Internal Revenue Service

Number: **200537019**
Release Date: 9/16/2005
Index Number: 691.01-00, 642.03-03

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:PSI:B02
PLR-137172-03
Date:
May 25, 2005

Estate =

X =

D1 =

D2 =

Year 1 =

x =

y =

z =

Dear :

This letter responds to a letter dated June 13, 2003, and subsequent correspondence, submitted by you as the executor of the Estate, requesting certain rulings under the Internal Revenue Code.

The information submitted states that X died on D1 of Year 1. Pursuant to X's will, the executor of the Estate will give certain bequests of cash and personal property to individual named beneficiaries. Any residual estate remaining is to be divided equally and distributed to ten named charitable organizations, each of which is represented as being an organization described in § 501(c)(3) (collectively, the Charities).

Article VIII of X's will grants the executor of the Estate the power to make distribution or division of the Estate in cash or in kind, or both; to allot different kinds or disproportionate shares of property or undivided interests in property among the beneficiaries, and to determine the value of any such property; and to make such elections under the tax laws applicable to the Estate as the executor determines should be made. No compensating adjustments between principal and income, nor with respect to any bequest or devise, shall be made even though the elections so made may affect (beneficially or adversely) the interests of the beneficiaries.

At the time of X's death, X owned a non-qualified annuity contract (the Contract), which had a basis in X's hands of $x and a value of $y as of D1 of Year 1. The Contract was purchased after October 21, 1979. No payments had been received by X under the Contract. The named beneficiary of the death benefit under the Contract is the Estate. The Estate surrendered the Contract on D2 of Year 1 for $z. The difference between $y and $z represents interest accrued after the death of X. The Estate has not included any amount in its gross income or taken any income tax deduction with respect to the Contract for any taxable year. The Estate has made interim distributions satisfying all specific and pecuniary bequests. The amounts received upon surrender of the Contract will be distributed as part of the remaining residuary bequest to the Charities, which have also received interim cash distributions.

The Estate has filed its income tax returns for all taxable years on a fiscal year ending D1, which is not the last day of any month.

Section 441(a) provides that taxable income shall be computed on the basis of the taxpayer's taxable year. In general, an estate may adopt a calendar year or a fiscal year. Section 441(e) defines a fiscal year as a period of twelve months ending on the last day of any month other than December.

Section 642(c)(1) provides that in the case of an estate, there shall be allowed as a deduction in computing its taxable income (in lieu of the deduction allowed by § 170(a), relating to deduction for charitable, etc., contributions and gifts) any amount of the gross income, without limitation, which pursuant to the terms of the governing instrument is, during the taxable year, paid for a purpose specified in § 170(c) (determined without regard to § 170(c)(2)(A)).

Section 642(c)(2) provides that in the case of an estate, there shall be allowed as a deduction in computing its taxable income any amount of the gross income, without limitation, which pursuant to the terms of the governing instrument is, during the taxable year, permanently set aside for a purpose specified in § 170(c), or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or for the establishment, acquisition, maintenance, or operation of a public cemetery not operated for profit.

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

Rev. Rul. 2005-30, 2005-20 I.R.B. 1015, holds that if the owner-annuitant of a deferred annuity contract dies before the annuity starting date, and the beneficiary receives a death benefit under the annuity contract, the amount received by the beneficiary in a lump sum in excess of the owner-annuitant's investment in the contract is includible in the beneficiary's gross income as IRD within the meaning of § 691. Rev. Rul. 2005-30 applies to deferred annuity contracts purchased on or after October 21, 1979.

Based solely on the facts and representations submitted, we conclude that the excess of $y over $x received by the Estate (as the named beneficiary of the Contract) upon the surrender of the Contract was IRD includible by the Estate in its Year 1 gross income. The Estate is entitled to a deduction under § 642(c)(1) for the amounts of IRD paid to the Charities in the Year 1 taxable year, or under § 642(c)(2) for the remaining amounts of IRD which were set aside for charitable purposes. We further conclude that the Estate has not filed its income tax returns based on an allowable taxable year under § 441.

The Estate must file amended income tax returns for all taxable years based upon an allowable taxable year. Those returns, as amended, must include the IRD in the Estate's gross income and claim the appropriate deduction under § 642(c). A copy of this letter should be attached to each return.

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the transactions described above.

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

Sincerely,

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

Enclosures: 2
Copy of this letter
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