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Legend

Parent =
Company 1 =
Company 2 =
State 1 =
State 2 =
Licensed Jurisdictions 1 =

Licensed Jurisdictions 2 =

Dear :

I. STATEMENT OF FACTS

Companies make the following representations:

Company 1 is a stock life insurance company organized under the laws of State 1. Company 1 is a life insurance company within the meaning of § 816(a), and is licensed to engage in the life insurance and annuity business in Licensed Jurisdictions 1.

Company 2 is a stock life insurance company organized under the laws of State 2. Company 2 is a life insurance company within the meaning of § 816(a), and is licensed to engage in the life insurance business in Licensed Jurisdictions 2. Company 1 and Company 2 (each a “Company” and together the “Companies”) join in the filing of a consolidated federal income tax return on a calendar year basis, using an accrual method of accounting of which Parent is the parent.

The Companies intend to issue a form of deferred "annuity" contract (the "Contracts") that provides no cash value or death benefits during the deferral period (the "Deferral Period").[1] Each Contract constitutes an annuity contract under the laws of each state or other jurisdiction in which it will be issued.

The Annuitant is the natural person (or persons) on whose life (or lives) Contract benefits are based, *i.e.*, the Annuitant is the measuring life under the Contract.[2] The Annuitant cannot be changed after the Contract is issued. However, once the Deferral Period ends and the Owner becomes eligible to access the cash value and elect annuity payments, the Owner may change the Annuitant and the payee in connection with electing an annuity payment option ("Annuity Payment Option").

A Contract is purchased by an Owner with an initial premium payment. The Owner may make, but is not required to make, additional premium payments (subject to certain limitations) after issuance, but prior to the Maturity Date (which will occur on or after the last day of the Deferral Period (the "Deferral Period End Date")). However, during a period of time prior to the Deferral Period End Date, referred to as the Premium Restriction Period, no additional premiums will be accepted. Premiums paid, net of applicable taxes and less a premium expense charge (the "Premium Expense Charge"), are credited to the contingent account value (the "Contingent Account Value") for a Contract.

The premiums paid for the Contracts will be accounted for on the Companies' NAIC Annual Statements as annuity considerations and will be subject to state premium taxes where applicable. The initial premium payment, any subsequent premium payments, and any applicable) are credited to the Contract's Contingent Account Value.

The account value is referred to as "contingent" because the Owner's access to the value is contingent upon the Annuitant surviving to the Deferral Period End Date. Premiums are allocated to

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[1] A rider, amendment or endorsement to a Contract may provide for a death benefit during the Deferral Period.

[2] The Contract also permits two joint Annuitants.

As is the case with typical deferred annuity products,

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. An annual administrative charge may be deducted from the Contingent Account Value on each applicable contract anniversary (“Contract Anniversary”) as shown on the Contract schedule page. During the Deferral Period, there is no death benefit, and the Contract has a Cash Value of zero. As a result, there is no cash surrender value available for either a complete or partial withdrawal, nor can the Contract be annuitized. On the Deferral Period End Date, the Contract’s Contingent Account Value becomes the cash value under the Contract and is fully accessible by the Owner.

The Contract provides for the crediting

The applicable is specified in the Contract schedule page, will be specific to each Contract, and will not change after the Contract has been issued. The is determined based on the age(s) and gender(s) of the Annuitant(s) and the length of the Deferral Period. In order to receive a on any given Contract Anniversary, the Annuitant must be living on that date. The schedule of Deferral Credits included in any given Contract will depend , but once the Contract is issued, the Company cannot change the schedule.

The is an amount that rewards a particular Annuitant’s continued survival, and reflects the fact that other Annuitants under other Contracts will not survive to the end of their Deferral Period. However, the Contingent Account Value depends on the value of the

, the Contingent Account Value could decrease from one year to the next.

The Deferral Period extends from the date the Contract is issued until the Deferral Period End Date. The Owner selects the Deferral Period at the time the Contract is issued. There are several constraints on the selection of the Deferral Period. The Deferral Period cannot extend beyond the Maturity Date, but can end prior to the Maturity Date within the foregoing constraints. Once the Contract has been issued, the Deferral Period cannot be changed.

After the Deferral Period ends and prior to the Maturity Date, the Cash Value of a Contract is equal to the Contingent Account Value. At the end of the Deferral Period, the Contract provides for a variety of different benefits, including a death benefit, the right to receive annuity payments at guaranteed rates, the right to surrender the Contract for its Cash Value, and the right to take partial withdrawals of the Cash Value. These benefits are only available, however, if the Annuitant is alive at the end of the Deferral Period. Loans are not available under the Contract at any time.

If the Owner dies during the Deferral Period, the Contract does not provide for the payment of any death benefit. However, after the end of the Deferral Period, but prior to the Maturity Date, a Death Benefit is payable to the Beneficiary upon the death of the Owner. The amount of the Death Benefit equals the Contingent Account Value.

Each Contract has a Maturity Date, which must meet certain requirements. The Maturity Date cannot be changed once the Contract has been issued. If the Contract is in force on the Maturity Date and the Owner does not surrender the Contract, the Contingent Account Value will be applied to provide a single life annuity with a 10 year period certain. The Maturity Date may be the same date as the Deferral Period End Date, or, within the constraints applicable to the Maturity Date and the Deferral Period described above, it may be a date later than the Deferral Period End Date.

The Contract terminates on the earliest of certain specified dates, depending on whether the Deferral Period has ended. During the Deferral Period, the Contract terminates on the earlier of (1) the date of death of the Annuitant, or (2) the date that the Contingent Account Value is reduced to zero. The Contract cannot be surrendered or otherwise voluntarily terminated during the Deferral Period. After the end of the Deferral Period, the Contract terminates on the earliest of (1) the date the Contingent Account Value is reduced to zero, (2) the date the Owner elects an Annuity Payment Option, (3) the date the Contract is surrendered, or (4) the Maturity Date.

Each Contract will comply with the requirements of § 72(s). A Contract will not be issued to a non-natural holder in circumstances that would cause the Contract not to be treated as an annuity contract under § 72(u)(1).

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II. REQUESTED RULING

The Companies have requested the Service to rule that the Contracts constitute annuity contracts for purposes of § 72.

III. STATEMENT OF LAW

Section 72(a) provides that except as otherwise provided, gross income includes any amount received as an annuity (whether for a period certain or during one or more lives) under an annuity, endowment, or life insurance contract. The Code does not otherwise define an annuity contract or "any amount received as an annuity."[3]

Section 1.72-2(a)(1) of the Income Tax Regulations provides that the contracts under which amounts paid will be subject to the provisions of § 72 include contracts which are considered to be life insurance, endowment, and annuity contracts in accordance with the customary practice of life insurance companies.

Section 1.72-2(b)(2) describes the circumstances under which amounts subject to § 72 are considered "amounts received as an annuity." Amounts received as an annuity must (1) be received on or after the 'annuity starting date' as defined in § 1.72-4(b); (2) be payable in periodic installments at regular intervals over a period of more than one full year from the annuity starting date; and (3) have the total amount be determinable at the annuity starting date ether directly from the terms of the contract or indirectly by the use of either mortality tables or compound interest computations, or both.

Explaining imposition of an "income-out-first" rule under §72(e) for withdrawals prior to the annuity starting date, the Senate report described a commercial annuity as

> a promise by a life insurance company to pay the beneficiary a given sum for a specified period, which period may terminate at death. Annuity contracts permit the systematic liquidation of an amount consisting of principal (the policyholder's investment in the contract) and income. . . . An individual may purchase an annuity by payment of a single premium or by making periodic payments. A deferred annuity contract may, at the election of the individual, be surrendered before annuity payments begin, in exchange for the cash value of the contract.

S. Rep. No. 97-494 at 349 (1982)(footnote omitted).

The report also explains an exclusion ratio regime: "[a] portion of each amount paid to a policyholder as an annuity generally is taxed as ordinary income under an 'exclusion ratio' (§ 72(b)) computed to reflect the projected nontaxable return of investment in the

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[3] Section 72 does have special definitional rules, however they do not define "annuity contract." For example, § 72(s) states that a contract will not be treated as an annuity contract for purposes of the Code unless it provides for certain distributions upon the death of the holder. In addition, § 72(u) states that a contract held by a non-natural person "shall not be treated as an annuity contract for purposes of this subtitle (other than subchapter L)," subject to certain exceptions.

contract and the taxable growth on the investment." Id. As described in *Samuel v. Commissioner*, 306 F.2d 682, 687 (1st Cir. 1962), aff'g *Archibishop Samuel Trust v. Commissioner*, 36 T.C. 641 (1961), acq., 1964-2 C.B. 3,

> [i]nherent in the concept of an annuity is a transfer of cash or property from one party to another in return for a promise to pay a specific periodic sum for a stipulated time interval. . . . Again, in the normal annuity situation, once the annuitant has transferred the cash or property to the obligor and has received his contractual right to periodic payments, he is unconcerned with the ultimate disposition of the property transferred once it is in the obligor's hands.

Apart from the regulations, a number of cases and rulings have construed the term "annuity contract" for purposes of § 72 or its predecessor statutes. For example, in *Bodine v. Commissioner*, 103 F.2d 982, 984 (3d Cir. 1939), the court stated, "[i]n our opinion an annuity may be described as a sum paid yearly or at other specified intervals in return for the payment of a fixed sum by the annuitant." However, the case law and the Service's rulings also hold that an annuity contract should be distinguished from an agreement to pay interest and, therefore, the contract must provide for periodic payments that will liquidate a fund. For example, in *Igleheart v. Commissioner*, 174 F.2d 605, 606 (7th Cir. 1949), the court stated that "an annuity has as its basic function the systematic liquidation of the principal." *See also Comm'r v. Meyer*, 139 F.2d 256 (6th Cir. 1943). Similarly, in Rev. Rul. 75-255, 1975-2 C.B. 22, the Service observed that a necessary element of an annuity is that the periodic payments made under the contract consist in part of a return of the premiums paid for the contract.

IV. ANALYSIS

A. The Contracts Are Annuity Contracts In Accordance with the Customary Practice Of Life Insurance Companies.

The Contracts have zero Cash Value during the Deferral Period, but, notwithstanding, are annuity contracts in accordance with the customary practice of life insurance companies. Like a traditional deferred variable annuity contract, premiums are

. The difference is that the contingent cash value under the Contracts – the Contingent Account Value – is not made available to the Owner during the Deferral Period. Additionally, the Contracts will be treated as annuity contracts in the states in which they will be issued.

During the first half of the 20th century, insurance companies issued deferred annuity contracts that, like the Contracts, did not have any cash value during the deferral stage and did not provide any death benefit or refund feature should the Annuitant die during this time. In 1947, the Treasury Department conducted a study of the tax rules applicable to pensions and annuity contracts. *See* U.S. DEPT. OF TREASURY, THE INCOME TAX TREATMENT OF PENSIONS AND ANNUITIES, Appendix D (1947) (hereafter "Treasury Report"). In this study, the Treasury Department specifically recognized a class of deferred annuity contracts that had no cash value.[4] Furthermore, insurance texts and law review articles from the first half of the 20th century describe deferred annuity contracts with deferral characteristics similar to the Contracts. See, S.S. Huebner, Life Insurance 59, 115 (1919); MacLean, Life Insurance 62 (2d ed. 1929); Robert Meisenholder, *Taxation of Annuity Contracts under Estate and Inheritance Taxes*, 39 Mich. L. Rev. 856, 860 (1941). There is also no indication that § 72 or § 1.72-2 intended to exclude annuity contracts without cash value from annuity treatment.

In light of the fact that the Contracts are substantially similar to typical deferred annuities and the history of annuity contracts without a cash value during a deferral period, we do not believe that survival of the Annuitant through the Deferral Period is an inappropriate contingency for the vesting of Cash Value and the application of annuity treatment to the Contracts.

B. The Contracts Are Not Contracts That Make Periodic Payments of Interest

In addressing the definition of an annuity contract, courts have described an annuity contract as a contract under which the issuer, in exchange for consideration, promises to pay a stated sum of money periodically over a term of years or for life. *See*, *e.g.*, *Bodine v. Comm'r*, 103 F.2d 982, 985 (3d Cir.), *cert. denied*, 308 U.S. 576 (1939) ("[A]n annuity may be described as a sum paid yearly or at other specified intervals in return for the payment of a fixed sum by the annuitant."); *Manne v. Comm'r*, 155 F.2d 304, 306 (8th Cir. 1946); *Silberman v. U.S.*, 333 F. Supp. 1120, 1126 (W.D. Pa 1971). However, courts have distinguished between periodic payments under an annuity versus periodic payments of interest. *See*, *e.g.*, *Igleheart v. Comm'r*, 174 F.2d 605, 606 (7th Cir. 1949); *Comm'r v. Meyer*, 139 F.2d 256, 259 (6th Cir. 1943).

The Contracts are not periodic payments of interest. The Owner pays premiums to the Companies, which are credited to a fund – the Contingent Account Value – where they accumulate earnings. In exchange for these premiums, the insurance company promises to make periodic payments under various annuity options at any time after the end of the Deferral Period, and these annuity options involve the systematic liquidation

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[4] The Treasury Report classified deferred annuity contracts as "refund" or "nonrefund." A nonrefund deferred annuity contract is one where there is no cash value, so that there is no refund of premiums paid in the event of the death of the annuitant during the deferral period. *See id*. Appendix D, at 1.

of a fund and not the payment of interest if and when payments are made upon reaching the Maturity Date or when the Owner elects an Annuity Payment Option.[5]

Pursuant to § 1.72-2(b)(2), amounts received under the Contracts are amounts received as an annuity. They are received on or after the "annuity start date" as defined in § 1.72-4(b); they are payable in periodic installments at regular intervals and over a period of more than one full year from the annuity start date; and the total amount is determinable at the annuity start date either directly from the terms of the contract or indirectly by the use of either mortality tables or compound interest computations or both.

The Service has concluded that an annuity contract is distinguishable from periodic payments of interest, and that the former involves the liquidation of a fund. *See*, *e.g.*, Rev. Rul. 75-255. The Service has also addressed the circumstances when a deferred annuity contract should be treated as a valid annuity contract for federal income tax purposes. If a contract lacks permanent annuity purchase rate guarantees, it should not be treated as an annuity. *See*, *e.g.*, Rev. Rul. 77-286, 1977-2 C.B. 228; GCM 39270 (Aug. 3, 1984); GCM 38378 (May 16, 1980).

The Contracts are annuity contracts. The Contracts provide for periodic payments that are designed to liquidate a fund. In addition, the Contracts contain permanent annuity purchase rate guarantees which allow the owner of a Contract to have the Contingent Account Value of the Contract applied to provide a stream of annuity payments for life or a fixed term at any time after the Deferral Period. The amount of such annuity payments is determined under rates guaranteed in the Contract, which cannot be changed by the Companies.

V. CONCLUSION

Based upon the foregoing facts and representations, and for the reasons discussed above, the Contracts constitute annuity contracts for purposes of § 72.

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

[5] Since the Contracts have no Cash Value or death benefit during the Deferral Period, the amount of annuity payments that an Owner is entitled to receive after the end of the Deferral Period is higher than it would otherwise have been because the Companies credit the Contract Owners with .

this letter, including any that may raise issues relating to the applicability of the investor control doctrine to the Contract.

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.

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/

Sheryl B. Flum
Branch Chief, Branch 4
(Financial Institutions & Products)