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Date:
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Legend:

Age A =
Age B =
Age C =
Collective Bargaining
Agreement =

Date A =
Date B =
Employees =

Employees' Association =
Employer =

Group Annuity Contract

Organization =
Plan =

State =
Trust =

Trust Agreement =

Trustees =

Dear :

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

FACTS

The Plan

The Plan was established by the Organization and the Employees' Association as a result of the Collective Bargaining Agreement. The objective of the Plan is to provide a source of post-employment income for Employees between Age A and Age B, as well as after Age B at the election of the Employee, through the purchase of annuity contracts.

The Plan is funded with contributions to a trust, as provided by the Collective Bargaining Agreement, by each Employer (or the Organization as agent for the Employer) on behalf of its Employees. Each Employee is allocated a portion of such contribution, as provided by the Plan, and such portion is includible in the Employee's taxable income. In future years, an Employee may be able to elect to contribute additional after-tax amounts from the Employee's salary. Thus, Employees are taxed currently on all contributions made pursuant to the Plan.

The Plan provides for the purchase of one or more group annuity contracts. The Group Annuity Contract, which is relevant to this ruling, was entered into on Date B.

The amount of each contribution allocated to an Employee, together with any elective contributions made by the Employee, is used as the premium to purchase annuity benefits on behalf of the Employee as described in the Group Annuity Contract ("Annuity Benefits"). An Employee is fully vested in such Employee's Annuity Benefits after they are purchased. An account is maintained for each Employee to track the Annuity Benefits purchased for the Employee.

The Plan is subject to the requirements of the Taft-Hartley Act and the Employee Retirement Income Security Act of 1974, as amended, but is not intended to be a qualified retirement plan.

The Trust

Pursuant to the Plan, the Trust was established by the Trust Agreement that was entered into by the Employees' Association, the Organization, and the Trustees. The Trust was created to purchase and hold legal title to one or more group annuity contracts and administer the Plan. Each Employer (or the Organization as agent for the Employer) makes contributions to the Trust as required by the Collective Bargaining Agreement or any other agreements in effect between the Organization and the Employees' Association. The contributions to the Trust are used to purchase Annuity Benefits under the Group Annuity Contract. The interests in the Group Annuity Contract are beneficially owned by, and fully allocated to, the Employees, all of whom are natural persons. The Trust has no separate economic interest in the Group Annuity Contract. The Group Annuity Contract is not an asset that can be reached by the Employers, the Organization, or their respective creditors.

The Trustees' duties include receiving contributions from Employers (or the Organization as agent for the Employers) and forwarding the contributions to the insurance company that issued the Group Annuity Contract ("Insurance Company") as premiums for the purchase of Annuity Benefits as well as directing the Insurance Company to make payments to Employees (or their beneficiaries) who qualify for such payments under the Plan. The Trustees have the exclusive authority to make determinations regarding questions of eligibility and benefit entitlement under the Plan. The Trustees have the power to approve amendments to the Group Annuity Contract, to terminate the Group Annuity Contract, and upon termination, to enter one or more new annuity contracts to provide benefits under the Plan. Additionally, the Trustees have the absolute and exclusive power to interpret, control, implement, and manage the Plan and the Trust and to interpret any other document or agreement in so far as it relates to the operation of the Plan. The Trust is construed in accordance with the provisions of ERISA and, to the extent permitted by ERISA, is governed by and construed in accordance with the substantive laws of State.

The Group Annuity Contract

Under the Group Annuity Contract, a certificate guaranteeing the Annuity Benefits is issued for each Employee showing such Employee's interest in the Group Annuity Contract based on the premiums paid on such Employee's behalf. When an Employee begins receiving Annuity Benefits, the obligation to pay the Annuity Benefits becomes the liability of only the Insurance Company.

Under the Group Annuity Contract, an Employee will begin receiving Annuity Benefits in the month following the later of (i) the Employee's first birthday on or following the first anniversary of the Employee's termination of employment or (ii) the Employee's attainment of Age A. An Employee may elect however, subject to actuarial adjustment, to begin receiving Annuity Benefits either (i) under certain circumstances, at a date after the Employee's attainment of Age A or (ii) at a date after which the Employee would otherwise begin to receive them, provided such date is not after the month the Employee attains Age C.

An Employee who begins to receive Annuity Benefits prior to attaining Age B will receive the Annuity Benefits in the form of fixed monthly installments over a period of not less than ten years that ends in the month the Employee attains Age B (or later age up to Age C, at the Employee's election). Such an Employee may elect however, subject to actuarial adjustment and certain other requirements, to receive the Annuity Benefits in the form of a single life annuity, a single life annuity with a return of premiums guaranteed, or a joint and survivor annuity. An Employee who begins to receive Annuity Benefits after attaining Age B may elect to receive the Annuity Benefits only in the form of a single life annuity, a single life annuity with a return of premiums guaranteed, or a joint and survivor annuity. Additionally, an Employee entitled to receive Annuity Benefits purchased prior to Date A may elect to receive such benefits in the form of fixed monthly installments over a period, not less than five years, that ends in the month the Employee attains Age B (or later age up to Age C, at the Employee's election).

If an Employee dies before starting to receive Annuity Benefits, the Annuity Benefits attributable to that Employee are generally paid to the Employee's beneficiary in the form of a single sum payment or annuity paid over the life or life expectancy of the beneficiary. If an Employee dies after receiving Annuity Benefits, any remaining payment is paid to the Employee's beneficiary in accordance with the payment option elected by the Employee and the terms of the certificate guaranteeing the Annuity Benefits.

REPRESENTATIONS

Except with respect to the issue of whether the Group Annuity Contract is held by a trust or other entity as an agent for a natural person, which is the subject of this ruling, it has been represented that the Group Annuity Contract (i) satisfies the requirements to be an annuity contract under section 72 and the Treasury regulations thereunder and

(ii) is considered an annuity contract in accordance with the customary practice of life insurance companies. See section 1.72–2(a)(1) of the Income Tax Regulations.

LAW

Section 72

Section 72 prescribes the income tax treatment of amounts received under annuity contracts. Section 1.72–2(a) 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(q) provides, subject to certain exceptions, that if a taxpayer receives an amount under an annuity contract, such taxpayer's tax for the taxable year in which such amount is received is increased by 10 percent of the portion of such amount that is includible in gross income.

Section 72(s) provides that a contract will not be treated as an annuity contract for federal income tax purposes unless, with certain exceptions, the contract provides for certain distributions in the event its holder dies before the entire interest in the contract is distributed. Under section 72(s)(1)(A), the contract must provide that if any holder dies on or after the annuity starting date and before the entire interest in the contract has been distributed, the remaining portion of such interest will be distributed at least as rapidly as under the method of distribution being used as of the date of such death. Under section 72(s)(1)(B), the contract must also provide that if any holder dies before the annuity starting date, the entire interest in the contract will be distributed within five years after the date of such death. Exceptions apply when distributions after a holder's death are made to a designated beneficiary, including the surviving spouse of the deceased holder.

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).

Grantor Trust

Section 671 provides that when it is specified in subpart E of part I of subchapter J that the grantor or another person is treated as the owner of any portion of a trust, there will be included in computing the taxable income and credits of the grantor or the other person those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account under chapter 1 in computing taxable income or credits against the tax of an individual.

Section 1.671–2(e)(1) provides that, for purposes of part I of subchapter J, a grantor includes any person to the extent such person either creates a trust or directly or indirectly makes a gratuitous transfer (within the meaning of section 1.671–2(e)(2)) of property to a trust. For purposes of section 1.671–2(e)(1), the term "property" includes cash. If a person creates or funds a trust on behalf of another person, both persons are treated as grantors of the trust. However, a person who creates a trust but makes no gratuitous transfers to the trust is not treated as an owner of any portion of the trust under sections 671 through 677 or 679.

Section 1.671–2(e)(2)(i) provides that a gratuitous transfer is any transfer other than a transfer for fair market value. A transfer of property to a trust may be considered a gratuitous transfer without regard to whether the transfer is treated as a gift for gift tax purposes.

Section 677(a) provides, in relevant part, that the grantor is treated as the owner of any portion of a trust, whether or not the grantor is treated as such owner under section 674, whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a nonadverse party, or both, may be (1) distributed to the grantor or the grantor’s spouse or (2) held or accumulated for future distribution to the grantor or the grantor’s spouse.

Revenue Ruling 85–13, 1985–1 C.B. 184, provides that a grantor who is treated as the owner of the entire trust under section 671 is treated as the owner of the trust assets for federal income tax purposes. Therefore, a transfer of assets between the grantor and the trust is not recognized as a sale or exchange.

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.

Based solely on the facts submitted and the representations made, we conclude that the Trust is classified as a trust for federal income tax purposes under section 301.7701–4(a). The Trust is the holder of the Group Annuity Contract within the meaning of section 72(u)(1) because it is named in the Group Annuity Contract as owner of the Group Annuity Contract.

Amounts contributed under the Plan with respect to an Employee are taxable income to the Employee at the time of contribution and are deemed to be contributed to the Trust by the Employee. Based solely on the facts and representations submitted, we conclude that each Employee will be treated as a grantor and as the owner of the portion of the Trust related to the contributions made on behalf of the Employee under sections 671 and 677. As the owner of a portion of the Trust for federal income tax purposes, the Employee is considered the owner of that portion of the trust assets. See Rev. Rul. 85–13.

The Employees, in the aggregate, are considered the owners of the Group Annuity Contract for federal income tax purposes. The Trust is holding the Group Annuity Contract for the Group Annuity Contract's tax owners, the Employees, each of whom is a natural person. Accordingly, the holding of the Group Annuity Contract by the Trust is not 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 provide benefits to employees under qualified pension plans, which are subject to certain requirements, instead of providing deferred compensation to employees on a tax-favored basis. Because the Group Annuity Contract is funded with after-tax amounts, the Plan does not provide the sort of tax-favored benefit that section 72(u) was intended to limit.

RULING

Based solely on the information submitted and the representations made, we rule that the Group Annuity Contract is held by the Trust for natural persons within the meaning of section 72(u).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter, including whether the Group Annuity Contract qualifies as an annuity contract for purposes of section 72, including by satisfying the requirements of section 72(s), and, where applicable, the "investor control" doctrine and the requirements of section 817(h).

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 rulings, 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
(Financial Institutions & Products)

cc: