

**Internal Revenue Service**

Number: **201149005**  
Release Date: 12/9/2011

Index Number: 72.00-00, 1001.00-00,  
752.04-00

Department of the Treasury  
Washington, DC 20224

Third Party Communication: None  
Date of Communication: Not Applicable

Person To Contact:  
, ID No.

Telephone Number:

Refer Reply To:  
CC:FIP:B04  
PLR-109506-11, PLR-109507-11

Date:  
September 06, 2011

Trust 1

Trust 2

Buyer

Date 1

Date 2

Date 3

Date 4

Date 5

Date 6

Date 7

Date 8

Grantor:

Co-Trustees:

Beneficiary 1

Beneficiary 2

Amount 1

Amount 2

Amount 3

Amount 4

Amount 5

Amount 6

Amount 7

Corporation 1

Corporation 2

Corporation 3

Partnership 1

Partnership 2

Partnership 3

Real Property

City

Dear

This is in response to your request for a letter ruling regarding the application of the Internal Revenue Code to a transaction you contemplate undertaking.

FACTS

The following is represented:

On Date 1, Grantor and Co-Trustees, established Trust 1 for the sole benefit of Beneficiary 1. On Date 1, Grantor and Co-Trustees established Trust 2 for the sole benefit of Beneficiary 2.

Date 2 Annuity Contracts:

On Date 2, Trust 1 and Trust 2 (“Trusts”) each purchased Amount 1 shares of common stock of Corporation 1 from Grantor. The consideration paid by each Trust was Date 2 Annuity Contracts that provide that each Trust must pay a fixed annual annuity payment to Grantor for the full term of Grantor’s life. The present value of the fixed annual annuity payments to be made by the Trusts pursuant to the Date 2 Annuity Contracts, as determined pursuant to the regulations under section 2512 of the Internal Revenue Code, was equal to the fair market value of the Corporation 1 Stock as of Date 2.

Trusts have paid the fixed annual annuity payments to Grantor as required by the Date 2 Annuity Contracts.

On Date 3, each Trust exchanged the Corporation 1 Stock for Amount 2 shares of Corporation 2 stock pursuant to a tax-free merger of Corporation 1 and Corporation 2.

Each Trust subsequently sold some shares of Corporation 2 Stock to unrelated third parties.

On Date 4, each Trust exchanged Amount 3 shares of Corporation 2 Stock for Amount 4 shares of Corporation 3 pursuant to a tax-free merger of Corporation 2 and Corporation 3.

Each Trust subsequently sold all of its shares of Corporation 3 stock to unrelated third parties.

On Date 5, each Trust purchased Amount 5 shares of common stock of Corporation 2 from Grantor pursuant to a Sale Agreement. The consideration paid by each Trust in exchange for the Amount 5 of stock was an annuity (Date 5 Annuity Contracts). The Date 5 Annuity Contracts provide that the Trusts must pay a fixed annual annuity payment to Grantor for the full term of Grantor’s life. The present value of the fixed annual annuity payments to be made by the Trusts pursuant to the Date 5 Annuity Contracts, as determined pursuant to section 2512, was equal to the fair market value of the Date 5 Corporation 2 Stock as of Date 5.

On Date 4, each Trust exchanged the Date 5 Corporation 2 Stock for Amount 6 shares of Corporation 3 stock pursuant to a tax-free merger of Corporation 2 and Corporation 3.

Each Trust subsequently sold all of its shares of Corporation 3 stock to unrelated third parties.

Taxpayer represents that the annuity contracts are unsecured.

#### Contemplated Transaction:

On or around Date 6, each Trust acquired Amount 7 partnership interest in Partnership 1. On or around Date 7, each Trust acquired Amount 7 partnership interest in Partnership 2. On or around Date 8, Partnership 1 merged with Partnership 2. The surviving entity changed its name to Partnership 3. As a result of the merger, each Trust owns an amount 7 partnership interest in Partnership 3. Partnership 3 owns Real Property in City.

Grantor intends to assign his rights and obligations under the Annuity Contracts to Buyer. Thereafter, Trust 1 and 2 intend to sell their Partnership Interests to the Buyer in exchange for 1) the termination of the Annuity Contracts and 2) cash.

Buyer is a grantor Trust within the meaning of section 671 of the Internal Revenue Code.

The fair market value of the Partnership Interest of each of Trust 1 and Trust 2 at the time of the sale will equal the sum of 1) the present value of the future annuity payments due under the Annuity Contracts, plus 2) the Cash Payment. The Annuity Value will be computed as of the closing date of the contemplated transaction using the appropriate table identified in Treas. Reg. section 20.2031-7T and the applicable section 7520 interest rate as of the closing date of the contemplated transaction and the age of the Grantor.

#### REQUESTED RULINGS

Taxpayer requests rulings that:

1. The transfer by each Trust of a portion of each Trust's Partnership Interest to the Buyer in exchange for the termination of the Annuity Contracts is treated as an annuity payment made under each of the Annuity Contracts in an amount equal to the Annuity Value for purposes of Revenue Ruling 55-119, 1955-1 C.B. 352, and each Trust shall recognize gain or loss as a result of such transfer in the tax year that includes such transfer as provided therein.
2. Each Trust will recognize gain or loss as a result of the sale of its Partnership Interest to the Buyer in the tax year that includes such sale in an amount equal to the

difference between each Trust's adjusted basis in its Partnership Interest and the sum of (i) the Annuity Value, (ii) the Cash Payment, and (iii) the Trust's allocable share of the Partnership's liabilities immediately prior to the sale pursuant to section 752(d).

## LAW and ANALYSIS

### *Requested Ruling #1*

Section 72(a) of the Internal Revenue Code provides that gross income includes any amount received as an annuity. Section 72(b) provides that to the extent an amount received as an annuity represents a reduction or return of premiums or other consideration paid, such amount is not included in gross income.

An annuity is a periodic amount paid at a regular interval under an annuity contract which provides a determinable amount of payments in consideration for a fixed sum or a transfer of property. See section 1.72-2 of the Income Tax Regulations.

Treas. Reg. section 1.72-1(b), in defining "amounts received as an annuity," provides that in general they are "amounts which are payable at regular intervals over a period of more than one full year from the date on which they are deemed to begin, provided the total of the amounts so payable or the period for which they are to be paid can be determined as of that date." Thus, an annuity may be for a fixed period of time (so the payments will total a predetermined amount), or for a period determined by the life of the annuitant, or a combination of the two.

A private annuity is generally an arrangement whereby an individual transfers property, usually real estate, to a transferee who promises to make periodic payments to the transferor for the remaining life of the transferor. A private annuity may also include a transaction whereby the transferee agrees to make periodic payments until a specific monetary amount is reached or until the transferor's death, whichever occurs first. Private annuity arrangements are often used for intra-family transfers whereby an older family member transfers appreciated property to a younger family member in order to gain tax advantages, e.g., removal of the property from the transferor's gross estate.

Various revenue rulings have prescribed methods for recognizing gain, recovering basis, and computing the transferee's basis in this type of annuity transaction. See Rev. Rul. 69-74, 1969-1 C.B. 43, and Rev. Rul. 55-119, 1955-1 C.B. 352.

In Rev. Rul. 69-74, a father transferred a capital asset having an adjusted basis of \$20,000 and a fair market value of \$60,000 to his son in exchange for the son's legally enforceable promise to pay him a life annuity of \$7,200 per year, in equal monthly installments of \$600. The present value of the life annuity was \$47,713.08. The ruling

concluded that: (1) the father realized capital gain based on the difference between the father's basis in the property and the present value of the annuity; (2) the gain was reported ratably over the father's life expectancy; (3) the investment in the contract for purposes of computing the exclusion ratio was the father's basis in the property transferred; (4) the excess of the fair market value of the property transferred over the present value of the annuity was a gift from the father to the son; and (5) the prorated capital gain reported annually was derived from the portion of each annuity payment that was not excludible.

Rev. Rul. 55-119, 1955-1 C.B. 352, holds that, if property is exchanged for an annuity, and such annuitized property is disposed of prior to the death of the annuitant, the basis (unadjusted) for determining gain shall be the total of the annuity payments made under the contract up to the date of disposition plus the value of the prospective payments remaining to be paid at the date of such disposition. The basis (unadjusted) for determining loss shall be the total of the annuity payments actually made at the time of disposition. If the selling price is less than the adjusted basis for gain and greater than the adjusted basis for loss, neither gain nor loss would be recognized at the time of the sale. See sections 72(e)(5)(A) and 72(e)(5)(E)(ii) (distribution on complete surrender or redemption of a contract included in gross income only to the extent that the distribution exceeds the investment in the contract, determined under section 72(e)(6)). This treatment applies even if the distribution arises from a complete surrender or redemption of the contract on or after the annuity starting date. Section 72(e)(5)(E) (flush language)).

When a taxpayer conveys appreciated or depreciated property in satisfaction of an obligation or in exchange for the performance of services, that taxpayer must recognize gain or loss equal to the difference between the basis in the transferred property and the property's fair market value at the time of the transfer. See, e.g., United States v. Davis, 370 U.S. 65 (1962), International Freighting Corp., v. Commissioner, 135 F.2d 310 (2<sup>nd</sup> Cir. 1943), United States v. General Shoe Corp., 282 F.2d 9 (6<sup>th</sup> Cir. 1960); Wood v. Commissioner, 39 T.C. 1 (1962).

The transfer by each Trust of a portion of each Trust's Partnership Interest to the Buyer in exchange for the termination of the Annuity Contracts is treated as an annuity payment in an amount equal to the Annuity Value made under each of the Annuity Contracts under section 72. The termination of the Annuity Contracts ceases the deferral treatment set forth in Rev. Rul. 69-74 and causes recognition of any remaining gain. Furthermore, the disposition of the property that was exchanged for the Annuity Contracts may be relevant in determining the gain or loss realized. Each Trust shall recognize gain or loss as a result of such transfer in the tax year that includes such transfer in accordance with Rev. Rul. 55-119.

*Requested Ruling #2*

Section 61 (a)(3) provides that gross income includes gains derived from dealings in property.

Section 1001(a) provides that gain from the sale or other disposition of property is the excess of the amount realized over the adjusted basis provided in section 1011 for determining gain, and the loss shall be the excess of the adjusted basis over the amount realized.

Section 1001(b) provides, in part, that the amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

Treas. Reg. section 1.1001-2(a)(1) provides that the amount realized from a sale or other disposition of property generally includes the amount of liabilities from which the transferor is discharged as a result of the sale or disposition.

Section 752(d) provides that, in the case of a sale or exchange of an interest in a partnership, liabilities shall be treated in the same manner as liabilities in connection with the sale or exchange of property not associated with partnerships.

When a taxpayer conveys appreciated or depreciated property in satisfaction of an obligation or in exchange for the performance of services, that taxpayer must recognize gain or loss equal to the difference between the basis in the transferred property and the property's fair market value at the time of the transfer. See, e.g., United States v. Davis, 370 U.S. 65 (1962), International Freighting Corp., v. Commissioner, 135 F.2d 310 (2<sup>nd</sup> Cir. 1943), United States v. General Shoe Corp., 282 F.2d 9 (6<sup>th</sup> Cir. 1960); Wood v. Commissioner, 39 T.C. 1 (1962).

In Rev. Rul. 68-392, 1968-2 C.B. 284, a testator established a trust for the benefit of his daughter. Under the terms of the trust document, the trustee was directed to distribute 24x dollars to daughter annually for her life, first out of income of the trust and, if necessary, out of corpus. In its first taxable year, the trust had income of 10x dollars all of which was distributed to daughter. In satisfaction of her right to receive an additional 14x dollars, daughter accepted securities that were part of trust corpus. The securities had a fair market value of 14x dollars at the time of distribution and a basis of 12x dollars in the hands of trust. Rev. Rul. 68-392 concludes that transfer of the securities to daughter in partial satisfaction of the annuity obligation is treated as though the trustee had sold the securities to daughter for cash and immediately thereafter distributed the entire proceeds to her. Since the securities distributed had a fair market value in excess of their basis at the time of distribution, the gain (2x dollars) must be included in the gross income of the trust as capital gain.

In addition, Rev. Rul. 2007-40, 2007-1 C.B. 1426, concludes that a partnership realizes gain upon the transfer of appreciated property to one of its partners as a section 707(c) guaranteed payment in an amount equal to the difference between the partnership's adjusted basis in the property and the property's fair market value at the time of the payment.

In the instant case, each Trust is obligated to make fixed annuity payments to Grantor under the Annuity Contracts. Pursuant to the proposed transaction, following the assignment by Grantor of his rights and obligations under the Annuity Contracts to the Buyer, each Trust will transfer its Partnership Interest to the Buyer in exchange for the termination of the Annuity Contracts and the Cash Payment.

In determining the gain to be recognized by the Trusts in connection with the proposed sale, the Trusts' allocable share of liabilities with respect to their Partnership Interests must be taken into account both for purposes of determining the tax bases that the Trusts have in their Partnership Interests under sections 722 and 752(a) and also the amount realized by the Trusts in connection with the proposed sale under section 752(d).

Accordingly, we conclude that each Trust will recognize gain or loss as a result of the sale of its Partnership Interest to Buyer in the tax year that includes such sale in an amount equal to the difference between each Trust's adjusted basis in its Partnership Interest and the sum of (i) the Annuity Value; (ii) the Cash Payment, and (iii) the Trust's allocable share of the Partnership's liabilities immediately prior to the sale pursuant to section 752 (d).

### Conclusion

Based solely on the facts submitted and the representations made, we conclude as follows:

1. The transfer by each Trust of a portion of each Trust's Partnership Interest to the Buyer in exchange for the termination of the Annuity Contracts is treated as an annuity payment in an amount equal to the Annuity Value made under each of the Annuity Contracts under section 72. The termination of the Annuity Contracts ceases the deferral treatment set forth in Rev. Rul. 69-74 and causes recognition of any remaining gain. Furthermore, the disposition of the property that was exchanged for the Annuity Contracts may be relevant in determining the gain or loss realized. Each Trust shall recognize gain or loss as a result of such transfer in the tax year that includes such transfer in accordance with Rev. Rul. 55-119.



2. Each Trust will recognize gain or loss as a result of the sale of its Partnership Interest to the Buyer in the tax year that includes such sale in an amount equal to the difference between each Trust's adjusted basis in its Partnership Interest and the sum of (i) the Annuity Value, (ii) the Cash Payment, and (iii) the Trust's allocable share of the Partnership's liabilities immediately prior to the sale pursuant to section 752(d).

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) of the Code 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 representative.

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.

Sincerely,

/S/

Sheryl B. Flum  
Chief, Branch 4  
(Financial Institutions & Products)