

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:04 – PLR-114599-04

Date: MAY 27, 2004

Re:

Legend

Decedent =
Brother =
Contract A =

Contract B =

Company =
\$m =
\$n =
\$o =
\$p =
Date 1 =
Date 2 =
Date 3 =
Date 4 =
Date 5 =
State 1 =
State 1 Statute =
State 2 =

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Dear _____ :

This responds to a letter dated March 4, 2004 requesting a ruling under sections 1014 and 72 of the Internal Revenue Code.

The facts and representations submitted are summarized as follows: On Date 1, Brother, Decedent's brother, purchased a deferred fixed annuity contract (Contract A) issued by Company, an insurance company, by making a single purchase payment of \$m. No additional premium payments were made to Company under Contract A.

On Date 2, Brother purchased a second deferred fixed annuity contract (Contract B) issued by Company, by making a single purchase payment of \$n. No additional premium payments were made to Company under Contract B.

The maturity date of Contract A and B is Date 3, a date which has not passed as of the date of this letter.

Brother was designated as the owner and annuitant under Contracts A and B. The terms of the annuity contracts provide that Company agrees to pay to the annuitant, if the annuitant is living on the maturity date, a monthly income for a guaranteed period of ten years and for as long thereafter as the annuitant shall live. The first payment shall be on the maturity date and the monthly income shall be in an amount determined by applying the annuity purchase value calculated as of such date under certain terms prescribed under the contract.

The annuity contracts further provide that if the annuitant dies prior to the maturity date, Company agrees to pay to the beneficiary the current contract value of the contract, calculated as of the date of death. Brother designated himself as the "Primary Beneficiary" and Decedent as the "Contingent Beneficiary" under Contract A to receive benefits under the contract. Under Contract B, Brother designated his "estate" as the "Primary Beneficiary". Brother wrote "none" for "Contingent Beneficiary".

Brother died intestate on Date 4, prior to the maturity date at which time annuity payments would begin under both contracts. The Federal Estate (and Generation-Skipping Transfer) Tax Return, Form 706, for Brother's estate was filed and included Contract A and Contract B in the gross estate with a fair market value as of Brother's date of death of \$o dollars and \$p dollars, respectively.

Brother was a resident of State 1 when he died. Under State 1 Statute, the intestate real and personal estate of a resident decedent and the intestate real estate in State 1 of a nonresident decedent, after all just claims against his estate are fully paid,

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descends and shall be distributed if there is no surviving spouse or descendant but a parent, brother, sister or descendant of a brother or sister of the decedent: the entire estate to the parents, brothers and sisters of the decedent in equal parts, allowing to the surviving parent if one is dead a double portion and to the descendants of a deceased brother or sister per stirpes the portion which the deceased brother or sister would have taken if living.

It is represented that Decedent was Brother's sole surviving relative (other than Decedent's children) and Brother's legal heir under State 1 Statute. Decedent, a resident of State 2, died on Date 5. During the administration of Brother's estate, the payment amount under Contract A was made to Decedent's estate, as Decedent was the named contingent beneficiary. The payout under Contract B was made to Brother's estate and subsequently allocated to Decedent's estate, as Decedent was the only beneficiary of Brother's estate under State 1 Statute.

You request the following rulings:

(1) The conclusions of Rev. Rul. 70-143, 1970-1 C.B. 167, apply to Contract A and Contract B because (a) Contract A and Contract B were purchased and all contributions were applied to them prior to October 21, 1979, and (b) the Annuitant, Brother, died prior to the maturity date of Contract A and Contract B.

(2) Contract A had an adjusted tax basis in the hands of the Decedent's estate and Contract B had an adjusted tax basis in the hands of the Brother's estate equal to their respective date of death values upon Brother's death.

(3) Section 72(s) does not apply to Contract A or Contract B because Contract A and Contract B were issued before the enactment of the Deficit Reduction Act of 1984.

Section 1014(a) provides, in part, that the basis of property in the hands of a person acquiring the property from a decedent or to whom the property passed from a decedent is the fair market value of the property at the date of the decedent's death.

Section 1014(b)(9) provides in the case of persons dying after December 31, 1953, property acquired from the decedent by reason of death, form of ownership, or other conditions (if by reason thereof the property is required to be included in determining the value of the decedent's gross estate) shall, for purposes of section 1014(a), be considered to have been acquired from or to have passed from the decedent. However, section 1014(b)(9)(A) provides that the foregoing shall not apply to annuities described in section 72.

Section 72 prescribes the tax treatment of amounts received under an annuity contract. Contracts under which amounts paid will be subject to the provisions of

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section 72 include contracts which are considered to be life insurance, endowment, and annuity contracts in accordance with the customary practice of life insurance companies. For purposes of section 72, however, it is immaterial whether such contracts are entered into with an insurance company. Section 1.72-2(a)(1) of the Income Tax Regulations.

Section 1.72-2(b)(2) provides, in part, that amounts subject to section 72 are considered amounts received as an annuity only in the event the amounts are received on or after the annuity starting date.

Rev. Rul. 70-143, 1970-1 C.B. 167, considers a situation where an annuity contract owner dies prior to the annuity starting date. Under the contract, in the event of the contract owner's death prior to the annuity starting date, the beneficiary has the option to surrender the contract in exchange for a lump sum payment of the cash redemption value, at any time prior to the annuity starting date. The revenue ruling treated a beneficiary's contract right to receive the redemption value in the deferred variable annuity contract is not an annuity under section 72, because the redemption value would not be received on or after the annuity starting date. Accordingly, the revenue ruling concludes that under section 1014, the basis of the contract right to receive the redemption value is the fair market value of the contract right on the date of the decedent's death, or the alternate valuation date, if so elected.

Rev. Rul. 79-335, 1979-2 C.B. 292, revokes Rev. Rul. 70-143 and holds that, for purposes of section 1014(b)(9), amounts received under a deferred variable annuity contract is an annuity described in section 72. However, the revenue ruling expressly does not apply to deferred variable annuity contracts purchased prior to October 21, 1979, including any contributions applied to such contracts pursuant to a binding commitment entered into before that date. The revenue ruling applies to all other amounts contributed to deferred annuity contracts on or after October 21, 1979.

Under section 72(s)(1)(B), a contract shall not be treated as an annuity contract unless the contract provides that if any holder of such contract dies before the annuity starting date, the entire interest in such contract will be distributed within 5 years of the death of such holder.

Section 72(s)(1)(B) was added by section 222(b) of the Deficit Reduction Act of 1984, 98 Stat. 494, 774-75 (1984). Section 222(c)(1) of the Act provides that it applies "to contracts issued after the day which is 6 months after the date of enactment of the Act in taxable years ending after such date." The date of enactment is July 18, 1984.

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In the instant case, Contract A and Contract B were purchased prior to October 21, 1979, and contributions to the contracts were made prior to that date. Therefore, Rev. Rul. 70-143 governs the application of section 1014 with respect to the contracts.

Brother died prior to the maturity date of Contract A, and the value of the right to the single sum benefit payable under Contract A is includible in determining the value of Brother's gross estate. Accordingly, the right that passes to Decedent as the designated beneficiary of Contract A, which was received by Decedent's estate upon death, is, under section 1014(b)(9), considered to have been acquired from or to have passed from the decedent, in this case Brother. In accordance with Rev. Rul 70-143, under section 1014(a) and (b)(9), the basis of Contract A in the hands of Decedent's estate is the fair market value of the contract at the date of Brother's death.

Brother died prior to the maturity date of Contract B, and the value of the right to the single sum benefit payable under Contract B is includible in determining the value of Brother's gross estate. Accordingly, the right that passes to Brother's estate as the designated beneficiary of Contract B, then to Decedent as the intestate beneficiary of Brother's estate under State 1 Statute, which was received by Decedent's estate upon death, is, under section 1014(b)(9), considered to have been acquired from or to have passed from the decedent, in this case Brother. In accordance with Rev. Rul. 70-143, under section 1014(a) and (b)(9), the basis of Contract B in the hands of Brother's estate is the fair market value of the contract at the date of Brother's death.

We further conclude that section 72(s) does not apply to Contract A or Contract B because Contract A and Contract B were issued before the enactment of the Deficit Reduction Act of 1984.

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. This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

The rulings contained in this letter are 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.

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

Sincerely,

Lorraine E. Gardner
Senior Counsel, Branch 4
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures

Copy for section 6110 purposes
Copy of this letter

cc: