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Person To Contact:
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Refer Reply To:
CC:FIP:B04
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Date
September 30, 2005

Legend

Taxpayer =

Subsidiary A =

Country X =

State 1 =

State 2 =

Number Z =

BBs =

CCs =

DDs =

Dear

This letter is in response to the ruling request filed on behalf of Taxpayer, dated April 18, 2005. The Taxpayer has requested a ruling with respect to certain assets held by the Taxpayer in a variable annuity separate account.

FACTS:

Taxpayer is a stock life insurance company, as defined in § 816(a), and is subject to taxation under Part I of Subchapter L of the Code. Taxpayer is organized and operated under the laws of State 1, and maintains its executive offices in State 2. Taxpayer also has a branch office in Country X. Taxpayer files a consolidated income tax return with its wholly owned subsidiary, Subsidiary A, on a calendar year basis, and each company reports its income on an accrual method. Taxpayer is licensed to conduct a life insurance business, and issues variable life and/or variable annuity contracts, in Number Z states and the District of Columbia, and in Country X.

Taxpayer represents that it has recently begun to issue group variable annuity contracts through its branch office in Country X (the Contracts). The assets supporting the Contracts are held in a separate account (the Separate Account) established under the laws of State 1. Taxpayer further represents that the income, deductions, assets, and liabilities associated with the Separate Account will be maintained separately from Taxpayer's other accounts.

Taxpayer reports that the Contracts are issued to pension plan trustees and sponsors to fund the obligations of various types of defined contribution pension plans (the Plans). The Plans are established under the laws of Country X by Country X employers. The Plans are the Contract holders. Under the Plans, amounts are contributed by or on behalf of employee Plan members (Members), and then used to fund the Contracts. Taxpayer states that it will establish an "account" for each Member to separately account for that Member's Contract amounts.

Taxpayer represents that the Contract amounts are invested in one or more of the investment options available under the Contracts (the Underlying Investment Assets), as directed by the Members. Per Taxpayer, the number of investment options varies by Plan, but there is no limit on the maximum number of investment options that can be made available. Each Plan permits Members to reallocate their Contract amounts on a specified frequency.

As explained in Taxpayer's submission, the investment options under a Contract include BBs, which are the equivalent of the subaccounts or subdivisions of a separate account used in connection with U.S. variable contracts. Each BB invests in one or more of three different types of assets: (1) units of Country X investment funds known as CCs (described by Taxpayer as similar to a type of U.S. "private placement" investment fund); (2) units of Country X investment funds known as DDs (per Taxpayer these are essentially the same as U.S. mutual funds); and (3) shares of stock of the Country X employer that established the Plan.

Taxpayer represents that all of the assets that fund the Plans are, and will be, available for purchase directly by the public without the purchase of a Contract, although some of these assets (i.e., units in CCs) are available to only large, sophisticated investors.

As represented by Taxpayer, under the Contracts, a Member is vested in and is entitled to receive the value of his or her account, as permitted under the laws of Country X. The value of the account at any time is based upon the value of the CC or DD units (or employer stock) allocable to such account. The Contract does not contain any permanent annuity purchase rate guarantees or any other type of insurance guarantee. However, at retirement, a Member may elect to have his or her account applied to provide immediate annuity payments by Taxpayer. In that event, Taxpayer will withdraw from the Member's account the amount necessary to provide the annuity payments, which will be determined based on the current annuity purchase rates then in effect by Taxpayer. Taxpayer expects, however, that Members will rarely, if ever, elect this option. Should a Member elect to purchase an annuity, the Member will pay a fee to Taxpayer.

Taxpayer represents that the Contracts do not impose any surrender charges. However, periodic asset-based fees and charges are imposed by Taxpayer on each account under a Contract (Contract Charges). Taxpayer further represents that the Contracts do not comply with § 72(s), do not qualify as "variable contracts" for purposes of § 817(d), are not "pension plan contracts" within the meaning of § 818(a), and do not comply with the diversification requirements of § 817(h) and the regulations thereunder.

LAW AND ANALYSIS

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.

Since 1977, the Service has issued a number of revenue rulings addressing when an investor in a contract has sufficient control over the underlying investments to be treated as the owner of those investments. Rev. Rul. 77-85, 1977-1 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. Rev. Rul. 77-85 also states that:

> [B]ecause the insurance company receives nothing until a portion of the custodial account is liquidated and remitted to it by the custodian as either charges or premiums due under the contract, the insurance company should only include the premiums and charges paid each year in its premium income for that year under section 809(c)(1) of the Code (predecessor of current § 803(a)(1)).

Similarly, Rev. Rul. 80-274, 1980-2 C.B. 27 holds that where a savings and loan 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 C.D for tax purposes.

Rev. Rul. 81-225, 1981-2 C.B. 12, clarified and amplified by Rev. Rul. 2003-92, 2003-2 C.B. 350, analyzes five situations involving purported variable "annuity" contracts. In four of the situations, the ruling concludes that the contracts are not annuity contracts and that prior to the annuity starting date the contract holders are the owners of the assets held by the insurance company with regard to the contracts. In these situations, the insurance company holds shares of mutual funds that are directly or indirectly available to the public. In the fifth situation, the contract holder can invest only in a non-publicly-available mutual fund managed by the insurance company or one of its affiliates. The shares in that mutual fund are available only through the purchase of an annuity contract. In that situation, the ruling concludes that the insurance company is treated as the owner of the mutual fund shares held by the company for the contracts.

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. 81-225. 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 subaccount 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.

In Rev. Rul. 2003-92, 2003-2 C.B. 350, a holder of a variable annuity or life insurance contract is the owner of interests in a nonregistered partnership where interests in the nonregistered partnership are not available exclusively through the purchase of a life insurance or annuity contract. The ruling concludes that, pursuant to § 61(a), the owner of interests held in a Sub-account must include in its gross income any interest, dividends, or other income derived from the interests held in the Sub-account in the year in which the interest, dividends, or other income is earned.

Section 817 was enacted as part of the Deficit Reduction Act of 1984 (Pub. L. No. 98-369). In the legislative history of that act, Congress expressed its intent to deny life insurance treatment to any variable contract containing segregated accounts backed by publicly available funds. H.R. Conf. Rep. No. 98-861, at 1055 (1984).

HOLDING

Taxpayer will not be considered the owner of the Underlying Investment Assets for federal income tax purposes.

This ruling makes no conclusion regarding the federal income tax liability of the Plans.

The ruling contained in this letter is 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.

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.

A copy of this letter must be attached to any income tax return to which it is relevant.

Sincerely,

/S/

Donald J. Drees, Jr.
Senior Technical Reviewer, Branch 4
Office of Associate Chief Counsel
(Financial Institutions & Products)