

remarriage. In order to avoid keeping the estate open for many years, the Executor acquired a commercial annuity providing for the required payments to Taxpayer.

The owner of the annuity is Husband's Estate and the annuitant (payee) is Taxpayer. The annuity "guarantee[s] the payment of at least 191 monthly payments of \$b each to insure the return of the entire single premium amount." The first payment under the annuity occurred on Date 4, and payments have been occurring monthly since then. Under the annuity contract, Taxpayer does not have any right to a lump sum or accelerated payment. Monthly payments have commenced and are being made to the Estate "on the same day of the month as the first payment...." which then pays the Taxpayer the required amount under the will. The annuity further provides that:

We will pay the payments shown [(\$b)] to the payee named by the owner as long as the annuitant is living. If no payee is named, or if the payee dies before this contract terminates, we will pay the annuitant, if living. In addition, if the annuitant is not living, any remaining guaranteed payments will be made to the beneficiary.

The owner of the annuity has the right to designate the beneficiary. Unlike the obligation set forth in the Settlement Agreement, which provides that the payments will terminate upon the death or remarriage of Taxpayer, the annuity contract only "terminates on the later of the payment of the last guaranteed payment or the death of the annuitant."¹

The Executor proposes to distribute the annuity contract to Taxpayer in exchange for her release of all claims against the estate, provided the requested private letter rulings are granted by the Service.

RULINGS REQUESTED

1. The distribution of the annuity contract to Taxpayer will constitute a distribution to a beneficiary pursuant to § 661.
2. In the alternative, Taxpayer may recover the investment in the contract by the Estate to the extent provided in § 72.

LAW AND ANALYSIS

First Requested Ruling

Section 661(a) provides that in any taxable year there shall be allowed as a deduction in computing the taxable income of an estate or trust (other than a trust which distributes current income only), the sum of (1) any amount of income for such taxable

¹ In the submission, Taxpayer represents that an annuity terminating upon death or remarriage of the annuitant is not commercially available.

year required to be distributed currently (including any amount required to be distributed which may be paid out of income or corpus to the extent such amount is paid out of income for such taxable year); and (2) any other amounts properly paid or credited or required to be distributed for such taxable year; but such deduction shall not exceed the distributable net income of the estate or trust.

Section 662(a)(1) provides, in part, that there shall be included in the gross income of a beneficiary to whom an amount specified in § 661(a) is paid, credited, or required to be distributed (by a trust described in § 661), the amount of income for the taxable year required to be distributed currently to such beneficiary, whether distributed or not. For purposes of this section, the phrase "the amount of income required to be distributed currently" includes any amount required to be paid out of income or corpus to the extent such amount is paid out of income for such tax year.

Section 682(a) provides that there shall be included in the gross income of a wife who is divorced or legally separated under a decree of divorce or of separate maintenance (or who is separated from her husband under a written separation agreement) the amount of the income of any trust which such wife is entitled to receive and which, except for this section, would be includible in the gross income of her husband, and such amount shall not be includible in the gross income of such husband.

Section 682 (b) provides that for purposes of computing the taxable income of the estate or trust and the taxable income of a wife to whom subsection (a) applies, such wife shall be considered as a beneficiary.

Based solely on the facts and the representations submitted, the distribution of the annuity to Taxpayer is not a distribution to a beneficiary under § 661 because Taxpayer is not a beneficiary of Husband's Estate but rather a creditor. In addition, the distribution of the annuity to Taxpayer would not be, except for § 682, includible in the gross income of Husband. Therefore Husband's Estate is not subject to § 682 and Taxpayer is not a beneficiary of Husband's Estate under § 682(b). See Kitch v. Commissioner, 103 F.3d 104 (10th Cir. 1996).

Second Requested Ruling

Under § 72(a), gross income includes any amount received as an annuity under an annuity, endowment, or life insurance contract. Section 72(b) excludes from gross income a portion of the amounts received as an annuity based on an exclusion ratio. The exclusion ratio compares the taxpayer's investment in the contract with the expected return under the contract.

Section 72(a) provides that this rule of income inclusion applies "except as otherwise provided in this chapter." Section 1.72-14(b) of the Income Tax Regulations clarifies that to the extent payments to a spouse are includible in gross income by reason of § 71, they are not excluded from gross income under the principles of § 72,

even if they are made under a contract (e.g., an annuity contract) to which that section applies. Thus, § 72(a) applies only if § 71 does not apply to Taxpayer in this situation.

Section 71 provides that gross income includes amounts received as alimony. Alimony is defined, in relevant part, as a payment in cash received by a spouse pursuant to a divorce instrument. § 71(b)(1)(A). Here, the issue is not whether the Estate's cash payments to Taxpayer constitute alimony within the meaning of § 71, but whether the transfer of ownership of the annuity contract itself constitutes alimony. What will be transferred to Taxpayer in the proposed distribution is ownership of the annuity contract itself (including the ability to designate the beneficiary and to designate someone other than herself as the payee). Section 71 and the regulations make it clear that, in order to constitute alimony, a payment must be in cash. § 71(b)(1), § 1.71-1T(b)(Q-5) of the regulations ("Only cash payments . . . qualify as alimony or separate maintenance payments. Transfers of services or property (including . . . an annuity contract) . . . do not qualify. . ."). Thus, transfer of ownership of the annuity contract to Taxpayer does not constitute alimony includable in Taxpayer's gross income pursuant to § 71. Because it does not constitute alimony, the transfer of the annuity contract does constitute gross income under § 61, unless it is excluded by another provision, such as § 72.

As discussed above, § 72 does apply because § 71 does not. Under § 72(c)(1), a taxpayer's investment in an annuity contract generally is equal to the aggregate amount of premiums or other consideration paid for the contract, subject to adjustments not here relevant. Under § 72(g), where the transferee of an annuity contract receives the contract for a valuable consideration, the investment in the contract is determined based on the actual value of the consideration paid by the transferee where the transferee's basis is not determined with regard to the transferor's basis. Section 72(g) is applicable to the present case where Taxpayer will receive the Annuity Contract in exchange for her rights under the alimony agreement and where Taxpayer's basis is not determined by that of the transferor (Estate), such as a gift or a tax-free exchange. See § 1.72-10(a) of the regulations. The annuity is not being distributed to the Taxpayer as a beneficiary of the Estate, but instead is being exchanged for Taxpayer's preexisting claim (for monthly alimony payments) against the decedent (Husband). Taxpayer is not a beneficiary under Husband's will, but rather a creditor of the Estate under the alimony agreement. After the transfer of the policy from the Estate to the Taxpayer, Taxpayer will continue to receive monthly payments as set forth in the policy, with no right of acceleration or lump sum award. Taxpayer will agree to receive the Annuity Contract in exchange for her rights to alimony. The Annuity Contract is a single premium immediate annuity pursuant to which payments began on Date 4, for a minimum of 191 payments of \$b each. At the time of distribution of the Annuity Contract, Taxpayer's investment in the contract will be the value of the remaining guaranteed payments to be made under the Contract that she agrees to receive in exchange for giving up her right to alimony from the Estate under the Settlement Agreement. § 1.72-10(a) of the regulations.

The taxation of payments received by Taxpayer under this life annuity with refund feature will be determined by calculating the exclusion ratio under § 72(b), the expected return under § 1.72-5(a), the investment in the contract under § 1.72-6, and the adjustment for refund under § 1.72-7(b). Furthermore, under § 72(q), if annuity payments are made to the Taxpayer before she becomes age 59 ½, a 10% tax will be imposed on the payment.

CONCLUSION

The distribution of the annuity contract to Taxpayer will not constitute a distribution to a beneficiary pursuant to § 661. Transfer of the annuity contract to Taxpayer is includable in Taxpayer's gross income pursuant to § 72(a), subject to the exclusions of § 72(b) outlined 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.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Christopher F. Kane
Branch Chief, Branch 3
(Income Tax & Accounting)

cc: