

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

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March 16, 2011

**Trust**

H

W

Beneficiary A

Beneficiary B

Beneficiary C

Beneficiary D

Beneficiary E

Beneficiary F

Dear \_\_\_\_\_ :

This is in reply to your request for rulings under §§ 72(u)(1) and 72(e)(4)(C) of the Internal Revenue Code.

FACTS

Taxpayer represents that:

Prior to death, H established Trust as a grantor trust. The named beneficiaries were W and A, B, C, D, E, and F (“Beneficiaries”), the descendants of H and W.

During H's life, H and W were co-trustees. H died. Upon H's death, W became sole trustee and Trust was divided into three sub-trusts: Trust A, Trust B, and Trust C. Trust A was allocated an amount based on the allowed exemption and marital deduction for Federal estate tax purposes. Trust C was allocated an amount based on the exemption from the Federal Estate Tax provided the amount was not used for the payment of taxes, debts, or administration expenses of H's estate. Once all taxes, debts, and expenses have been paid, the assets of Trust C are to be distributed to Trust B. Trust B contains all the property not in Trusts A or C. During the life of W, trustee (in this case, W) may in its discretion pay or use the property of Trust B for the benefit of W, and others partly or wholly dependent upon W, to maintain the standard of living which W enjoyed prior to H's death, and for the support an education of descendants and others dependent upon W. At W's death, the property of Trust B is to be divided and distributed among Beneficiaries A, B, C, D, E, and F in the proportions stated in Trust.

Trustee intends to purchase flexible premium deferred annuity contracts (Annuity Contracts), naming each of Beneficiaries A, B, C, D, E, and F as the annuitant on one Annuity Contract, in proportion to each Beneficiary's residuary share of Trust. The material provisions of each Annuity Contracts will be substantially the same except for the dates of annuitization. Trust will be the owner and beneficiary of the Annuity Contracts during the life of W. In the event of the death of an annuitant, the proceeds from that annuity will be paid to Trust.

Trust projects that its other assets will be sufficient to fund its expenses (including taxes) and make nominal distributions to W; there should not be any need for the Trust to take a distribution(s) from the Annuity Contracts.

Upon final distribution of Trust, each Beneficiary will be distributed the Annuity Contract for which that Beneficiary is the annuitant; it is anticipated that this distribution will occur prior to that Annuity Contract's annuity starting date. Trust will not receive any consideration from any Beneficiary in exchange for the distribution of the Annuity Contracts.

### REQUESTED RULINGS

Taxpayer requests rulings that:

1. the Annuity Contracts are considered owned by natural persons for purposes of § 72(u); and,
2. the distribution of the Annuity Contracts by the Trust to the Beneficiaries will not be treated as an assignment of an annuity contract without full and adequate consideration under § 72(e)(4)(C).

### LAW AND ANALYSIS

*Request #1*

Section 72(u)(1) provides, in part, that if any annuity contract is held by a person who is not a natural person, such contract shall not be treated as an annuity contract for purposes of the Federal income tax (other than subchapter L). However, for purposes of this rule, holding by a trust or other entity as an agent for a natural person shall not be taken into account.

This rule is explained by H.R. Rep. No. 99-426 at 703-04 (1985) and S. Rep. No. 99-313 at 567-68 (1986)

The committee believes that the present-law rules relating to deferred annuity contracts present an opportunity for employers to fund, on a tax-favored basis, significant amounts of deferred compensation for employees. This favorable tax treatment may create a disincentive for employers to provide benefits to employees under qualified pension plans, which are subject to significantly greater restrictions. In addition, because deferred annuity contracts can be provided to a limited class of employees, rather than to employees generally (as is required in the case of a qualified pension plan), the committee is concerned that the present-law treatment of deferred annuity contracts dilutes the effect of the nondiscrimination rules applicable to qualified pension plans.

Under the bill, in the case of a contract the nominal owner of which is a person who is not a natural person (e.g., a corporation or a trust), but the beneficial owner of which is a natural person, the contract generally is treated as held by a natural person. Thus, if a group annuity contract is held by a corporation as an agent for natural persons who are beneficial owners of the contract, the contract is treated as an annuity contract for Federal income tax purposes. However, the committee intends that, if an employer is the nominal owner of an annuity contract, the beneficial owners of which are employees, the contract will be treated as held by the employer. The committee intends this rule because it is concerned that the Internal Revenue Service would have difficulty monitoring compliance with the general rule that a deferred annuity is not available on a tax-favored basis to fund nonqualified deferred compensation.

Here, the annuity contracts are owned by a trust under which all the beneficial interests are owned by natural persons in a non-employment context. Accordingly, the contracts will be treated as being owned by a natural person for purposes of § 72(u)(1).

### *Request #2*

Section 72(e)(4)(C)(i) provides that if an individual who holds an annuity contract transfers it without full and adequate consideration, such individual shall be treated as receiving an amount equal to the excess of (i) the cash surrender value of such contract at the time of transfer, over (ii) the investment in such contract at such time, under the contract as an amount not received as an annuity.

Explaining the rule as originally proposed, H.R. Rep. No. 99-426 at 971 indicates that

The bill also adds a provision which states that if an individual who holds an annuity contract transfers it by gift or, in the case of a holder which is not an individual, if there is any change in the primary annuitant, then such transfer or change shall be treated as the death of the holder.<sup>[1]</sup> This correction is made in order to implement fully the forced distribution rules adopted under the 1984 Act<sup>[2]</sup>, which were intended to terminate deferral allowed in annuity contracts when such contracts were no longer required as a retirement vehicle for the contractholder who was enjoying the tax deferral on the income accumulating in the contract. Without the correction covering gratuitous transfers of annuity contracts, the required distribution rules adopted in the 1984 Act could be avoided easily because they would allow taxpayers to continue tax deferral beyond the life of an individual taxpayer.

The Senate amendment<sup>3</sup> was in the same vein, and explained at S. Rep. No. 99-313 at 994 that

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<sup>1</sup> Cf. § 72(s)(7).

<sup>2</sup> Codified at § 72(s).

<sup>3</sup> The Conference Report indicates that the conference agreement followed the Senate amendment, with changes. H.R. Rep. No. 99-841 (Vol. II) at 846 (1986) (Conf. Rep.). As codified, § 72(e)(4)(C) provides that if an individual who holds an annuity contract transfers it without full and adequate consideration, such individual shall be treated as receiving a specified amount; § 72(s)(7) provides that in the case of a holder of a contract which is not an individual, if there is a change in a primary annuitant such change shall be treated as the death of the holder.

is any change in the primary annuitant, then such change shall be treated as an assignment of the contract (sec. 72(e)(4)), which treats the amount assigned as received as an amount not received as an annuity. ... Without the clarification treating gratuitous transfers of annuity contracts as assignments, the required distribution rules adopted in the 1984 Act could be avoided easily because they would allow taxpayers to continue tax deferral beyond the life of an individual taxpayer.

Here, the transfer of the contracts from the Trust to the Beneficiaries does not have the effect of avoiding the required distribution rules of § 72(s); the annuitant is not changed. Accordingly, the distribution of the contracts from Trust to Beneficiaries will not be treated as an assignment of an annuity contract without full and adequate consideration under § 72(e)(4)(C).

### RULINGS

Accordingly, we rule that:

1. the Annuity Contracts are considered owned by natural persons for purposes of § 72(u); and,
2. the distribution of the Annuity Contracts by the Trust to the Beneficiaries will not be treated as an assignment of an annuity contract without full and adequate consideration under § 72(e)(4)(C).

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.

Except as specifically set forth above, no opinion is expressed as to the tax treatment of the Annuity Contracts or Trust under the provisions of any other section of the Code or applicable Regulations. Specifically, no opinion is expressed as to whether or not the Annuity Contracts are in fact annuity contracts for purposes of § 72, nor is any opinion expressed regarding the application of Subchapter J (relating to estates, trusts, beneficiaries, and decedents) or of Chapters 11 (Estate Tax), 12 (Gift Tax) or 13 (Generation-Skipping Transfers) of the Code, to Trust or any transaction involving H, W, Trust, or Beneficiaries.

These rulings are directed to Taxpayer only. Section 6110(k)(3) provides that they may not be used or cited as precedent.

A copy of this letter ruling should be attached to Taxpayer's return as required by § 7.05, Rev. Proc. 2010-1, 2010-1 I.R.B. 1, 29.

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

Sincerely,

/s/

John E. Glover  
Senior Counsel, Branch 4  
(Financial Institutions & Products)