

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact:

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Telephone Number:

Refer Reply To:

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Date: August 12, 2004

In Re:

Legend

Trustee =

Trust =

Annuity Contract =

Settlor =

Beneficiary =

Life Insurer 1 =

Life Insurer 2 =

Life Insurer 3 =

Dear :

This is in reply to the letters dated April 14, 2004 and July 14, 2004 submitted on your behalf requesting rulings concerning the taxability of the Annuity Contract held by Trustee on behalf of Beneficiary under § 72(u)(1) of the Internal Revenue Code and the

applicability of § 72(e)(4)(C) to a distribution, in kind, of a portion of the Annuity Contract to Beneficiary.

The information submitted states that on June 17, , the Settlor established Trust for the sole benefit of his grandchild, Beneficiary. The Settlor made a single gift of \$ to Trust upon its creation. As represented below, the Settlor is not considered the owner of Trust for purposes of §§ 672 through 679 of the Code.

On November 22, , Trustee invested the entire \$ that the Settlor contributed to Trust in a single premium annuity issued by Life Insurer 1. In , Trustee, in a § 1035 transaction, exchanged the Life Insurer 1 annuity for an annuity contract issued by Life Insurer 2. In , Trustee, in another § 1035 transaction, exchanged the Life Insurer 2 annuity contract for an annuity contract issued by Life Insurer 3.

The Annuity Contract names Trust as the owner of the Annuity Contract and names Beneficiary as the annuitant. The Annuity Contract is the only asset that Trust owns.

The terms of Trust provide further that if Beneficiary attains age 30, Beneficiary may request that Trustee distribute 25 percent of the principal of Trust to Beneficiary outright. When Beneficiary attains the ages of 35 and 40, Beneficiary may request that Trustee distribute 33 1/3 percent and 100 percent, respectively, of the principal of Trust to Beneficiary outright.

The terms of Trust provide further that if Beneficiary elects not to request any of the distributions of principal, mentioned above, from Trust upon attaining a designated age (30, 35, or 40), Trustee is required to hold the portion of the principal over which Beneficiary has a power of withdrawal in a separate trust for the sole benefit of Beneficiary. Beneficiary may direct Trustee to distribute any portion of the principal of such separate trust to Beneficiary outright, and such separate trust may continue beyond the date on which Beneficiary attains age 40.

Any distributions from the Trust to Beneficiary or to a separate trust for Beneficiary will be in the form of distributions of an annuity contract (or annuity contracts) in kind.

Trust will not receive any consideration from Beneficiary, or any other individual or entity, in exchange for the aforementioned distribution of an annuity contract (or annuity contracts).

Section 72(u)(1) of the Code 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.

The legislative history to § 72(u)(1) of the Code 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, 99th Cong., 2d Sess. Vol. II 401-402 (1986), 1986-3 (Vol. 4) C.B. 401-402. Although Trustee is the contract owner of the annuity, its ownership interest is nominal. Beneficiary is the beneficial owner of the Annuity Contract.

Section 72(e)(4)(C) of the Code provides, in part, 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 the cash surrender value of such a contract at the time of transfer over the investment in such contract at such time under the contract as an amount not received as an annuity. A distribution of the Annuity Contract by Trust to Beneficiary does not constitute a transfer without full and adequate consideration under § 72(e)(4)(C) because Trust is not an individual for purposes of § 72(e)(4)(C).

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

- (a) Beneficiary is a natural person as that term is defined in § 72(u) of the Code.
- (b) Settlor as the grantor of Trust will not be considered the owner of Trust for purposes of §§ 671-679 of the Code.
- (c) Beneficiary is not employed by Trust.
- (d) Any annuity contract[s] involved satisfy the terms of § 72(s).
- (e) Under no circumstance will Trust distribute any (portion) of the Annuity Contract described in this request to anyone other than Beneficiary, or other than to the separate trust, described above, for Beneficiary's sole benefit, if Beneficiary is living. If Beneficiary dies prior to attaining age 40, the distribution will be made to Beneficiary's issue, or, if Beneficiary dies without issue, the distribution will be made to or for the benefit of persons related to Beneficiary.
- (f) When Beneficiary attains age 30, Beneficiary will deliver notice in writing to Trustee that such Beneficiary exercises her right to receive an annuity contract or

annuity contracts equal in value to 25% of the principal and accumulated income (or earnings) of Trust and will actually receive such annuity contract or annuity contracts.

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

(1) The Annuity Contract is considered owned by a natural person for purposes of § 72(u)(1) of the Code.

(2) The distribution of all or any portion of an annuity contract (or annuity contracts) from Trust to Beneficiary pursuant to Trust will not be treated as an assignment of an annuity contract without full and adequate consideration under § 72(e)(4)(C) of the Code.

Except as specifically set forth above, no opinion is expressed as to the tax treatment of the Annuity Contract, Trust or the separate 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 of the Code. No opinion is expressed as to whether the Annuity Contract meets the requirements of § 72(s). Furthermore, no opinion is expressed as to any tax consequences under § 72 if any distributions from Trust are cash.

This ruling letter is directed only to the taxpayer who requested it. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent. Temporary or final regulations pertaining to one or more of the issues addressed in this ruling have not yet been adopted. Therefore, this ruling will be modified or revoked by the adoption of temporary or final regulations to the extent the regulations are inconsistent with any conclusion in the ruling.

A copy of this letter should be attached to any Federal income tax return to which it is relevant.

In accordance with the power of attorney on file in this office, we are sending a copy of this letter to your authorized representative.

Sincerely yours,

/S/

DONALD J. DREES, JR.
Senior Technician Reviewer
Branch 4
Office of Associate Chief Counsel
(Financial Institutions & Products)