

INTERNAL REVENUE SERVICE  
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CC:DOM:FI&P:4-PLR-102784-99  
May 25, 1999

Legend

Trust =  
  
The Grantors =  
  
Initial Trustee =  
  
S =  
  
Date A =  
  
IC =  
  
x =  
  
y =  
  
z =

Dear

This letter responds to your request dated January 13, 1999 requesting a ruling under § 72(u)(1) of the Internal Revenue Code regarding a deferred annuity contract to be purchased by Trust. Additional information was submitted in a letter dated March 19, 1999.

The objective of the following arrangement is that Initial Trustee of Trust together with his wife, the Grantors of Trust, desire to make a gift in trust for the benefit of S, the Initial Trustee's son, and his descendants. In order to maximize the potential investment gains from the initial gift, the Grantors desire that the investment gains from the gift benefit from tax deferral (thus they propose to use a deferred annuity). The Grantors also want to protect the assets from creditors, and even protect the child, S, from making ill advised judgments on his own by not allowing him a measure of control of the assets in Trust until his retirement years.

To further the above purposes, Trust was established on Date

A as a complex, irrevocable trust. The Grantors will contribute cash to Trust which will be used by Trust to purchase a deferred annuity from IC, a commercial life insurance company. S will be the annuitant. The annuitization date will be when S, now age x, reaches age y. Trust will continue for S's lifetime and will terminate upon S's death, however, to the extent that S has descendants, "subtrusts" for those descendants (e.g., children and/or grandchildren) will be created at the time of his death. (Generally, these "subtrusts" will have identical terms to Trust.) If, however, S dies without descendants, unappointed Trust property will be distributed (generally, outright) to relatives of the Grantors (or S). Initial Trustee of Trust or successor trustee, once the annuity contract is purchased, will have the power to select the annuitization options and to terminate the annuity contract at any time (subject to the terms of the annuity contract).

The arrangement begins with the Grantors contributing cash to Trust. More specifically, the Grantors propose to make a "one time" gift of cash to Trust of \$z, and after a 60 day waiting period, Trust will purchase a variable deferred annuity contract from I.C.<sup>1</sup> Under Trust's terms while either of the Grantors is serving as trustee, the trustee will be required to accumulate all income in trust and make no distributions of income or principal. If neither of the Grantors is serving as trustee, such as at the time of the annuitization date of the annuity, Trust allows for the trustee to distribute to the beneficiary of Trust (e.g., S or his descendants) such amounts of income and principal of Trust as are necessary when added to the funds reasonably available to such beneficiary from other sources known to the trustee, to provide for the beneficiary's health, support, maintenance and education, taking into consideration age, education and station in life. The only other triggering event whereby funds could be distributed from Trust during the annuity accumulation phase (while S is still alive and one of the Grantors is serving as trustee) is if additional gifts were made by the Grantors (at this juncture there would be another 60 day opportunity for S to make a claim against Trust, e.g., for the value of the current gift).

Assuming that S attains the age of y years (the annuitization date), the annuity will annuitize inside of Trust

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<sup>1</sup> The 60 day waiting period prior to investing the contributed funds into the annuity is intended to conform to certain language in Trust that is designed to allow for the possibility (however, remote) that S (or a Parent or guardian acting on his behalf) would, for example, withdraw the value of a current gift made by the Grantors to Trust.

such that Trust will receive whatever annuitization option that is selected by Trust. Also at the same time, according to Trust language, S (to the extent that he had not already done so) will replace the Grantors as the trustee of Trust. As indicated above, once neither of the Grantors serves as trustee, it is possible for distributions to be made from Trust. The standards for making distributions from Trust, however, are limited to the amounts necessary when added to other funds reasonably available to such beneficiary from other sources known to the trustee, to provide for the beneficiary's health, support, maintenance and education, taking into consideration age, education and station in life. If S were to die after Trust begins to receive annuity payments, but prior to the completion of annuitization,<sup>2</sup> the assets will continue to remain in trust for S's descendants or blood relatives. If S has no descendants living at the time of his death, there will be a per stirpes distribution of Trust property distribution to the descendants of the Grantors unless S has exercised his special power of appointment. In no event will a nonnatural person be a contingent beneficiary.

S has a special power to appoint by will (or after age y by separate document) all or any part of the property remaining in Trust to any person related to S by blood, marriage or adoption. This special power of appointment, however, shall not be exercisable in favor of S, S's creditors, S's estate, or the creditors of S's estate.

#### LAW AND ANALYSIS

Section 72(u)(1) provides that if an annuity contract is held by a person who is not a natural person, then such contract shall not be treated as an annuity contract for purposes of subtitle A (other than subchapter L) and the income on the contract for any taxable year of the policyholder shall be treated as ordinary income received or accrued by the owner during such taxable year. Section 72(u)(1) further provides that if an annuity contract is held by a trust or other entity as an agent for a natural person, then § 72(u)(1) shall not apply.

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<sup>2</sup> The annuity contract provides for a number of annuitization options in addition to a single life annuity which would cease with the last payment due prior to the death of the annuitant (i.e., S). For example, an alternative option is a "life annuity with a period certain" whereby monthly payments are paid for the life of the annuitant with a period certain of not less than 10, 15 or 20 years.

The legislative history to § 72(u)(1) states that if an annuity contract is held by a person who is not a natural person (such as a corporation), then the contract is not treated as an annuity contract for federal income tax purposes and the income on the contract for any taxable year is treated as ordinary income received or accrued by the owner of the contract during the taxable year. However, the legislative history further provides that in the case of an annuity contract the nominal owner of which is not a natural person (e.g., a corporation or a trust), but the beneficial owner of which is a natural person, the contract is treated as held by a natural person. H.R. Conf. Rep. No. 841, 99<sup>th</sup> Cong., 2d Sess. Vol. II, 400-403 (1986), 1986-3 (Vol. 4) C.B. 400-403.

The following representations were made in connection with this ruling request:

- a) S is a natural person as that term is used in § 72(u).
- b) The Grantors of Trust are not considered to be the owners of Trust for purposes of §§ 671-679.
- c) The annuity contract at issue satisfies the terms of § 72(s).
- d) Under no circumstances will Trust distribute the annuity contract to anyone other than S or S's descendants or relatives of S or the Grantors. All of these contingent beneficiaries will be natural persons.

Accordingly, based solely on the information submitted and the representations made, we hold as follows:

The annuity contract held by Trust is considered owned by a natural person for purposes of § 72(u).

Except as specifically set forth above, no opinion is expressed as to the tax treatment of the annuity contract or Trust under the provisions of any other section of the Code or the Income Tax Regulations. Specifically, no opinion is expressed as to whether or not the annuity contract is in fact an annuity contract under § 72. In addition, no opinion is expressed or implied as to the tax treatment of the transaction under the estate, gift or generation-skipping transfer tax provisions. Finally, no opinion is expressed as to whether the annuity contract meets the requirements of § 72(s).

The ruling is based on the facts presented and the applicable law in effect on the date of this letter. If there is

a change in material fact or law (state or federal) before the transactions considered in this ruling take effect, the ruling will have no force or effect.

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 must be attached to the federal income tax return to which it is relevant.

Sincerely yours,

Assistant Chief Counsel  
(Financial Institutions and  
Products)

By: Signed by Donald J. Drees, Jr.  
Donald J. Drees, Jr.  
Senior Technician Reviewer,  
Branch 4