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Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:2 - PLR-135440-01
Date:
November 29, 2001

Estate =

Decedent =

A =

B =

C =

D =

Country =

Court =

D1 =

x =

y =

z =

Treaty =

Dear :

This letter responds to a letter dated June 25, 2001, submitted by you as the co-executor of Estate, requesting certain rulings under §§ 691 and 894 of the Internal Revenue Code.

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The information submitted states that Decedent died on D1. Decedent's Estate included non-probate assets consisting of a tax-deferred annuity account (TDA), the beneficiaries of which are A, B, and C, and an individual retirement account (IRA), the beneficiary of which is D. A, B, C, and D are all non-resident aliens (NRAs) who are citizens of Country.

Decedent's will provides that "all transfer, estate, or inheritance taxes in connection with my estate shall be apportioned among the beneficiaries." The executors of Estate were concerned that they would not be able to recover any portion of the federal and state estate taxes that was to be apportioned among the NRA beneficiaries of the TDA and IRA accounts, A, B, C, and D, which the executors of Estate calculated as x% of the respective values of the accounts.

Therefore, Estate petitioned Court to order the custodians of the TDA and IRA to set aside x% of the account values, and direct payments of such amounts to Estate for the purpose of paying estate taxes. Court granted these petitions.

The custodians of the TDA and IRA paid over to Estate x% of the account values, which Estate used to pay federal and state estate taxes. The amount distributed from the TDA was \$y; the amount distributed from the IRA was \$z. The custodians issued Forms 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc., to Estate.

Estate requests a ruling that the distributions paid to Estate reported on the Forms 1099-R are not income to the estate, but to the NRA beneficiaries of the accounts. However, if the distributions paid to Estate are income to Estate, Estate requests rulings that the estate tax payments made by Estate will be treated as distributions to A, B, C, and D under § 661 and that such distributions are not subject to United States income tax or withholding because of the provisions of Treaty.

RULING 1

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

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amount by bequest, devise, or inheritance, if the amount is received after a distribution by the decedent's estate of such right.

Section 1.691(a)-1(b) of the Income Tax Regulations provides that the term "income in respect of a decedent" refers to those amounts to which a decedent was entitled as gross income, but which were not properly includable 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.

Rev. Rul. 92-47, 1992-1 C.B. 198, holds that a distribution to the beneficiary of a decedent's IRA that equals the amount of the balance in the IRA at the decedent's death, less any nondeductible contributions, is income in respect of a decedent under § 691(a)(1) that is includable in the gross income of the beneficiary for the tax year the distribution is received.

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 in which the right to receive the income was originally derived and the amount includable in gross income shall be considered, in the hands of the estate or such person to have the character which it would have had in the hands of the decedent if the decedent had lived and received such income.

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 (other than a trust to which subpart B applies), the sum of (1) any amount of income for such taxable year required to be distributed currently (including any amount required to be distributed which may be paid out of income or corpus to the extent such amount is paid out of income for such taxable year); and (2) any other amounts properly paid or credited or required to be distributed for such taxable year; but such deduction shall not exceed the distributable net income (DNI) of the estate or trust.

Section 1.661(a)-2(d) provides that the terms "income required to be distributed currently" and "any other amounts properly paid or credited or required to be distributed" also include any amount used to discharge or satisfy any person's legal obligation as that term is used in § 1.662(a)-4.

Based solely on the facts and representations submitted, we conclude that the distributions from the TDA and IRA to the Estate made pursuant to the order of the Court are IRD to the Estate and will be included in the DNI of the Estate. Furthermore, the payments of Estate's federal estate taxes by Estate that A, B, C, and D are obligated to pay will be treated as distributions of DNI to A, B, C, and D, to the extent the payments are made from the IRD amounts.

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RULING 2

In general, where a nonresident alien who is not engaged in a United States trade or business receives certain income from the United States, 30 percent U.S. income tax withholding is levied on the gross amount received under § 871(a)(1). Income subject to withholding includes “interest, dividends, rents, salaries, wages, emoluments, and other fixed or determinable annual or periodical gains, profits and income” (“FDAP”). Section 871(a)(1)(A). A single lump-sum payment may be considered FDAP and is subject to withholding. Section 1.1441-2(b)(1)(ii). “Other fixed or determinable annual or periodical gains, profits and income” is defined in relevant part as all income included in gross income under § 61, with the exception of certain items specified in the regulations and items of income that are excluded from income without regard to the U.S. or foreign status of the owner of the income. 1.1441-2(b)(1)(i).

Under domestic law, the payments made by the custodians of the TDA and IRA accounts would be subject to 30% withholding under §§ 871(a) and 1441. However, the provisions of the Code “shall be applied to any taxpayer with due regard to any treaty obligation of the United States which applies to such taxpayer”. Section 894(a)(1). Under § 1.1441-6, the 30% tax may be reduced or eliminated to the extent provided under an income tax treaty in effect between the United States and a foreign country.

In this case, the potentially applicable treaty is Treaty, because the TDA and IRA beneficiaries are citizens and residents of Country. Article 20 (Private Pensions and Annuities) of the Treaty provides in relevant part as follows:

(1) Except as provided in Article 22 (Government Functions), pensions and other similar remuneration paid to an individual shall be taxable only in the Contracting State of which he is a resident.

(2) Alimony and annuities paid to an individual who is a resident of one of the Contracting States shall be taxable only in that Contracting State.

* * * *

(4) The term “pensions and other similar remuneration”, as used in this Article, means periodic payments other than social security payments covered in Article 21 (Social Security Payments) made (a) by reason of retirement or death and in consideration for services rendered...

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(5) The term “annuities”, as used in this Article, means a stated sum paid periodically at stated times during life, or during a specified number of years, under an obligation to make the payments in return for adequate and full consideration (other than services rendered).

The Technical Explanation of Treaty prepared by the Department of the Treasury paraphrases Treaty:

[P]rivate pensions and similar remuneration derived from sources within one Contracting State by an individual resident of the other Contracting State are exempt from tax in the first-mentioned Contracting State... The term “pensions and similar remuneration” is defined in paragraph (4) as periodic payments, other than social security payments covered in Article 21 (Social Security Payments), made by reason of retirement or death and in consideration for services rendered.

The distributions in this case cannot constitute annuities within the meaning of paragraph 5 of Article 20, because they are not in return for adequate and full consideration other than services rendered. They are, in fact, in return for services rendered by Decedent.

In order to constitute “pensions and other similar remuneration” within the meaning of paragraph 4, the payments must be made by reason of retirement or death and “in consideration for services rendered”. In this case, we conclude that it would be appropriate to treat distributions from the TDA and the IRA as pension distributions for purposes of the Treaty.

The payments in this case are being made in lump sums rather than a series of periodic payments. However, although the definition of “pensions and other similar remuneration” in paragraph 4 refers to “periodic payments,” the fact that a pension distribution may be in the form of a lump sum will not, by itself, disqualify the distribution for treaty benefits unless the treaty partner interprets the term “periodic” to exclude lump-sum distributions.

Therefore, based solely on the facts and representations submitted, we conclude that the distributions from Decedent’s TDA and IRA accounts to the Estate, which are then treated as distributed to beneficiaries A, B, C, and D, who are residents of Country, are not subject to U.S. withholding and are taxable only in Country pursuant to Article 20(1) of Treaty.

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Except as set forth above, no opinion is expressed or implied as to the federal income tax consequences of the transactions described above under any other provision of the Code.

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

Sincerely yours,
J. THOMAS HINES
Chief, Branch 2
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures: 2
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