1361(c)(2)(A)(i) immediately before the death of the deemed owner and that continues in existence after such death is a permitted S corporation
shareholder, but only for the two-year period beginning on the day of the deemed owner’s death. Section 1.1361-1(h)(3)(i)(B) provides that if stock is held by a trust described in § 1.1361-1(h)(1)(ii), the estate of the deemed owner is generally treated as the shareholder as of the day of the deemed owner’s death.

Section 1361(c)(2)(A)(v) provides that for the purposes of § 1362(b)(1)(B), an ESBT may be a shareholder.

Section 1361(d)(1) provides, in part, that in the case of a QSST with respect to which a beneficiary makes an election under § 1361(d)(2)(A) such trust shall be treated as a trust described in § 1361(c)(2)(A)(i).

Section 1362(d)(2) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the 1st day of the 1st taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2) or (3) (2) the Secretary determines that the circumstances resulting in such termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such termination, steps were taken so that the corporation for which the termination occurred is a small business corporation, and (4) the corporation for which the termination occurred, and each person who was a shareholder in such corporation at any time during the period specified pursuant to 1362(f), agrees to make such adjustments (consistent with the treatment of such corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

iii.  **Ruling.**

Based solely on the facts submitted and representations made, we conclude that X’s S corporation election terminated beginning on Date 5, when the stock in X was transferred to Trust 2, because the trustee of Trust 2 failed to timely file the ESBT election under § 1361(e)(1)(A)(v). We conclude that the termination was inadvertent within the meaning of § 1362(f). Moreover, had X’s S corporation election not already terminated on Date 5, it would have terminated on Date 6, when stock was transferred to Trust 3 and the beneficiary of Trust 3 failed to a timely file QSST election under § 1361(d)(2). Similarly, this termination was inadvertent within the meaning of § 1362(f).

Pursuant to the provisions of § 1362(f), X will be treated as an S corporation on and after Date 5, unless X’s S corporation election is otherwise terminated under § 1362(d). This ruling is conditioned on (1) the trustee of Trust 2 filing an ESBT election effective Date 5, with the appropriate service center within 120 days of the date of this letter, and 2) the beneficiary of Trust 2 filing a QSST election for Trust 2 effective Date 6, within 120 days from the date of this letter. A copy of this letter should be attached the ESBT and QSST elections.
d. PLR 201908003 - Section 671 - Trust income, deductions, and credits attributable to grantors and others as substantial owners

i. Facts.

Grantor created an irrevocable trust (“Trust”) for the benefit of Grantor, Child, Individual A, Individual B, Individual C, and Individual D (collectively the “Lifetime Beneficiaries”). Child is a minor. Grantor is the only donor of all property contributed to Trust. A corporate trustee, Trustee, is the trustee of Trust. Trust has been a domestic trust since the time of its creation.

Section 5.01 of Trust provides that during Grantor's lifetime, Trustee must retain all contributions to Trust in a single trust for the benefit of the Lifetime Beneficiaries. Further, pursuant to Section 5.02 of Trust, Trustee must not make any distributions except as appointed by Grantor or the Power of Appointment Committee (“Committee”). During Grantor’s lifetime, Grantor may appoint trust principal (including the whole thereof) outright or in trust to or for the benefit of any one or more of the Lifetime Beneficiaries as Grantor deems advisable for the beneficiary’s health, education, maintenance, or support. Grantor may not exercise this power to appoint any interest in trust to Grantor, Grantor's estate, Grantor’s creditors, or the creditors of Grantor’s estate. Grantor holds this power in a non-fiduciary capacity.

Section 5.02(b)(1) provides that during Grantor’s lifetime, a majority of the Committee members, with Grantor’s written consent, may (but are not required to) appoint Trust income or principal (including the whole thereof) outright or in trust to or for the benefit of the Lifetime Beneficiaries, including the Grantor, for any purpose at any time and from time to time.

Section 5.02(b)(2) of Trust provides that during Grantor’s lifetime, the Committee members, other than Grantor, by unanimous vote, may (but are not required to) appoint Trust income or principal (including the whole thereof) to or for the benefit of any one or more of the Lifetime Beneficiaries, including the Grantor, for any purposes at any time and from time to time.

Section 5.03 of Trust provides that, during Grantor’s lifetime, if at any time the Committee ceases to exist, Trustee may (but is not required to) distribute income or principal to the Lifetime Beneficiaries, other than Grantor, as follows: (a) Independent Trustee may distribute any portion of Trust property outright or in trust to or for the benefit of any Lifetime Beneficiary as Independent Trustee determines advisable for any purpose, including distribution of all or part of the trust principal to fund a beneficiary’s business ventures, investment ventures, or charitable giving. An Interested Trustee must not make distributions from Trust. Independent Trustee is defined as any trustee who is not an Interested Trustee. An Interested Trustee is defined as a Trustee who is a transferor or beneficiary, is related or subordinate to a transferor or beneficiary, can be removed and replaced by a transferor with either the transferor or a party who is related or subordinate to the transferor, or can be removed and replaced by a beneficiary with either the beneficiary or a party who is related or subordinate to the beneficiary. Section 5.03(d) provides that under no circumstances may Trustee make any distribution to any beneficiary in a manner that would discharge any of Grantor’s legal obligations.
Section 5.05 of Trust provides that upon Grantor's death, Grantor may appoint the balance of Trust to any one or more persons or charities in equal or unequal proportions and on any terms or conditions Grantor designates. Grantor may not exercise this power for the purpose of discharging Grantor’s legal obligations or otherwise for Grantor’s pecuniary benefit and may not exercise this power to appoint any interest in Trust to Grantor, Grantor’s estate, Grantor’s creditors or the creditors of Grantor’s estate. Further, Grantor may not exercise this power of appointment to create another power of appointment that, under any applicable law, can be validly exercised to postpone the vesting of any estate or interest in the property subject to the power, for a period ascertainable without reference to the first power of appointment.

Section 6.01 of Trust provides that in default of Grantor’s exercise of Grantor’s testamentary power of appointment, Trustee must distribute ten percent of the remaining trust property in equal shares to each member of the Committee, other than Grantor. Trustee shall administer the share for each beneficiary in a separate trust for the benefit of the beneficiary. In addition, Trustee must distribute ten percent of the remaining trust property to one or more charities supported by Grantor during Grantor’s lifetime. Trustee, in Trustee’s sole discretion, may determine the charities, amounts, and charitable purposes of such distributions. Finally, Trustee must allocate the balance of the remaining trust property among Grantor’s descendants. Trustee, in Trustee’s sole discretion, may determine the beneficiaries, amounts, shares, and interests of the allocations but must administer the allocation to a descendant as provided in the Trust.

Trust provides that any member of the Committee may resign as a member without prior approval of any court or the consent of any person. However, at all times there must be at least three members of the Committee in addition to Grantor. If at any time there are fewer than three members serving on the Committee, then the Committee automatically ceases to exist, and all trust distributions are governed under Section 5.03 of Trust. Section 5.02(b) of Trust provides that the initial members of the Committee include Grantor, Child, when Child reaches age 18, Individual A, Individual B, Individual C, Individual D, and Personal Representative until Child reaches age 18. Committee will cease to exist upon Grantor's death. Further, Committee members exercise their powers of appointment in a nonfiduciary capacity.

Article Eight, Section 8.01 provides that whenever Trust authorizes or directs Trustee to make a net income or principal distribution to a beneficiary, Trustee may apply any property that otherwise could be distributed directly to the beneficiary for their benefit or to some other qualified trust, except to make a discretionary distribution to Grantor, or any trust where Grantor is a beneficiary, or to any trust which is a grantor trust as to Grantor under §§ 672 through 679.

Grantor requested the following rulings:

(1) As long as the Committee is serving, no portion of the items of income, deductions and credits against tax of Trust shall be included in computing the taxable income, deductions, and credits of Grantor or any other member of the Committee.

(2) The contribution of property to Trust by Grantor is not a completed gift subject to federal gift tax.
(3) Any distribution of property by the Committee from Trust to Grantor will not be a completed gift, subject to federal gift tax, by any member of the Committee.

(4) Any distribution of property by the Committee from Trust to any beneficiary of the Trust, other than Grantor, will not be a completed gift by any member of the Committee, other than Grantor.

(5) No member of the Committee, upon his or her death, will include in his or her estate any property held in Trust because such member is deemed to have a general power of appointment within the meaning of § 2041 over property held in Trust.

ii. **Ruling.**

The IRS first concluded that Trust included none of the circumstances that would cause Grantor to be treated as the owner of any portion of Trust under §§ 673, 674, 676, or 677 as long as the Committee is serving. Further, because none of the members of the Committee have a power exercisable by himself to vest trust income or corpus in himself, the IRS determined that none of the members of the Distribution Committee would be treated as the owner of the Trust under § 678(a). The IRS also noted that an examination of Trust revealed none of the circumstances that would cause administrative controls to be considered exercisable primarily for the benefit of the Grantor under § 675, but stated that the circumstances attendant on the operation of Trust will be what determines whether the Grantor will be treated as the owner of any portion of the Trust under § 675 and therefore the determination of whether Grantor is treated as owner of Trust under § 675 would be deferred until the federal income tax returns of all parties involved have been examined.

With respect to the second ruling requested, the IRS determined that the transfer of property to Trust by Grantor would not be a completed gift. This is because Grantor retained the power to consent to a distribution by the Committee under Section 5.02(b)(1) of Trust, Grantor retained the power to appoint trust principal during Grantor’s lifetime and retained a testamentary power of appointment.

With respect to rulings three through five, the IRS concluded that any distribution of property by the Committee from Trust to Grantor would not be a completed gift, subject to federal gift tax, by any member of the Committee, but instead would merely be a return of capital to Grantor. Further, the IRS concluded that any distribution of property by the Committee from Trust to any beneficiary of Trust, other than Grantor, would not be a completed gift subject to federal gift tax, by any member of the Committee, because the Committee members had substantial adverse interests in the property subject to the power and some of their powers were only exercisable in conjunction with the Grantor. Finally, the IRS concluded that the powers held by the Committee are not general powers of appointment for purposes of § 2041(a)(2) and, accordingly, no member of the Committee upon his or her death will include in his or her estate any property held in Trust because such member is deemed to have a general power of appointment within the meaning of § 2041 over property held in Trust.

- See Also PLRs 201908004, 201908005, 201908006, and 201908007.
e. PLR 201903007 - Section 1362 - Election; revocation; termination.

See also:

- PLR 201911005 - Section 1362 - Election; revocation; termination.
- PLR 201910005 - Section 1362 - Election; revocation; termination.
- PLR 201910014 - Section 1362 - Election; revocation; termination.
- PLRs 20198015, 201908017 - Section 1362 - Election; revocation; termination.
- PLR 201908019 - Section 1362 - Election; revocation; termination.
- PLR 201904001 - Section 1362 - Election; revocation; termination.
- PLRs 201902001, 201902002, 201902003, 201902004, 201902005, 201902006, 201902007, 201902008, 201902009, 201902010, 201902011, 201902012, 201902013, 201902014, 201902015, 201902016, 201902017, 201902018, 201902019, 201902020, 201902021 - Section 1362 - Election; revocation; termination.

i. Facts.

X was incorporated under the laws of State on Date 1 and elected to be treated as an S corporation effective Date 2. As of Date 2, A’s shares of X were held through Trust 1, a grantor trust that was treated (under subpart E of part 1 of subchapter J of chapter 1) as entirely owned by A. On Date 3, A died and Trust 1 ceased to be a grantor trust. Nevertheless, Trust 1 continued to qualify as a permissible S corporation shareholder under § 1361(c)(2)(A)(ii) for the 2-year period beginning Date 3. Trust 1’s trust agreement provided that upon the death of A, the X stock held by Trust 1 is to be held by six shares, Share 1A, Share 1B, Share 1C, Share 1D, Share 1E, and Share 1F (collectively Trust 1 Shares). Each Trust 1 share is treated as a separate share under § 663(c).

X represents that each of the Trust 1 shares would have qualified as a qualified subchapter S trust (QSST) under § 1361(d)(1) on Date 4 except for the fact that the sole beneficiary of each share failed to make an election under § 1361(d)(2) to treat the share as a QSST. Accordingly, the Trust 1 shares became ineligible shareholders of X and X’s S corporation election terminated effective Date 4.

On Date 5, B, a shareholder of X died. Pursuant to B’s last will and testament, B’s estate transferred B’s X stock to Trust 2 on Date 6. Trust 2 qualified as a permissible S corporation shareholder under § 1361(c)(2)(A)(iii) for the 2-year period beginning on Date 6, the day on which the X stock was transferred to it. Effective Date 6, trustees held Trust 2 in five shares. Four shares, Share 2A, Share 2B, Share 2C, and Share 2D (Trust 2 Shares), held X stock and were administered as QSSTs, effective Date 7. Although the Trust 2 Shares were administered as QSSTs no election under § 1362(d)(2) was made to treat the Trust 2 shares as QSSTs effective Date 7 and the governing document of Trust 2 did not satisfy the requirements to qualify the Trust 2 shares as QSSTs.
On Date 7, the Trust 2 Shares became ineligible shareholders of X. On Date 8, the beneficiaries the Trust 2 Shares and the trustees of Trust 2 entered into a binding non-judicial settlement agreement under State law effective as of Date 6 to qualify the Trust 2 shares as QSSTs.

X represents that all income has been reported on all affected returns consistent with the treatment of X as an S corporation for Date 2 and thereafter. X further represents that the beneficiaries of the Trust 1 shares and the Trust 2 Shares have filed their federal income tax returns consistent with the Trust 1 shares and Trust 2 shares being treated as QSSTs. X represents that the circumstances resulting in the termination of X’s S corporation election were inadvertent and were not motivated by tax avoidance or retroactive tax planning.

X and its shareholders have agreed to make any adjustments that the Commissioner may require, consistent with the treatment of X as an S corporation.

ii. **Analysis.**

Section 1362(a) provides that, except as provided in § 1362(g), a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

Section 1361(a)(1) provides that the term “S corporation” means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1)(B) provides that, for purposes of subchapter S, the term “small business corporation” means a domestic corporation which is not an ineligible corporation and which does not have as a shareholder a person (other than an estate, a trust described in §1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual.

Section 1361(c)(2)(A)(i) provides that, for the purposes of § 1361(b)(1)(B), a trust all of which is treated (under title 26, subtitle A, chapter 1, subchapter J, part I, subpart E of the United States Code) as owned by an individual who is a citizen or resident of the United States may be a shareholder of an S corporation.

Section 1361(c)(2)(A)(ii) and § 1.1361-1(h)(1)(ii) of the Income Tax Regulations provide that, for purposes of § 1361(b)(1)(B), a trust that is described in § 1361(c)(2)(A)(i) immediately before the death of the deemed owner and that continues in existence after such death is a permitted shareholder, but only for the two-year period beginning on the day of the deemed shareholder’s death.

Section 1361(c)(2)(A)(iii) and § 1.1361-1(h)(1)(iv)(A) of the Income Tax Regulations provide that, for purposes of § 1361(b)(1)(B), a trust with respect to stock transferred to it pursuant to the terms of a will may be a shareholder, but only for the two-year period beginning on the day on which such stock is transferred to it.

Section 1.1361-1(h)(3)(i)(B) of the Income Tax Regulations provides that, if stock is held by a trust described in § 1.1361-1(h)(1)(ii), the estate of the deemed owner is generally treated as the shareholder as of the day of the deemed owner’s death.
Section 1.1361-1(h)(3)(i)(D) of the Income Tax Regulations provides that, if stock is
transferred to a testamentary trust described in § 1.1361-1(h)(1)(iv), the estate of the testator is
treated as the shareholder until the earlier of the transfer of that stock by the trust or the
expiration of the two-year period beginning on the day that the stock is transferred to the trust.

Section 1361(d)(1) provides that, in the case of a qualified subchapter S trust with respect
to which a beneficiary makes an election under 1361(c)(2)(A) such trust will be treated as a trust
described in § 1361(c)(2)(A)(i) , and (B) for purposes of § 678(a) the beneficiary of such trust
shall be treated as the owner of that portion of the trust which consists of stock in an S
corporation with respect to which the election under § 1361(d)(2) is made.

Section 1361(d)(2)(A) provides that a beneficiary of a QSST (or his legal representative)
may elect to have § 1361(d) apply. Section 1361(d)(2)(D) provides that an election under §
1362(d)(2) shall be effective up to 15 days and 2 months before the date of the election.

Section 1361(d)(3) provides that the term “qualified subchapter S trust” means a trust (A)
the terms of which require that (i) during the life of the current income beneficiary, there shall be
only 1 income beneficiary of the trust, (ii) any corpus distributed during the life of the current
income beneficiary may be distributed only to such beneficiary, (iii) the income interest of the
current income beneficiary in the trust shall terminate on the earlier of such beneficiary’s death
or the termination of the trust, and (iv) upon termination of the trust during the life of the current
income beneficiary, the trust shall distribute all of its assets to such beneficiary, and (B) all of the
income (within the meaning of § 643(b) ) of which is distributed (or required to be distributed)
currently to 1 individual who is a citizen or resident of the United States.

Section 1.1361-1(j)(3) provides that for purposes of § 1361(c) and § 1361(d), a
substantially separate and independent share of a trust, within the meaning of § 663(c) and the
regulations thereunder is treated as a separate trust. For a separate share which holds S
corporation stock to qualify as a QSST, the terms of the trust applicable to that separate share
must meet the QSST requirements stated in § 1.1361-1(j)(1)(i) and (ii).

Section 1.1361-1(j)(6)(iii) provides that if S corporation stock is transferred to a trust, the
QSST election must be made within the 16-day-and-2-month period beginning on the day that
the stock is transferred to the trust.

Section 1.1361-1(j)(6)(iii)(C) provides that if a trust ceases to be a qualified subpart E
trust, satisfies the requirements of a QSST, and intends to become a QSST, the QSST election
must be filed within the 16-day-and-2-month period beginning on the date on which the trust
ceases to be a qualified subpart E trust. If the estate of the deemed owner of the trust is treated as
the shareholder under § 1.1361-1(h)(3)(i), the QSST election may be filed at any time, but no
later than the end of the 16-day-and-2- month period beginning on the date on which the estate of
the deemed owner ceases to be treated as a shareholder.

Section 1.1361-1(j)(7)(i) provides that the income beneficiary who makes the QSST
election and is treated (for purposes of § 678(a)) as the owner of that portion of the trust that
consists of S corporation stock is treated as the shareholder for purposes of §§ 1361(b)(1), 1366,
1367, and 1368.
Section 1362(d)(2) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation. The termination is effective on and after the day of the termination.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consents; (2) the Secretary determines that the circumstances resulting in such ineffectiveness were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness, steps were taken so that the corporation for which the election was made is a small business corporation, or to acquire the required shareholder consents; and (4) the corporation for which the election was made, and each person who was a shareholder in such corporation at any time during the period specified pursuant to § 1362(f), agrees to make such adjustments (consistent with the treatment of such corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such ineffectiveness, such corporation shall be treated as an S corporation during the period specified by the Secretary.

Rev. Rul. 93-79, 1993-2 C.B. 269, provides that a reformation of a trust to meet the requirements of a QSST is recognized prospectively.

iii. Conclusion.

Based solely on the information submitted and the representations made, we conclude that X’s S corporation election was terminated on Date 4, when the Trust 1 shares became ineligible shareholders. We conclude that the termination of X’s S corporation election was an inadvertent termination within the meaning of § 1362(f). Moreover, had X’s S corporation election not already terminated on Date 4, it would have terminated on Date 7, when the Trust 2 shares became ineligible shareholders. Similarly, this termination would have also been inadvertent. Accordingly, pursuant to the provisions of § 1362(f), X will be treated as an S corporation from Date 4 and thereafter, provided that X’s S corporation election was otherwise valid and not otherwise terminated under § 1362(d).

This ruling is contingent on QSST elections being made for the Trust 1 shares effective Date 4 and elections being made for the Trust 2 shares effective Date 8 within 120 days of the date of this letter. A copy of this letter should be attached to the QSST elections.

The shareholders of X must include their pro-rata share of the separately stated and non-separately computed items of X as provided in § 1366, make adjustments to basis as provided in § 1367, and take into account any distributions made by X as provided in § 1368. If X or its shareholders fail to treat themselves as described above, this ruling is null and void.
f. PLR 201909003 - Section 401 - Qualified pension, profit-sharing, and stock bonus plans.

i. Facts.

Decedent maintained an Individual Retirement Account (IRA), IRA X. Decedent died after his required beginning date, as defined in section 401(a)(9). Prior to his death, Decedent had received required minimum distributions from IRA X for the year of death. Estate A was sole the beneficiary of IRA X. Executor B is the executor of Estate A. Decedent was unmarried at the time of his death. Decedent was survived by N nonspousal beneficiaries. (Beneficiaries) Decedent’s Last Will and Testament, executed on Date O, was duly admitted to probate in County P, of State Q. Pursuant to Item 5 of Decedent’s Last Will and Testament, the Estate’s interest was bequeathed to the Beneficiaries. Executor B proposes to divide IRA X, as of Decedent’s date of death, by trustee-to-trustee transfer into N inherited IRAs for the benefit of each Beneficiary according to their equitable bequests under the Decedent’s Last Will and Testament. Each inherited IRA will be titled under the Decedent’s name for the benefit of each Beneficiary.

ii. Analysis.

1. The division of IRA X as of the date of Decedent’s death by means of trustee-to-trustee transfers into IRAs for the benefit of the N Beneficiaries according to their equitable percentages and titled in the name of the Decedent for the benefit of each individual Beneficiary (instead of titled to Estate A), will not result in taxable distributions or payments under section 408(d)(1) to Estate A.

2. The Beneficiaries can take the required minimum distributions from their inherited IRAs for the remaining life expectancy of the Decedent using the actuarial table and each inherited IRA will be independent of any required minimum distributions taken by other Beneficiaries.

3. The division of IRA X and the establishment of the N inherited IRAs will not constitute a transfer within the meaning of section 691(a)(2) and the Beneficiaries will include in gross income the amounts of income in respect to their required minimum distributions from their respective inherited IRAs when the distributions are received by the Beneficiaries, under section 691(a)(1)(C).

4. When the Beneficiaries receive their required minimum distributions, the Beneficiaries are responsible separately for any tax liabilities on the required minimum distributions for the tax year subsequent to the year the inherited IRAs are established or the year of death if later (and all subsequent tax years). No income taxes or penalties for failure of the Beneficiaries to take their own required minimum distributions for the tax year subsequent to the year the inherited IRAs are established or the year of death if later (and all subsequent tax years) will be passed to Estate A or Executor B.
Under section 408(a)(6) and the regulations thereunder, rules similar to the rules of section 401(a)(9) and the incidental death benefit requirements of section 401(a) apply to the distribution of the entire interest of an individual for whose benefit the IRA is maintained.

Section 1.408-8, Q&A-1(a), provides that an IRA is subject to the required minimum distribution rules under section 401(a)(9). In order to satisfy section 401(a)(9), the rules of section 1.401(a)(9)-1 through 1.401(a)(9)-9 must be applied, except as otherwise provided.

Section 1.408-8, Q&A-1(b) provides that for purposes of applying the required minimum distribution rules in section 1.401(a)(9)-1 through 1.401(a)(9)-9, the IRA trustee, custodian or issuer is treated as the plan administrator, and the IRA owner is substituted for the employee.

Section 401(a)(9)(A) provides, in general, that a trust will not be considered qualified unless the plan provides that the entire interest of each employee (i) will be distributed to such employee not later than the required beginning date, or (ii) will be distributed, beginning not later than the required beginning date, over the life of such employee or over the lives of such employee and a designated beneficiary or over a period not extending beyond the life expectancy of such employee or the life expectancy of such employee and a designated beneficiary.

Section 401(a)(9)(B)(i) provides, in general, that if an employee/IRA holder dies after distribution of his interest has begun in accordance with section 401(a)(9)(A)(ii) (after his required beginning date), the remaining portion of his interest must be distributed at least as rapidly as under the method of distribution being used as of the date of his death.

Section 401(a)(9)(C) provides, in relevant part, that for purposes of this paragraph, the term “required beginning date” means April 1 of the calendar year following the calendar year in which the IRA holder attains age 70 ½.

Section 401(a)(9)(E) provides that for purposes of section 401(a)(9), the term designated beneficiary means any individual designated as beneficiary by the employee.

Section 1.401(a)(9)-4, Q&A-3, states that only individuals may be designated beneficiaries for purposes of section 401(a)(9). A person that is not an individual, such as the employee’s/IRA holder’s estate, may not be a designated beneficiary.

Section 1.401(a)(9)-4, Q&A-4, provides, in relevant part, that in order to be a designated beneficiary, an individual must be a beneficiary as of the date of the employee’s death. Generally, an employee’s designated beneficiary for purposes of determining the distribution period for required minimum distributions after the employee’s death will be determined based on the beneficiaries designated as of the date of death who remain beneficiaries as of September 30 of the calendar year following the calendar year of the date of death (that is, have not received their entire interest before that September 30).

Section 1.401(a)(9)-5, Q&A-5(a)(2) provides, in summary, that if an employee/IRA holder dies on or after his required beginning date without having designated a beneficiary, then post-
death distributions must be made over the remaining life expectancy of the employee/IRA holder determined in accordance with paragraph (c)(3) of this A-5.

Section 1.401(a)(9)-5, Q&A-5(c)(3) provides, in general, that with respect to an employee/IRA holder who does not have a designated beneficiary, the applicable distribution period measured by the employee’s/IRA holder’s remaining life expectancy is the life expectancy of the employee/IRA holder using the age of the employee/IRA holder as of the employee’s/IRA holder’s birthday in the calendar year of the employee’s/IRA holder’s death. In subsequent calendar years, the applicable distribution period is reduced by one for each calendar year that has elapsed after the calendar year of the employee’s/IRA holder’s death.

Under section 1.401(a)(9)-8, Q&A-2, in general and relevant part, if an account/IRA is divided into separate accounts/IRAs for the benefit of different beneficiaries, for years subsequent to the year the separate accounts/IRAs are established or the date of death if later, then the rules of section 401(a)(9) are applied separately to each of the respective accounts/IRAs.

Section 1.401(a)(9)-8, Q&A-3, provides that, for purposes of section 401(a)(9), separate accounts in an employee’s/IRA holder’s account are separate portions of an employee’s/IRA holder’s benefit reflecting the separate interests of the employee’s/IRA holder’s beneficiaries under the plan as of the date of the employee’s/IRA holder’s death for which separate accounting is maintained. The separate accounting must allocate all post-death investment gains and losses, contributions, and forfeitures, for the period prior to the establishment of the separate accounts on a pro rata basis in a reasonable and consistent manner among the separate accounts. However, once the separate accounts are actually established, the separate accounting can provide for separate investments for each separate account under which gains and losses from the investment of the account are only allocated to that account, or investment gain or losses can continue to be allocated among the separate accounts/IRAs on a pro rata basis. A separate accounting must allocate any post-death distribution to the separate account/IRA of the beneficiary receiving that distribution.

The relevant Single Life Table determining life expectancy is provided in 1.401(a)(9)-9, Q&A-1.

Section 408(d)(1) provides that, except as otherwise provided in section 408(d), any amount paid or distributed out of an IRA 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) 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: (i) the entire amount received (including money and any other property) is paid into an IRA for the benefit of such individual not later than the 60th day after the day on which the individual receives the payment or distribution, or (ii) the entire amount received (including money and any other property) is paid into an eligible retirement plan (other than an IRA) for the benefit of such individual not later than the 60th day after the date on which the payment or distribution is received, except that the maximum amount which may be paid into such plan may not exceed the portion of the amount received which is includible in gross income (determined without regard to section 408(d)(3)).
Section 408(d)(3)(C) provides, generally, that amounts from an “inherited” IRA cannot be rolled over into another IRA. In general, an “inherited” IRA is an IRA maintained by an individual who acquired the IRA by reason of the death of another if the acquiring individual is not the surviving spouse of such individual.

Revenue Ruling 78-406, 1978-2 C.B. 157, provides that the direct transfer of funds from one IRA trustee to another IRA trustee, even if at the behest of the IRA holder, does not constitute a payment or distribution to a participant, payee or distributee, as those terms are used in section 408(d). Furthermore, such a transfer does not constitute a rollover distribution. Revenue Ruling 78-406 is applicable if the trustee-to-trustee transfer is directed by the beneficiary of an IRA after the death of the IRA owner as long as the transferee IRA is set up and maintained in the name of the deceased IRA owner for the benefit of the beneficiary.

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 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 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 request, 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)-1(c) provides that the term “income in respect of decedent” 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(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 section 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. In this situation, a transfer within the meaning of section 691(a)(2) has not occurred.

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.

Revenue Ruling 92-47, 1991-1 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 section 691(a)(1) that is includible in the gross income of the beneficiary for the tax year the distribution is received.

iii. **Ruling.**

1. The division of IRA X as of the Decedent’s date of death by means of trustee-to-trustee transfers into inherited IRAs for the benefit of the N Beneficiaries, according to their equitable percentages and titled in the name of the Decedent and each individual Beneficiary (instead of titled to Estate A), will not result in taxable distributions or payments under section 408(d)(1) to Estate A.

2. Because Estate A was listed as the designated beneficiary of IRA X, IRA X is treated as having no designated beneficiary. Because IRA X had no designated beneficiary and the Decedent died after his required beginning date, the Beneficiaries can take required minimum distributions from each of their inherited IRAs for the remaining life expectancy of the Decedent. The amount required to be distributed each year is determined using the Decedent’s age in the calendar year of death and the applicable actuarial table. The life expectancy factor is reduced by one each subsequent calendar year. The amount required to be taken from each inherited IRA will be determined independently of any required minimum distributions required to be taken by the other Beneficiaries.

3. The division of IRA X by means of trustee-to-trustee transfer into N inherited IRAs will not constitute a transfer within the meaning of section 691(a)(2). The Beneficiaries will each include, in their gross income, the amounts of IRD from their respective inherited IRA when the distribution or distributions from the inherited IRAs are received.
4. The Beneficiaries of each respective inherited IRA are separately responsible for any tax liabilities relating to required minimum distributions from their inherited IRAs for the tax year subsequent to the year the inherited IRAs are established or the year of death if later (and all subsequent tax years). No income taxes or penalties for failure of the Beneficiaries to take their required minimum distributions for the tax year subsequent to the year the inherited IRAs are established or the year of death if later (or any subsequent tax years) will be passed to Estate A or Executor B.