INTERNAL REVENUE SERVICE
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Legend

Company =

State A =
Fund =
State B =

a =

Corporation X =
Class-1 Portfolios =
Class-2 Portfolios =

Class-3 Portfolios =

b =

c =

Dear

This refers to the letter dated November 10, 1999, which requests certain rulings relating to the qualification of a segregated asset account's investment in a regulated investment company for "look-through" treatment under § 817(h)(4) of the Internal Revenue Code and § 1.817-5(f) of the Income Tax Regulations. Additional information in connection with this ruling request was submitted by letter dated December 9, 1999.

Facts

Company is a stock life insurance company domiciled in State A which is subject to taxation as a life insurance company within the meaning of § 816. As part of its life insurance business, Company issues certain variable annuity and variable life insurance contracts (hereinafter referred to collectively as the "Contracts") which provide cash surrender values and other benefits that vary according to the investment experience of an underlying separate account. Some of the Contracts are "non-qualified" contracts that are purchased with "after-tax" money, whereas others are pension plan contracts within the meaning of § 818(a).

Some of Contracts offer a number of variable investment options as well as a fixed investment option. If the contract holder selects a fixed investment option, the applicable portion of the Contract premium less a contractual expense charge is generally held in Company's general investment account. The applicable portion of the Contract premium allocated by the contract holder to one or more of the Contract's variable investment options is transferred to Company's separate accounts. In accordance with the applicable agreements, all investment income and capital gains and losses (whether or not realized) from assets held in Company's separate accounts are credited to, or changed against, the contract holders' cash surrender values and other benefits under the Contracts. Company's separate accounts are registered with the SEC as unit investment trusts under the Investment Company Act of 1940 (the "1940 Act").

The assets of Company's separate accounts attributable to the Contracts are allocated among various sub-accounts. Each sub-account reflects one of the variable investment options of the Contracts and holds shares of a corresponding Portfolio of Fund, as described more fully below. The applicable portion of the Contract premium allocated by the contract holder to each variable investment option, and thus to each sub-account, is determined when a Contract is issued. The investment allocation under the Contract may be changed by the contract holder from time to time. Each of the sub-accounts of Company's separate accounts is a segregated asset account within the meaning of § 1.817-5(e).

Fund is organized as a State B corporation and is registered with the SEC as an open-end management investment company under the 1940 Act. Fund currently includes a separate investment Portfolios. Each Portfolio is a registered "series" of Fund and shares of each portfolio are registered under the Securities Act of 1933. Pursuant to § 851(g), each Portfolio will qualify as a regulated investment company under Part I of subchapter M of the Code and has its own investment objectives and strategies. Corporation X, a wholly owned subsidiary of Company, serves as the principal investment adviser to each of the investment portfolios of Fund.

Shares of the investment Portfolios of Fund are not for sale directly to the public, but are available only to Company's general account, through the ownership of a variable contract issued by Company and one or more other insurance companies, or by participation in certain qualified retirement plans that make one or more of the Portfolios available for investment. Thus, for

example, a contract holder that selects one of a Contract's variable investment options may not deal directly with Fund regarding the purchase or redemption of a Portfolio's shares. Rather, Company's separate accounts place orders to purchase and redeem shares of the Portfolios of Fund based on the investment allocations of the contract holders with respect to their individual Contracts.

Each sub-account of Company's separate accounts attributable to the Contracts invests in shares of either :

1. An investment Portfolio of Fund which invests directly in various types of securities, such as common stocks, bonds, government securities, or a portfolio of securities designed to track the performance of a benchmark index (a "Class-1 Portfolio"), or

2. An investment Portfolio of Fund which pursues an overall asset allocation program by investing exclusively in shares one or more of the Class-1 Portfolios (a "Class-2 Portfolio" or Class-3 Portfolio," as described below).

Each Class-1 Portfolio is required by its investment policies to manage its investment assets in a manner that will assure that those assets will always be adequately diversified within the meaning of § 817(h) and § 1.817-5(b).

Fund has offered b Class-2 Portfolios as an investment option for segregated asset accounts of Company and one or more other life insurance companies in connection with variable contracts (other than pension plan contracts as defined in § 818). Each of these Class-2 Portfolio pursues a particular asset allocation program by investing exclusively in one or more Class-1 Portfolios in different proportions based on an investor's risk tolerance, investment horizon, and personal objectives.

Fund has recently created c Class-3 Portfolios, shares of each of which are made available only to (i) Company's general account, (ii) qualified pension and retirement plans as defined in Rev. Rul. 94-62, and (iii) the segregated asset accounts of Company and one or more other life insurance companies in connection with pension plan contracts as defined in § 818(a). Each Class-3 Portfolio pursues a particular asset allocation program by investing exclusively in one or more Class-1 Portfolios in different proportions based on an investor's risk tolerance, investment horizon, and personal objectives. Although a particular Class-2 Portfolio and Class-3 Portfolio may pursue similar investment objectives, Fund currently imposes a lower level of expense charges on funds invested in a Class-3 Portfolio than with respect to funds invested in a Class-2 Portfolio.

Applicable law and analysis

Under § 817(h) of the Code, a segregated asset account upon which a variable annuity or life insurance contract (other than a pension plan contract) is based must be adequately diversified in accordance with regulations prescribed the Secretary in order for the variable contract to be treated as an annuity under § 72 or a life insurance contract under § 7702.[1]

Section 1.817-5 of the regulations provides guidance relating to the minimum level of diversification applicable to the investments underlying variable annuity and life insurance contracts. Generally, under § 1.817-5(b), the investments of a segregated asset account with respect to a variable contract will be considered adequately diversified only if no more than 55 percent of the value of the total assets of the account is represented by any one investment, no more than 70 percent by any two investments, no more than 80 percent by any three investments, and no more than 90 percent by any four investments.

Section 817(h)(4) and § 1.817-5(f) provide that in certain cases diversification may be satisfied under a "look-through" rule. Under § 817(h)(4), if all of the interests of a regulated investment company or trust are held by (a) one or more insurance companies (or affiliated companies) in their general account or in segregated asset accounts, or (b) fund managers (or affiliated companies) in connection with the creation or management of the regulated investment company or trust, the diversification requirements will be applied by taking into account the assets of such regulated investment company or trust. In effect, compliance with the diversification requirements is determined taking into account the underlying investments of the regulated investment company or trust in which the segregated asset account invests rather than treating the beneficial interest in such regulated investment company or trust as a single investment of a segregated asset account. See § 1.817-5(f)(1).

Section 1.817-5(f)(2)(i) provides, in relevant part, that the "look-through" rule will apply to a regulated investment company only if (i) all of the beneficial interests in the investment company (except as otherwise provided by § 1.817-5(f)(3)) are held by one or more segregated asset accounts of one or more life insurance companies , and (ii) public access to this investment company is available exclusively (except as otherwise provided by § 1.817-5(f)(3)) through the purchase of a variable contract.

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[1] The diversification requirements under § 817(h) apply to variable contracts other than pension plan contracts. Section 818(a) defines the term "pension plan contract" for this purpose to include a tax-sheltered annuity contract under § 403(b) and an individual retirement annuity contract under § 408(b). See §§ 818(a)(4) and (5). Thus, the diversification requirements apply to variable contracts purchased with "after-tax" monies, and do not apply to contracts which are tax-sheltered annuities or individual retirement annuities.

Section 1.817-5(f)(3) provides, in relevant part, that satisfaction of the ownership conditions set forth in § 1.817-5(f)(2)(i) will not be prevented if beneficial interests in a regulated investment company are held by:

> (i) The general account of a life insurance company or a corporation related in a manner specified in § 267(b) to a life insurance company, but only if the return on such interest is computed in the same manner as the return on an interest held by a segregated asset account is computed (determined without regard to expenses attributable to variable contracts), there is no intent to sell such interests to the public, and a segregated asset account of such life insurance company also holds a beneficial interest in the investment company, partnership, or trust;
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> (ii) The manager, or a corporation related in a manner specified in § 267(b) to the manager, of the regulated investment company, but only if the holding of the interests is in connection with the creation or management of the investment company, the return on such interest is computed in the same manner as the return on an interest held by a segregated asset account is computed (determined without regard to expenses attributable to variable contracts), and there is no intent to sell such interests to the public;
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> (iii) The trustees of a qualified pension or retirement plan; or
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> (iv) The public, or treated as owned by policyholders pursuant to Rev. Rul. 81-225, 1981-2 C.B. 12, but only if (1) the investment company, partnership or trust was closed to the public in accordance with Rev. Rul. 82-55, 1982-1 C.B. 12, or (2) all the assets of the segregated asset account attributable to premium payments prior to September 26, 1981, to premium payments made in connection with a qualified pension or retirement plan, or to any combination of such premium payments.

Rev. Rul. 94-62, 1994-2 C.B. 164, provides a list of various arrangements that will be treated as a "qualified pension plan" for purposes of the exception from the ownership conditions of § 1.817-5(f)(2)(i) provided by § 1.817-5(f)(3)(iii). Specifically, for purposes of § 1.817-5(f)(3)(iii), the term "qualified pension plan" includes: (i) a plan described in § 401(a) that includes a trust exempt from tax under § 501(a); (ii) an annuity plan described in § 403(a); (iii) an annuity contract described in § 403(b)(7); (iv) an individual retirement account described in § 408(a); (v) an individual retirement annuity described in § 408(b); (vi) a government plan within the meaning of § 414(d) or an eligible deferred compensation plan within the meaning of § 457(b); (vii) a simplified employee pension plan of an employer that satisfies the requirements of § 408(k); (viii) a plan described in § 501(c)(18); and (ix) any other trust, plan, account, contract, or annuity that the Internal Revenue Service has determined in a letter ruling to be within the scope of § 1.817-5(f)(3)(iii).

Ruling No. 1.

Section 1.817-5(f)(2)(i) provides that the "look-through" rule applies with respect to a segregated investment account's investment in a regulated investment company only if 1) all the beneficial interests of the regulated investment company are held by one or more segregated asset accounts of one or more life insurance companies, and (2) public access to interests in such regulated investment company is available exclusively (except as provided by § 1.817-5(f)(3)) through the purchase of a variable contract.

Subject to certain conditions, § 1.817-5(f)(3) permits the general accounts of life insurance companies (or affiliated companies), fund managers (or affiliated companies), and qualified pension and retirement plans to hold beneficial interests in a regulated investment company without violating the ownership conditions of § 1.817-5(f)(2)(i) for application of the "look-through" rule.

Under the proposed transaction, Company will create c different Class-3 Portfolios, each of which will pursue an overall asset allocation program by investing exclusively in shares of one or more of the Class-1 Portfolios. Shares of the Class-3 Portfolios will be available as an investment option only to (i) Company's general account, (ii) the segregated asset accounts of Company and one or more life insurance companies pursuant to pension plan contracts as defined in § 818(a), and (iii) qualified pension and retirement plans as defined in Rev. Rul. 94-62 as direct investments in such plans.

Company represents that all of the beneficial interests of Class-1 Portfolios have been held by segregated asset accounts of Company and one or more other life insurance companies in connection with variable contracts, and other investors permitted by § 1.817-5(f)(3). Company also represents that the return on the beneficial interests of a Class-1 Portfolio held by Company's general account is computed in the same manner as the return on interests in such Portfolio held by a segregated asset account is computed (without regard to expenses attributable to variable contracts) within the meaning of § 1.817-5(f)(3)(i).

Company further represents that these conditions will continue to apply after the Class-3 Portfolios begin to invest in the Class-1 Portfolios. Shares of Class-3 Portfolios will made be available only to Company in its general account and segregated asset accounts, to the segregated asset accounts of one or more other life insurance companies, and to qualified pension and retirement plans as defined in Rev. Rul. 94-62. Thus, the beneficial interests in the Class-1 Portfolios will continue to be held (either directly or indirectly) by segregated asset accounts of Company and one or more other life insurance companies in connection with variable contracts, and other investors permitted by § 1.817-5(f)(3). Accordingly, application of the "look-through" rule to a segregated asset account's interest in a Class-1 Portfolio is not prevented by reason of an investment in such Portfolio by a Class-3 Portfolio.

Ruling No. 2.

Section 817(h)(4) and § 1.817-5(f) provide that where a segregated asset account invests in a regulated investment company, and certain ownership requirements are met, the diversification requirements of § 817(h) and § 1.817-5(b) are applied by taking into account the assets held by such regulated investment company. Without this "look-through" rule, a segregated asset account that invests all of its assets in a regulated investment company would be treated as owning only one asset – the beneficial interest in the regulated investment company. If the "look-through" rule of § 817(h)(4) and § 1.817-5(f) applies, however, the underlying assets of the regulated investment company in which the segregated asset account invests its funds are examined in order to determine if the segregated asset account is adequately diversified under § 817(h) and § 1.817-5(b).

In this case, the "look-through" rule of § 817(h)(4) applies with respect to a segregated asset account's investment in a Class-2 Portfolio since, as noted above, the beneficial interests in the Class-2 Portfolio will held by segregated asset accounts of Company and one or more other insurance companies, and other holders expressly permitted by § 1.817-5(f)(3) and Rev. Rul. 94-62. In addition, public access to a Class-2 Portfolio currently is available exclusively through the purchase of a variable contract, except where shares are held by qualified pension and retirement plans for direct investment by such plans as permitted by § 1.817-5(f)(3) and Rev. Rul. 94-62.

As noted above, each Class-2 Portfolio pursues an overall asset allocation program by investing exclusively in shares of one or more Class-1 Portfolios. Interests in the Class-2 Portfolios are exclusively held by segregated asset accounts of Company and one or more other insurance companies, and holders expressly permitted by § 1.817-5(f)(3). Accordingly, under the "look-through" rule of § 817(h)(4) and § 1.817-5(f), it is appropriate to take into account the underling assets of the Class-2 Portfolio for purposes of determining whether a segregated asset account that invests in a Class-2 Portfolio is adequately diversified under § 817(h) and § 1.817-5(b). In turn, to the extent that a Class-2 Portfolio invests exclusively in shares one or more of Class-1 Portfolios, shares of which would otherwise qualify for "look-through" treatment under §§ 1.817-5(f)(2)(i) and 1.817-5(f)(3) if held directly by the segregated asset account, it is also appropriate under the "look-through" rule of § 817(h)(4) and § 1.817-5(f) for the segregated asset account to take into account a pro rata share of the assets of each Class-1 Portfolio in which the Class-2 Portfolio is invested.

Accordingly, based solely on the information submitted and the representations made in connection with Company's ruling request, we conclude as follows:

1. Satisfaction of the ownership requirements of § 1.817-5(f)(2)(i) with respect to a segregated asset account's beneficial interest in a Class-1 Portfolio will not be prevented by an investment in such Class-1 Portfolio by a Class-3 Portfolio.

2. For purposes of determining whether a segregated asset account that holds shares in a Class-2 Portfolio is adequately diversified under § 817(h) and § 1.817-5(b), the segregated asset account is treated under the "look-through" rule of § 817(h)(4) and § 1.817-5(f) as owning a pro rata share of the each of the investment assets of the Class-2 Portfolio. In turn, to the extent that the Class-2 Portfolio invests exclusively in shares of one or more Class-1 Portfolios, and the interest in such Class-1 Portfolios would qualify for "look-through" treatment if held directly by the segregated asset account, the segregated asset account is also treated under the "look-through" rule of § 817(h)(4) and § 1.817-5(f) as owning a pro rata share of each of the investment assets of the Class-1 Portfolio in which the Class-2 Portfolio is invested.

Except as specifically set forth above, no opinion is expressed as to the tax treatment of the Contracts under the provisions of any other section of the Code or regulations. Specifically, no opinion is expressed, except to the extent set forth above, as to the application of the investment control rules as set forth in Christoffersen v. United States, 749 F. 2d 513 (8th Cir. 1984), cert. denied 473 U.S. 905 (1985); Rev. Rul. 82-54, 1982-1 C.B. 11; Rev. Rul. 81-225, 1982-2 C.B. 12; Rev. Rul. 80-274, 1980-2 C.B. 27; and Rev. Rul. 77-85, 1977-1 C.B. 12.[2]

A copy of this ruling letter should be attached to Company's federal income tax returns for the taxable year in which the proposed transactions that are covered by this ruling letter is consummated.

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

Pursuant to a power of attorney on file in this office, a copy of this letter is being sent to Company's authorized representative.

Sincerely yours,

Assistant Chief Counsel
(Financial Institutions & Products)
By: /s/
Mark Smith
Chief, Branch 4

[2] Rev. Rul. 81-225 was clarified by Rev. Rul. 82-55, 1982-1 C.B. 12, and Rev. Proc. 99-44, 1999-48 I.R.B. 598.