

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

Number: **201948002**  
Release Date: 11/29/2019  
Index Number: 72.00-00

[Third Party Communication:  
Date of Communication: Month DD, YYYY]

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, ID No.

Telephone Number:

Refer Reply To:  
CC:FIP:B04  
PLR-101324-19  
Date:  
August 06, 2019

Taxpayer =  
Parent =

Dear :

This letter responds to Taxpayer's request for a letter ruling that the payment of certain investment advisory fees from an annuity contract will not be treated as an amount received by the owner of that annuity contract for purposes of section 72(e) of the Internal Revenue Code.

**FACTS**

Taxpayer is a life insurance company within the meaning of section 816(a). Taxpayer joins in the filing of a consolidated federal tax income tax return with Parent on a yearly calendar basis, using an accrual method of accounting. Taxpayer intends to offer three non-qualified deferred annuity contracts (referred to herein as the "Contract"). The Contract will be issued to and owned by an individual, or issued to and owned by "a trust or other entity as an agent for a natural person" within the meaning of section 72(u)(1) (the "Owner").

The Contract is an annuity contract under the law of the jurisdiction where issued. The Contract qualifies for treatment as an annuity contract for federal income tax purposes, including by complying with the requirements of section 72(s). One of the Contracts is a variable contract under section 817(d), while two of the Contracts are not variable

contracts under section 817(d). The Contract is not part of any qualified retirement plan within the meaning of section 4974(c).

The Contract is comprised of an accumulation phase and a payout phase. During the accumulation phase, the cash value of the Contract is credited with earnings or interest based on options the Owner selects from a menu provided by Taxpayer (the "Options"), consistent with applicable nonforfeiture law. The Contract is designed for Owners who will receive ongoing investment advice from an investment adviser (the "Adviser") on how to allocate the Contract's cash value (within the meaning of section 72(e)(3)(A)(i)) among the available Options. The Adviser is expected to take into account factors such as (1) the Owner's personal risk tolerance and investment timeline, (2) the interest rate and market environment, (3) the menu of Options available under the Contract, and (4) the various other benefits and features available under the Contract. The Adviser will be an appropriately licensed professional who is in the business of providing investment advice.

In consideration for its advice, the Owner will authorize investment advisory fees (the "Fees") to be paid periodically to the Adviser from the Contract's cash value (the "Authorization"). The Fees will be determined based on an arms-length transaction between the Owner and the Adviser. The Fees will not exceed an amount equal to an annual rate of 1.5% of the Contract's cash value (within the meaning of section 72(e)(3)(A)(i)), determined at the time and in the manner provided in the Authorization or other written agreement with the Adviser but in all events based on such cash value during the period to which the Fees relate. The Fees will compensate the Adviser only for investment advice that the Adviser provides to the Owner with respect to the Contract, and not for any other services. The Fees will not result in any reduction in fees related to any other asset or for any other service.

Taxpayer will pay the Fees directly to the Adviser. During any period for which the Authorization is in effect, the Contract will be solely liable for paying the Fees and the Fees will not be paid directly by the Owner. The Owner will not have the right to direct payment of the Fees for any other purpose or to any other person. The Adviser will not receive a commission for the sale of the Contract from Taxpayers.

#### REQUESTED RULING

Taxpayer requests a ruling that the Fees Taxpayer deducts from the Contract's cash value and remit to the Adviser will not be treated as an "amount received" by the Owner of the Contract for purposes of section 72(e).

## LAW AND ANALYSIS

*Law*

Section 72 distinguishes between an “amount received as an annuity” under an annuity, endowment, or life insurance contract and an “amount not received as an annuity” under those contracts. Section 1.72-1(b) of the Income Tax Regulations (the “Regulations”) provides that “amounts received as an annuity” are amounts which are payable at regular intervals over a period of more than one full year from the date on which they are deemed to begin, provided the total of the amounts so payable or the period for which they are to be paid can be determined as of that date. See section 1.72-1(b)(2) and (3) of the Regulations. Any other amounts to which the provisions of section 72 apply are considered to be “amounts not received as an annuity.”

Section 1.72-2(b)(2) of the Regulations provides that amounts are considered “amounts received as an annuity” only in the event that the following tests are met:

- (i) They must be received on or after the “annuity starting date” as that term is defined in paragraph (b) of section 1.72-4 of the Regulations (the first day of the first period for which an amount is received as an annuity under the contract);
- (ii) They must be payable in periodic installments at regular intervals (whether annually, semiannually, quarterly, monthly, weekly, or otherwise) over a period of more than one full year from the annuity starting date; and
- (iii) Except as indicated in subparagraph 1.72-2(b)(3) of the Regulations (relating to variable contracts), the total of the amounts payable must be determinable at the annuity starting date either directly from the terms of the contract or indirectly by the use of either mortality tables or compound interest computations, or both, in conjunction with such terms and in accordance with sound actuarial theory.

Section 1.72-11(a)(1) of the Regulations describes “amounts not received as an annuity” as any amount received under an annuity contract if the amount:

- (i) does not meet the requirements set forth in section 1.72-2(b) of the Regulations for amounts received as an annuity;
- (ii) meets the requirements of section 1.72-2(b) of the Regulations for amounts received as an annuity but the annuity payments received differ in either amount, duration, or both, from those originally provided under the contract; or
- (iii) meets the requirements of section 1.72-2(b) of the Regulations for amounts received as an annuity but the annuity payments are received by a beneficiary

after the death of an annuitant (or annuitants) in full discharge of the obligation under the contract and solely because of a guarantee.

Section 72(e) applies to any “amount not received as an annuity” under an annuity, endowment, or life insurance contract. Section 72(e)(2)(A) provides that if any amount which is not received as an annuity is received on or after the annuity starting date, it is included in gross income. Section 72(e)(2)(B) provides that if any amount which is not received as an annuity is received before the annuity starting date it is included in gross income to the extent allocable to income on the contract and is not included in gross income to the extent allocable to the investment in the contract.

### *Analysis*

In this case, the Fees are integral to the operation of the Contract. During any period for which the Authorization is in effect, the Owner will receive ongoing investment advice from the Adviser with respect to the Contract so that the Owner may properly utilize the Contract. The Adviser is expected to help the Owner select Options related to the Contract. Taxpayer has represented that the Fees will not serve as consideration for anything other than investment advice provided by the Adviser in relation to the Contract. Furthermore, Taxpayer has represented that the Fees will not exceed an annual rate of 1.5% of the Contract’s cash value based on the period in which the fees related. Based on Taxpayer’s representations, the Fees will only be used to pay for investment advisory services relating to the Contract. Because the Contracts are designed to work with an Adviser, the Contract is solely liable for the Fees. The Fees do not constitute compensation to the Advisor for services related to any assets of the Owner other than the Contract or any services other than investment advice services with respect to the Contract. Therefore, the Fees are an expense of the Contract, not a distribution to the Owner.

### RULING

Based solely on the information submitted and the representations made, the Fees Taxpayer deducts from the Contract’s cash value and remit to the Adviser will not be treated as an “amount received” by the Owner of the Contract for purposes of section 72(e).

### CAVEATS

The ruling contained in this letter is based upon information and representations Taxpayer submitted, accompanied by penalty of perjury statements executed by appropriate parties. This office has not verified any of the material submitted in support of the ruling request and it is subject to verification on examination.

The ruling contained in this letter does not apply to any amount paid by Taxpayer that compensate the Advisor for services related to assets other than the Contract or for any services provided other than investment advice services with respect to the Contract. Any such amount would be an "amount received" by the Owner of the Contract for purposes of section 72(e).

No opinion is expressed as to the tax treatment of the transaction under the provisions of any of the other sections of the Code and regulations which may also be applicable thereto or to the tax treatment of any conditions existing at the time of, or effects resulting from, the transaction which are not specifically covered by the above rulings.

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

A copy of this letter should be attached to the federal income tax return of Taxpayers for the taxable year in which the transaction covered by this ruling is consummated.

Pursuant to a power of attorney on file in this office, a copy of this ruling is being furnished to your authorized representatives.

Sincerely,

John Glover  
Senior Counsel, Branch 4  
Associate Chief Counsel  
(Financial Institutions and Products)