

Internal Revenue Service

Department of the Treasury

Index Number: 9114.03-48; 691.00-00

Washington, DC 20224

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Telephone Number:

Number: **200004030**
Release Date: 1/28/2000

Refer Reply To:
CC:INTL:Br1-PLR-110724-99
Date:
November 2, 1999

DO: TY:

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|-----------|---|
| Date A | = |
| Year B | = |
| C | = |
| Decedent | = |
| E | = |
| Country F | = |
| Treaty | = |

Dear :

This is in response to your letter dated May 14, 1999, requesting rulings under the Treaty and sections 691, 871 and 1441 of the Internal Revenue Code with respect to distributions by you, as administrator of Decedent's estate (the "Estate"), to the nonresident alien intestate distributees of the Estate.

The rulings contained in this letter are based upon information and representations submitted by you and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification upon examination.

Decedent was born in what is now Country F and subsequently became a naturalized United States citizen. Decedent died unmarried, without issue, and intestate on Date A. During the period of administration, it was established that four nonresident alien individuals are the only legal heirs of the Estate. All four distributees are citizens and residents of Country F, a foreign country with which the United States has an income tax treaty.

The Estate consists, in part, of a number of Series E, Series EE, and Series HH United

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States savings bonds (the "Bonds"), owned solely by Decedent or jointly with C, who predeceased Decedent. The Bonds were issued to Decedent between December 1954 and September 1984. With the exception of a small number of Series HH bonds, the Bonds were issued prior to July 18, 1984.

In Year B, the Estate redeemed the Bonds and distributed the accumulated interest income therefrom to the nonresident alien legal heirs of the Estate. Neither Decedent, during her lifetime, nor the Estate, after the death of Decedent, made an election under section 454(a) of the Code. Both Decedent and the Estate are calendar year, cash method taxpayers.

LAW AND ANALYSIS - - ESTATE AND TRUST

Section 454(c) provides, in part, that an owner of Series E bonds employing the cash receipts and disbursements method of accounting, who has not made the election under section 454(a), must include the increase in redemption value in excess of the amount paid for such Series E bonds in gross income in the first taxable year in which the bonds are disposed of, redeemed, or reach final maturity.

Section 691(a)(1) of the Code provides that the amount of all items of gross income in respect of a decedent which are not properly includible in the taxable period in which falls the date of his death or a prior period will 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 received the amount, if the right to receive the amount is not acquired after a distribution 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)(3) provides that the right to receive an amount of income in respect of a decedent shall be treated in the hands of the estate of the decedent, or any person who acquired such right by reason of the death of the decedent, or by bequest, devise, or inheritance from the decedent, as if it had been acquired by the estate or such person in the transaction by which the decedent acquired such right, and the amount includible in gross income under section 691(a)(1) will be considered in the hands of the estate or such person to have the character that it would have had in the hands of the decedent if the decedent had lived and received such amount.

Rev. Rul. 64-104, 1964-1 C.B. 223, concludes that the unreported increment in value reflected in the redemption value of Series E bonds as of the date of decedent's death constitutes income in respect of a decedent under section 691(a). Therefore, where the decedent and the decedent's estate have not made the section 454(a) election, the unreported increment in value of the Series E bonds still held by the decedent at the

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decedent's death should be returned as income for the taxable year in which the bonds are disposed of, redeemed, or reach final maturity, whichever is earlier, by the estate or the decedent, or by the person entitled to the bonds by bequest or inheritance or by reason of the death of the decedent.

Section 641(a) provides that the tax imposed by section 1(e) shall apply to the taxable income of estates.

Section 661(a) provides that in any taxable year there shall be allowed as a deduction in computing the taxable income of an estate or trust the sum of: (1) any amount of income for such tax year required to be distributed currently; and (2) any other amounts properly paid or credited or required to be distributed for such taxable year. However, the deduction may not exceed the distributable net income (DNI) of the estate or trust.

Section 661(b) provides that the amount determined under section 661(a) shall be treated as consisting of the same proportion of each class of items entering into the computation of DNI of the estate or trust as the total of each class bears to the total DNI of the estate or trust in the absence of the allocation of different classes of income under the specific terms of the governing instrument.

Section 662(a) requires a beneficiary of an estate or trust described in section 661 to include in gross income the amount of income for the taxable year required to be distributed currently to such beneficiary, whether actually distributed or not, and any other amount properly paid or credited or required to be distributed to them for the taxable year. The amount of income that beneficiaries must include in any particular taxable year is limited to the distributable net income of the estate with respect to such year.

Section 662(b) provides that the amounts included in the beneficiary's gross income under section 662(a) shall have the same character in the beneficiary's hands as in the hands of the estate or trust. The amounts shall be treated as consisting of the same proportion of each class of items entering into the computation of DNI as the total of each class bears to the total DNI of the estate or trust unless the terms of the governing instrument specifically allocate different classes of income to different beneficiaries.

HOLDINGS - - ESTATE AND TRUST

Based solely on the information submitted and on the representations made by the Taxpayer, it is held as follows:

(1) The accrued interest on the Bonds as of the date of Decedent's death was income in respect of a decedent (IRD) taxable to the Estate in Year B under section 691(a)(1)(A). The accrued interest that constitutes IRD to the Estate shall be considered to have been acquired by the Estate in the transaction in which the right to receive the income was originally derived and will have the same character that it would have had in the hands of

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Decedent, had she lived and received the accrued interest herself.

(2) The interest that accrued on the Bonds after the date of Decedent's death was ordinary income to the Estate in Year B and includible in the Estate's gross income under section 641.

(3) To the extent such pre- and post-death accrued interest income is distributed to the beneficiaries in Year B, such distributions will be fully deductible by the estate and will be fully includible in the gross income of the beneficiaries if the total distributions from the Estate to the beneficiaries in Year B did not exceed the Estate's DNI for that year. If the amounts distributed from the Estate to the beneficiaries in Year B exceeded the Estate's DNI for that taxable year, then the amount deductible by the Estate and includible in the beneficiaries' gross income will be limited by the Estate's DNI.

(4) The distributions of both pre- and post-death accrued interest from the Estate to the beneficiaries shall have the same character in the hands of the beneficiaries as they did in the hands of the Estate. If the distributions exceed the Estate's DNI, the amounts shall be treated as consisting of the same proportion of each class of items entering into the computation of DNI as the total of each class bears to the total DNI of the Estate.

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

LAW AND ANALYSIS - - INTERNATIONAL ASPECTS

The United States income tax treatment of distributions to nonresident alien individuals depends on both the statutory and regulatory rules of taxation and withholding and, where the recipient is a citizen or resident of a country with which the United States has an income tax treaty, the application of that treaty.

Section 861(a)(1) of the Code provides, in part, that interest from the United States, or the District of Columbia, and interest on bonds, notes or other interest-bearing obligations of residents, corporate or otherwise, shall be treated as income from sources within the United States.

Section 871(a)(1)(A) of the Code provides, generally, that a nonresident alien individual is subject to a tax of 30-percent tax on amounts received as interest from sources within the United States, but only to the extent the amount so received is not effectively connected with the conduct of a trade or business within the United States. It is assumed for purposes of this ruling that the Bonds are not effectively connected with a trade or business in which the beneficiaries are engaged in the United States, if any.

Section 1441(a) of the Code provides, in part, for the withholding of tax on items of income paid from United States sources to nonresident aliens. Treasury Regulation

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§1.1441-3(c)(1), in effect for tax years beginning prior to January 1, 2001, provides that withholding is required in the case of interest paid on obligations issued on or after March 1, 1941, by the United States or any agency or instrumentality thereof. Treasury Regulation §1.1441-3(f), in effect for tax years beginning prior to January 1, 2001, provides, in part, that a resident or domestic fiduciary of an estate is required to withhold tax on payments of United States source income to beneficiaries who are nonresident alien individuals.

Sections 871(h) and 1441(c)(9) provide an exemption from the withholding requirements of section 1441(a) for portfolio interest, within the meaning of section 871(h)(2), attributable to certain debt obligations. Portfolio interest, as defined in section 871(h)(2)(B), is any interest that would be subject to tax under section 871(a) which is paid on an obligation, (i) which is in registered form, and (ii) with respect to which the United States person who would otherwise be required to deduct and withhold tax from such interest under section 1441(a) receives a statement that the beneficial owner of the obligation is not a United States person. Treas. Reg. §1.871-14(c)(1)(ii)(1) provides, in part, that interest received on an obligation that is in registered form qualifies as portfolio interest only if the interest is paid on an obligation issued after July 18, 1984.

Title 31 CFR section 352.2 provides that Series HH bonds are issued only in registered form.

Section 894(a) states that the provisions of the Code will be applied to a taxpayer with due regard to any treaty obligation of the United States. Treas. Reg. §1.1441-6 provides that the 30-percent rate of tax imposed on U.S. source interest income described in section 871(a)(1)(A) may be eliminated or reduced under an income tax treaty. Form 1001 (Ownership, Exemption or Reduced Rate Certificate) must be filed by the taxpayer with the withholding agent in order to claim an exemption from U.S. income tax withholding under a treaty with respect to certain types of income. Treas. Reg. §1.1441-6(c).

The United States has an income tax treaty with Country F. Article 11 of the Treaty provides, in part, that income from government securities, and income from bonds or debentures, received from sources in the United States by a nonresident alien individual who is a resident of Country F, who did not have a permanent establishment in the United States during the tax year in which the interest is received, is exempt from taxation by the United States provided the interest is fair and reasonable consideration on the indebtedness. It is assumed, for purposes of this ruling, that none of the nonresident alien beneficiaries had a permanent establishment in the United States during Year B.

HOLDINGS - - INTERNATIONAL ASPECTS

Based solely on the information submitted and on the representations made by the Taxpayer, it is held as follows:

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(5) With respect to bonds issued prior to July 18, 1984, provided that the beneficiaries are residents of Country F on the date of each distribution and file Form 1001 with E pursuant to section 1.1441-6(c), it is held that E is not obligated to withhold tax from the portion of any amounts paid, credited or required to be distributed to the nonresident alien beneficiaries that are characterized as interest on such bonds. Article 11 of the Treaty and Treas. Reg. §1.1441-6(c).

(6) With respect to bonds issued after July 18, 1984, provided that the beneficiaries file a Form W-8 with E, it is held that the interest payments on such bonds qualify as portfolio interest under section 871(h) and E is, therefore, not required to withhold tax from the portion of any amounts paid, credited or required to be distributed to the nonresident alien beneficiaries that are characterized as interest accruing on such bonds. Sections 871(h) and 1441(c)(9).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. No opinion is expressed as to whether the beneficiaries are residents of Country F for purposes of the application of the Treaty.

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

Sincerely,

Elizabeth U. Karzon
Branch Chief, Branch 1
Associate Chief Counsel (International)