Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

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Date:
November 29, 2012

Taxpayer	=
Date 1	=
Date 2	=
Date 3	=
Foreign Country	=
Fund 1	=
Fund 2	=
General Partner	=
Parent	=
Separate Account 1	=
Separate Account 2	=
State Z	=
X	=
Y	=
Year 1	=
Year 2	=
Year 3	=

Dear :

This is in response to the letter submitted by your authorized representatives, dated July 20, 2012, requesting rulings on whether each of Fund 1 and Fund 2 will be treated as satisfying the diversification requirements of § 817(h) of the Internal Revenue Code (the "Code").

I. FACTS

Taxpayer

Taxpayer was incorporated under the laws of Foreign Country. Taxpayer's principal office is located in Foreign Country. Taxpayer is licensed to engage in the life

insurance business in Foreign Country and is not licensed to engage in such business in any U.S. jurisdiction.

Pursuant to § 953(d), Taxpayer elected to be treated as a domestic corporation for federal tax purposes in Year 1. The Internal Revenue Service accepted Taxpayer's election in Year 2, effective for Taxpayer's taxable year commencing on Date 1. As a result, Taxpayer is taxed as a domestic life insurance company under § 801.

Taxpayer is a wholly-owned, third-tier subsidiary of Parent. Taxpayer and Parent file a consolidated federal income tax return with other includible affiliates on an accrual accounting, calendar year basis.

Contracts

As part of its business, Taxpayer issues variable life insurance contracts (the "Contracts"). Each Contract permits the contractholder to allocate premium payments among one or more variable investment options. Each variable investment option corresponds to a segregated asset account. The Separate Accounts include Separate Account 1 and Separate Account 2 (together, the "Separate Accounts"). The Service previously recognized that Taxpayer's separate accounts maintained under the laws of Foreign Country are segregated from its general asset accounts "pursuant to State law or regulation" for purposes of § 817(d)(1) in PLR 201027038 (March 31, 2010).

All amounts invested in the Separate Accounts are invested in corresponding funds. All amounts invested in Separate Account 1 are invested in Fund 1; all amounts invested in Separate Account 2 are invested in Fund 2 (together with Fund 1, the "Funds").

Under the Contracts, each contractholder has the right, subject to certain contractual limitations, to: (1) reallocate Contract values from one variable investment option to another; (2) withdraw cash from the Contract, and (3) surrender the Contract for its cash surrender value (collectively, the "Cash Value Requests"). Taxpayer has represented that as part of the Proposed Transaction a Cash Value Request cannot be used to reallocate funds from Fund 1 to Fund 2, or vice-versa, and new amounts cannot be invested in either Fund 1 or Fund 2. Under the Contracts, General Partner in its role as the manager of each Fund may suspend its obligation to satisfy immediately Cash Value Requests in the manner described below in order to protect the best interests of all the investors in each Fund.

Funds

Each Fund is a limited partnership under the laws of State Z and is treated as a partnership for federal income tax purposes. Each Separate Account is a limited partner in the Fund to which it corresponds, i.e., Separate Account 1 is a limited partner

in Fund 1 and Separate Account 2 is a limited partner in Fund 2. General Partner is the general partner and investment manager of each Fund.

Except as otherwise permitted by Treas. Reg. § 1.817-5(f)(3), all beneficial interests in each Fund are held by the corresponding Separate Account and other segregated accounts of life insurance companies. Public access to each Fund is available exclusively through the purchase of variable contracts within the meaning of § 817(d).

Underlying Assets

The Funds primarily invest the amounts received under the Contracts in other investment pools (e.g., partnerships or limited liability companies) and managed accounts (the "Investment Vehicles"), as well as other assets (together with the Investment Vehicles, the "Underlying Assets"). There are two types of Investment Vehicles: Investment Vehicles that are not managed by General Partner and for which General Partner is not the general partner ("Unaffiliated Investment Vehicles"), and Investment Vehicles that are managed by General Partner and for which General Partner is the general partner ("Affiliated Investment Vehicles"). The recent economic crisis resulted in significant investment losses for the Investment Vehicles. As a result, the managers of some of the Unaffiliated Investment Vehicles have suspended or otherwise restricted the ability of the Funds to redeem the Funds' investment interests in the Unaffiliated Investment Vehicles in connection with the liquidation of those Unaffiliated Investment Vehicles. These redemption restrictions are being imposed on the Funds, in their capacity as investors in the Unaffiliated Investment Vehicles, by the managers of the liquidating Unaffiliated Investment Vehicles and are beyond the control of the Funds or General Partner.

In addition to the redemption restrictions and suspensions being imposed on the Funds by the managers of the Unaffiliated Investment Vehicles, General Partner has suspended redemptions from the Affiliated Investment Vehicles. Under its obligations to all investors in the Affiliated Investment Vehicles under federal securities law, General Partner is obligated to act in the best interests of all of the investors. All investors in the Affiliated Investment Vehicles are subject to the same redemption restrictions. Taxpayer represents that the decision to suspend redemptions from the Affiliated Investment Vehicles was based entirely on non-tax considerations and was not intended to facilitate any particular tax result for the Funds. The Funds own, directly and indirectly, between approximately % and % of the interests of any particular Affiliated Investment Vehicle and the remaining interests in each such Affiliated Investment Vehicle are owned by investors other than the Funds. The Funds' ownership interests in the Affiliated Investment Vehicles are de minimis relative to the ownership interests of the other investors.

General Partner does not expect to acquire any assets for the Affiliated Investment Vehicles. There may be circumstances, however in which General Partner in its role as manager of the Affiliated Investment Vehicles finds it necessary to acquire new assets for an Affiliated Investment Vehicle's portfolio in order to protect the best interests of all of the investors in that Affiliated Investment Vehicle. Any such acquisition activity will be limited to situations in which General Partner determines that it is in the best economic interests of all investors in the Affiliated Investment Vehicles to acquire an asset in order to protect or preserve the value of existing investments or to prevent or limit losses on existing investments. Any such activity will occur in the normal course of General Partner managing the assets of an Affiliated Investment Vehicle, consistent with General Partner's objective of liquidating and redeeming all interests therein as soon as reasonably practicable.

As of Date 2, Fund 1 had received redemption requests totaling approximately X% of its net asset value. As of Date 3, Fund 2 had received redemption requests totaling approximately Y% of its net asset value. As a result of suspensions and other redemption restrictions imposed by the managers of the Investment Vehicles described above, for reasons beyond the control of either the Funds or General Partner, the Funds are no longer able to satisfy immediately Cash Value Requests.

In Year 3, General Partner suspended its obligation to fulfill Cash Value Requests. General Partner will redeem all of the contractholders' interests in each Fund, regardless of whether General Partner has received a Cash Value Request from every contractholder. As a result of the Proposed Transaction described below, each Fund will redeem all of the limited partners' interests in each Fund. Pursuant to the Proposed Transaction, described below, General Partner will redeem all of the limited partners' interests in the Funds on a pro rata basis by distributing cash generated from the disposition of the Investment Vehicles and other Underlying Assets.

II. PROPOSED TRANSACTION

To facilitate the pro rata redemption of the limited partners' interests in the Funds, as described above, Taxpayer proposes to engage in the following transaction with respect to each Fund (the "Proposed Transaction"):

1. Each Fund will distribute some or all of the cash it may currently hold to its limited partners.
2. As each Fund receives additional amounts of cash, it will distribute that cash on a pro rata basis to its limited partners. The additional amounts of cash may result from either a payment generated by an Underlying Asset or through the disposition of an Underlying Asset.
3. Shortly after receiving the cash with respect to its Underlying Assets, each Fund will distribute the cash it receives to its respective limited partners pro rata based on each limited partner's capital account.

4. The Funds will not use the cash to purchase other assets or increase the Funds' investment in any of the existing Underlying Assets. Neither Fund will exchange any of its assets for any other non-cash assets.
5. Taxpayer, which holds its limited partnership interest in each Fund through a Separate Account, will transfer any cash it receives as part of the Proposed Transaction in accordance with contractholders' instructions pursuant to Cash Value Requests. While a contractholder may reallocate cash received under a Contract to another investment option under the Contract, a contractholder may not reallocate any cash received in the Proposed Transaction to either Fund 1 or Fund 2.
6. With respect to each Fund, the Proposed Transaction will last until each Fund has redeemed all of its limited partners' interests. The Proposed Transaction is expected to last multiple calendar quarters. Taxpayer has represented that the Proposed Transaction will be completed as soon as reasonably practicable.

As a result of engaging in the Proposed Transaction, Taxpayer expects that during the Proposed Transaction a discrepancy may arise between each Fund's holdings and the diversification requirements of § 817(h). Taxpayer expects that any such discrepancy between the asset composition of either Fund and the diversification requirements of § 817(h) would continue for multiple calendar quarters.

III. ADDITIONAL REPRESENTATIONS

In addition to the facts and representations presented above, Taxpayer has also made the following representations:

1. With respect to the Unaffiliated Investment Vehicles, General Partner will not directly or indirectly attempt to influence the investment manager of any Unaffiliated Investment Vehicle to engage in any activity involving the acquisition of assets. The independent investment managers of the Unaffiliated Investment Vehicles may decide on their own to engage in such activity, and General Partner would have no control over such decisions.
2. Neither Fund will increase or otherwise modify its non-cash holdings as part of the Proposed Transaction.
3. Each Fund will be adequately diversified within the meaning of § 817(h) at the end of the calendar quarter immediately preceding the calendar quarter in which the Proposed Transaction first occurs and each Separate Account has satisfied the diversification requirements of § 817(h) since its inception.
4. The Contracts are variable contracts within the meaning of § 817(d).
5. The Contracts qualify as life insurance contracts for federal income tax purposes.

6. Other than any discrepancy that may arise in connection with the Proposed Transaction, each Fund has satisfied and will satisfy the diversification requirements under § 817(h).

IV. REQUESTED RULING

Under Treas. Reg. § 1.817-5(d) any discrepancy that may arise as a result of the Proposed Transaction would not cause either Fund 1 or Fund 2 to fail the diversification requirements of § 817(h) in the calendar quarter in which such discrepancy arises or any subsequent calendar quarter.

V. LAW AND ANALYSIS

Section 817(d) defines the term "variable contract" for purposes of Part I of Subchapter L of the Code. A life insurance contract is one type of variable contract recognized under § 817(d). For a life insurance contract to be a variable contract, all or part of the amounts received by the insurance company pursuant to the contract must be allocated to a segregated asset account which, pursuant to State law or regulation, is separate from the general assets of the insurance company. In addition, the amount of the contractholder's death benefit (or the period of coverage) must be adjusted on the basis of the investment return and the market value of the segregated asset account. § 817(d).

Section 817 was enacted as part of the Deficit Reduction Act of 1984, Pub. L. No. 98-369. The Conference Report to the Deficit Reduction Act of 1984, H.R. Conf. Rep. No. 98-861, at 1055 (1984), indicates that "[i]n 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 and investments which are made, in effect, at the direction of the investor." In addition to the diversification requirements under § 817, the investor control doctrine applies to determine whether a variable contract based on a given segregated asset account qualifies for treatment as a life insurance contract. *See e.g.,* Rev. Rul. 77-85, 1977-1 C.B. 12; *see also* T.D. 8101, 1986-2 C.B. 97 (providing that the diversification rules do not override the investor control doctrine). Taxpayer has represented that the Contracts qualify as life insurance contracts for federal income tax purposes.

Section 817(h)(1) generally provides that a variable contract that otherwise meets the requirements of § 817 shall not be treated as a life insurance contract for any period (and for any subsequent period) for which the investments made by the underlying segregated asset account are not adequately diversified in accordance with Treasury regulations. Section 1.817-5(b) of the regulations states the diversification requirements for variable contracts based on segregated asset accounts, including variable life insurance contracts. Generally, the investments of a segregated asset account are considered to be adequately diversified for purposes of § 817(h) if there are

at least five investments and no more than 55 percent of the total asset value of the segregated asset 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. The diversification of segregated asset accounts is tested quarterly. Treas. Reg. § 1.817-5(c).

For purposes of applying the diversification requirements of § 817(h), a look-through rule in Treas. Reg. § 1.817-5(f) applies to a segregated asset account's assets held through a partnership. The look-through rule only applies to a partnership if all beneficial interests in the partnership are held by one or more segregated asset accounts of one or more insurance companies, or as otherwise described in Treas. Reg. § 1.817-5(f)(3). Treas. Reg. § 1.817-5(f)(2)(A). Interests in the partnership must also be available exclusively through the purchase of a variable contract. Treas. Reg. § 1.817-5(f)(2)(B). If the look-through rule applies, the partnership interest of the segregated asset account is not treated as a single investment of the segregated asset account. Instead, the regulations look through the partnership to the partnership's assets. A pro rata portion of each partnership asset is treated as an asset of the segregated asset account. Each partner's ratable interest in a partnership asset is determined in accordance with the partner's capital interest in the partnership. Treas. Reg. § 1.817-5(f)(1).

Treas. Reg. § 1.817-5(d) provides that a segregated asset account that satisfies the diversification requirements stated in Treas. Reg. § 1.817-5(b) at the end of any calendar quarter (or within 30 days after the end of such calendar quarter) shall not be considered nondiversified in a subsequent quarter because of a discrepancy between the value of its assets and the diversification requirements unless such discrepancy exists immediately after the acquisition of any asset and such discrepancy is wholly or partly the result of such acquisition. Treas. Reg. § 1.817-5(d) does not provide an exception to the diversification requirements of § 817(h). In the interests of sound tax administration, the regulation clarifies that neither holding assets in nor disposing assets from a segregated asset account, which otherwise satisfied the diversification requirements at the end of the preceding calendar quarter (or within 30 days thereafter), does not give rise to a failure to meet the diversification requirements in a subsequent quarter. The regulation provides that there is no failure to meet the diversification requirements in such situations unless the discrepancy exists immediately after the acquisition of any asset and such discrepancy is wholly or partly the result of such acquisition (and the discrepancy is not remedied within 30 days after the end of the calendar quarter in which such post-acquisition discrepancy arises).

Taxpayer has represented that each Contract is a variable contract within the meaning of § 817(d) and qualifies as a life insurance contract. Taxpayer has represented that each of Separate Account 1 and Separate Account 2 is a segregated asset account. For a Contract to be treated as a variable contract, the segregated asset account underlying each Contract must be diversified. Taxpayer has represented that

the diversification requirements must be applied at the Fund level according to the look-through rule in Treas. Reg. § 1.817-5(f).

Taxpayer has represented that each Fund will be adequately diversified within the meaning of § 817(h) at the end of the calendar quarter immediately preceding the calendar quarter in which the Proposed Transaction first occurs. Neither Fund will increase or otherwise modify its non-cash holdings as part of the Proposed Transaction. Although neither Fund will increase or otherwise modify its non-cash holdings as part of the Proposed Transaction, each cash distribution a Fund makes will reduce its overall holdings such that the relative value of the Fund's remaining assets, expressed as a percentage of each Fund's reduced overall holdings, will increase. Taxpayer expects that the Proposed Transaction may generate discrepancies between the diversification requirements and the holdings of each Fund. Any potential discrepancy between the relative value of each Fund's remaining assets and the diversification requirements imposed by § 817(h) will result from the disposition of Underlying Assets by each of the Funds, and the related distributions to the contractholders, in the Proposed Transaction. No potential discrepancy will exist immediately after the acquisition of any asset. No potential discrepancy will arise either wholly or partly as the result of the acquisition of any asset. Accordingly, under Treas. Reg. § 1.817-5(d) neither Fund will be considered to fail the diversification requirements imposed by § 817(h) in the calendar quarter in which any discrepancy arises pursuant to the Proposed Transaction or in any subsequent calendar quarter.

VI. HOLDING

Based on the information submitted and Taxpayer's representations, under Treas. Reg. § 1.817-5(d) any discrepancy that may arise as a result of the Proposed Transaction would not cause either Fund 1 or Fund 2 to fail the diversification requirements of § 817(h) in the calendar quarter in which such discrepancy arises or any subsequent calendar quarter.

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 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 who requested 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 representatives.

Sincerely,

SHERYL B. FLUM
Branch Chief, Branch 4
Office of Associate Chief Counsel
(Financial Institutions & Products)