

Revenue Ruling 2005-36

ISSUE

Is a beneficiary's disclaimer of a beneficial interest in a decedent's individual retirement account (IRA) a qualified disclaimer under § 2518 of the Internal Revenue Code even though, prior to making the disclaimer, the beneficiary receives the required minimum distribution for the year of the decedent's death from the IRA?

FACTS

Decedent dies in 2004. At the time of death, Decedent is the owner of an IRA described in § 408(a) with assets having a fair market value of \$2,000x. Decedent's "required beginning date," as described in § 401(a)(9)(A), occurred prior to 2004, and accordingly Decedent was receiving annual distributions from the IRA prior to the time of death. However, at the time of death, Decedent had not received the required minimum distribution for the 2004 calendar year.

Situation 1: Under the terms of the IRA beneficiary designation pursuant to the IRA governing instrument, Decedent's spouse, Spouse, is designated as the sole beneficiary of the IRA after Decedent's death. A, the child of Decedent and Spouse, is designated as the beneficiary in the event Spouse predeceases Decedent. Three months after Decedent's death, in accordance with § 1.401(a)(9)-5, A-4, of the Income Tax Regulations, the IRA custodian pays Spouse \$100x, the required minimum distribution for 2004. No other amounts have been paid from the IRA since Decedent's date of death.

Seven months after Decedent's death, Spouse executes a written instrument pursuant to which Spouse disclaims the pecuniary amount of \$600x of the IRA account balance plus the income attributable to the \$600x amount earned after the date of death. The income earned by the IRA between the date of Decedent's death and the date of Spouse's disclaimer is \$40x. The disclaimer is valid and effective under applicable state law. Under applicable state law, as a result of the disclaimer, Spouse is treated as predeceasing Decedent with respect to the disclaimed property. As soon as the disclaimer is made, in accordance with the IRA beneficiary designation, A, as successor beneficiary is paid the \$600x amount disclaimed, plus that portion

of IRA income earned between the date of death and the date of the disclaimer attributable to the \$600x amount (\$12x).

Situation 2: The facts are the same as in *Situation 1*, except that, instead of disclaiming a pecuniary amount, Spouse validly disclaims, in the written instrument, 30 percent of Spouse's entire interest in the principal and income of the balance of the IRA account remaining after the \$100x required minimum distribution for 2004 and after reduction for the pre-disclaimer income attributable to the \$100x required minimum distribution (\$2x). As soon as the disclaimer is made, in accordance with the beneficiary designation, A is paid 30 percent of the excess of the remaining account balance over \$2x.

Situation 3: The facts are the same as in *Situation 1*, except that A is designated as the sole beneficiary of the IRA after Decedent's death, Spouse is designated as the beneficiary in the event A predeceases Decedent, and the \$100x required minimum distribution for 2004 is paid to A 3 months after Decedent's death. Seven months after Decedent's death, A disclaims the entire remaining balance of the IRA account except for \$2x, the income attributable to the \$100x required minimum distribution paid to A. As soon as the disclaimer is made, in accordance with the IRA beneficiary designation, the balance of the IRA account, less \$2x, is distributed to Spouse as successor beneficiary. A receives a total of \$102x.

LAW AND ANALYSIS

Section 408(a) provides that the term "individual retirement account" means a trust created or organized in the United States for the exclusive benefit of an individual or his or her beneficiaries, but only if the written governing instrument creating the trust meets certain specified requirements.

Section 408(a)(6) provides that, under regulations prescribed by the Secretary, rules similar to the rules of § 401(a)(9) and the incidental death benefit requirements of § 401(a) shall apply to the distribution of the entire interest of an individual for whose benefit an IRA trust is maintained.

Under § 401(a)(9)(A), a trust will not constitute a qualified trust unless the plan provides that the entire interest of each employee (i) will be distributed to such employee not later than the

required beginning date, or (ii) will be distributed, beginning not later than the required beginning date, in accordance with regulations, over the life of such employee or over the lives of such employee and a designated beneficiary (or over a period not extending beyond the life expectancy of such employee or the life expectancy of such employee and a designated beneficiary).

Under § 1.408-8, A-1, an IRA is subject to the required minimum distribution rules of § 401(a)(9) and must satisfy the requirements of §§ 1.401(a)(9)-1 through 1.401(a)(9)-9 in the same manner as a plan, except as otherwise specified in § 1.408-8. Under § 1.408-8, A-1, for purposes of applying the rules of §§ 1.401(a)(9)-1 through 1.401(a)(9)-9, the IRA owner is substituted for the employee. Under § 1.408-8, A-3, the term "required beginning date" means April 1 of the calendar year following the calendar year in which the IRA owner attains age 70 1/2.

Under § 1.401(a)(9)-4, A-1, a designated beneficiary is an individual who is designated as a beneficiary either by the terms of the plan or by an affirmative election by the employee (or the employee's surviving spouse) specifying the beneficiary. A beneficiary designated as such under the plan is an individual who is entitled to a portion of an employee's benefit, contingent on the employee's death or another specified event.

Section 1.401(a)(9)-4, A-4, provides that the employee's designated beneficiary generally will be determined based on the beneficiaries designated as of the employee's date of death who remain beneficiaries as of September 30th of the calendar year following the calendar year of the employee's death. Generally, any person who was a beneficiary as of the employee's date of death, but is not a beneficiary as of that September 30th (e.g., because the person receives the entire benefit to which the person is entitled before that September 30th), is not taken into account in determining the employee's designated beneficiary for purposes of determining the distribution period for required minimum distributions after the employee's death. Accordingly, if a person disclaims entitlement to the employee's benefit by a disclaimer that satisfies § 2518 by that September 30th, thereby allowing other beneficiaries to receive the disclaimed benefit instead, the disclaimant is not taken into account in determining the employee's designated beneficiary.

Under § 2518(a), if a person makes a qualified disclaimer with respect to any interest in property, then for estate, gift, and generation-skipping transfer tax purposes, the disclaimed interest will be treated as if the interest had never been transferred to the disclaimant. Instead, the interest will be considered as having passed directly from the decedent to the person entitled to receive the property as a result of the disclaimer.

Under § 2518(b), the term "qualified disclaimer" means an irrevocable and unqualified refusal by a person to accept an interest in property, but only if: (1) the refusal is in writing; (2) the writing is received by the transferor of the interest, his or her legal representative, or the holder of the legal title to the property to which the interest relates, not later than the date that is 9 months after the later of--(A) the date on which the transfer creating the interest in the person is made, or (B) the day on which the person attains the age of 21; (3) the person has not accepted the interest or any of its benefits; and (4) as a result of the refusal, the interest passes without any direction on the part of the person making the disclaimer and passes either--(A) to the spouse of the decedent, or (B) to a person other than the person making the disclaimer.

Section 25.2518-2(d)(1) of the Gift Tax Regulations provides that a qualified disclaimer cannot be made with respect to an interest in property if the disclaimant has accepted the interest or any of its benefits, expressly or impliedly, prior to making the disclaimer. Acceptance is manifested by an affirmative act that is consistent with ownership of the interest in the property. Acts indicative of acceptance include: using the property or the interest in the property; accepting dividends, interest, or rents from the property; and directing others to act with respect to the property or interest in the property. However, a disclaimant is not considered to have accepted the property merely because, under applicable local law, title to the property vests immediately on the decedent's death in the disclaimant.

Section 25.2518-3 provides rules regarding the circumstances under which an individual may make a qualified disclaimer of less than the individual's entire interest in property and may accept the balance of the property. Section 25.2518-3(b) provides that a disclaimer of an undivided portion of a separate interest in property that meets the other requirements of a qualified disclaimer under § 2518(b) and the corresponding regulations is a qualified disclaimer. Under the regulations, each interest in property that is separately created by the transferor is

treated as a separate interest in property. An undivided portion of a disclaimant's separate interest in property must consist of a fraction or percentage of each and every substantial interest or right owned by the disclaimant in the property and must extend over the entire term of the disclaimant's interest in the property and in other property into which the property is converted.

Section 25.2518-3(c) provides that the disclaimer of a specific pecuniary amount out of a pecuniary or nonpecuniary bequest or gift can be a qualified disclaimer provided that no income or other benefit of the disclaimed amount inures to the benefit of the disclaimant either prior to or subsequent to the disclaimer. Following the disclaimer, the amount disclaimed and any income attributable to that amount must be segregated based on the fair market value of the assets on the date of the disclaimer or on a basis that is fairly representative of the value changes that may have occurred between the date of transfer and the date of the disclaimer. The regulation further provides that a pecuniary amount that is distributed to the disclaimant from the bequest prior to the disclaimer is treated as a distribution of corpus from the bequest that does not preclude a disclaimer with respect to the balance of the bequest. However, the acceptance of a distribution from the bequest is considered an acceptance of a proportionate amount of the income earned by the bequest. That income must be similarly segregated from the disclaimed amount and cannot be disclaimed. The regulation provides a formula to determine the proportionate share of the income considered to be accepted by the disclaimant, and thus, not eligible to be disclaimed, as follows:

$$\frac{\text{Total amount of distributions received by the disclaimant out of gift or bequest}}{\text{Total value of the gift or bequest on the date of the transfer}} \times \frac{\text{Total amount of income earned by the bequest between the date of transfer and the date of disclaimer}}{\text{Total amount of income earned by the bequest}}$$

See § 25.2518-3(d), *Example 17* (illustrating a beneficiary's qualified disclaimer of an interest in a brokerage account passing to the beneficiary when, prior to the disclaimer, the beneficiary withdrew a pecuniary amount from the account); see also § 25.2518-3(d), *Example 19*

(regarding a pecuniary disclaimer funded on a basis that is fairly representative of value changes that occurred between the date of transfer and the date of the disclaimer).

In *Situations 1, 2, and 3*, the beneficiary's receipt of the \$100x distribution from the IRA constitutes an acceptance of \$100x of corpus, plus the income attributable to that amount. Based on the formula contained in § 25.2518-3(c), the amount of income attributable to the \$100x distribution that the beneficiary is deemed to have accepted, and therefore cannot disclaim, is \$2x computed as follows:

$$\frac{\$100x \text{ (distribution)}}{\$2000x \text{ (date of death value of IRA)}} \times \$40x \text{ (IRA income from date of death to date of disclaimer)}$$

However, the beneficiary's acceptance of these amounts does not preclude the beneficiary from making a qualified disclaimer with respect to all or a portion of the balance of the IRA.

Accordingly, in *Situation 1*, assuming the other requirements of § 2518(b) are satisfied, Spouse's disclaimer constitutes a qualified disclaimer under § 2518(b) of the \$600x pecuniary amount, plus \$12x (the IRA income attributable to the disclaimed amount (\$600x/\$2000x X \$40x)).

In *Situation 2*, Spouse disclaims, in accordance with § 25.2518-3(b), an undivided portion (30 percent) of Spouse's principal and income interest in the remaining IRA account balance, rather than a pecuniary amount as in *Situation 1*. However, as in *Situation 1*, Spouse's receipt of the \$100x distribution also constitutes acceptance of \$2x of income deemed attributable to the amount distributed. Spouse may not disclaim any portion of the \$2x. Therefore, in *Situation 2*, assuming the other requirements of § 2518(b) are satisfied, Spouse's disclaimer of 30 percent of Spouse's entire interest in the principal and income of the balance of the IRA account remaining after the \$100x required minimum distribution for 2004 and after reduction for the pre-disclaimer income attributable to that amount (\$2x), constitutes a qualified disclaimer to the extent of 30 percent of the remaining IRA account balance after reduction for the \$2x of income

Spouse is deemed to have accepted (that is, $.30 \times [\text{value of remaining account balance on date of disclaimer} - \$2x]$).

The results in *Situations 1* and *2* would be the same if the amount disclaimed, plus that portion of the post-death IRA income attributable to the disclaimed amount, is not distributed outright to A, but instead is segregated and maintained in a separate IRA account of which A is the beneficiary as described in § 1.401(a)(9)-8, A-3. See also, § 1.401(a)(9)-8, A-2(a)(2). Separate accounts for A and Spouse may be made effective as of the date of Decedent's death in 2004, and the 2004 required minimum distribution does not have to be allocated among the beneficiaries of the separate accounts for purposes of the separate account rules under § 1.401(a)(9)-8, A-3.

In *Situation 3*, A disclaims A's entire principal and income interest in the remaining IRA account balance after the payment of the required minimum distribution for 2004, except for \$2x. As in *Situations 1* and *2*, A's receipt of the \$100x required minimum distribution also constitutes an acceptance of the \$2x of income that is deemed attributable to the required minimum distribution that is distributed. A may not disclaim any portion of the \$2x. Therefore, in *Situation 3*, assuming the other requirements of § 2518(b) are satisfied, A's disclaimer of the entire principal and income balance of the IRA remaining after the payment of the required minimum distribution for 2004, except for \$2x (that is, 100% of value of the remaining account balance on the date of the disclaimer, less \$2x) constitutes a qualified disclaimer.

In addition, under § 1.401(a)(9)-4, A-4, any person who was a beneficiary of the employee's benefit as of the date of the employee's death, but is not a beneficiary as of September 30th of the calendar year following the calendar year of the employee's death, is not considered a designated beneficiary for purposes of § 401(a)(9). In *Situation 3*, A both received the required minimum distribution amount and timely disclaimed entitlement to the entire balance of the IRA account on or before September 30, 2005. Accordingly, if A is paid the \$2x of income attributable to the required minimum distribution amount on or before September 30, 2005, A will be treated as not entitled to any further benefit as of September 30, 2005, and therefore, A will not be considered a designated beneficiary of the IRA for purposes of § 401(a)(9).

HOLDINGS

A beneficiary's disclaimer of a beneficial interest in a decedent's IRA is a qualified disclaimer under § 2518 (if all of the requirements of that section are met), even though, prior to making the disclaimer, the beneficiary receives the required minimum distribution for the year of the decedent's death from the IRA. The beneficiary may make a qualified disclaimer under § 2518 with respect to all or a portion of the balance of the account, other than the income attributable to the required minimum distribution that the beneficiary received, provided that at the time the disclaimer is made, the disclaimed amount and the income attributable to the disclaimed amount are paid to the beneficiary entitled to receive the disclaimed amount, or are segregated in a separate account.

Further, a person disclaiming his or her entire remaining interest in an IRA will not be considered a designated beneficiary of the IRA for purposes of § 401(a)(9), if the qualified disclaimer is made on or before September 30th of the calendar year following the calendar year of the employee's death, and if, on or before that September 30th, the disclaimant is paid the income attributable to the required minimum distribution amount, so that the disclaimant is not entitled to any further benefit in the IRA after September 30th of the calendar year following the calendar year of the employee's death.

DRAFTING INFORMATION

The principal author of this revenue ruling is Susan H. Levy of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling, contact Susan H. Levy at (202) 622-3090 (not a toll-free call).