

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact:
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Telephone Number:

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Date:
July 10, 2013

Trust =

Survivor's Trust =

Decedent's Trust =

Decedent =

A =

B =

C =

State =

Date 1 =

Date 2 =

Date 3 =

Dear :

This responds to a letter dated December 24, 2012, and subsequent correspondence, submitted by A, requesting rulings under § 691 and 454 of the Internal Revenue Code.

FACTS

The information submitted states that Trust held U.S. Series I savings bonds (the "Bonds") on Date 1, the date of Decedent's death. Decedent and her husband, A, originally purchased the Bonds in paper form using community property funds. Each

bond was registered with two owners: either (1) Decedent and one of A, B or C, or (2) A, and one of Decedent, B or C. In Date 2, the Bonds were re-registered in the name of Trust. In Date 3, the Bonds were converted to electronic bonds held in a TreasuryDirect account in the name of Trust (Account 1).

The Trust provides that upon the death of either Decedent or A survived by the other, the trustee shall divide the Trust estate into two trusts, namely Survivor's Trust and Decedent's Trust. Trust further provides that the trustee of Decedent's Trust shall distribute the assets of Decedent's Trust to the trustee of Survivor's Trust, unless the surviving spouse makes a qualified disclaimer (as defined in § 2518), in which case the trustee of Decedent's Trust shall hold this disclaimed interest in further trust.

Trust and Survivor's Trust are grantor trusts under § 676. Decedent's Trust is not a grantor trust. Since Decedent's death, A, as trustee of Decedent's Trust, has established a second TreasuryDirect account (Account 2) in the name of Decedent's Trust. A intends to make a qualified disclaimer under the terms of Trust with respect to Decedent's share of the Bonds, with the result that Decedent's share of the Bonds will remain in Decedent's Trust. A further intends that Decedent's share of the Bonds will be transferred to Account 2.

Decedent's final tax return will not include any interest earned on the Bonds prior to Decedent's death. Decedent's Trust will use the cash method of accounting and intends not to report the interest on the Bonds annually.

LAW

Section 691(a)(1) of the Code provides that the amount of all items of gross income in respect of a decedent (IRD) 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.

Section 691(a)(2) provides that if a right, described in § 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 bequest, devise, or inheritance from the decedent.

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 § 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.

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

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

CONCLUSION

Based solely on the facts submitted and the representations made, we conclude that:

1. If (1) Decedent's final tax return does not include the interest earned on the Decedent's share of the Bonds before Decedent's death; (2) A, as trustee of Survivor's Trust makes a qualified disclaimer pursuant to Trust with respect to Decedent's share of the Bonds; and (3) Decedent's share of the Bonds are transferred to Account 2, the interest earned on the Bonds up to the date of Decedent's death is income in respect of the decedent (IRD).
2. If Decedent's Trust uses the cash method of accounting, and does not elect to report interest income on the Bonds annually, Decedent's Trust may defer reporting interest income on the Bonds until the bonds are disposed of, redeemed, or reach final maturity, whichever is earlier.
3. Any interest that the Decedent's Trust reports and distributes currently to the beneficiaries of Decedent's Trust will have the same character in the hands of the beneficiaries as in the hands of the Decedent's Trust.
4. Upon the death of A, and the distribution by Decedent's Trust to its beneficiaries of any remaining non-matured Bonds pursuant to the terms of Decedent's Trust, Decedent's Trust will not recognize any taxable income on this distribution and the beneficiaries may defer reporting the accrued interest on the Bonds until the bonds are disposed of, redeemed, or reach final maturity, whichever is earlier.

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.

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

Sincerely,

Melissa C. Liquerman
Chief, Branch 2
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures: 2
Copy of this letter
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