Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact:
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In Re:

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Date:
September 30, 2005

Taxpayer =

Parent =

Subsidiary =

Company X =

State =

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Dear

This is in response to the letter submitted by your authorized representative dated April 8, 2005, requesting a ruling on whether assets held in certain variable contract segregated asset accounts are to be treated for federal income tax purposes as owned by Taxpayer. Additional information was submitted in letters dated August 8, 2005 and August 31, 2005.

FACTS

Taxpayer is a life insurance company taxable under § 816(a) of the Internal Revenue Code and is licensed to conduct an insurance business in 49 states and the District of Columbia. Taxpayer is a wholly owned subsidiary of Parent and is a stock life insurance company organized under the laws of State. Taxpayer and its wholly owned subsidiary, Subsidiary, file a consolidated income tax return on a calendar year basis.

Taxpayer issues deferred and immediate variable annuity contracts (the "Contracts") The Contracts currently offer up to v variable investment options and a fixed investment option. Only Taxpayer can add or remove investment options under the Contracts.

The portion of a premium, less any applicable state and local taxes related to the premium (a "net premium"), allocated by the owner of a Contract to the fixed investment option under the Contract is held in Taxpayer's general account. The portion of a net premium allocated to the variable investment options under a Contract is held in a separate account (the "Separate Account"), which is registered with the Securities and Exchange Commission (the "SEC") as a unit investment trust under the Investment Company Act of 1940, as amended (the "1940 Act").

The assets of the Separate Account are currently allocated among sub-accounts (the "Existing Sub-Accounts") that correspond to the variable investment options under the Contracts. Taxpayer represents that the owners of the Contracts do not possess investment control and sufficient other incidents of ownership over the assets in the Existing Sub-Accounts to be considered the owner of those assets for federal income tax purposes. Each Existing Sub-Account invests all of its assets in a regulated investment company (an "Existing Fund").

Taxpayer will establish w new sub-accounts (the "New Sub-Accounts") of the Separate Account. Each New Sub-Account will represent an investment strategy based on the approximate year of a Contract holder's retirement. Each New Sub-Account will invest all of its assets in a regulated investment company (a "New Fund").

Taxpayer represents that all segregated asset accounts under the Contract are adequately diversified within the meaning of § 817(h). Taxpayer represents that, except as otherwise permitted by § 1.817-5(f)(3) of the Income Tax Regulations, all the beneficial interests in each of the Existing Funds and New Funds ("Insurance Funds") are held by one or more insurance companies and that public access to each of the Insurance Funds is available exclusively through the purchase of a variable contract. Each Insurance Fund is a Massachusetts business trust registered with the SEC under the 1940 Act as an open-end management investment company, and shares of each

Insurance Fund are registered with the SEC under the Securities Act of 1933, as amended.

Initially, each New Fund will invest solely in funds from a certain subset of the Existing Funds (the "Second-Tier Insurance Funds"). However, each New Fund can choose to invest a portion of its assets from among x funds that are available to investors other than through the purchase of a variable contract ("Public Funds"). All Public Funds are managed by Company X or its affiliates. Company X is an affiliate of Taxpayer and is a wholly owned subsidiary of Parent. No more than y% of a New Fund's total assets will be invested in any single Public Fund and no more than z% of a New Fund's total assets will be invested in any combination of Public Funds. If fluctuations in the market values of Second-Tier Insurance Funds and Public Funds cause a New Fund's investments in Public Funds to exceed the y% and z% limits as of the last day of any fiscal quarter, the New Fund's investments will be reallocated to comply with the limits within 30 days of the end of such quarter. Each Public Fund invests in many assets.

The specific assets held by each New Fund will be determined by an investment manager ("Investment Manager"), and will be subject to change at any time. Other than a Contract owner's ability to allocate premiums and transfer dollars among the various New Funds, all investment decisions regarding the New Funds will be made by the Investment Manager in its sole and absolute discretion. A Contract owner will not be able to direct a New Fund's investment in any particular asset, and there will be no agreement or plan between Taxpayer and a Contract owner, or between the Investment Manager and a Contract owner, regarding such an investment. A Contract Owner has no knowledge of the present assets invested by a New Fund and has no knowledge of the specific investment techniques of the Investment Manager.

A Contract owner will have no legal, equitable, direct, or indirect ownership interest in any of the New Fund assets. Rather, the Contract owner will have only a contractual claim against Taxpayer to collect cash under the terms of the Contract.

REQUESTED RULING

The assets of each New Sub-Account will be treated for federal income tax purposes as owned by Taxpayer and not by the owner of a Contract.

LAW

Section 61(a) provides that the term "gross income" means all income from whatever source derived, including gains derived from dealings in property, interest and dividends.

Section 817(d) defines a “variable contract” as a contract that provides for the allocation of all or part of the amounts received under the contract to an account that, pursuant to state law or regulation, is segregated from the general asset accounts of the company and that provides for the payment of annuities, or is a life insurance contract.

Section 817(h)(1) provides that, for purposes of subchapter L and § 7702(a) (relating to definition of life insurance contract), a variable contract (other than a pension contract), that is otherwise described in § 817 and that is based on a segregated asset account, shall not be treated as a 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 817(h)(4) provides, in certain situations, a "look-through" rule for meeting the diversification requirements. If all of the beneficial interests in a regulated investment company or trust 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 (or affiliated companies) in connection with the creation or management of the regulated investment company, the diversification requirements of § 817(h) are applied by taking into account the assets held by such regulated investment company.

Section 1.817-5 are the regulations prescribed by the Secretary that set forth the diversification requirements for variable contracts. Generally, the investments of a segregated asset account will be considered to be "adequately diversified" for purposes of § 817(h) and § 1.817-5 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 per cent by any four investments. See § 1.817-5(b)(1).

Section 1.817-5(f)(1) provides that, if the "look-through" rule applies, a beneficial interest in an investment company, partnership, or trust will not be treated as a single investment of the segregated asset account. Instead, a pro rata portion of each asset of the investment company, partnership, or trust is treated, for purposes of § 1.817-5, as an asset of the segregated asset account.

Section 817 was enacted by Congress as part of the Deficit Reduction Act of 1984 (Pub. L. No. 98-369) (the “1984 Act”). In the legislative history of the 1984 Act, Congress expressed its intent to deny annuity or life insurance treatment to any variable contract if the assets supporting the contract include funds publicly available to investors:

> The conference agreement allows any diversified fund to be used as the basis of variable contracts so long as all shares of the funds are owned by one or more segregated asset accounts of insurance companies, but only if access to the fund is available exclusively through the purchase of a variable contract from an insurance company. . . . In authorizing Treasury

> to prescribe diversification standards, the conferees intend that the standards be designed to deny annuity or life insurance treatment for investments that are publicly available to investors . . .

H.R. Conf. Rep. No. 98-861, at 1055 (1984).

Approximately two years after enactment of § 817(h), the Treasury Department issued proposed and temporary regulations prescribing the minimum level of diversification that must be met for an annuity or life insurance contract to be treated as a variable contract within the meaning of § 817(d). The preamble to the regulations stated as follows:

> The temporary regulations . . . do not provide guidance concerning the circumstances in which investor control of the investments of a segregated asset account may cause the investor, rather than the insurance company, to be treated as the owner of the assets in the account. For example, the temporary regulations provide that in appropriate cases a segregated asset account may include multiple sub-accounts, but do not specify the extent to which policyholders may direct their investments to particular sub-accounts without being treated as owners of the underlying assets. Guidance on this and other issues will be provided in regulations or revenue rulings under section 817(d), relating to the definition of variable contracts.

51 FR 32633 (Sept. 15, 1986). The text of the temporary regulations served as the text of proposed regulations in the notice of proposed rulemaking. See 51 FR 32664 (Sept. 15, 1986). The final regulations adopted, with certain revisions not relevant here, the text of the proposed regulations.

A long standing doctrine of taxation provides that "taxation is not so much concerned with the refinements of title as it is with actual command over the property taxed--the actual benefit for which the tax is paid." Corliss v. Bowers, 281 U.S. 376 (1930). The incidence of taxation attributable to ownership of property is not shifted if the transferor continues to retain significant control over the property transferred, Frank Lyon Company v. United States, 435 U.S. 561 (1978); Commissioner v. Sunnen, 333 U.S. 591 (1948); Helvering v. Clifford, 309 U.S. 331 (1940), without regard to whether such control is exercised through specific retention of legal title, the creation of a new equitable but controlled interest, or the maintenance of effective benefit through the interposition of a subservient agency. Christoffersen v. U.S., 749 F.2d 513 (8th Cir.), rev'g 578 F. Supp. 398 (N.D. Iowa 1984).

Rev. Rul. 77-85, 1977-1 C.B. 12, considers a situation in which the individual purchaser of a variable annuity contract retains the right to direct the custodian of the account supporting that variable annuity to sell, purchase, and exchange securities or other assets held in the custodial account. The purchaser also is able to exercise an

owner's right to vote account securities either through the custodian or individually. The Service concludes that the purchaser possesses "significant incidents of ownership" over the assets held in the custodial account. The Service reasons that if a purchaser of an "investment annuity" contract can select and control the investment assets in the separate account of the life insurance company issuing the contract, then the purchaser is treated as the owner of those assets for federal income tax purposes. Thus, any interest, dividends, or other income derived from the investment assets is included in the purchaser's gross income.

In Rev. Rul. 80-274, 1980-2 C.B. 27, the Service, applying Rev. Rul. 77-85, concludes that, if a purchaser of an annuity contract can select and control the certificates of deposit supporting the contract, then the purchaser is considered the owner of the certificates of deposit for federal income tax purposes. Similarly, Rev. Rul. 81-225, 1981-2 C.B. 12, concludes that investments in mutual fund shares to fund annuity contracts are considered to be owned by the purchaser of the annuity if the mutual fund shares are available for purchase by the general public. Rev. Rul. 81-225 also concludes that, if the mutual fund shares are available only through the purchase of an annuity contract, then the sole function of the fund is to provide an investment vehicle that allows the issuing insurance company to meet its obligations under its annuity contracts and the mutual fund shares are considered to be owned by the insurance company. Finally, in Rev. Rul. 82-54, 1982-1 C.B. 11, the purchaser of certain annuity contracts can allocate premium payments among three funds and has an unlimited right to reallocate contract value among the funds prior to the maturity date of the annuity contract. Interests in the funds are not available for purchase by the general public, but are instead only available through purchase of an annuity contract. The Service concludes that the purchaser's ability to choose among general investment strategies (for example, between stock, bonds, or money market instruments) either at the time of the initial purchase or subsequent thereto, does not constitute control sufficient to cause the contract holders to be treated as the owners of the mutual fund shares.

In Christoffersen v. U.S., the Eighth Circuit considered the federal income tax consequences of the ownership of the assets supporting a segregated asset account. The taxpayers in Christoffersen purchased a variable annuity contract that reflected the investment return and market value of assets held in an account that was segregated from the general asset account of the issuing insurance company. The taxpayers had the right to direct that their premium payments be invested in any one of six publicly traded mutual funds. The taxpayers could reallocate their investment among the funds at any time. The taxpayers also had the right upon seven days notice to withdraw funds, surrender the contract, or apply the accumulated value under the contract to provide annuity payments. The Court of Appeals held that the taxpayer, not the insurance company that issued the annuity contract, owned the mutual fund shares for Federal income tax purposes. Thus, the taxpayers were required to include in gross income any gains, dividends, or other income derived from the mutual fund shares.

In Rev. Rul. 2003-91, 2003-33 I.R.B. 347, a variable contractholder does not have control over segregated account assets sufficient to be deemed the owner of the assets. The variable contracts at issue are funded by a separate account that is divided into 12 sub-accounts. The issuing insurance company can increase or decrease the number of sub-accounts at any time, but there will never be more than 20 sub-accounts available under the contracts. Each Sub-account offers a different investment strategy. Interests in the sub-accounts are available solely through the purchase of a Contract. The investment activities of each sub-account are managed by an independent investment advisor. There is no arrangement, plan, contract, or agreement between the contractholder and the issuing insurance company or between the contractholder and the independent investment advisor regarding the availability of a particular sub-account, the investment strategy of any sub-account, or the assets to be held by a particular sub-account. Other than a contractholder's right to allocate premiums and transfer funds among the available sub-accounts, all investment decisions concerning the sub-accounts are made by the issuing insurance company or the independent investment advisor in their sole and absolute discretion. A contractholder has no legal, equitable, direct, or indirect interest in any of the assets held by a sub-account but has only a contractual claim against the issuing insurance company to collect cash in the form of death benefits or cash surrender values under the contract. The Service concludes that based on all the facts and circumstances, the contractholder does not have direct or indirect control over the separate account or any sub-account asset, and therefore the contractholder does not possess sufficient incidents of ownership over the assets supporting the variable contracts to be deemed the owner of the assets for federal income tax purposes.

ANALYSIS

The determination of whether the owner of a Contract possesses sufficient incidents of ownership over New Sub-Account assets to be deemed the owner of the assets depends on all of the relevant facts and circumstances.

All investment decisions regarding the New Funds will be made by the Investment Manager in its sole and absolute discretion. A Contract owner will not be able to direct a New Fund’s investment in any particular asset, and there will be no agreement or plan between Taxpayer and a Contract owner, or between the Investment Manager and a Contract owner, regarding such an investment.

The investment strategies of the New Sub-Accounts currently available are sufficiently broad to prevent the owner of a Contract from making particular investment decisions through investment in a New Sub-Account. Only Taxpayer can add or remove investment options under the Contracts.

Shares of each New Fund will be available only to one or more segregated asset accounts of one or more insurance companies or to investors described in § 1.817-

5(f)(3) for the purpose of funding variable contracts. Thus, New Fund shares are not sold directly to the general public.

Based on all the facts and circumstances, a Contract owner does not have direct or indirect control over the Separate Account or any sub-account asset. Taxpayer represents that the owners of the Contracts do not possess investment control and sufficient other incidents of ownership over the assets in the Existing Sub-Accounts to be considered the owner of those assets for federal income tax purposes. The owner of a Contract will not be treated as the owner of the investments underlying the Contract by reason of the addition of the New Funds. Therefore, the assets of each New Sub-Account will be treated for federal income tax purposes as owned by Taxpayer and not by the owner of a Contract. So long as the Contracts continue to satisfy the diversification requirements of § 817(h) and Taxpayer's and Contract owner's future conduct is consistent with the facts of this ruling request, the Contract owner will not be required to include the earnings on the assets held in the New Sub-accounts in income under § 61(a).

Except as expressly provided herein, no opinion is expressed concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. The rulings contained in this letter are based upon information and representations submitted by Insurer 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. 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.

Sincerely,
/S/

DONALD J. DREES, JR.
Senior Technician Reviewer
Branch 4
Office of Associate Chief Counsel
(Financial Institutions & Products)