

Rev. Rul. 92-47, I.R.B. 1992-28, 6.

ISSUE

What are the federal income tax consequences to the non-spouse beneficiary of an individual retirement account (IRA) of a decedent on receipt of a lump sum distribution from the IRA?

FACTS

A died owning an IRA. As of *A*'s death, the IRA held assets that had appreciated since they were acquired by the IRA. Some of the contributions by *A* to the IRA had been nondeductible contributions. The designated beneficiary of the IRA was *A*'s child, *B*. The entire balance in the IRA, including appreciation and income accruing before and after *A*'s death, was distributed to *B* in a lump sum shortly after *A*'s death.

LAW AND ANALYSIS

Section 691(a)(1) of the Code provides rules regarding items of gross income in respect of a decedent that are not properly includible in respect of the taxable period in which the decedent's death occurs or a prior period. Under that section, all such items are included in the gross income, for the taxable year received, of the person who, by reason of the death of the decedent, acquires the right to receive the amount.

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 that were not properly includible in computing taxable income for the taxable year ending with the date of death or for a previous taxable year under the method of accounting employed by the decedent.

Section 408(d)(1) of the Code provides that, except as otherwise provided in section 408(d) (relating to rollover contributions), any amount paid or distributed out of an IRA is included in gross income by the payee or distributee in the manner provided under section 72. Under section 72, nondeductible contributions to an IRA are not included in the gross income of the payee or distributee.

Section 408(e)(1) of the Code provides that an IRA is exempt from income taxation.

Section 1.408—4(a)(2) of the regulations provides that notwithstanding section 1015(d) or any other provision of the Code, the basis (or investment in the contract) of any person in an IRA is zero. This regulation has been superseded by changes in the law to the extent that an individual does have basis in his IRA equal to his nondeductible contributions.

Section 691(c)(1)(A) of the Code provides that a person who includes an amount in gross income under section 691(a) is allowed, for the same taxable year, as an income tax deduction an amount determined by reference to the estate tax attributable to the amount included in gross income under section 691(a). Section 691(c) and section 1.691(c)-1(a) of the regulations provide rules for determining the amount of the deduction.

In Rev. Rul. 69-297, 1969-1 C.B. 131, an employee died designating his estate the beneficiary of his interest in a qualified profit-sharing trust. His interest in the trust, which included appreciated securities of the employer corporation, was distributed to his estate within one taxable year of his death. Rev. Rul. 69-297 holds that for the taxable year in which the distribution was made, the estate is required by section 402(a) of the Code to include in its gross income an amount equal to the cost or other basis to the trust of the employer securities (thus excluding any net unrealized appreciation in the employer securities), plus an amount equal to the cash and the fair market value of any other property received as part of the distribution, minus the amount of the employee's contributions. Rev. Rul. 69-297 characterizes this income as income in respect of a decedent under section 691(a), and holds that the estate is allowed a deduction under section 691(c) for that portion of the estate tax attributable to the inclusion in the decedent's estate of the distribution from the employee's trust. Rev. Rul. 69-297 further holds that the net unrealized appreciation in the securities of the employer is includible in gross income as income in respect of a decedent in the taxable year of their disposition by either the executor or the residuary legatees in a taxable transaction and that the transferor will be allowed the deduction provided under section 691(c) for any estate tax paid attributable to the net unrealized appreciation.

In Rev. Rul. 75-125, 1975-1 C.B. 254, a retired employee received from a qualified trust a lump sum distribution consisting entirely of securities of his corporate employer. The securities had a basis to the qualified trust of 5□ dollars and a fair market value on the date of distribution of 10□ dollars. Under section 402(a)(2), as in effect at the time of the distribution, the 5□ dollars net unrealized appreciation in the securities was not taxed to the employee upon distribution. Following the distribution, the employee died leaving the securities to his surviving spouse. Rev. Rul. 75-125 holds that the net unrealized appreciation of 5□ dollars attributable to the employer securities constitutes income in respect of a decedent under section 691(a) to be included in gross income by the surviving spouse when she disposes of the securities. Rev. Rul. 75-125 also holds that the surviving spouse is entitled to a deduction under section 691(c) for that portion of the federal estate tax attributable to the amount of the net unrealized appreciation included in the decedent's estate.

Amounts in *A*'s IRA that were not distributed to *A* prior to *A*'s death are not includible on *A*'s final income tax return. If distributions from the IRA had been made to *A* prior to *A*'s death, the distributions would have been taxable to *A* to the extent required under section 72. Upon *A*'s death, the value of the IRA was included in *A*'s estate and the entire balance in the IRA was distributed to *B* as designated beneficiary.

Under the above facts, the amount of the distribution that equals the balance in the IRA at *A*'s death less *A*'s nondeductible contributions to the IRA constitutes income in respect of a decedent and is includible in *B*'s gross income for the taxable year in which *B* receives the distribution. The balance of the distribution, which represents appreciation and income accruing between the date of death and the date of distribution, is taxable to *B* under sections 408(d) and 72 of the Code. In computing income tax for the taxable year of inclusion of the income in respect of a decedent, *B* may claim a deduction for any federal estate tax on *A*'s estate attributable to that income in respect of a decedent.

HOLDING

(1) The portion of a lump sum distribution to the beneficiary of a decedent's IRA that equals the amount of the balance in the IRA at the owner's death, including unrealized appreciation and income accrued to that date, minus the aggregate amount of the owner's nondeductible contributions to the IRA, is income under section 408(d)(1) of the Code and is income in respect of a decedent under section 691(a)(1) that is includible in the gross income of the beneficiary for the taxable year the distribution is received. (If the designated beneficiary had been the owner's surviving spouse, the surviving spouse would have been permitted, under section 408(d)(3)(C), to roll the distribution over into another IRA and avoid current inclusion.)

(2) In accordance with section 691(c) of the Code, in computing income tax for the taxable year the income in respect of a decedent is included in income, the beneficiary may claim a deduction for the portion of the federal estate tax on the decedent's estate that was attributable to that income in respect of a decedent.

(3) The portion of the lump sum distribution to the beneficiary in excess of the entire balance (including unrealized appreciation, accrued income and nondeductible contributions) in the IRA at the owner's death is not income in respect of a decedent. Such amount is taxable to the beneficiary under sections 408(d) and 72 of the Code.

DRAFTING INFORMATION

The principal author of this revenue ruling is David H. McDonnell of the Office of the Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling contact Mr. McDonnell on (202) 377-9470 (not a toll-free call).