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Person to Contact:

Telephone Number:

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April 27, 2000

Legend

Taxpayer =
Date A =
Form B =
Number C =
State D =
Location E =
Location F =
Amount G =
Amount H =
Amount I =
Percent J =
Percent K =
Amount L =

Dear

This is in reply to the letter from your representatives dated Date A in which you requested a ruling on behalf of Taxpayer with respect to contracts labeled Form B (the “Contracts”). Taxpayer requests that the Service rule as to the amount includible in gross income upon certain distributions made from the Contracts after the annuity starting date.

Taxpayer is a mutual life insurance company, as defined by section 816(a) of the Internal Revenue Code, and is subject to taxation under Part I of Subchapter L of the Code. Taxpayer is licensed to engage in the life insurance business in Number C states, the District of Columbia, Puerto Rico, and Canada. The Taxpayer is also an authorized reinsurer in State D. Taxpayer files its federal income tax returns with the Internal Revenue Service Center in Location E and is subject to the audit jurisdiction of the District Director in Location F.

The Contracts are immediate variable annuity contracts that provide for a stream of payments commencing within the period specified under sections 1.72-2(b)(2) and 1.72-4(b) of the Income Tax Regulations. Taxpayer represents that the Contracts qualify as annuity contracts under the applicable insurance law in each state in which they are sold. The Contracts also include provisions that Taxpayer represents comply with the requirements of section 72(s).

The Contracts are sold primarily, although not exclusively, to individuals who have reached or are near retirement age. Some of the Contracts have been used to receive rollover distributions from section 401(k) plans, individual retirement accounts, and similar tax-qualified arrangements.

Form B, upon which the Contracts are issued, makes available two specially designed features, which are:

(1) The right of the owner to make additional purchase payments into the Contract at any time after the initial purchase payment until the expiration of the life expectancy of the annuitant as of the date of issue (the cash value period); and

(2) The right of the owner to take withdrawals from the Contract's cash value during the cash value period.

The Contracts provide a cash value benefit throughout the cash value period which can be viewed as a period certain determined at issue of the contract. The period certain consists of the life expectancy of the annuitant(s) that fixes the cash value period as determined upon issuance of the Contract under Table V or Table VI (as applicable) of section 1.72-9 of the Income Tax Regulations. The owner of the Contract can withdraw all or a portion of the Contracts' cash value at any time during the cash value period. Any withdrawal will reduce the future minimum guaranteed annuity payment. The cash value period begins on the date of the first annuity payment and ceases upon expiration of the original life expectancy(ies) without regard to whether the annuitant may still be living. After the cash value period terminates, the owner has no right to make additional purchases into the Contract or to withdraw from the Contract.

Form B provides only for two payout options: a single life annuity or a joint life annuity where the annuitants are husband and wife and the payments continue through the survivor's life. The Contracts provide for a minimum guaranteed annuity payment. However, subject to this guarantee, the annuity payments and cash value of each Contract will vary in accordance with the investment performance of a separate account of Taxpayer. The separate account invests exclusively in a mutual fund available only though variable life insurance and annuity contracts issued by the Taxpayer. The particular mutual fund attempts to mirror the price and yield performance of the common stocks included in the Standard & Poor's Corporation 500 Companies Stock Price Index. Taxpayer represents that the diversification requirements of section 817 are satisfied through use of this investment arrangement.

Contracts may be purchased for an initial payment of at least Amount G and additional purchases may be made in amounts of at least Amount H. Aggregate purchases may not exceed Amount I. Each purchase payment is subject to sales charges, risk charges and, where applicable, state premium taxes. Annuity payments under any Contract must begin on a date that is no later than twelve months after the date the initial purchase payment is received. An initial annuity payment amount is calculated as of the issue date of the Contract by applying the applicable annuity purchase rate per $1,000 of purchase payment to the net amount paid. This initial annuity payment amount is converted into a fixed number of annuity units of the separate account supporting the Contract. Each annuity payment thereafter will be equal to the greater of

(1) The product of the number of annuity units allocated to the Contract by the value of an annuity unit on the date of the annuity payment, or

(2) The guaranteed minimum payment, which is equal to Percent J of the initial payment amount.

The annuity purchase tables used in the computation of the initial annuity payment amount reflect

(1) An assumed interest rate of Percent K,

(2) The Taxpayer's current mortality rates, and

(3) Assumed level annuity payments for the cash value period determined at the issue of each Contract.

Additional purchase payments applied to the Contract after the issue date affect both the number of annuity units allocated to the Contract and the guaranteed minimum payment in a complex, non-linear fashion not relevant to the rulings requested.

Owners of Contracts may also withdraw a portion of all of the cash value of the Contract during the cash value period. The cash value that may be withdrawn on any particular date is equal to the product of:

(1) The number of annuity units held under the Contract as of that date, times

(2) The value of an annuity unit on that date, times

(3) A cash value factor specified in the Contract for each date during the Contract's term of existence.

The cash value factor gradually decreases over the life expectancy of the annuitants, eventually reaching zero. The cash value factor is designed to provide funding for the obligation of the Taxpayer to provide continuing benefits under the Contracts during the cash value period and for the life (or lives) of the annuitant, even if the entire cash value is withdrawn.

Only the owner (or the designated beneficiary after the death of the annuitant) of the Contract may make withdrawals from the Contract. Each withdrawal must be of a minimum of Amount L, unless the remaining available cash value is less, in which case the total remaining cash value must be withdrawn. Any withdrawal reduces the number of annuity units and the amount of any subsequent annuity payments. However, as noted before, the Taxpayer remains liable to make payments, albeit at a considerably reduced level, until the death of the annuitant or the surviving annuitant even if the entire cash value is withdrawn.

In all events under which the future minimum guaranteed annuity payments are calculated, whether at issue, upon a withdrawal or upon receipt by the Taxpayer of an additional purchase payment, the determination will produce a level annuity payment for the remainder of the original cash value period, if the investment performance of the underlying separate account exactly equals Percent K. Further, if the performance of the underlying separate account exceeds Percent K, the excess is distributed currently. If the separate account underperforms, the annuitant may have his or her annuity payments reduced, subject to the minimum guaranteed annuity payment amount (Percent J of each newly determined level annuity payment amount).

The Contracts also provide a death benefit payable to a designated beneficiary if the annuitant, or, in the case of a joint and last survivor annuity, the last surviving annuitant, dies during the cash value period determined at issue. In general, the designated beneficiary may either receive a lump sum or continue the payments established by the owner for the remainder of the life expectancy of the annuitant, as determined at issue. The designated beneficiary also succeeds to the right to make withdrawals from the Contract during that period.

In general,[1] section 72 provides that distributions under an annuity contract will be taxed as ordinary income, subject only to reducing the taxable portion of the payments by an amount attributable to the annuitant's investment in the contract. To

[1] This discussion assumes an annuity contract issued after August 13, 1982 which has no investment in the contract or income on the contract attributable to periods before that date.

determine the tax treatment of payments from an annuity, payments made under the annuity contract are divided into two categories – amounts received as an annuity and amounts not received as an annuity. Section 72(b)(1) provides that, with respect to annuity payments, the portion of any amount received that is excludible from gross income is based on an exclusion ratio. The exclusion ratio is determined by dividing the investment in the contract by the expected return under the contract (the pro-rata rule).

Section 72(e) governs the tax treatment of payments received under an annuity contract that are not in the form of an annuity, such as cash withdrawals or dividend payments. For amounts received before the annuity starting date, section 72(e)(2)(B)(i) provides that the amount received is includible in the taxpayer’s gross income to the extent of the income on the contract (income-first rule). The income on the contract is equal to the excess of the cash value of the contract (determined without regard to any surrender charge) immediately before the amount is received, over the investment in the contract at such time. Section 72(e)(3). Section 72(e)(2)(A) provides that amounts not received as annuities that are paid after the annuity starting date are includible in the taxpayer’s gross income.

Section 72(e)(5)(E) provides a statutory exception to section 72(e)(2)(A). The rule of section 72(e)(2)(A) is not applicable if the amount received is “under a contract on its complete surrender, redemption, or maturity.” Section 72(e)(5)(A) provides that in situations in which paragraph (e)(5) applies, then paragraphs (2)(B) and (4)(A) shall not apply and if paragraph (2)(A) does not apply, then the amount distributed shall be included in gross income, but only to the extent that it exceeds the investment in the contract (basis-first rule). The basis-first rule provides that the taxpayer does not have to include any amounts into income to the extent that it does not exceed the taxpayer’s investment in the contract.

Based on the information submitted and on the representations made, it is held that any amount not received as an annuity under a Contract on or after the annuity starting date shall be included in gross income but, except for an amount in the nature of a dividend or similar distribution, only to the extent allocable to income on the contract.

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. Specifically, but not inclusively, we are not ruling on the effect of additional purchase payments paid after the issue date of any Contract nor on the effect on the exclusion ratio of any withdrawal made after that date.

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

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative. Further, a copy of this letter must be attached to any income tax return to which it is relevant.

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,

Associate Chief Counsel
(Financial Institutions & Products)

By: /s/
Donald J. Drees, Jr.
Senior Technician Reviewer
Branch 4