Internal Revenue Service

Department of the Treasury

200025062

Washington, DC 20224

Significant Index Nos.: 402.08-00; 3405.00-00

Contact Person:

Telephone Number:

In Reply Refer to:
T:EP:RA:T2

Date:

LEGEND:

Taxpayer A =

Taxpayer B =

Trustee E =

Trust F =

Trust G =

State J =

Employer M =

Administrator P =

Plan X =

Plan Y =

Dear :

This is in response to your request for a private letter ruling dated March 16, 1999, as amended by letters dated July 20, 1999, January 26, 2000, and March 25, 2000, submitted on your behalf by your authorized representative. In support of your request, you have submitted the following facts and representations.

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Taxpayer A, a United States citizen, died on October 13, 1998, survived by his spouse, Taxpayer B, age 53, also a United States citizen. At the time of his death, Taxpayer A was 55 years old, was employed by Employer M and was a participant in Plan X. Taxpayer A also participated in Plan Y administered by Administrator P. On January 11, 1995, Taxpayer A designated, via beneficiary designation forms, Trust F as the beneficiary to receive Plan X benefits and PlanY benefits payable at his death. Taxpayer A created Trust F on November 29, 1994, by an Agreement of Trust with Trustee E as the trustee.

The trust agreement, under Article Seventh, requires Trustee E to create a separate marital deduction trust, known as Trust G, upon the death of Taxpayer A. This separate marital deduction trust is funded under a pecuniary formula, contained in Article Seventh of the trust agreement. The formula requires marital deduction trust funding equal to one-half of the federal adjusted gross estate, less the value of federal gross estate assets passing directly to Taxpayer B outside of Trust G. This pecuniary formula is set forth as follows:

> "SEVENTH. MARITAL DEDUCTION TRUST. On the death of the Settlor (Taxpayer A), if the Settlor's said spouse survives the Settlor, the following pecuniary amount shall be placed in a separate trust to be known as "TRUST G":
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> > An amount that, when added to the value of all interests in property in the Settlor's federal gross estate that pass or have passed from the Settlor to the Settlor's said spouse, either by the Settlor's Will or apart from the Settlor's Will, in a manner qualified for the federal estate tax marital deduction (but not including interests that are qualified terminable interests, regardless of the election made by the Settlor's executor) under the provisions of the Internal Revenue Code (the "Code") in effect at the time of the Settlor's death, will produce a total value that is equal to one-half of the Settlor's federal adjusted gross estate (the Settlor's federal adjusted gross estate is the Settlor's federal gross estate minus the deductions allowed under Sections 2053 and 2054 of the Code), which amount shall be increased or decreased to the extent necessary, if any, to make such amount, when added to the value for state estate tax purposes of the items in the Settlor's state gross estate that pass or have passed to the Settlor's said spouse, either by the Settlor's Will or apart from the Settlor's Will, in a manner qualified for the State J estate tax marital deduction equal to, but not less than or in excess of, one-half of the Settlor's State J adjusted gross estate.

Under Article Seven of the trust agreement, the pecuniary amount is determined as follows:

"In determining the above-described pecuniary amount, values as finally determined for federal estate tax purposes and State J estate tax purposes, whichever are applicable, shall control. The trust property available to place in the marital deduction trust to make up the above-described pecuniary amount shall (with certain exceptions later noted) consist of the property held in trust by Trustee E at the time of the Settlor's death, plus any undistributed income, and any additions to the property held in trust hereunder made as a result of the death of the Settlor by the Settlor's Will or from any other source. Trustee E shall not use, to make up the above-described pecuniary amount, any trust property or the proceeds of any trust property that does not qualify for the federal and State J estate tax marital deduction (such as disqualified terminable interests or trust property not includible in the Settlor's federal or State J gross estate) or that is subject to foreign death taxes. Trust property distributed in kind to make up the above-described amount shall be valued at values current at the date of distribution. The above-described pecuniary amount shall be entitled to interest at the average rate of return of the trust property from the date of the Settlor's death to the date it is placed in the marital deduction trust."

Your authorized representative has asserted on your behalf that, under the laws of State J, Trustee E must fund Trust G with the proceeds from Plan X and Plan Y in order to minimize taxes incurred by Trust F and to avoid a wasting of Trust assets. Failure to fund Trust G with Plans X and Y benefits would subject Trustee E to potential liability to the Trust's beneficiaries.

Taxpayer B, as beneficiary of Trust G, has the right to withdraw all trust principal from Trust G pursuant to Article Seventh, Paragraph 1, which reads as follows:

The terms of "Trust G" are as follows:

"1. The trustee shall pay the net income from the time of the Settlor's death to the Settlor's said spouse for such spouse's life; and, in addition, the trustee E shall pay to the Settlor's said spouse, or as said spouse directs, from the principal of the trust, from time to time, such amount or amounts or all of the principal as the Settlor's said spouse may specify in an instrument or instruments in writing delivered to the trustee in said spouse's lifetime. If, in the opinion of the disinterested trustee, the Settlor's said spouse is incapacitated through illness, age or other cause, the disinterested trustee may in his uncontrolled discretion, from time to time, while he believes such incapacity continues, apply all or any part of the principal toward the support, care and benefit of the Settlor's said spouse, in such amount or amounts and in such manner as he may determine without regard to the other means of the Settlor's said spouse."

Taxpayer B proposes to establish an IRA rollover account in her name, which meets the requirements of Code section 408(a). Taxpayer B further proposes to direct Trustee E to arrange for a trustee-to-trustee transfer of Plan X and Plan Y death benefits directly to her IRA rollover account. These transfers will in total be equal to the lesser of the amount required to fully fund Trust G under the pecuniary funding formula contained in the trust agreement to Trust F or the value of the death benefits available from Plan X and Plan Y.

Based on the above, you request the following letter rulings:

1. That the proposed direct trustee-to-trustee transfers from Plan X and Plan Y to a rollover IRA established by Taxpayer B in an amount equal to the lesser of the funding level required to fully fund Trust G or the value of the death benefits available from Plan X and Plan Y, constitute direct rollovers of eligible rollover distributions and that as such the amount of the direct rollovers is not taxable in the year of such rollover to either Taxpayer B or Trustee E.

2. That the proposed direct trustee-to-trustee transfer from Plan X and Plan Y as direct rollovers of eligible rollover distributions will be exempt from the withholding requirements of section 3405(c)(1) of the Code pursuant to section 3405(c)(2) of the Code.

Section 402(c)(1) of the Code provides, generally, that if (A) any portion of the balance to the credit of an employee in a qualified trust is paid to the employee in an eligible rollover distribution, and (B) the distributee transfers any portion of the property received in such distribution to an eligible retirement plan, then such distribution (to the extent so transferred) shall not be includible in gross income for the taxable year in which paid.

Section 402(c)(4) of the Code defines the term "eligible rollover distribution" as any distribution to an employee of all or any portion of the balance to the credit of an employee in a qualified trust (defined in section 402(c)(8) of the Code) except the following distributions:

(A) any distribution which is one of a series of substantially equal periodic payments (not less frequently than annually) made —

(i) for the life (or life expectancy) of the employee or the joint lives (or joint life expectancies) of the employee and the employee's designated beneficiary, or

(ii) for a period of 10 years or more, and

(B) any distribution to the extent such distribution is required under section 401(a)(9).

Section 402(c)(8)(B) of the Code defines the term "eligible retirement plan" as (i) an individual retirement account described in section 408(a), (ii) an individual retirement annuity described in section 408(b) (other than an endowment contract), (iii) a qualified trust, and (iv) an annuity plan described in section 403(a).

Section 402(c)(3) of the Code provides that section 402(c)(1) shall not apply to any transfer of a distribution made after the 60th day following the day on which the distributee received the property distributed.

Section 402(c)(5) of the Code provides that a transfer to an eligible retirement plan described in section 402(c)(8)(B)(i) or section 402(c)(8)(B)(ii) resulting in any portion of a distribution being excluded from gross income under section 402(c)(1) shall be treated as a rollover contribution described in section 408(d)(3).

Section 402(c)(9) of the Code provides that if any distribution attributable to an employee, is paid to the spouse of the employee after the employee's death, the provisions of section 402(c)(1) through (8) shall apply to such distribution in the same manner as if the spouse were the employee; except that a trust or plan described in section 402(c)(8)(B)(iii) or section 402(c)(8)(B)(iv) shall not be treated as an eligible retirement plan with respect to such distribution.

Section 401(a)(31)(A) of the Code provides that a trust shall not constitute a qualified trust under this section unless the plan of which such trust is a part provides that if the distributee of any eligible rollover distribution —

(i) elects to have such distribution paid directly to an eligible retirement plan, and

(ii) specifies the eligible retirement plan to which such distribution is to be paid (in such form and at such time as the plan administrator may prescribe),

such distribution shall be made in the form of a direct trustee-to-trustee transfer to the eligible retirement plan so specified.

Section 401(a)(31)(B) of the Code states that subparagraph (A) shall apply only to the extent that the eligible rollover distribution would be includible in gross income if not transferred as provided in subparagraph (A) (determined without regard to sections 402(c) and 403(a)(4)).

Section 401(a)(31)(C) of the Code provides that the term "eligible rollover distribution" has the meaning given such term by section 402(f)(2)(A) (i.e., when used in section 401(a)(31) of the Code, the term has the same meaning as when used in section 402(c) of the Code).

Section 401(a)(31)(D) of the Code provides that the term "eligible retirement plan" has the meaning given such term by section 402(c)(8)(B), except that a qualified trust shall be considered an eligible retirement plan only if it is a defined contribution plan, the terms of which permit the acceptance of rollover distributions.

Generally, a direct trustee-to-trustee transfer described in section 401(a)(31) of the Code constitutes a "direct rollover" of an "eligible rollover distribution" and is entitled to tax-deferred treatment pursuant to section 402(c) of the Code.

Section 1.402(c)-2 of the Income Tax Regulations, Q&A 10, provides, generally, that if a distribution attributable to an employee is paid to the employee's surviving spouse, sections 402(c) and 401(a)(31) apply to the distribution in the same manner as if the spouse were the employee. Q&A 10 further provides that only individual retirement accounts described in sections 408(a) and (b) of the Code are treated as eligible retirement plans for purposes of receiving distributions made to surviving spouses of deceased employees/plan participants.

Generally, if a decedent's section 401(a) of the Code qualified plans' proceeds pass through a third party, e.g., an estate or a trust, and then are distributed to the decedent's surviving spouse, said spouse will be treated as acquiring them from the third party and not from the decedent. Thus, generally, said surviving spouse will not be eligible to roll over the section 401(a) plan proceeds into her IRA.

In this situation, however, in order to satisfy the terms of the trust agreement, Trustee E must allocate benefit proceeds available from Plan X and Plan Y to Trust G (to the extent necessary to fully fund Trust G under the trust funding formula). Trustee E has no discretion as to allocating Plan X and Plan Y benefits to Trust G. Taxpayer B, the decedent's (*i.e.*, Taxpayer A's) surviving spouse, is the beneficiary of Trust G (a trust required to be created by Trustee E under the trust agreement to Trust F upon the death of Taxpayer A) under the terms of Trust F, and has a lifetime interest in the income of Trust G and has the authority to direct Trustee E to pay from the principal of Trust G, from time to time, such amount or amounts or all of the principal as she may specify in an instrument or instruments in writing delivered to Trustee E in Taxpayer B's lifetime. Taxpayer B has indicated her intention to exercise her authority to withdraw any benefits so allocated by directing Trustee E to seek a direct trustee-to-trustee transfer of said benefits to an IRA rollover account established by Taxpayer B in her own name. Taxpayer B proposes to withdraw all assets allocated to Trust G. Under the circumstances, we do not believe that the general rule above should apply. In such a situation, for purposes of section 402(c)(9) of the Code, the Internal Revenue Service will treat the surviving spouse as having acquired the section 401(a) qualified plan proceeds from the decedent and not the trust.

Thus, with respect to your first ruling request, the proposed direct trustee-to-trustee transfers from Plan X and Plan Y to an IRA rollover account established by Taxpayer B in her own name in an amount equal to the lesser of the funding level required to fully fund Trust G or

the value of the death benefits available from Plan X and Plan Y, constitute direct rollovers of eligible rollover distributions and that as such the amount of the direct rollovers is not taxable in the year of such rollover to either Taxpayer B or Trustee E.

With respect to your second ruling request, section 3405(c)(1)(B) of the Code provides that in the case of any designated distribution which is an eligible rollover distribution, the payor of such distribution shall withhold from such distribution an amount equal to 20 percent of such distribution.

Section 3405(c)(2) of the Code provides that paragraph (1)(B) shall not apply to any distribution if the distributee elects under section 401(a)(31)(A) to have such distribution paid directly to an eligible retirement plan.

Section 3405(c)(3) of the Code provides that, for purposes of this subsection, the term "eligible rollover distribution" has the meaning given such term by section 402(f)(2)(A).

Section 402(f)(2)(A) of the Code provides that the term "eligible rollover distribution" has the same meaning as when used in section 402(c).

With respect to your second ruling request, since the Internal Revenue Service has already determined that the proposed transfer from Plan X to an IRA rollover account established by Taxpayer B in her own name will be in accordance with section 401(a)(31), we conclude that the proposed direct trustee-to-trustee transfers from Plan X and Plan Y as direct rollovers of eligible rollover distributions will be exempt from the withholding requirements of section 3405(c)(1) of the Code pursuant to section 3405(c)(2).

This ruling assumes that Plan X and Plan Y are qualified under section 401(a) of the Code and that each plan's trust is tax-exempt under section 501(a) at all relevant times thereto. It also assumes that the IRA rollover account set up by Taxpayer B in her own name to receive amounts transferred from Plan X and Plan Y will meet the requirements of section 408(a).

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

A copy of this ruling is being sent to your authorized representative in accordance with a power of attorney on file in this office.

Sincerely yours,

(signed) JOYCE E. FLOYD

Joyce E. Floyd, Manager
Employee Plans Technical Branch 2
Tax Exempt and Government Entities Division

Enclosures:
Deleted copy of ruling letter
Form 437 (Notice of Intention to Disclose)

cc: