INTERNAL REVENUE SERVICE
UIL No.: 72.21-00

Ruling: **199905015**
Release Date: 2/5/1999

CC:DOM:FI&P:4/PLR-103647-98
Date 11/05/98

Legend

Trust =

Decedent =

Trustee =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

X =

B =

C =

D =

E =

F =

G =

H =

I =

J =

K =

L =

M =

N =

Dear

This is in response to your letter of Date 1, supplemented on Date 2, requesting rulings under sections 72(u)(1) and 72(e)(4)(C) of the Internal Revenue Code regarding certain deferred annuity contracts purchased by Trust.

Facts

Decedent created Trust, which became irrevocable at Decedent’s death on Date 3. Under the terms of the trust instrument, Trustee is directed to make a nominal distribution to X each year. This distribution is distributed first from trust income, and, if necessary, from trust principal. It has not been necessary to distribute trust principal to meet this nominal distribution. In addition, Trustee has sole discretion to distribute the remaining annual net income for the benefit of B. No distributions of income have been made for the benefit of B. Trustee views the interests of X and B as de minimis. The primary beneficiaries of Trust are C, D and E. Trust accumulates its income (after the nominal distribution to X) and principal for distribution on the date H years after the death of Decedent. On that date, the entire Trust estate will be distributed equally to C, D and E.

Shortly after the death of Decedent, Trust purchased three F single premium deferred annuities with Trust as owner and beneficiary and C, D and E, respectively, as the annuitant. The material terms of the three F contracts, other than the dates of annuitization, are essentially identical. These contracts were purchased in order to permit tax deferral on the growth of the investment in the contracts. Other assets of Trust remain in a brokerage account to diversify investments and to cover Trust’s expenses, taxes, and the nominal distribution to X.

On Date 4, the three F single premium deferred annuities were exchanged for three G annuity contracts pursuant to Internal Revenue Code section 1035. The material terms of the three G contracts, other than the dates of annuitization, are essentially identical. One G contract names C as annuitant, one names D as annuitant and one names E as annuitant. At the time the ruling request was filed, C, D and E were ages I, J and K, respectively. The three G annuity contracts will not commence until C, D and E reach ages L, M and N, respectively.

The three G annuity contracts guarantee a death benefit if either the annuitant or the contract owner dies prior to the annuity starting date. If C, D and E reach the ages of L, M and N, the three G annuity contracts provide C, D and E with a number of settlement options. According to the terms of Trust, Trust terminates H years after Decedent's death. At termination, the contracts are to be distributed to the named annuitants C, D and E, respectively, as beneficiaries of Trust.

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 section 72(u)(1) shall not apply.

The legislative history to section 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, 99th Cong., 2d Sess. Vol. II, 401-402 (1986), 1986-3 (Vol. 4) C.B. 401-402. Although Trust is the owner of the three G contracts, its ownership interest is nominal compared to the ownership interests of C, D and E. Consequently, C, D and E are the beneficial owners of the three G annuity contracts.

Section 72(e)(4)(C) 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 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. The distribution of the three G annuity contracts by Trust to C, D and E does not constitute a transfer without full and adequate consideration under section

72(e)(4)(C) because Trust is not an individual for purposes of section 72(e)(4)(C).

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

a) C, D and E are natural persons as that term is used in section 72(u).

b) Decedent, the settlor of Trust, will not be considered the owner of Trust for purposes of sections 671-679.

c) C, D and E are not employed by Trust or any entity held by Trust.

d) The three G annuity contracts satisfy the terms of section 72(s).

e) Under no circumstances will Trust distribute the three G annuity contracts to anyone other than C, D and E.

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

1) The three G annuity contracts are considered owned by natural persons for purposes of section 72(u).

2) The distribution of the three G annuity contracts by Trust to C, D and E, respectively, will not be treated as an assignment of an annuity contract without full and adequate consideration under 72(e)(4)(C).

Except as specifically set forth above, no opinion is expressed as to the tax treatment of the three G annuity contracts or Trust under the provisions of any other section of the Code nor the Income Tax Regulations. Specifically, no opinion is expressed as to whether or not the three G annuity contracts are in fact annuity contracts under section 72. Further, no opinion is expressed as to whether the three G annuity contracts meet the requirements of section 72(s).

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 any income tax return to which it is relevant.

Sincerely yours,

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Branch 4