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| **Internal Revenue Service** | Department of the Treasury<br>Washington, DC 20224 |
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<u>Legend</u>:

| | |
|---|---|
| Settlor = | |
| A = | |
| B = | |
| C = | |
| the Trust = | |
| Year 1 = | |
| Year 2 = | |
| Year 3 = | |
| Year 4 = | |

Dear

:

This letter responds to your submission requesting a ruling under section 72 of the Internal Revenue Code (the "Code") regarding an annuity contract to be purchased and held by a trust.

**FACTS**

In Year 1, Settlor established an irrevocable trust for the benefit of his three children: A, B, and C (the "Original Trust"). Under the terms of the Original Trust, the trustee had broad authority over trust property.

In Year 2, the original trustee resigned, the person named in the Original Trust instrument as first successor trustee declined to serve as successor trustee, and A, who had been named as the second successor trustee, accepted the appointment as successor trustee. In Year 3, B and C were appointed as co-trustees with A of the Original Trust. In Year 4, A, B, and C divided the Original Trust equally into three separate trusts, one of which was the Trust. The Trust has provisions identical to those of the Original Trust, except that A is the sole income and principal beneficiary of the Trust. A, B, and C serve as co-trustees for the Trust. Under the terms of the Trust, A may not alienate or otherwise transfer A's interest in the Trust during A's lifetime.

The co-trustees of the Trust intend to purchase a single premium deferred annuity contract for the Trust. The Trust is to be the owner and beneficiary of the annuity contract during the life of A. A is to be the measuring life for the annuity contract.

If A dies, the annuity contract's proceeds (if any) will be paid to the Trust. The Trust will then pay the proceeds to A's designated heir and terminate.

**REPRESENTATIONS**

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

1. No co-trustee of the Trust may withdraw property from the Trust without the consent of at least one other co-trustee.
2. The Trust is a taxable trust under section 641 and is not a grantor trust under section 671.

**LAW**

<u>Section 72</u>

Section 72 prescribes the income tax treatment of amounts received under annuity contracts. Section 1.72–2(a) of the Income Tax Regulations provides that contracts under which amounts paid will be subject to section 72 include contracts that are considered to be annuity contracts in accordance with the customary practice of life insurance companies.

Section 72(u)(1) generally provides that if an annuity contract is held by a person who is not a natural person, then such contract is not treated as an annuity contract for federal income tax purposes (other than subchapter L) and the income on such contract for any taxable year is treated as ordinary income received or accrued by the owner during such taxable year.

Section 72(u) was enacted as part of the Tax Reform Act of 1986, Pub. L. No. 99–514, 100 Stat. 2085, 1986–3 (Vol. 1) C.B. 1. The legislative history contains the following reasons for enacting section 72(u):

> 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.

H.R. Rep. No. 426, 99th Cong., 1st Sess. 703 (1985), 1986–3 (Vol. 2) C.B. 1, 580.

The flush language of section 72(u)(1), however, provides that holding by a trust or other entity as an agent for a natural person is not taken into account. The legislative history contains the following explanation of this flush language:

> 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 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 the beneficial owners of the contracts, 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.

H.R. Rep. No. 426, 99th Cong., 1st Sess. 704 (1985), 1986–3 (Vol. 2) C.B. 1, 580.

Trust Classification

Section 301.7701–4(a) of the Procedure and Administration Regulations provides that, in general, the term “trust” as used in the Code refers to an arrangement created either by a will or by an inter vivos declaration whereby trustees take title to property for the purpose of protecting or conserving it for the beneficiaries under the ordinary rules applied in chancery or probate courts. Usually, the beneficiaries of a trust do no more than accept the benefits thereof and are not the voluntary planners or creators of the trust arrangement. However, the beneficiaries may be the persons who created the trust, and the trust will be recognized as a trust under the Code if it was created for the purpose of protecting or conserving the trust property for beneficiaries who stand in the same relation to the trust as they would if the trust had been created by others for them. Generally speaking, an arrangement will be treated as a trust under the Code if it can be shown that the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit.

Rev. Rul. 69–300, 1969–1 C.B. 167, concludes that an agreement creates a trust rather than an agency relationship if the trustee is vested with broad discretionary powers of administration and management.

United States v. Anderson, 132 F.2d 98 (6th Cir. 1942), involved the issue of whether an agreement between the taxpayer and a bank created a trust or an agency relationship. In that case, the bank could not invest or dispose of any corpus without the consent of the settlor and was relieved of all liability for any decline in the value of the corpus. The settlor had the power to vote any corporate stock held by the bank and could remove the bank and select a successor at any time. The court stated that while an agent undertakes to act on behalf of its principal and is subject to its control, a trustee usually has discretionary powers and acts for a term. Accordingly, because the bank did not have discretionary powers, the court held that the agreement created an agency relationship rather than a trust. See also City Nat'l Bank & Trust Co. v. United States, 109 F.2d 191 (7th Cir. 1940) (holding that no trust was formed where bank's investment decisions could be overridden by settlor and other evidence of managerial power was lacking).

Non-Grantor Trust

Section 641(a) generally provides that the tax imposed by section 1(e) applies to the taxable income of estates or of any kind of property held in trust. Section 1.641(a)–0(b) provides that subparts A through D of part I of subchapter J (including section 641) have no application to any portion of the corpus or income of a trust which is to be regarded, within the meaning of the Code, as that of the grantor or others treated as its substantial owners.

**ANALYSIS**

Section 72(u)(1) generally provides that an annuity contract is not treated as such for federal income tax purposes (other than subchapter L) if it is held by a person who is not a natural person. The flush language of section 72(u)(1), however, provides that holding by a trust or other entity as an agent for a natural person is not taken into account for this purpose.

A trustee generally has fiduciary obligations under trust documents and governing law that are inconsistent with it acting as an agent for the beneficiary of a trust. See, e.g., Restatement (Third) of Agency section 1.01 cmt. g (2018); Restatement (Third) of Trusts section 5(e) & cmt. e (2003); Restatement (Second) of Agency section 14B (1958). This principle also applies for federal income tax purposes. See, e.g., Rev. Rul. 69–300; United States v. Anderson, 132 F.2d 98 (6th Cir. 1942). Accordingly, the phrase “as an agent” in the flush language of section 72(u)(1) pertains only to “other entity.” It does not pertain to “trust.” Thus, for purposes of section 72(u)(1), the holding of an annuity contract by a trust is not taken into account if the contract is held for a natural person.

The Trust would be the “holder” of its annuity contract within the meaning of section 72(u)(1) because the Trust would be designated in its annuity contract as the owner of the contract. The Trust is a not a grantor trust, and A is the sole beneficiary of the Trust. Thus, the Trust would be holding its annuity contract for the benefit of A. A is a natural person. Accordingly, the holding of the annuity contract by the Trust would not be taken into account for purposes of section 72(u)(1).

This determination is consistent with the purpose for adopting section 72(u). Section 72(u) was adopted to encourage employers to offer benefits to employees under qualified pension plans, which are subject to certain restrictions and generally must be made available to a wide class of employees, as opposed to offering deferred compensation to a limited class of employees that is funded by deferred annuity contacts. Because the annuity contract would not be issued in an employment context, the arrangement would not provide the sort of tax-favored benefit that section 72(u) was intended to limit.

**RULING**

We rule that for purposes of section 72(u)(1) and pursuant to the flush language of that section, an annuity contract held by the Trust would be held for A, so that section 72(u)(1) would not apply.

Except as expressly provided herein, no opinion is expressed concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter, including whether the annuity contract would qualify as an annuity contract for purposes of section 72.

The ruling contained in this letter is 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 a ruling, it is subject to verification on examination. This ruling is directed only to the taxpayer who requested it. A copy of this ruling must be attached to any tax return to which it is relevant. Section 6110(k)(3) provides that it may not be used or cited as precedent.

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

Sincerely,

Daniel P. Phillips
Senior Counsel, Branch 4
Financial Institutions & Products

cc: