**Internal Revenue Service**

Number: **200508002**
Release Date: 2/25/05
Index Number: 817.08-04

Department of the Treasury
Washington, DC 20224

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Refer Reply To:
CC:FIP:4 / PLR-112415-04
Date:
September 30, 2004

Legend:

Company A =

Company B =

Company C =

Company D =

Company E =

Company F =

Company G =

Parent` =

State A =

State B =

T =

U =

V =

W =

X Structure =

Y Structure =

Z Structure =

Dear

This is in response to your letter dated February 19, 2004, requesting rulings on behalf of seven affiliated life insurance companies (the Companies) as listed above. The Companies have requested certain rulings with respect to the tax consequences stemming from certain investments by the Companies' separate accounts in the shares of certain regulated investment companies for purposes of applying the diversification requirements of section 817(h) of the Internal Revenue Code.

## FACTS

Each of the Companies is a life insurance company as defined in section 816(a) of the Code. Parent, a non-insurance company, is the common parent of the Companies, although not all of the Companies are included in Parent's life-nonlife consolidated return group due to the limitations in section 1504(c). Each Company issues variable life insurance contracts and/or variable annuity contracts that are variable contracts within the meaning of section 817(d). The variable contracts are based on one or more separate accounts maintained by the issuing Company and provide both fixed and variable investment options. Each separate account is segregated from the general asset account of the issuing Company pursuant to the requirements of state law or regulations. The assets of the separate accounts attributable to the contracts are allocated among various subaccounts. Each subaccount corresponds to a particular variable investment option available to the contract owner under the terms of the contract, and is comprised of assets that are consistent with the investment strategies and goals of that subaccount. The investment return and market value of the assets held by each subaccount are allocated in an

identical manner to any variable contract supported in whole or in part by that subaccount.

Each subaccount invests or will invest in shares of a particular regulated investment company (RIC) as defined in section 851(a). The assets of some of these RICs (the Lower-Tier Funds) are comprised of individual securities such as stocks and bonds. Other RICs in which the subaccounts invest (the Upper-Tier Funds) generally do not or will not hold individual securities, but rather hold or will hold primarily the shares of Lower-Tier Funds. Such arrangements are referred to as "master-feeder" arrangements (where multiple Upper-Tier Funds invest in a single Lower-Tier Fund) or "fund of funds" arrangements (where a single Upper-Tier Fund invests in multiple Lower-Tier Funds). The Upper-Tier Funds and the Lower-Tier Funds that are the subject of this ruling request comprise three groups of related RICs, referred to as Structure X, Structure Y, and Structure Z.

Although none of the Companies has invested or will invest through its separate accounts in each Upper-Tier and Lower-Tier Fund available through Structure X, Structure Y, or Structure Z, as the legal issues presented in applying the diversification requirements of section 817(h) to the Companies' respective investments in shares of these Funds are essentially the same, this ruling will be addressed using Company A and Company E, exemplars for all of the Companies.

Company A is a stock life and health insurance company organized under the laws of State A. Company A is licensed to do business in 49 states, the District of Columbia, and Puerto Rico. Company A does not join in the filing of a consolidated return with any other corporation. Company A issues variable annuity contracts that are supported by a separate account referred to as Separate Account B. In support of such variable annuity contracts, certain subaccounts of Separate Account B invest in Upper-Tier Funds available through Structure X. Company A generally employs X Structure Upper-Tier Funds in connection with variable contracts that have significant servicing and/or distribution costs. The X Structure Upper-Tier Funds provide Company A with flexibility in meeting its revenue requirements with respect to variable contracts in situations where a Lower-Tier Fund does not offer a class of shares suitable to meet these requirements.

The X Structure Upper-Tier Funds consist of three portfolios, each of which is a series of W, an open-end management investment company registered under the Investment Company Act of 1940 (the 1940 Act). Each X Structure Upper-Tier Fund invests in a single one of three corresponding X Structure Lower-Tier Funds. The X Structure Lower-Tier Funds are each a series of T, an open-end management investment company registered under the 1940 Act. Accordingly, each X Structure Upper-Tier Fund serves as a feeder for a corresponding X Structure Lower-Tier Fund.

In addition to investments in X Structure Upper-Tier Funds, Company A plans to offer holders of its variable annuity contracts additional investment options by creating additional subaccounts of Separate Account B that will invest in Upper-Tier Funds of Structure Y. The Y Structure Upper-Tier Funds will consist of four portfolios, each of which will be a series of W. Each Y Structure Upper-Tier Fund will invest in approximately five to ten Y Structure Lower-Tier Funds (although that number will vary), and may also invest directly in cash, government securities or other short-term investments. Currently, there are fifty-four Y Structure Lower-Tier Funds from which the investment manager of a Y Structure Upper-Tier Fund may choose. Each Y Structure Lower-Tier Fund may be a series of a proprietary Y Structure Fund, which will be an open-end management investment company registered under the 1940 Act.

In addition to the shares purchased by Y Structure Upper-Tier Funds, shares of Y Structure Lower-Tier Funds are or will be made available to other RICs, partnerships, or trusts that serve as investment vehicles for variable contracts issued by life insurance that are not affiliated with the Companies, but which satisfy the requirements of sections 1.817-5(f)(2)(i) and 1.817-5(f)(3) of the regulations (Third Party Funds). Moreover, shares of Y Structure Lower-Tier Funds are also offered for direct purchase by segregated asset accounts of life insurance companies; general accounts of life insurance companies, (or corporations that are related taxpayers as specified in section 267(b)); managers of the Lower-Tier Funds or related taxpayers of such managers; or trustees of qualified pension or retirement plans within the meaning of section 1.817-5(f)(3)(iii) of the regulations. Each Y Structure Lower-Tier Fund is treated as a separate RIC for federal income tax purposes and the shares each Lower-Tier Fund are registered under the 1933 Act.

Company E is a stock life and health insurance company organized under the laws of State B. Company E is licensed to conduct an insurance business in all 50 states, the District Columbia, Guam, Puerto Rico, and the U.S. Virgin Islands. Company E joins with its subsidiary (Company D, listed above) in the filing of a life-life consolidated federal income tax return. Company E issues both variable life insurance and variable annuity contracts. The variable life insurance contracts issued by Company E are supported by Company E's Variable Life B Separate Account. The variable annuity contracts issued by Company E are supported by Company E's Variable Annuity B Separate Account, Variable Annuity C Separate Account, and Variable Annuity D Separate Account. Subaccounts of Company E's separate accounts invest in Upper-Tier Funds available through Structure Z. The Z Structure Upper-Tier Funds consist of four portfolios, each of which will be a series of U, an open-end management investment company registered under the 1940 Act. Each Z Structure Upper-Tier Fund will invest in a single one of four corresponding Lower-Tier Funds. The Z Structure Lower-Tier Funds are each a series of V, an open-end management investment company registered under the 1940 Act. Accordingly, each Z Structure Upper-Tier Fund serves as a feeder to a corresponding Z Structure Lower-Tier Fund.

REPRESENTATIONS

The Companies make the following representations in connection with the ruling request:

1. Except as otherwise permitted by section 1.817-5(f)(3) of the regulations, (a) shares of each Upper-Tier Fund are or will be available exclusively for purchase by segregated asset accounts of life insurance companies in support of variable contracts as described in section 817(d), and (b) shares of each Lower-Tier Fund are or will be available exclusively for purchase by Upper-Tier Funds, Third Party Funds, or directly by segregated asset account of life insurance companies in support of variable contracts as described in section 817(d). Shares of each Fund will not be available for purchase by the general public, and will be registered under the 1933 Act. Each Upper-Tier and each Lower-Tier Fund will be treated as a separate RIC for federal income tax purposes pursuant to section 851(g).

2. Except as otherwise permitted by section 1.817-5(f)(3) of the regulations, all beneficial interests in any other RIC, partnership, or trust (a Third Party Fund) that purchases shares of a Lower-Tier Fund will be held by one or more segregated asset accounts of one or more insurance companies and public access to each Third Party Fund will be available exclusively through the purchase of a variable contract within the meaning of section 817(d).

3. To the extent the general account of a life insurance company or related taxpayer holds or will hold an interest in an Upper or Lower-Tier Fund, (i) the return on such interest is will be computed in the same manner that the return on an interest held by a segregated asset account is computed (determined without regard to expenses attributable to variable contracts); (ii) there is or will be no intent to sell such interest to the public; and (iii) a segregated asset account of the life insurance company also holds or will hold a beneficial interest in the Fund.

4. To the extent the manager of an Upper or Lower-Tier Fund, or a related taxpayer, holds or will hold an interest in the Fund, (i) the holding of such interest is or will be in connection with the creation or management of the Fund; (ii) the return on such interest is or will be computed in the same manner that the return on an interest held by a segregated asset account is computed (determined without regard to expenses attributable to variable contracts); and (iii) there is or will be no intent to sell such interest to the public.

## REQUESTED RULINGS

1. The diversification requirements of section 817(h) of the Code and section 1.817-5(b) of the regulations will be applied to a subaccount that invests directly in a Lower-Tier Fund by treating as an asset of the subaccount a pro rata share of each asset of the Lower-Tier Fund in accordance with sections 1.817-5(f)(1) and (2)(i) of the regulations.

2. The diversification requirements of section 817(h) of the Code and section 1.817-5(b) of the regulations will be applied to a subaccount that invest s in an Upper-Tier Fund by treating as an asset of the subaccount a pro rata share of each asset of any Lower-Tier Fund in which the Upper-Tier fund invests in accordance with sections 1.817-5(f)(1) and (2)(i) of the regulations.

## STATUTORY AND REGULATORY PROVISIONS

For purposes of part I of subchapter L of chapter 1 of the Code (sections 801-818), the term "variable contract" is defined in section 817(d). For an annuity contract to be a variable contract, (1) it must provide for the allocation of all or a part of the amounts received under the contract to an account which, pursuant to state law or regulation, is segregated from the general asset accounts of the issuing insurance company; (2) it must provide for the payment of annuities; and (3) the amounts paid in, or the amounts paid out, must reflect the investment return and the market return of the segregated asset account. See, § 817(d)(1) – (3).

Section 817(h)(1) of the Code provides that, for purposes of subchapter L, § 72 (relating to annuities), and § 7702(a) (relating to the definition of life insurance contract), a variable contract (other than a pension plan contract), which is otherwise described in § 817 and which is based on a segregated asset account, shall not be treated as an annuity, endowment, or life insurance contract for any period (and any subsequent period) for which the investments made by such account are not, in accordance with regulations prescribed by the Secretary, adequately diversified. Section 1.817-5(e) of the regulations provides that a segregated asset account shall consist of all the assets for which the investment return and market value is allocated in an identical manner to any variable contract invested in any of such assets.

Section 1.817-5 of the regulations sets forth the diversification requirements for variable contracts based on segregated asset accounts. Generally, the investments of a segregated asset account will be considered to be "adequately diversified" for purposes of § 817(h) of the Code and § 1.817-5 of the regulations 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. See § 1.817-5(b)(1).

In certain situations, § 817(h)(4) of the Code provides a "look-through" rule for meeting the diversification requirements. If all of the beneficial interests in a regulated investment company are held by one or more (A) insurance companies (or affiliated companies) in their general account or in segregated asset accounts, or (B) fund managers (of affiliated companies) in connection with the creation or management of the regulated investment company, the diversification requirements of section 817(h)(1) are applied by taking into account the assets held by such regulated investment company.

Section 1.817-5(f) of the regulations further describes the look-through rule for the application of the diversification requirements of § 1.817-5. Section 1.817-5(f)(1) provides that, if the look-through rule applies, a beneficial interest in a regulated investment company will not be treated as a single investment of a segregated asset account; instead, a pro rata portion of each asset of the investment company will be treated, for purposes of § 1.817-5, as an asset of the segregated asset account.

Section 817-5(f)(2)(i) of the regulations provides that the look-through rule of § 1.817-5(f) shall apply to an investment company if:

> (A) All the beneficial interest in the investment company (other than those described in § 1.817-5(f)(3)) are held by one or more segregated asset accounts of one or more insurance companies; and
>
> (B) Public access to such investment company is available exclusively (except as otherwise permitted under § 1.817-5(f)(3)) through the purchase of a variable contract. Solely for this purpose, the status of the contract as a variable contract will be determined without regard to § 817(h) of the Code and § 1.817-5 of the regulations.

The beneficial interests described in § 1.871-5(f)(3) are (i) under specified circumstances, the general account of a life insurance company or a corporation related in a manner specified in § 267(b) of the Code to a life insurance company; (ii) under specified circumstances, the manager, or a corporation related in a manner specified in § 267(b) to the manager of the investment company; (iii) the trustee of a qualified pension or retirement plan; and (iv) the public or policyholders that are treated as owners of beneficial interests in the investment company under Rev. Rul. 81-225, 1981-2 C.B. 12, but only if (A) the investment company was closed to the public in accordance with Rev. Rul. 82-55, 1982-1 C.B. 12, or (B) all the assets of the segregated asset account are attributable to premium payments made by policyholders 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.

Since 1977, the Service has issued a number of requested rulings addressing when the investor in a variable annuity contract has sufficient control over the underlying investments to be treated as the owner of those investments. Rev. Rul. 77-85, 1077-1 C.B. 12, concludes that if a purchaser of an "investment annuity" contract selects and controls the investment assets in the separate account of the issuing life insurance company, then the purchaser is treated as the owner of those assets for federal income tax purposes. Similarly, Rev. Rul. 80-274, 1980-2 C.B. 27 holds that where an S&L depositor transfers a certificate of deposit (C.D.) to a life insurer in exchange for an annuity contract, and the life insurer is expected to continue to hold the C.D. for the benefit of the depositor, the depositor (not the insurance company) is considered the owner of the D.C. for tax purposes.

Revenue Ruling 81-225, 1981-2 C.B. 12, clarified by Rev. Rul. 82-55, 1982-1 C.B. 12, and Rev. Rul. 2003-92, 2003-2 C.B. 350, describes four situations in which investments in mutual funds to fund annuity contracts are considered to be owned by the policyholder, rather than by the insurance company issuing the annuity contracts, and one situation in which the insurance company is considered the owner of the mutual fund shares. In situation 1, the investment assets in the segregated account supporting the annuity contracts consist solely of shares in a single, publicly available mutual fund managed by an independent investment advisor. Situation 2 is similar to situation 1 except that the mutual fund is managed by the insurance company or one of its affiliates. Situation 3 also is similar to situation 1 except that the segregated asset account supporting the annuity contracts consists of five subaccounts. The policyholder retains the right to allocate or reallocate funds among the five subaccounts during the life of the annuity contract. Situation 4 is similar to situation 2, except that the shares of the mutual fund are not sold directly to the public, but are available only through the purchase of an annuity contract or by participation in an investment plan account of the type described in Rev. Rul. 70-525, 1970-2 C.B. 144. Situation 5 also is similar to situation 2, except that the shares in the mutual fund are available only through the purchase of an annuity contract.

Rev. Rul. 81-225 concludes that the policyholders in situations 1 – 4 have sufficient control and other incidents of ownership to be considered the owners of the mutual fund shares for federal income tax purposes. The ruling reaches the opposite conclusion in situation 5, because the sole function of the mutual fund in situation 5 is to provide an investment vehicle to allow the insurance company to meet its obligations under its annuity contracts, and the insurance company possesses sufficient incidents of ownership to be considered the owner of the underlying portfolio of assets of the mutual fund. Thus, the ruling concludes that in situation 5, the insurance company, not the policyholder, is treated as the owner of the mutual fund shares for federal income tax purposes.

In Rev. Rul. 82-54, 1982-1 C.B. 11, the purchasers of certain annuity contracts have the right to direct the issuing insurance company to invest in the shares of any or

all of three mutual funds that are not available to the public. One mutual fund invests primarily in common stocks, another in bonds, and a third in money market investments. Policyholders are free to allocate their premium payments among the three funds and have an unlimited right to reallocate contract values among the funds prior to the maturity date of the annuity contract. The ruling concludes that the policyholders' ability to choose among general investment strategies (for example, between stocks, bonds, or money market instruments) either at the time of the initial purchase, or subsequent thereto, does not constitute sufficient control so as to cause the policyholders to be treated as the owners of the mutual fund shares.

In Christoffersen v. United States, 749 F. 2d 513 (8th Cir. 1984), cert. denied 473 U.S. 905 (1985), the court upheld the investor control theory of Rev. Rul. 81-255. The taxpayers in Christoffersen purchased a variable annuity contract that reflected the investment return and market value of assets held in a separate account that was segregated from the general assets of the issuing insurance company. The taxpayers had the right to direct that their premium payments be invested in any one or all of six publicly traded mutual funds. The taxpayers could reallocate their investment among the funds at any time, and had the right to make withdrawals, to surrender the contract, and to apply the accumulated value under the contract to provide annuity payments. The court held that the taxpayers, and not the issuing insurance company, owned the mutual funds for federal income tax purposes.

In Rev. Rul. 2003-91, 2003-2 C.B. 347, holders of variable annuity contracts were not considered the owners of the assets in which the funds invested even though the policyholders had the ability to allocate the premium paid among various subaccounts, change such allocations at any time and transfer funds from one subaccounts to another. The investment in the subaccounts was available solely through purchase of variable annuity contracts and was not otherwise publicly available. Moreover, the policyholders were not able to communicate directly or indirectly with the investment advisors regarding the investment strategies of the subaccounts. Rev. Rul. 2003-91 concludes that the policyholders did not have direct or indirect control over any of the assets in the subaccounts and, therefore, would not be treated as the owners of such assets.

Since all of the shares of the Lower-Tier Funds will be held by either segregated asset accounts or subaccounts of life insurance companies or Upper -Tier Funds and public access to the Lower-Tier Funds is available exclusively through the purchase of variable annuity contracts or variable life insurance policies (except as otherwise permitted by Treas. Reg. § 1.817-5(f)(3), the requirements of § 1.817-5(f)(2) of the regulations are satisfied with respect to segregated asset accounts or subaccounts that invest in the Lower-Tier Funds. Pursuant to the look-through rule of §1.817-5(f)(1) a pro rata portion of each asset of the Lower-Tier Fund will be treated as an asset of each segregated asset account or subaccount that invests a Lower-Tier Fund.

Similarly, the requirements of § 1.817-5(f)(2) of the regulations are satisfied by the indirect investment of segregated asset accounts and subaccounts in shares of any Lower-Tier Fund through an investment in an Upper-Tier Fund. Therefore, pursuant to the look-through rule of § 1.817-5(f)(1) a pro rata portion of each asset of any such Lower-Tier Fund will be treated as an asset of each segregated asset account or subaccount that indirectly invests in a Lower-Tier Fund through investment in a Upper-Tier Fund.

HOLDINGS

Based solely upon the information provided and the representations made, we conclude:

1. The look-through rule of Treas. Reg. §1.817-5(f) will apply to a subaccount that invests in shares of a Lower-Tier Fund such that a pro rata share of the assets of the Lower-Tier Fund will be treated as assets of the subaccount for purposes of applying the diversification test of section 817(h) of the Code.

2. The look-through rule of Treas. Reg. §1.817-5(f) will apply to a subaccount that invests in an Upper-Tier Fund such that a pro rata share of the assets of any Lower-Tier Fund in which the Upper-Tier Fund invests will be treated as assets of the subaccount for purposes of applying the diversification test of section 817(h) of the Code.

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, no opinion is expressed concerning the application of the investor control rules set forth in Christoffersen, or Rev. Ruls. 2003-92, 2003-91, 81-225, 80-274 and 77-85.

This ruling is directed only to the taxpayers 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.

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,

/S/

Gary Geisler
Assistant to the Branch Chief, Branch 4
Office of Associate Chief Counsel

(Financial Institutions & Products)