

Internal Revenue Service

Department of the Treasury

Index Number: 2055.00-00
Number: **200002011**
Release Date: 1/14/2000

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:DOM:P&SI:Br.7-PLR-121893-98

Date:

September 30, 1999

Legend

Taxpayer:

Corporation:
year 1:

Dear :

We received your letter dated, November 30, 1998, in which you request a ruling concerning the estate and income tax consequences under §§ 2055, 691 and 83 of the Internal Revenue Code related to the Taxpayer's designation, in the event of the Taxpayer's death, of one or more charitable organizations as the beneficiaries of certain deferred compensation to which he is entitled and to Taxpayer's bequest at his death to one or more charitable organizations certain stock options which he owns. This letter is in response to your request.

The represented facts are as follows: Taxpayer has been employed by Corporation, since he founded Company in year 1. Taxpayer is currently Chairman of Corporation's Board of Directors.

During the course of Taxpayer's employment, he has elected to defer receipt of certain amounts to which he was entitled, consisting of (1) compensation that had been payable to Taxpayer but the receipt of which he elected to defer pursuant to Corporation's deferred compensation plan, (2) shares of Corporation stock that had been payable to Taxpayer as a result of his exercise of compensatory stock options granted to him by Corporation, the receipt of which he elected to defer pursuant to Corporation's deferred stock option plan. Furthermore, Taxpayer negotiated with Corporation for the Corporation to provide a death benefit to his estate or designated beneficiaries upon his death. Collectively, these three items are referred to as the deferred compensation.

Pursuant to Taxpayer's agreement with Corporation with respect to the deferred compensation, Taxpayer may designate any one or more beneficiaries within a certain class, which would include charitable organizations, to whom the deferred compensation would be payable in the event of his death.

Taxpayer intends to name as the designated beneficiaries of the deferred compensation one or more charitable organizations, each of which qualifies for tax-exempt status pursuant to § 501(a) as an organization described in § 501(c)(3).

During the course of his employment with the Corporation, Taxpayer also has been granted certain rights (options) to purchase shares of Corporation stock at specified option prices. No option price was less than the fair market value of the stock to which it applied on the date the option was granted.

It is represented that the options are the type of options commonly known as "nonstatutory options" because they do not meet the requirements for special income tax treatment under §§ 421 through 424 ("statutory options"). It is further represented that at the time of their grant, the options did not have a readily ascertainable fair market value.

Pursuant to Taxpayer's agreement with Corporation under which the options were granted, in the event of his death, Taxpayer may transfer the options by will to any one or more beneficiaries within a certain class, which would include charitable organizations. Taxpayer intends to bequeath the options under his will to one or more of the charitable organizations.

Specifically, you request the following rulings:

1. Taxpayer's estate will be eligible for a federal estate tax charitable deduction under § 2055(a) for the deferred compensation passing to the charitable organizations and for the value of the options passing to the charitable organizations.

2. The deferred compensation to which the charitable organizations will become entitled following Taxpayer's death will be income in respect of a decedent under § 691 which will be included in the gross income of the charitable organizations in the year in which the charitable organizations receive such income.

3. When, following Taxpayer's death, the charitable organizations exercise the options which Taxpayer bequeaths to them under his Will, the charitable organizations will recognize income in respect of a decedent under § 691 which will be included in the gross income of the charitable organizations.

ISSUE 1: (Estate Tax Charitable Deduction)

Section 2055(a)(2) provides that for purposes of the tax imposed by § 2001, the value of the taxable estate shall be determined by deducting from the value of the gross estate the amount of all bequests, legacies, devises, or transfers to or for the use of any corporation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes.

Based on facts submitted and representations made the deferred compensation and the value of the options will be includible in the Taxpayer's gross estate under §§ 2033 and 2039(a) of the Code. We also conclude that, assuming the charitable organizations are organizations described in § 501(c)(3) at the time of the Taxpayer's death, the Taxpayer's estate will be eligible for a federal estate tax deduction under § 2055(a) of the Code for the deferred compensation payable to the charitable organizations in accordance with Taxpayer's beneficiary designation and for the value of the options passing to the charitable organizations under Taxpayer's will.

ISSUES 2 & 3: (Income in Respect of a Decedent)

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.

Section 691(a)(2) of the Code provides that if a right, described in section 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 section 691(a)(2), 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, described in § 691(a)(1), to receive an amount 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 in which the right to receive the income was originally derived and the amount includible in gross income under § 691(a)(1) or (2) shall be considered in the hands of the estate or such person to have the character which it would have had in the hands of the decedent if the decedent had lived and received such amount.

Section 1.691(a)-1(b) of the Income in Respect of Decedents 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 which were not properly includible in computing the decedent's taxable income for the taxable year ending with the date of the decedent's death or for a previous taxable year under the method of accounting employed by the decedent.

Section 83(a) of the Code provides that if, in connection with the performance of services, property is transferred to any person other than the person for whom the services are performed, the excess of--(1) the fair market value of the property (determined without regard to any restriction other than a restriction which by its terms will never lapse) at the first time the rights of the person having the beneficial interest in the property are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier, over (2) the amount, if any, paid for the property, will be included in the gross income of the person who performed the services in the first taxable year in which the rights of the person having the beneficial interest in the property are transferable or are not subject to a substantial risk of forfeiture, whichever is applicable. Under § 83(e)(3) of the Code, § 83 does not apply to the transfer of an option without a readily ascertainable fair market value.

Section 1.83-1(d) provides that if substantially nonvested property has been transferred in connection with the performance of services and the person who performed the services dies while the property is still substantially nonvested, any income realized on or after such death with respect to the property under this section is income in respect of a decedent to which the rules of § 691 apply. In such a case the income in respect of the property shall be taxable under § 691 (except to the extent not includible under § 101(b)) to the estate or beneficiary of the person who performed the services, in accordance with § 83 and the regulations thereunder.

Section 1.83-7(a) of the regulations provides, in part, that if there is granted to an employee or independent contractor (or beneficiary thereof) in connection with the performance of services, an option to which § 421 (relating generally to certain qualified and other options) does not apply, § 83(a) shall apply to the grant if the option has a readily ascertainable fair market value (determined in accordance with § 1.83-7(b)) at the time the option is granted. If § 83(a) does not apply to the grant of the option because it does not have a readily ascertainable fair market value at the time of the

grant, §§ 83(a) and 83(b) will apply at the time the option is exercised or otherwise disposed of, even though the fair market value of the option may have become readily ascertainable before such time. If the option is exercised, §§ 83(a) and 83(b) apply to the transfer of property pursuant to the exercise, and the employee or independent contractor realizes compensation upon the transfer at the time and in the amount determined under § 83(a) or 83(b). If the option is sold or otherwise disposed of in an arm's length transaction, §§ 83(a) and 83(b) apply to the transfer of money or other property received in the same manner as §§ 83(a) and 83(b) would have applied to the transfer of property pursuant to the exercise of an option. See § 1.83-7(b) of the regulations for the test to be applied in determining whether an option has a readily ascertainable fair market value. However, § 1.83-7 is silent regarding the transfer of a nonstatutory option in a non-arm's length transaction.

Based on facts submitted and representations made, we conclude that if the charitable organizations are named as the designated beneficiaries of the deferred compensation, the proceeds from the deferred compensation that would have been items of gross income to Taxpayer if the proceeds had been distributed to Taxpayer before his death will be income in respect of a decedent to the charitable organizations under § 691(a)(1)(B) when distributed to the charitable organizations. The proceeds from the deferred compensation will not be income in respect of a decedent to Taxpayer's estate.

Based on facts submitted and representations made, we conclude that Taxpayer's bequest of the options to the charitable organizations is governed by the rule set forth in § 1.83-1(d). Therefore, we also conclude that any income realized by the charitable organizations after Taxpayer's death by exercise of the options is income in respect of a decedent to the charitable organizations under § 691(a)(1)(C). The income from the options will not be income in respect of a decedent to Taxpayer's estate.

Except as ruled above, we express or imply no opinion concerning the federal tax consequences of this transaction under the cited provisions or any other provision of the Code. In particular we express or imply no opinion regarding the value of any stock options.

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

Sincerely,

Christine E. Ellison

Christine E. Ellison
Branch Chief, Branch 7
Office of the Assistant Chief Counsel
(Passthroughs and Special Industries)

Copy to: