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Department of the Treasury
Washington, DC 20224

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Person To Contact:
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Telephone Number:

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April 30, 2024

Taxpayer =

Dear :

This letter responds to Taxpayer's request for a letter ruling that the payment of certain investment advisory fees from an annuity contract will not be treated as an amount received by the owner of that annuity contract for purposes of § 72(e) of the Internal Revenue Code. This letter ruling is being issued electronically in accordance with section 7.02(2) of Rev. Proc. 2023-1, 2023-1 I.R.B. 1.

FACTS

Taxpayer is a stock life insurance company within the meaning of § 816(a). Taxpayer proposes to offer two types of non-qualified deferred annuity contracts (the "Contracts"). Each Contract will be issued to and owned by an individual, or issued to and owned by "a trust or other entity as an agent for a natural person" within the meaning of § 72(u)(1) (the "Owner").

Each Contract is an annuity contract under the law of the jurisdiction where issued. Each Contract qualifies for treatment as an annuity contract for federal income tax purposes, including by complying with the requirements of § 72(s). Each Contract is comprised of an accumulation phase and a payout phase. During the accumulation phase, the cash value (within the meaning of section 72(e)(3)(A)(i)) of a Contract is credited with interest based on the Crediting Rate Strategies (the "Strategies") that the Owner selects from a menu provided by Taxpayer. The Strategies, described below, may consist of one or more fixed rate ("Fixed Rate Strategies") and/or index-based ("Indexed Strategies") interest crediting strategies that are supported by Taxpayer's

general account. The cash value of a Contract is credited with interest in accordance with formulas reflected in those Strategies.

The Contracts are not variable contracts within the meaning of § 817(d) because they do not provide benefits that vary with the performance of separate account assets. The Fixed Rate Strategies credit interest based on an interest rate that is set by Taxpayer in advance of each crediting period, subject to a guaranteed minimum rate. The Indexed Strategies credit interest based on the positive performance of a specified market index over each crediting period, subject to how the amount of interest is determined for each Index Strategy. While negative performance of the index over the crediting period may mean that a Contract is not credited with any interest for that period, the negative performance of the index does not reduce the Contract's cash value. In addition under state standard nonforfeiture law, the Contract provides a guaranteed minimum surrender value for the Contract as a whole, calculated using a specified percentage of the initial premium payment(s), less any withdrawals from the contract effective date and plus a standard nonforfeiture law annual interest rate credited from the contract effective date.

The Contracts will have an Advisory Fee Endorsement, which is designed typically for an Owner who will receive ongoing investment advice from a registered investment advisor ("Advisor") on how to allocate a Contract's cash value (within the meaning of § 72(e)(3)(A)(i)) among the available Strategies. The Advisor is expected to take into account factors such as (1) the Owner's personal risk tolerance and investment timeline, (2) the interest rate and market environment, (3) the menu of Strategies available under the Contract. The Advisor will be an appropriately licensed professional who is in the business of providing investment advice.

Under the Contract, in consideration for the Advisor's advice and services, the Owner will authorize the Advisor in a separate agreement between the Owner and Taxpayer (the "Authorization") to withdraw funds from the Contract's cash value to pay the advisory fees ("Fees"). The Fees will be determined based on an arms-length transaction between the Owner and the Advisor. The Fees will not exceed an annual rate of 1.5% of the Contract's cash value (within the meaning of § 72(e)(3)(A)(i)), determined at the time and in the manner provided in the Authorization or other written agreement with the Advisor but in all events based on such cash value during the period to which the Fees relate. The Fees will compensate the Advisor only for investment advice provided to the Owner with respect to the Contract, and not for any other services. The Fees will not result in any reduction in fees related to any other asset or any other service.

Taxpayer will pay the Fees directly to the Advisor. During any period for which the Authorization is in effect, the Contract will be solely liable for paying the Fees, and the Fees will not be paid directly by the Owner. The Owner will not have the right to direct payment of the Fees for any other purpose or to any other person. The Advisor will not receive a commission for the sale of the Contract from Taxpayer.

REQUESTED RULING

Taxpayer requests a ruling that the Fees Taxpayer deducts from the Contract's cash value and remits to the Advisor will not be treated as an "amount received" by the Owner of the Contract for the purposes of § 72(e).

LAW AND ANALYSIS

Law

Section 72 distinguishes between an "amount received as an annuity" under an annuity, endowment, or life insurance contract and an "amount not received as an annuity" under those contracts. Section 1.72-1(b) of the Income Tax Regulations (the "Regulations") provides that "amounts received as an annuity" are amounts which are payable at regular intervals over a period of more than one full year from the date on which they are deemed to begin, provided the total of the amounts so payable or the period for which they are to be paid can be determined as of that date. *See* section 1.72-2(b)(2) and (3) of the Regulations. Any other amounts to which the provisions of section 72 apply are considered to be "amounts not received as an annuity."

Section 1.72-2(b)(2) of the Regulations provides that amounts are considered "amounts received as an annuity" only in the event that the following tests are met:

> (i) they must be received on or after the "annuity starting date" as that term is defined in paragraph (b) of section 1.72-4 of the Regulations (the first day of the first period for which an amount is received as an annuity under the contract);
>
> (ii) they must be payable in periodic installments at regular intervals (whether annually, semiannually, quarterly, monthly, weekly, or otherwise) over a period of more than one full year from the annuity starting date; and
>
> (iii) except as indicated in section 1.72-2(b)(3) of the Regulations (relating to variable contracts), the total of the amounts payable must be determinable at the annuity starting date either directly from the terms of the contract or indirectly by the use of either mortality tables or compound interest computations, or both, in conjunction with such terms and in accordance with sound actuarial theory.

Section 1.72-11(a)(1) of the Regulations describes “amounts not received as an annuity” as any amount received under an annuity contract if the amount:

> (i) does not meet the requirements set forth in section 1.72-2(b) of the Regulations for amounts received as an annuity;
>
> (ii) meets the requirements of section 1.72-2(b) of the Regulations for amounts received as an annuity but the annuity payments received differ in either amount, duration, or both, from those originally provided under the contract; or
>
> (iii) meets the requirements of section 1.72-2(b) of the Regulations for amounts received as an annuity but the annuity payments are received by a beneficiary after the death of an annuitant (or annuitants) in full discharge of the obligation under the contract and solely because of a guarantee.

Section 72(e) applies to any “amount not received as an annuity” under an annuity, endowment, or life insurance contract. Section 72(e)(2)(A) provides that if any amount which is not received as an annuity is received on or after the annuity starting date, it is included in gross income. Section 72(e)(2)(B) provides that if any amount which is not received as an annuity is received before the annuity starting date, it is included in gross income to the extent allocable to income on the contract and is not included in gross income to the extent allocable to the investment in the contract.

Analysis

In this case, the Fees are integral to the operation of the Contracts. During any period for which the Authorization is in effect, the Owner will receive ongoing investment advice from the Advisor with respect to the Contract so that the Owner may properly utilize the Contract. The Advisor is expected to help the Owner select Strategies for the Contract. Taxpayer has represented that the Fees will not serve as consideration for anything other than investment advice provided by the Advisor in relation to the Contract. Furthermore, Taxpayer has represented that the Fees will not exceed an annual rate of 1.5% of the Contract’s cash value based on the period in which the Fees related. Based on Taxpayer’s representations, the Fees will only be used to pay for investment advisory services relating to the Contract. Because the Contract is designed to work with an Advisor, the Contract is solely liable for the Fees. The Fees do not constitute compensation to the Advisor for services related to any assets of the Owner other that the Contract or any services other than investment advice services with respect to the Contract. Therefore, the Fees are an expense of the Contract, not a distribution to the Owner.

RULING

The Fees Taxpayer deducts from the Contract's cash value and remits to the Adviser will not be treated as an "amount received" by the Owner of the Contract for purposes of section 72(e).

CAVEATS

The ruling contained in this letter is based upon information and representations Taxpayer submitted, accompanied by penalty of perjury statements executed by appropriate parties. This office has not verified any of the material submitted in support of the ruling request and it is subject to verification on examination.

The ruling contained in this letter does not apply to any amount paid by Taxpayer that compensates the Adviser for services related to assets other than the Adviser Contract or for any services provided other than investment advice services with respect to the Adviser Contract. Any such amount would be an "amount received" by the Owner of the Adviser Contract for purposes of section 72(e).

Except as specifically set forth above, no opinion is expressed or implied concerning the federal tax consequences of the proposed transaction under any other provision of the Internal Revenue Code or Regulations.

This ruling letter is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Taxpayer must attach a copy of this letter ruling to any tax return to which it is relevant.

In accordance with a power of attorney on file in this office, a copy of this ruling is being furnished to your authorized representatives.

Sincerely,

Rebecca L. Baxter
Senior Technician Reviewer, Branch 4
Office of the Associate Chief Counsel
(Financial Institutions & Products)

cc: