Abstract: Trustees have shown an increasing interest in annuities during the last 10 years largely because of the benefit guarantees offered by new types of annuity riders. However, annuities and trusts are complex instruments, and a combination of the two may present unique tax, financial, and legal issues. The Internal Revenue Code Section 72 rules on nonnatural persons, taxable distributions, penalty taxes, and death distributions for annuities must be considered. The taxation rules for grantor, simple, and complex trusts should also be reviewed. The trustee must be certain that an annuity purchase does not impinge on a beneficiary’s rights and is consistent with the risk profile of the trust. State trust law may also impact the decision of an annuity purchase.

Note: The reader should note that as of this date, the federal estate tax has been repealed. However, the author and most tax planners believe that Congress will soon pass new estate tax legislation that will be similar or identical to the estate tax law that applied in 2009. Consequently, this article assumes that the 2009 estate tax rates apply.

In deciding whether to purchase an annuity, a trustee must often resolve some difficult tax, financial, and legal issues. Developing general guidelines for the purchase of annuities in a trust is difficult because the issues involve legal instruments that are complex and varied. Trusts may be revocable or irrevocable, simple or complex, grantor or nongrantor, and inter vivos or testamentary. The potential differences in the legal and beneficial ownership provisions of trusts are substantial.

Likewise, annuities come in many forms. Annuities may be fixed, indexed, or variable; immediate or deferred; qualified or nonqualified; guaranteed or nonguaranteed; and with riders or without riders. These complex combinations added to the abstruseness of tax provisions relating to trusts and annuities under the Internal Revenue Code (IRC) may account for the relative dearth of information published on this topic.

Nevertheless, many trustees have resolved the issues to their satisfaction and have chosen to purchase annuities. This article will first briefly discuss some of the nontax considerations for trust ownership of nonqualified annuities. Second, the key tax issues applicable to trust ownership of nonqualified annuities will be explored. Third, the article will apply some of the tax principles to specific types of trusts frequently used in estate planning. Finally, a summary will present basic questions a trustee should ask before purchasing an annuity.

Overview of Potential Advantages and Disadvantages

Traditionally, a primary advantage sought by trustees with an annuity purchase is tax deferral. Generally, growth within an annuity contract accumulates income tax deferred until the owner takes distributions, annuitizes, or surrenders the contract. Tax rates on income retained by trusts are relatively high; therefore, trustees who accumulate income for later distribution may find the tax deferral desirable. However, trustees whose risk profile permits them to invest primarily in long-term-gain capital assets may have less incentive to seek tax deferral through annuities.

In recent years, the guarantees offered by annuity benefit riders have become popular with individual annuity purchasers and have caught the interest of trustees. Living benefit riders are annuity contract amendments that provide additional guarantees for withdrawals, annuitization, or surrender. Frequently marketed as providing "upside potential with downside protection," variable annuities with a guaranteed minimum withdrawal benefit or investment protection riders have sold well during recent years. These riders generally help protect against losses by guaranteeing that specified amounts may be withdrawn despite market decreases in the annuity sub-accounts. The recent stock market decline confirmed the advantages provided by such riders in the minds of many buyers. However, many insurance companies have discontinued offering the level of benefits they had previously offered under such riders for newly issued annuities.

Death benefit riders provide increased death benefits beyond those provided by the base contract. They are generally designed to protect designated beneficiaries against depressed annuity values that might exist if the annuity owner dies during a down market. Annuity death benefits may also help meet the "transfer of assets free of estate tax" objective of many trusts, but it is important to remember that death benefits paid into trusts will normally be income taxed under simple and complex tax rules discussed below. Both living and death benefit riders are generally designed only for variable annuity contracts, and an additional annual charge is normally made for the riders.

Fixed annuity contracts may also provide the advantages of tax deferral and guarantees and normally do not have the same volatility associated with variable annuity contracts. Sometimes a trustee may purchase a single premium immediate annuity (SPIA) to provide a guaranteed cash flow from which income payments may be made. In addition, the exclusion ratio treats each SPIA payment as a partial return of investment in the contract for tax purposes.

Annuities can sometimes be used to help moderate income distributions required by a trust. As discussed in tax considerations below, the undistributed gains inside of an annuity are not defined as income under the trust laws of many states. Therefore, gains within the annuity may not have to be distributed to the income beneficiary. In appropriate cases, an annuity may help a trustee minimize income that must be paid to the income beneficiary and increase accumulations for later distribution to the remainder beneficiaries. Presumably, long-term capital gain property could also accomplish this objective, but the investment risk associated with an annuity may be more consistent with the risk...
Trust Ownership of Nonqualified Annuities: General and Special Considerations

Key Tax Issues

Although this article cannot discuss all possible tax concerns that may be raised by trust ownership of a nonqualified annuity, the following key issues are the most frequently raised:

- Does the trust qualify as a nonnatural person under IRC Section 72(u)? Nongrantor trusts, grantor trusts, some irrevocable trusts, and charitable trusts raise specific issues.
- How are annuity distributions taxed during the lives of the trust's beneficial owners?
- How do the death distribution rules of IRC Section 72(s) apply to trust-owned annuities?

Many of the basic rules of annuity taxation that tangentially relate to trust ownership simply cannot be explained in an article of appropriate length. For example, the reader should know that annuity distributions do not qualify for capital gain treatment and may be subject to a 10% penalty tax in specific instances. The reader may want to review these rules before proceeding further.

In addition, many of the issues discussed below have not been specifically addressed in Treasury regulations or revenue rulings or procedures. Unfortunately, the sparse language of the IRC, the legislative history of IRC Section 72, and handful of private letter rulings are the only authority from which one may draw for answers to many of the following issues. The conclusions are based upon the most likely interpretation of these sources, but future pronouncements from the Treasury could differ from the inferences presented here.

The Nonnatural Person Rule

Under IRC Section 72(u), 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 income tax purposes. The income on the contract is treated as ordinary income by the owner. Legislative history indicates that Congress passed IRC Section 72(u) to discourage corporations and businesses from purchasing annuity contracts to fund discriminatory nonqualified deferred compensation plans. IRC Section 72(u) applies to any contributions made to annuity contracts after February 28, 1986.

However, if an annuity contract is held by a trust or other entity as an "agent" for a natural person, then the contract should not lose its annuity contract status, and tax deferral would not be lost. Legislative history also states that if a trust is the "nominal" owner for a beneficial owner who is a natural person, then the contract is treated as held by a natural person. However, if a trust beneficiary is a nonnatural person such as a business or corporation, then this trust exception would not apply.

IRC Section 72(u)(3) also provides several other exceptions to the nonnatural person rule. For example, single premium immediate annuity (SPIA) contracts are exempt from Section 72(u), therefore a nonnatural person like a corporation may purchase a SPIA and still receive an exclusion ratio for the annuity payments.

Business Entities as Natural Person, Agent, or Nominal Owner

Unfortunately the terms "natural person," "agent for a natural person," and "nominal owner" are not clearly defined in the IRC, Treasury regulations, revenue rulings, or case law. C corporations would be considered nonnatural persons in most cases. Although the legislative history clearly indicates that Section 72(u) was enacted to deny tax deferral for corporate-owned deferred annuities, it does not eliminate the possibility that a corporation could own an annuity as an agent for a natural person. Two private letter rulings held that corporate-created trusts for the purpose of purchasing group annuity contracts for employees were agents for natural persons.

Partnerships, S corporations, family limited partnerships, and LLCs would also be considered nonnatural persons in most cases. Since these business entities generally have an independent business purpose and do not simply hold legal title like a trust, they arguably are not agents or nominal owners for the entity owners. Although each of these entities usually has flow-through income tax treatment, each nevertheless could access policy values to meet its business or creditor obligations. In an Internal Legal Memorandum, the assistant chief counsel for the IRS concluded, "An annuity contract held as partnership property by a partnership may not be considered as held for natural persons within the meaning of Sec. 72(u)(1)." Although this memo has no precedent value, it provides insight into the definition of a nonnatural person.

Nongrantor Trusts

Most of the private letter rulings concerning nonnatural persons have involved trusts. Initially, one issue raised by the rulings was whether the trust could have more than one beneficiary and still be an agent for a natural person. After all, IRC Section 72(u)(1) states that the...
nonnatural person rule shall not apply to "a trust or other entity as an agent for a natural person" (emphasis added). Two rulings from 1992 found that each trust in question was a nonnatural person, but each trust had a single beneficiary. However, a trust would probably not be ruled as a nonnatural person simply because it has multiple natural person beneficiaries. First, under the United States Code Section 1, singular includes plural unless the context indicates otherwise; therefore, the presumption should be that a natural person or persons is an acceptable reading of the statute. Second, the legislative history uses language that seems to support multiple beneficiaries. Third, trusts with multiple beneficiaries were ruled as nominal owners for natural persons in two private letter rulings.

A similar but more difficult question relates to the nature of the beneficial interests in the trusts. If all trust beneficiaries are natural persons, is the trust always an agent for natural persons despite the nature of the trustee's powers and the beneficiaries' interests? For example, some persons have argued that the agent exception to the nonnatural person rule may not apply to "spray" trusts; that is, trusts that give the trustee discretion to distribute income or principal among multiple natural person trusts. Significant beneficial interests are held by nonnatural persons, an irrevocable grantor trust might not qualify as holder for a natural person, even if the trust is an agent for natural persons.

Revocable Grantor Trusts

A grantor trust is generally a trust under which the grantor (or some person usually related to the grantor) is treated as the owner of the trust assets for income tax purposes. Most revocable living trusts are grantor trusts, and the grantor, with the power to revoke the trust, holds the primary beneficial interest in the trust. Most revocable grantor trusts would fall under the agent or nominal owner exception to the nonnatural person rule. Since the grantor is the owner of the trust assets for income tax purposes, the grantor is also the owner of a grantor trust-owned annuity for purposes of Section 72(u). Grantor trusts have been ruled as owners for natural persons.

Irrevocable Grantor Trusts

Irrevocable grantor trusts may present more difficult nonnatural person issues. The problem is that a grantor trust treats the grantor as owner of trust assets for income tax purposes, but beneficial interests in the trust arguably may not qualify as holder for natural person under Section 72(u).

Charitable Remainder Trusts
PLR 9009047 held that an annuity owned by a charitable remainder trust would not be treated as an annuity contract for purposes of 72(u). The charity was determined to be a nonnatural person that held the remainder interest. Unfortunately, no guidance exists for a de minimus rule in regard to the beneficial interest in a trust that might be held by a charity. Even if a charity holds only a remote contingent interest, the trust might not be an agent under IRC Section 72(u) for the other natural beneficiaries who hold vested interests.

**Distributions during the Life of the Trust's Beneficial Owner(s)**

Assuming the trust qualifies as a nominal owner for a natural person or persons, distributions from a non-qualified annuity generally should be taxed under normal annuity taxation principles.

For a grantor revocable trust, the grantor is treated as the owner of the contract for income tax purposes. Annuity withdrawals would be taxed to the grantor to the extent of gains in the contract under IRC Section 72(e). If the grantor is under age 59½, then the 10% penalty tax on taxable withdrawals may apply unless an exception under IRC Section 72(q)(2) exists.

For a grantor irrevocable trust, annuity distributions should also be taxed to the grantor. As discussed above, if the primary beneficial interests of the trust are held by nongrantors, then these nongrantor beneficiaries could be considered as beneficial owners of the trust for purposes of the nonnatural person rule. Since the nonnatural person exception for trusts does not square precisely with the grantor trust taxation rules of IRC Sections 671-679, the trust beneficiaries could be considered owners for purposes of the nonnatural person rule, but the grantor could be the owner for purposes of the income taxation of distributions from a trust-owned annuity. Although the rulings and legislative history do not seem to provide a clear answer, the grantor trust rules appear to support this result.

For a nongrantor trust, annuity distributions should be taxed under both the simple and complex trust rules and the annuity distribution rules.

Simple trusts require the trustee to distribute all income currently and generally pay no tax at the trust level. Therefore, the trust beneficiaries should be taxed upon any gains recognized from annuity distributions pursuant to the tax rules for annuity distributions under IRC Section 72(e) and for simple trusts under IRC Section 652.

If a simple trust beneficiary is over age 59½, then the IRC Section 72(q)(2) exception to the 10% penalty tax on taxable withdrawals should apply. The character of distributed income items carries over to the beneficiary who becomes the taxpayer with respect to such items. If a trust beneficiary is under age 59½, then the 10% penalty tax on taxable withdrawals may be payable unless another exception under IRC Section 72(q)(2) applies.

**Example Two:** A simple trust owns an annuity contract with A as annuitant. A and B are the trust beneficiaries. A is age 62 and B is age 34. The trustee withdraws $20,000 of gains from the annuity contract and distributes $10,000 to A and $10,000 to B. Under Reg. 1.652(b)-1, character of distributed income items carries over to A and B who become the "taxpayers" with respect to such items. Therefore, the distributions are taxed as income to A and B. A's distribution is subject to the 10% penalty tax because she is over age 59½. B's distribution is subject to the 10% penalty tax because no other exception under IRC Section 72(q)(2) applies.

Complex trusts are trusts that are not simple trusts. Therefore, complex trusts usually 1) retain all or a portion of current income, 2) pay or set aside amounts for charitable purposes, or 3) distribute corpus of the trust. Similar to a simple trust, a complex trust is allowed a deduction for income distributed to beneficiaries. Income distributed or required to be distributed to beneficiaries is taxed to the beneficiaries personally. Taxable income not distributed is taxed to the trust at rates applicable to trusts and estates.

Generally, if annuity withdrawals are made and not distributed in the same taxable year to the beneficiaries of a complex trust, then gains to the extent of withdrawals would be taxable to the trust under the tax rules for complex trusts of IRC Section 662. The 10% penalty tax on taxable withdrawals should be payable on any amounts retained by the trust unless an exception under IRC Section 72(q)(2) applies. Even if the trust beneficiaries are older than age 59½, the 72(q)(2) exception for premature distributions would not appear to apply to annuity distributions retained by the trust. However, if the complex trust distributes the amounts withdrawn from the annuity before the end of the trust's taxable year, then the IRC Section 72(q)(2) exception to the 10% penalty tax on taxable withdrawals should apply if the trust beneficiary who receives the distribution is over age 59½.

IRC Section 72(e)(4)(C) provides that if an individual who holds a nonqualified annuity contract transfers it without full and adequate consideration, such individual shall be taxed on 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. An exception to this recognition rule exists for the transfer of annuity to a spouse. The distribution of an annuity contract from a nongrantor trust to a trust beneficiary normally would not trigger the above recognition of gain provision because a trust "is not an individual for purposes of section 72(e)(4)(C)." However, the distribution of an annuity contract from a grantor trust to a nongrantor, nonspousal beneficiary should trigger the above recognition provision.

If the trust does not qualify as a nominal owner for a natural person or persons, then a commercial annuity contract is not treated as an annuity contract for income tax purposes and apparently is treated as a contract to pay interest. Therefore, distributions from such a nonannuity contract would not be taxed under normal annuity taxation principles.

**Required Distributions at Death**

Pursuant to IRC Section 72(s), a tax-deferred annuity contract must require that distributions begin when the annuity owner dies, unless the beneficiary is the surviving spouse. If there are two or more owners, the death of any owner triggers distribution. If a nonnatural person is the owner, distributions generally must begin when the primary annuitant dies. Consequently, for nongrantor trusts, the death of the primary annuitant is a triggering event for required distributions.

**Example Three:** W creates a nongrantor trust with $1,000,000. The trust purchases an annuity with W's spouse, H, as annuitant, and the trust as designated beneficiary. H dies. The annuity values must be paid to the trust pursuant to the death distribution rules under IRC Section 72(s). The distributions cannot be rolled tax free into another annuity contract for W.
For grantor trusts, the grantor is the owner of trust property for income tax purposes (see discussion above). If the grantor and primary annuitant are different persons, the grantor’s death should be considered the death of the owner or “holder,” and thereby trigger the death distribution rules. Unfortunately, no authority is directly on point in this area. When co-grantors are also spouses, the surviving grantor could arguably continue the contract upon the death of the first grantor, but the issue is uncertain and may depend upon the annuity contract language.

The rules on annuity death distributions are less than clear, but they can be summarized as follows:

1. If the annuity holder dies after the annuity maturity date, the remaining annuity payments must be distributed at least as rapidly as the distribution method that was in effect when the holder died.

2. If the annuity holder dies before the annuity maturity date, then within five years of the death, the entire interest in the annuity must be distributed in one of the following ways: (a) a lump sum, (b) complete distribution of the annuity interest within five years of death, (c) beginning within one year of the holder’s death, annual distributions over the life of the beneficiary or over a period not exceeding the beneficiary’s life expectancy, or (d) if the beneficiary is the owner’s surviving spouse, then such spouse is treated as the holder of the contract under IRC Sec 72(s)(3), and he or she may continue the contract.

Unfortunately, options (c) and (d) above may not be available if a trust is the annuity owner. When a trust is the owner of an annuity, the trust normally is also named as the designated beneficiary of the annuity. Otherwise, death payments inconsistent with the terms of the trust could be made in ways that might violate the trustee’s fiduciary duty to the trust beneficiaries. Consequently, a trustee will normally require that the trust be named as the designated beneficiary. Even if the trustee were to designate the surviving spouse (or other trust beneficiary) as the annuity beneficiary, many annuities have contractual provisions that make the trust the designated beneficiary immediately upon the death of an annuitant, despite the beneficiary designation made by the trustee owner.

In either instance (i.e., the trust is specifically named as designated beneficiary or the annuity contractually makes the trust the designated beneficiary), the designated beneficiary is not an individual, and the death distribution options are limited. First, unlike an individual, a trust has no life expectancy; therefore, an annuity cannot be paid over a period of time determined or limited by its life expectancy. Consequently, the death proceeds must be paid as a lump sum or over five years to the trust. The trust will then distribute the proceeds to the beneficiaries according to the terms of the trust.

Second, spousal continuation of a nonqualified annuity contract would not normally be available even if the surviving spouse is the trustee or trust beneficiary. IRC Section 72(s)(3) states that if the designated beneficiary is the surviving spouse, that spouse may continue the contract and become the succeeding owner. With most trust-owned annuity contracts, either the contract makes the trust the designated beneficiary upon the annuitant’s death or the trustee (or issuing insurance company) requires the trust to be both owner and beneficiary at policy issue. In either case, the spouse will not be the designated beneficiary under IRC Section 72(s)(3), and spousal continuation would not be available. Although the distribution rules governing qualified plans and IRAs contain rules that sometimes permit a spouse to look through a trust and be treated as a designated beneficiary, no such provision exists for nonqualified annuity contracts.

Example Four: H creates a grantor trust with spouse W as the income beneficiary and children S and D as remainder persons. The trust purchases an annuity with H as annuitant. Upon application, the insurance company requires a trust owner to be the designated beneficiary of annuity contracts issued by the company. The trustee later changes the beneficiary designation and makes W the designated beneficiary. However, the language in the annuity contract states that when a nonnatural person owns a contract, the owner (the trust) will become designated beneficiary upon the death of the annuitant or grantor for a grantor trust. H dies. The trust is the designated beneficiary and neither the trust nor W can continue the annuity contract.

Example Five: Same facts as Example Four, except that W is the annuitant, and H is the owner of the annuity contract for income tax purposes under the grantor trust rules of IRC Section 671. H dies. Therefore, H’s death is the death of the owner, and distribution must be made under IRC Section 72.

The insurance company recognizes the death of the grantor as a triggering event in both its procedures and annuity contract. Neither the trust nor W can continue the annuity contract.

Because annuity death proceeds must be paid out to a nongrantor trust when an annuitant dies, the choice of annuitant can be important for trust-owned annuities. Guaranteed minimum withdrawal benefits from a living benefit rider may be paid longer if a younger annuitant is chosen. However, if the trust beneficiary/annuitant is younger than age 59½, the 10% penalty tax on premature distributions under IRC Section 72(q) may apply to the taxable part of any withdrawals from the annuity (i.e., for nondeath distributions). On the other hand, because of the distribution-at-death requirements, the choice of an older annuitant might cause the gains to be taxed sooner than if a younger annuitant were chosen.

If the trust does not qualify as a nominal owner for a natural person or persons, then a commercial annuity contract is not treated as an annuity contract for income tax purposes. Therefore, the distribution-at-death rules presumably would not apply to such a nonannuity contract that should be beyond the purview of IRC Section 72. Commercial annuities that are not annuity contracts because they fail to meet the requirements of IRC Section 72 may present some interesting issues.

Applications to Specific Types of Trusts

The principles discussed above may produce perplexing results when applied to specific types of trusts. Trusts vary enormously, and addressing even a fraction of the possible trust arrangements is not feasible. However, this article will address provisions commonly found in credit shelter trusts, marital trusts, and net income makeup trusts. As noted previously, this article assumes that the 2009 estate tax rules apply.

Credit Shelter or “B” Trusts

Also known as a “unified credit trust” or bypass trust, the B trust may be inter vivos or testamentary. The most common inter vivos or "living
credit shelter trust is the revocable grantor trust that becomes irrevocable upon the grantor's death. Upon the death of the grantor, the grantor's surviving spouse usually has income rights and certain limited rights to trust principal. The remainder beneficiaries (usually the children of the married couple) normally will receive the trust principal upon the surviving spouse's death.

The credit shelter trust usually is established for one or more of the following reasons:

- To minimize estate taxes on a married couple's estate by maximizing both spouse's applicable unified credits
- To provide income for the surviving spouse
- To minimize probate costs
- To maintain trust assets for the remainder beneficiaries (often the children of the married couple or one spouse's children by a previous marriage) and prevent the surviving spouse from obtaining full control of the assets

Credit Shelter Grantor Trust during Grantor's Life

The most common type of grantor credit shelter trust is also known as a revocable living trust. The purchase of an annuity by a credit shelter grantor trust during the grantor's life may not be advantageous. When an annuity is owned by a revocable living grantor trust, distribution of the annuity is usually required upon the death of the grantor, and income taxes normally must be paid on the gains. Since the grantor is the owner of the annuity for income tax purposes, the death of the grantor (i.e., owner) forces required distributions of the annuity under IRC Section 72(s) to the trust (which usually becomes irrevocable at the grantor's death).

Under most annuity contracts, the trust is the surviving owner and becomes the designated beneficiary for the annuity death proceeds. As surviving owner and designated beneficiary, the trust cannot claim spouse status for spousal continuation purposes, nor can it stretch payments over lifetime because the trust has no lifetime or life expectancy. Therefore its only distribution option is a lump sum or one or more distributions over a period of five years within the grantor's death.

In addition, most revocable living grantor trusts will not permit a distribution of all the annuity death proceeds to the surviving spouse or other beneficiaries if the annuity represents a large portion of the trust assets. Therefore, the trust may have to retain most of the distribution, and pay tax on the gain at the high trust tax rates (35% for income over $11,200 in 2010). This result is especially bad for a revocable living unified credit trust where the entire $3.5 million exemption equivalent is expected to be used to shelter the maximum amount of assets from the estate tax.

Example Six: H creates an inter vivos grantor trust with credit shelter provisions. His spouse, W, is the income beneficiary for life, and their two children, A and B, are the remainder beneficiaries. H funds the trust with $1.5 million of cash and an annuity with a cash value of $2 million and a $400,000 basis. Upon H's death, the trustee chooses to receive the annuity proceeds as a lump sum. Assume the trustee has to pay $650,000 federal and state income taxes on the gain. If W dies a few months later and the trust has not grown in value, the remainder beneficiaries would receive only about $2.85 million instead of the $3.5 million they expected to receive. Not only were high income tax rates applied to the annuity proceeds, but A and B lost part of the sheltering that the unified credit could have otherwise provided. In other words, $650,000 of the $3.5 million possible unified credit amount (that could have passed tax free to the children under the unified credit trust) has essentially been wasted.

Grantees of revocable living trusts can avoid the tax problem discussed above and obtain the benefits of annuity ownership by simply purchasing the annuity outside of the trust. Upon the advice of their attorneys or other advisors, many grantors transfer all of their assets (including annuities) into the revocable living trusts with the objective of avoiding probate. However, if the grantor's spouse is the designated beneficiary of a grantor-owned annuity, the annuity can pass directly to the grantor's surviving spouse upon the grantor's death by operation of the contract. The objective of avoiding probate is met without the trust owning the annuity. In some cases, the grantor may want to transfer money out of the revocable living trust and then purchase the annuity in his or her name.

Example Seven: H has $5 million in his revocable living trust, and W, his spouse, has an estate of less than $500,000. H wishes to purchase an annuity with a guaranteed minimum withdrawal benefit (GMWB) rider. Instead of having his trust purchase the annuity, H transfers $600,000 out of the trust and purchases the annuity in his own name. He makes W the designated beneficiary. Upon H's death, W can continue the annuity contract as owner. The annuity is not included in H's probate estate, and it qualifies for the estate tax marital deduction. In addition, W can make her children the designated beneficiaries who can stretch the death benefits payable upon her death over their lifetimes.

Credit Shelter Grantor Trust after Grantor's Death

After the grantor's death, the purchase of an annuity by a credit shelter trust may be suitable and desirable. However, the trustee should carefully consider who should be chosen as annuitant. If the surviving spouse is the annuitant, then the guaranteed withdrawal benefit and/or guaranteed death benefit riders available for some annuities may provide advantages consistent with the income and asset preservation goals of the trust.

Example Eight: H creates a living credit shelter grantor trust. His spouse, W, is the income beneficiary for life, and their two children, A and B, are the remainder beneficiaries. H funds the trust with $3.5 million of cash and other property. He dies shortly thereafter. After H's death, the trust purchases a $1 million annuity with a guaranteed minimum withdrawal benefit rider. The trustee makes W the annuitant. Consistent with the withdrawal limits of the annuity rider, the trustee withdraws 5% of the original annuity value each year and distributes it to W, who is taxed on the withdrawals, which, in this case, are always from gains in the contract. W is over age 59½; therefore, the 10% penalty tax on premature withdrawals does not apply. When W dies, the annuity has a basis of $1 million and a death benefit value of $1.3 million. The death benefit must be paid to the trust in no less than five years, and the gains of $300,000 will be income taxed according to the rules of simple and complex trusts discussed earlier. The annuity and withdrawal rider helped meet the objectives of guaranteed income for the spouse and preservation of principal for the beneficiaries.

If the surviving spouse has sufficient income and assets outside the unified credit trust, the trustee may desire to purchase separate annuity
contracts with each remainder beneficiary as an annuitant. If the remainder beneficiaries are the annuitants, then tax deferral and capital
preservation objectives for the remainder beneficiaries may be met.

Example Nine: Same initial facts as in Example Eight except that the trustee purchases two $500,000 annuities on children A and B. W has
sufficient assets to provide for her income needs; therefore, the trustee takes no withdrawals from the annuity contracts. A and B are under
age 59½. Upon W's death, the contracts are worth $1 million each. No death distributions are required from the contracts upon W's death
because she is not an owner or annuitant. The trustee can transfer the contracts to A and B, respectively. Gains in the contracts are not
taxed until A or B begins withdrawals or annuitizes the contracts.

Marital Deduction and QTIP Trusts

Unlike the credit shelter trust, the marital deduction trust is funded with property transfers that qualify for the estate and/or gift tax marital
deduction. The surviving spouse is the income beneficiary and may or may not have significant power over trust principal during lifetime.
Usually the surviving spouse's heirs are the remainder beneficiaries.61

Depending upon the terms and objectives of the trust, an annuity may be a suitable investment for a marital deduction trust. If the trust is
funded after the first spouse's death, then spousal continuation of the annuity is not a concern. If the intent is to provide a guaranteed
income for the surviving spouse or a guarantee of trust assets for the children, then an annuity with guaranteed withdrawal benefit rider or a
stepped-up death benefit rider may be suitable. However, if the surviving spouse is the annuitant, the trust will probably have to take death
distributions upon the spouse's/annuitant's death, and the remainder beneficiaries will not be able to continue the contract.62

A qualified terminal interest property (QTIP) trust is a special type of marital deduction trust that is often used when a grantor wants to
ensure that his or her children from a previous marriage will receive the trust property after both the grantor and the current spouse have
died. The surviving spouse has a right to all the income during his or her life, but the principal goes to the remainder beneficiaries when the
spouse dies.

Annuities may not be appropriate investments for QTIP trusts for a reason associated with state law definitions of income. In most states, the
undistributed gains inside of an annuity are not defined as income, and therefore may not have to be distributed to the income beneficiary.
Income would only be recognized to the extent the trustee made withdrawals of gains from the annuity. If the trustee made no withdrawals,
then there may be significantly less trust income to distribute to the surviving spouse. The trustee could be placed in an unenviable position
between the surviving spouse who may want to maximize income and the children who want to maximize principal for later distribution.
Unless the trustee and all beneficiaries agree on specific parameters for any annuity withdrawals, an annuity may present problems.

Charitable Remainder Trusts

In PLR 9009047, the IRS ruled that a charitable remainder trust (CRT) was a nonnatural person for purposes of Section 72(u) and could
hold an annuity without affecting its qualification as a “charitable remainder unitrust under section 664(d)(2) of the Internal Revenue Code
and the applicable regulations.”63 Tax deferral is obviously not an objective sought by a CRT since it pays no income tax. A CRT may
consider an annuity for reasons related to guarantees, rider benefits, and especially income accounting rules. In most states, the
undistributed gains inside of an annuity are not defined as trust income, and therefore do not have to be distributed currently to the income
beneficiary. For trust accounting income purposes, income may not be recognized until the trustee makes withdrawals from the annuity.

These accounting rules may present an opportunity for a type of CRT known as a net income make-up charitable remainder unitrust trust or
NIMCRUT. With a normal charitable remainder unitrust, the donor receives income from property he or she has gifted to the trust, and the
charity receives the gifted property after a term of years, or after the donor dies. A NIMCRUT is a CRT that accumulates income payments
inside the trust for later distribution to the donor, usually when the donor nears retirement.

When a NIMCRUT recognizes no current trust accounting income, it accounts for the shortfall owed to the donor beneficiary for future
distribution. Since under most state laws the undistributed gains inside of an annuity are not defined as trust income, the trustee may want to
use an annuity to increase accumulations for later distribution to the donor beneficiary under the make-up provisions.

The IRS has expressed unease with the use of annuities owned by CRTs to control the timing of income recognition. In Revenue Procedure
97-23, the IRS announced that it would not issue rulings or determination letters on whether “creating or using an income exception
charitable remainder unitrust to control the timing of the trust's receipt of trust income for the benefit of the unitrust recipient causes the trust
to fail to function exclusively as a charitable remainder trust under Section 1.664-1(a)(4) of the Income Tax Regulations.”64 However, less
than a year later, the IRS issued a technical advice memorandum in which it held that an annuity purchase by a NIMCRUT was not an act of
self-dealing nor would it affect the trust's status as a CRT.65

Summary

Annuities can offer advantages for some trusts, but trustees must be cautious. Trusts differ greatly, and some trusts should not purchase
annuities. Among the questions a trustee should ask are:

- Does the trust permit investments in annuities?
- Is an annuity purchase consistent with the investment objectives of the trust?
- Will an annuity purchase impinge on any beneficiaries’ rights?
- What income distributions are required by the trust?
- Are any trust beneficiaries nonnatural persons that would cause an annuity to lose tax-deferral under the nonnatural person rule?
- Is spousal continuation of the annuity an objective?
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- Do the remainder beneficiaries desire to annuitize or "stretch" annuity death proceeds over their life expectancies?
- Will the trustee make annuity withdrawals and distribute the proceeds of those withdrawals to trust beneficiaries who are younger than age 59 1/2?
- What are the costs, benefits, risks, and limitations of the annuity and annuity riders under consideration?

Trusts with annuities may have tax, spendthrift, diversification, and other protection advantages, especially if they are designed to purchase and hold annuities. However, when placing an annuity inside an existing trust, the trustee and legal advisor should check the trust document and state law carefully.

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(1) The taxation of annuities is covered generally under IRC Section 72.(2) For 2010, trust income in excess of $11,200 is taxed at 35%.(3) Guarantees associated with annuity riders are based on the claims-paying ability of the issuing insurance company.(4) Living benefit riders are generally designed for variable annuities. Guaranteed Minimum Withdrawal Benefit riders generally provide for some guaranteed withdrawal benefit. They may provide for specific guaranteed withdrawals that will not reduce the annuity death benefit value to less than the original investment in the contract. Such riders may guarantee an amount equal to a specified annual withdrawal amount percentage every year until the death of the annuitant, although the cash surrender value would have otherwise fallen to zero as a result of investment downturns or the withdrawals themselves. Guaranteed Minimum Income Benefit riders generally guarantee a minimum cash value over a period of time for annuitization purposes. They may accumulate the initial principal at a specified rate of interest or provide for other potential periodic increase in value. The guaranteed value is then converted into an immediate or other payout annuity at a guaranteed purchase rate.(5) Death benefit riders are generally designed for variable annuities. Roll-up Death Benefit riders generally increase the death benefits periodically by a specified percentage until the benefit is equal to some multiple of the original premium for the annuity contract. Most companies provide that lifetime withdrawals reduce the death benefit on a pro rata basis. The roll-up benefit is usually paid upon the death of the annuitant or contract owner. Step-Up Death Benefit riders usually increase the death benefit to the highest account value within periods of time specified in the annuity rider. The purpose is to protect against possible losses in the annuity in a down market.(6) IRC Secs. 72(a) and 72(b)(2). The exclusion ratio applies until the owner recovered his or her entire investment in the contract for annuities issued on or after January 1, 1987. Thereafter, annuity payments are taxable as ordinary income.(7) IRC Sec. 72(u)(1) states: "For purposes of this paragraph, holding by a trust or other entity as an agent for a natural person shall not be taken into account."(8) IRC Sec. 72(u)(2)(9) H.R. Rep. No. 426, 99th Cong., 1st Sess. 703, 704 (1985); 1986-3 (Vol. 3) C.B. 703. The report states, "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." See also, PLR 9316018.(10) For a good discussion of the grandfathering implications of this rule, see Tannahill, "Are Annuities Trustworthy: Avoiding the Tax Traps When a Trust Owns or is the Beneficiary of a Nonqualified Annuity," Probate & Property (July/August 2006).(11) IRC Sec. 72(u)(1).(12) H.R. Comm. Rep. for HR 99-841, P.L.99-514 (Vol. 4) 1986 C.B. 401-402 states: "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."(13) IRC Sec. 72(3).(14) H.R. Rep. No. 426, 99th Cong., 1st Sess. 703, 704 (1985); 1986-3 (Vol. 3) C.B. 703, 704 states, "Thus, if a group annuity contract is held by a corporation as an agent for natural persons (emphasis supplied) who are the beneficial owners of the contracts, the contract is treated as an annuity contract for Federal income tax purposes." See also, PLR 9316018.(15) PLR 200018046 and PLR 200720004.(16) Internal Legal Memorandum, ILM 199944020, Withdrawal of Ruling Request PLR 109833-99, August 5, 1999, UIL No. 72-21-00.(17) PLR 9204010 and PLR 9204014.(18) IRC Section 7701(o)(1)(1).H.R. Rep. No. 426, 99th Cong., 1st Sess. 703, 704 (1985); 1986-3 (Vol. 3) C.B. 703, 704 states, "Thus, if a group annuity contract is held by a corporation acting as an agent for natural persons who are the beneficial owners (emphasis supplied) of the contracts, the contract is treated as an annuity contract for Federal income tax purposes." Although this legislative history is not controlling, the language seems to indicate that ownership by a single beneficial owner is not a determinative factor for application of the "nominal owner" exception to the nonnatural person rule.(20) PLR 9752035 and PLR 199905015.(21) The argument would continue that all "nonnatural" entities ultimately had "natural" entities as owners or beneficiaries, and therefore the connection between the
beneficiary and annuity may have to be "direct" before the exception applies. (22) However, the ruling did not say separate shares were a necessary condition for the nominal owner exception to apply. Furthermore, the trustee had some discretion over payments to the beneficiaries. (23) The fact that the income tax treatment of disparate distributions among owners of an annuity may be different from the income tax treatment of spray distributions among trust beneficiaries is irrelevant for purposes of applying the nonnatural person principles behind Section 72 to spray trusts when a corporate or nonnatural person is not present. (24) PLR 199905015 describes the facts of the ruling as follows: "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." (25) Trust income is either paid out to the beneficiary or is accumulated. If the beneficiaries are all natural persons, then in either case, the benefit goes to natural persons in ways that would normally not violate the purposes of Section 72(u). (26) When a grantor dies, a grantor trust normally becomes a non-grantor irrevocable trust. (27) In extending the nonnatural person exception to a grantor trust, PLR 9316018 states: "Section 671 of the Code provides the general rule that when the grantor or another person is regarded as the owner of any portion of a trust, there shall be included in computing his taxable income and credits, those items of income, deduction, and credits against tax of the trust which are attributable to that portion of the trust (to the extent that such items could be taken into account in computing the taxable income or credits against the tax of an individual)." Sections 673 through 677 of the Code specify the circumstances that cause a taxpayer to be regarded as the owner of a portion of a trust. (28) PLR 9316018, 9322011, 9810015, 9120024. (29) Unfortunately, no guidance exists for a de minimus rule with regard to the beneficial interest in a trust that might be held by a nonnatural person. Clearly, if a corporation or charity were a primary income or principal beneficiary of a trust, then the trust would not qualify as an agent for a natural person. However, what if a charity held only a remote contingent interest? It would be interesting to see if the IRS would apply its "remote contingent interest" position in the Crummey power arena in a similar way (in reverse) to the nonnatural person question. (30) PLR 9322011. The grantors in this ruling were the employee participants who set up trusts. The ruling states, "Each Participant may elect either to receive the award in cash, or to direct X to contribute the award to an irrevocable trust ("Trust") created by the Participant…. A Participant (or his or her designated beneficiary) may receive distributions from the Trust upon the occurrence of one of the following events: (1) the Participant's completion of ten years of continuous employment with X after creating the Trust, (2) the tenth anniversary of the Participant's employment, (3) the Participant's death, disability, or retirement from X at or after age 60, or (4) certain hardships." (31) Ibid. (32) Under the 1099 reporting rules, most insurance companies would probably treat the grantor as the owner of the annuity, despite the underlying beneficial interests. (33) PLR 9316018 states: "Section 671 of the Code provides the general rule that when the grantor or another person is regarded as the owner of any portion of a trust, there shall be included in computing his taxable income and credits, those items of income, deduction, and credits against tax of the trust which are attributable to that portion of the trust (to the extent that such items could be taken into account in computing the taxable income or credits against the tax of an individual)." Sections 673 through 677 of the Code specify the circumstances that cause a taxpayer to be regarded as the owner of a portion of a trust." (34) IRC Sec. 651. (35) Reg. 1.652(b)-1 states, "In determining the gross income of a beneficiary, the amounts includable under §1.652(a)-1 have the same character in the hands of the beneficiary as in the hands of the trust. The tax treatment of amounts determined under §1.652(a)-1 depends upon the beneficiary's status with respect to them not upon the status of the trust" (emphasis supplied). (36) Reg. §1.662(a)-1 states: "Inclusion of amounts in gross income of beneficiaries of estates and complex trusts; general. There is included in the gross income of a beneficiary of an estate or complex trust the sum of: (1) Amounts of income required to be distributed currently to him, and (2) All other amounts properly paid, credited, or required to be distributed to him by the estate or trust." (37) IRC Sec. 662. For 2010, taxable income for trusts and estates in excess of $11,200 is taxed at 35% rates. (38) Taxable income that is not distributed to trust beneficiaries is taxed to the under the rules of IRC 662, the trust is taxed as an entity separate and apart from the beneficiaries. It may only claim deductions and exclusions from income for which it alone qualifies independent of the beneficiaries. Therefore it can claim only those exceptions to the 10% penalty tax for which it qualifies, independent of the beneficiaries. Since a trust has no age for purposes of the age 59½ exception, any taxable distributions from a trust-owned annuity would be subject to the 10% penalty tax. Under a literal interpretation of Reg. 1.662(b)-1, it is possible to conclude that any taxable withdrawal from a nonqualified annuity owned by a complex trust would be subject to the 10% penalty tax, even if the withdrawal was distributed to a beneficiary older than age 59½. However, such an interpretation seems neither fair nor consistent with the purpose of the IRC Sec. 72(q). (39) IRC Sec. 72(e)(1)(C)(i). (40) PLR 199905015, See also PLR 200449014. (41) The author found no specific authority for this conclusion, but the conclusion is logical. In a grantor trust, the grantor is considered the owner of the trust-owned annuity; therefore, a transfer to a nongrantor should be considered a transfer from an individual to another individual under IRC Sec. 72(e)(1)(C). A contrary view would permit an annuity owner an easy way to circumvent IRC Sec. 72(e). An annuity owner could simply transfer the annuity to a grantor trust, and then from the grantor trust to the trust beneficiary without triggering the recognition provision. (42) See, Reg. 1.72–2(b)(1)(ii). The regulation states: "Section 72 does not exclude from gross income any amounts received under an agreement to hold an amount and pay interest thereon. See paragraph (a) of Sec. 1.72-14." See also, Rev. Rul. 75–255. (43) IRC Sec. 72(s). (44) IRC Sec. 72(s)(6). IRC §72(s)(6)(B) defines primary annuitant as an individual. This rule applies to annuities issued after April 22, 1987. (45) Alternatively, one might argue that the death of a nongrantor annuitant triggers the death distribution rules, even for grantor trusts. Although no authority explicitly addresses this issue, distribution at the death of the grantor is the most logical choice. Since the grantor is the owner of grantor trust assets for income tax purposes, and the death of the owner is the primary trigger for annuity distributions at death, then the death of the grantor should trigger the death distribution requirements. It seems incorrect to assert that the grantor is the owner of the annuity for income tax purposes, but the grantor is not the owner for the income tax requirement of distributions at death under IRC Sec. 72. Although some insurance companies treat the death of the grantor as a distribution event, it is possible that other insurance companies may not
be aware of the death of a nonannuitant grantor and may not have reporting procedures in place to trigger a distribution.\(^{46}\)

For example, some annuity contracts provide that when an owner is a nonnatural entity and an annuitant dies (triggering death distributions), the owner (trust in this case) becomes the designated beneficiary. This contractual provision supersedes any designation made by the applicant. Although a surviving spouse who served as co-grantor should be considered owner for income tax purposes, the insurance company may only recognize the owner as designated in the contract. See, PLR 200622020 where an insurance company paid the death benefits to a trust where the surviving spouse was a co-annuitant with her deceased annuitant husband, but the company apparently did not consider her to be owner under the contract. If there are two or more owners, the death of any owner triggers distribution. However, where spouses are joint owners, the survivor usually becomes the designated beneficiary upon the first death and has the right to continue the contract. The same principle would arguably apply to spousal co-annuitants. A contrary view might say the surviving grantor is seeking continuation in the capacity of grantor and not as a surviving spouse and therefore continuation should not be allowed.\(^{47}\) IRC Sec. 72(s)(1)(B).

The five-year rule for qualified annuities differs slightly from the five-year rule for nonqualified annuities. Nonqualified annuities must pay out the entire annuity value within five years of the owner's death. For IRAs and qualified plans, the distribution must be made no later than December 31 of the fifth calendar year that contains the fifth anniversary of the date of the employee's death.\(^{48}\) IRC Sec. 72(s)(2)(B),\(^{49}\) IRC Sec. 72(s)(3).\(^{50}\) For example, assume a trustee purchases an annuity and makes the grantor the annuitant and the grantor's children, A and B, the annuity beneficiaries. Under the terms of the trust, if A or B dies, the deceased's children would receive shares of the trust per stirpes. Under the annuity, if A or B dies before the annuitant, the survivor of the two would receive the annuity death proceeds upon the annuitant's death. If B dies, and then the annuitant dies, A receives the annuity death proceeds, and the trustee may have broken his fiduciary duty to B's children who are also trust beneficiaries.\(^{51}\) Many insurance companies contractually make the trustee the designated beneficiary of a trust-owned nonqualified annuity upon the death of any annuitant or upon the death of the grantor for grantor trusts. This contractual provision supersedes any designation made by the applicant, presumably for the reasons discussed in the preceding endnote. A potential solution to the "trust contractually becomes designated beneficiary" problem might be to make the children the contingent beneficiaries and have the trustee disclaim the annuity benefits upon the annuitant's death, once the trustee is certain that such a disclaimer would not violate a fiduciary duty. However, the power to disclaim contractual rights under state law must be possible. For the Treasury's position on disclaiming qualified plan and IRA death benefits, see GCM 2008017.\(^{52}\) The rules pertaining to lifetime distributions should not be confused with the distribution rules at death for nonqualified annuities. Distributions made during the lives of the beneficiaries from simple or complex trusts are taxed under the rules discussed above. The distribution at death rules under IRC 72(s) are completely different and specify different requirements for death distributions.\(^{53}\) Under IRC Sec. 401(a)(9)(E), the designated beneficiary for a qualified account such as an IRA must be an individual. However, if the conditions stipulated in Reg. Sec. 1.401(a)(9)-4, A-5(b) are met, a trust may be permitted to "see through" to the trust beneficiary for minimum distribution purposes. However, the above see-through rules do not necessarily permit a surviving spouse to roll over a qualified plan or IRA benefit payable to a trust. For a surviving spouse to rollover an IRA benefit to trust, the spouse may have to seek a private letter ruling. See, PLR 200242044. Others feel that such a rollover is permitted under Treas. Dec. 8987. No similar regulation or private letter ruling exists for nonqualified annuities. The exception made under the above regulation for qualified accounts is unusual because it departs significantly from the wording of the IRC. Since there is no specific authority for a see-through exception for nonqualified annuities, it seems unlikely that the IRS would approve an exception that conflicts directly with the IRC. See, PLR 200622020 which involved a revocable trust with spouses as grantors and trustees. After Spouse One died, the insurance company paid the annuity death proceeds directly to the trust, despite Spouse Two's desire to roll over the contract. In denying relief to the surviving spouse, the IRS stated, "Taxpayer argues that she should be permitted to 'roll over' the proceeds from Annuity into another annuity contract, and cites as support several letter rulings in which the Service permitted such rollovers in the case of qualified annuities. We disagree, however, that a rollover may be effected under these facts. A rollover occurs when distributions from certain qualified retirement plans are contributed or deposited into another qualified plan within a 60-day time period. See, 26 C.F.R. section 1.402(c)-2, sections 402(c)(4), 403(a)(4), 403(b)(8), 408(d)(3)(A). The distribution of Amount X that Taxpayer received on Date 4 was from a nonqualified annuity. Therefore, no rollover could have occurred." Although this ruling is not directly on point concerning the see-through issue, it highlights the distinction that the IRS makes between qualified and nonqualified contracts even where a surviving spouse is a co-grantor and co-trustee.\(^{54}\) Although some insurance companies treat the death of the grantor as a distribution event, it is possible that other insurance companies may not be aware of the death of a nonannuitant grantor and may not have reporting procedures in place to trigger a distribution.\(^{55}\) See, Reg. 1.72--2(b)(1)(ii). The regulation states: "Section 72 does not exclude from gross income any amounts received under an agreement to hold an amount and pay interest thereon. See paragraph (a) of Sec. 1.72-14." See also, Rev. Rul. 75--255.\(^{56}\) These issues can be quite complex and present interesting ideas. For example, assume a NIMCRUT is owner and designated beneficiary of an annuity contract with the husband and wife as annuitants. Normally, Sec. 72(s) requires distribution upon the death of the first annuitant when a nonnatural person owns the contract. However, IRC Sec. 72(u) says that if a nonnatural person owns an annuity contract (e.g., a CRT), then the contract is no longer treated as an annuity contract for purposes of IRC Sec. 72. (A state may still recognize the contract as an annuity contract for state regulatory purposes). Since the contract is no longer an annuity contract, then the distribution-at-death rules of 72(s) may no longer apply to the holder of that annuity contract. However, insurance companies almost always include death distribution contractual provisions consistent with IRC Sec. 72 in their annuity contracts because, otherwise, the annuity contracts could not obtain tax deferral. For this reason, some insurance companies have language that may nullify the death distribution provisions if the annuity contract is not treated as an annuity contract under Sec. 72. In the above example, if the husband died and the contract was an annuity under IRC Sec. 72, the surviving spouse could not continue the contract because she is not the designated beneficiary; therefore, the contract would end and death benefits would be paid to the trust. However, if the contract was no longer an annuity under Sec. 72 and the contract had the above-mentioned language that nullified any death distribution requirements, then the NIMCRUT would be able to continue the contract. If the annuity contract had an annuity rider that paid benefits upon the death of the first annuitant, such death benefit would be paid, and the contract could continue with the surviving spouse as the annuitant. The NIMCRUT

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could make withdrawals as necessary to make payments to the surviving spouse. These considerations can sometimes be important for annuity contracts with guaranteed minimum benefit riders and death benefit riders. However, the surviving annuitant should discuss continuation or payment of death benefit issues with the insurance company quickly. Some insurance companies may immediately pay death benefits to a trust upon the death of the first annuitant. See, PLR 200622020. (57) Couples whose combined wealth exceeds $3.5 million most commonly use the "B" trust (the applicable credit exemption equivalent shelters $3.5 million per individual in assets from estate tax in 2009). (58) The spouse's income rights are usually subject to ascertainable standard language. The trust may permit the surviving spouse to take the trust income up to the greater of a specified percentage or a specified dollar amount. (59) Avoiding probate is often a primary objective of persons with estates of less than $7 million for a married couple or $3.5 million for a single individual. Minimizing probate is frequently accomplished with revocable living trusts that may or may not have similar limitations on the surviving spouse's rights in trust property as would normally exist for unified credit trusts for estates exceeding $7 million. However, the tax considerations for such trusts holding annuities are similar to unified credit trusts. (60) Qualified terminal interest property (QTIP) trusts are often used to prevent the surviving spouse from obtaining full control of the trust assets. (61) With QTIP trusts, the surviving spouse's heirs may or may not be the trust beneficiaries. (62) An alternative may be to remove assets from the marital trust to purchase an annuity in the surviving spouse's name. The surviving spouse/parent may be the owner and annuitant with the children as the beneficiaries. Upon the death of the spouse/parent, the annuity proceeds could be paid as a lump sum, over five years, or "stretched" over the lives of the children beneficiaries. The proceeds would normally not be subject to probate. (63) PLR 9009047. (64) Rev. Proc. 97-23. 

(65) TAM 9825001.