Internal Revenue Service

Department of the Treasury

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Legend

Taxpayer	=
Separate Account	=
Fund A	=
Fund B	=
Fund C	=
y	=
State A	=
Sub	=
m	=
D	=
State B	=
n	=
E	=

Dear

This is in response to your submission dated November 29, 1999, and supplementary submissions requesting on behalf of Taxpayer certain rulings regarding the treatment of sub-accounts of the Separate Account that invest in portfolios ("Portfolios") of Fund A, Fund B, and Fund C (collectively referred to as the "Funds"). Variable annuity contracts ("Contracts") issued by Taxpayer are based on the Separate Account and its sub-accounts. Taxpayer plans for the Portfolios to invest in certain existing and newly created lower-tier funds. Certain of these funds (the "Central Funds") also will offer shares to other entities and accounts in which the public may invest, while other lower-tier funds (the "Dedicated Funds") will offer shares only to the Portfolios. (Central Funds and Dedicated Funds are referred to collectively herein as the "Lower-Tier Funds.")

FACTS

I. TAXPAYER

Taxpayer is a y life insurance company organized under the laws of State A.

Taxpayer represents that it is a life insurance company within the meaning of section 816(a) of the Internal Revenue Code. Taxpayer joins in the filing of a calendar year consolidated federal income tax return with its wholly-owned subsidiary, Sub.

II. THE CONTRACTS

The Contracts, which are based on the Separate Account, are both deferred and immediate variable annuity contracts. Some of the Contracts are purchased with "after-tax" monies, while others, Taxpayer represents, are tax-sheltered annuity contracts under section 403(b) and individual retirement annuity contracts under section 408(b). The Contracts offer both a fixed investment option and m variable investment options. The portion of a premium, less any applicable federal, 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 the Separate Account. The Separate Account is a separate account registered with the Securities and Exchange Commission (the "SEC") as a unit investment trust under the Investment Company Act of 1940 (the "1940 Act").

The assets of the Separate Account attributable to the Contracts are allocated among m sub-accounts of the Separate Account. The sub-accounts correspond to the m investment options under the Contracts. The amount of net premiums allocated to each investment option, and thus to each sub-account, is selected by the owner when the Contract is issued and may be changed from time to time. Each sub-account invests in the shares of a Portfolio of the Funds that corresponds with the investment objective of the sub-account.[11]

Taxpayer represents that the investments of each sub-account are adequately diversified within the meaning of section 817(h) and Treas. Reg. section 1.817-5(b).

III. THE FUNDS

The Funds are open-end diversified management investment companies (i.e., series mutual funds) organized by D. Each of the Funds is registered with the SEC under the 1940 Act and the shares of each series (i.e., each Portfolio) are registered with the SEC under the Securities Act of 1933 (the "1933 Act"). Each series of the Funds is established as a separate regulated investment company within the meaning of section 851 of the Code. D is the investment advisor for the Funds.

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[1] Taxpayer reserves the right to delete any sub-account and to add new sub-accounts. Taxpayer also reserves the right to delete, add, and substitute Portfolios in which the sub-accounts invest.

As described above, the Funds and their Portfolios serve as investment media for the Contracts. In addition, D offers the Funds and some or all of their Portfolios under variable annuity contracts issued by Taxpayer's affiliate, Sub, and under variable annuity and variable life insurance contracts issued by other, unaffiliated life insurance companies. Taxpayer represents that (except as otherwise permitted by Treas. Reg. section 1.817-5(f)(3)) all the beneficial interests in each of the Portfolios currently are held by one or more segregated asset accounts of one or more insurance companies, and public access to each of the Portfolios is available exclusively through the purchase of a variable contract within the meaning of section 817(d) and (e) of the Code.

IV. EXISTING CENTRAL FUNDS

D has already established a Central Fund pursuant to Priv. Ltr. Rul. 9748035 (Aug. 29, 1997), which is a money market fund. The money market Central Fund is an open-end management investment company registered with the SEC under the 1940 Act. D serves as its investment advisor. This Central Fund qualifies as a regulated investment company within the meaning of the Code. The shares of this Central Fund are not registered with the SEC under the 1933 Act and are not sold directly to members of the general public. Instead, the shares are sold only to certain entities and accounts for which D or one of its various subsidiaries or affiliates acts as investment advisor (such as mutual funds, trust accounts, and pension plan accounts). Some of these entities (the "D mutual funds") allow direct investment by members of the general public.

Also, D established an additional Central Fund that is a pooled investment vehicle designed to retain cash collateral received by Taxpayer's funds and accounts in connection with securities lending transactions (i.e., transactions in which the funds lend securities to third parties). This fund is a portfolio series of a State B business trust that is registered with the SEC under the 1940 Act as an open-end management investment company and is taxable as a regulated investment company within the meaning of the Code. Shares of this fund are not registered with the SEC under the 1933 Act and have not been (and will not be) sold directly to members of the general public but instead only to funds and accounts for which D or one of its affiliates acts as investment advisor. This fund is available to both the Portfolios and the D public funds.

V. CREATION OF ADDITIONAL CENTRAL FUNDS

As currently structured, D manages n money market funds, n investment-grade bond funds, n high yield funds, and n equity funds. Because the investment style within each class is similar, D is planning to organize one Central Fund for each type of non-equity based investment class to serve as pooled investment vehicles that will enable D to manage each of these security types in a single fund rather than n different funds. In lieu of (or in addition to) purchasing each class of assets directly, the E funds will purchase shares of each Central Fund, which in turn will invest directly in the appropriate asset class. It is anticipated that this structure will allow for more efficient

portfolio management, and that the Contract owners and shareholders will ultimately benefit from this arrangement through reduced costs.

In order to provide this enhanced efficiency of its fund management, Taxpayer plans to expand its use of Lower-Tier Funds. More specifically, Taxpayer plans to allow certain Portfolios to invest in (1) newly created Central Funds in which both Portfolios and certain D mutual funds will invest and (2) in newly created Dedicated Funds in which only these Portfolios may invest. Taxpayer represents that if a Portfolio invests in one or more Lower-Tier Funds all the beneficial interest in a Portfolio will continue to be held by one or more segregated asset accounts of one or more insurance companies (except as otherwise permitted by Treas. Reg. section 1.817-5(f)(3)).

The Central Funds which D plans to establish are lower-tier funds for its E range of funds. The Central Funds will be open-end management investment companies registered with the SEC under the 1940 Act. Of the Central Funds which D plans to create within its E range of funds, one will be a money market fund organized as a regulated investment company. D is creating a new money market Central Fund rather than utilizing an existing Central Fund because the E funds tend to hold their money market investments for a longer period than average funds hold their investments in the existing money market Central Funds. As a result of the longer holding period, Taxpayer anticipates the new fund will be less susceptible to turnover and thus there will be fewer transactions and lower costs attributable to the money market investments of its E funds. The D mutual funds as well as Portfolios may invest in the new money market Central Fund.

D also plans to organize an investment-grade bond Central Fund and a high yield Central Fund for the E funds. Taxpayer represents that these Central Funds will be taxed either as partnerships or regulated investment companies and that neither of these Central Funds will elect to be taxed as a corporation for federal income tax purposes under Treas. Reg. section 301.7701-3(c). Taxpayer also represents that these Central Funds will be registered with the SEC under the 1940 Act. Both Portfolios and the D mutual funds may invest in these Central Funds.

D will also establish one Dedicated Fund (n in all) for the equity investments of each E Portfolio. Thus, a single Portfolio (and no D mutual funds) will be the only investor in each Dedicated Fund. The Dedicated Funds will be registered with the SEC under the 1940 Act as open-end management investment companies. Some Dedicated Funds will be structured as a portfolio series of business trusts taxable as regulated investment companies, while others will be structured as single-member limited liability companies (“LLCs”) under appropriate state law. The company represents that none of the Dedicated Funds organized as LLCs will elect to be treated as a corporation under Treas. Reg. section 301.7701-3(b)(1)(ii).

The shares of the Central Funds and the Dedicated Funds will not be registered with the SEC under the 1933 Act and will not be sold directly to members of the general public.

STATUTORY AND REGULATORY PROVISIONS

For purposes of part I of subchapter L of chapter 1 of the Code (sections 801-818), the term "variable contract" is defined in section 817(d). In order for an annuity contract to be a variable contract, (1) it must provide for the allocation of all or part of the amounts received under the contract to an account which, pursuant to state law or regulation, is segregated from the general asset accounts of the issuing insurance company; (2) it must provide for the payment of annuities; and (3) the amounts paid in, or the amounts paid out, must reflect the investment return and the market return of the segregated asset account. Section 817(d)(1)-(3) of the Code.

Section 817(h)(1) of the Code provides that, for purposes of subchapter L, section 72 (relating to annuities), and section 7702(a) (relating to the definition of a life insurance contract), a variable contract (other than a pension plan contract), which is otherwise described in section 817 and which is based on a segregated asset account, shall not be treated as an annuity, endowment, or 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) of the Code provides, in certain situations, a "look-through" rule for meeting the diversification requirements. If all of the beneficial interests in a regulated investment company 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 section 817(h)(1) are applied by taking into account the assets held by such regulated investment company.

Treas. Reg. section 1.817-5 contains the diversification requirements for variable contracts. Generally, the investments of a segregated asset account will be considered to be "adequately diversified" for purposes of section 817(h) of the Code and Treas. Reg. section 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 percent by any four investments.

Treas. Reg. section 1.817-5(f) provides a "look-through" rule for the application of the diversification requirements of Treas. Reg. section 1.817-5. Treas. Reg. section 1.817-5(f)(1) provides that, if the look-through rule applies, a beneficial interest in a regulated investment company will not be treated as a single investment of a segregated asset account; instead, a pro rata portion of each asset of the investment company will be treated, for purposes of Treas. Reg. section 1.817-5, as an asset of the segregated asset account.

Treas. Reg. section 1.817-5(f)(2)(i) provides that Treas. Reg. section 1.817-5(f) shall apply to an investment company if:

(A) all the beneficial interests in the investment company (other than those described in Treas. Reg. section 1.817-5(f)(3)) are held by one or more segregated asset accounts of one or more insurance companies; and

(B) public access to such investment company is available exclusively (except as otherwise permitted in Treas. Reg. section 1.817-5(f)(3)) through the purchase of a variable contract. Solely for this purpose, the status of the contract as a variable contract will be determined without regard to section 817(h) and Treas. Reg. section 1.817-5.

Treas. Reg. section 1.817-5(e) provides that, for purposes of section 817(h) of the Code and Treas. Reg. section 1.817-5, a "segregated asset account shall consist of all assets the investment return and market value of each of which must be allocated in an identical manner to any variable contract invested in any of such assets."

Treas. Reg. section 301.7701-2(a) states that, for purposes of sections 301.7701-2 and 301.7701-3, a business entity is any entity recognized for federal tax purposes (including an entity with a single owner that may be disregarded as an entity separate from its owner under section 301.7701-3) that is not subject to special treatment under the Internal Revenue Code. It further provides that if a business entity with only one owner is disregarded, its activities are treated in the same manner as a sole proprietorship, branch, or division of the owner.

Treas. Reg. section 301.7701-3(b) provides that, unless the entity elects otherwise, a domestic eligible entity is disregarded as an entity separate from its owner if it has a single owner.

REQUESTED RULINGS (1), (2), (3), and (4) (DIVERSIFICATION REQUIREMENTS)

The owners of the Contracts are permitted to allocate premiums among the sub-accounts of the Separate Account. Thus, each sub-account of the Separate Account is a segregated asset account within the meaning of section 817(h) and the regulations thereunder. See Treas. Reg. section 1.817-5(g), Example 1. Hence, the diversification requirements must be met by each sub-account of the Separate Account that is subject to section 817(h) in order for the Contracts to be treated as annuity contracts.[22]

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[2] The diversification requirements under section 817(h) apply to variable contracts other than "pension plan contracts." Section 818(a) defines the term "pension plan contract" for this purpose to include a tax-sheltered annuity contract under section 403(b) and an individual retirement annuity contract under section 408(b). See section 818(a)(4) and (5). Hence, the diversification requirements apply to Contracts purchased with "after-tax" monies, and do not apply to Contracts which are tax-sheltered annuities or individual retirement annuities.

Taxpayer represents that all the shares of each Portfolio are held exclusively by segregated asset accounts of one or more insurance companies (except as otherwise permitted under Treas. Reg. section 1.817-5(f)(3)). Taxpayer represents further that this will continue to be true after the Portfolios begin to invest in the newly created Central Funds and Dedicated Funds. Additionally, Taxpayer represents that public access to a Portfolio currently is available exclusively through the purchase of a variable contract (except as otherwise permitted under Treas. Reg. section 1.817-5(f)(3)). Taxpayer submits that this will also be true after the Portfolios invest in the newly created Central Funds and the Dedicated Funds.

The shares of the Central Funds will be sold to both the Portfolios and D mutual funds that are E funds. Shares of the D mutual funds are sold directly to members of the public. Therefore, all the beneficial interests in a Central Fund will not be held by one or more segregated asset accounts of one or more insurance companies (or such other holders that are permitted under Treas. Reg. section 1.817-5(f)(3)). Consequently, for purposes of Treas. Reg. section 1.817-5(f), a Central Fund's shares are treated as assets of a Portfolio that invests in that Central Fund (and therefore as assets of the sub-account that invests in the Portfolio). There is no look-through to the assets of the Central Funds.

Taxpayer represents that one or more of the Dedicated Funds will be established as a single-member limited liability company in accordance with the appropriate state law. Because such a business entity is not defined as a corporation under Treas. Reg. section 301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8), each such Dedicated Fund may choose its classification for federal tax purposes under Treas. Reg. section 301.7701-3(a). In addition, because each Dedicated Fund that is organized as an LLC will have a single corresponding Portfolio as its sole owner, the Dedicated Fund will be disregarded as an entity separate from the Portfolio, unless the Dedicated Fund makes an election to be treated as a separate corporation for federal tax purposes. Taxpayer has represented that no such election will be made. Therefore, because the Dedicated Fund will be disregarded as an entity separate from its underlying Portfolio, the individual assets of the Dedicated Fund will be treated as assets of the Portfolio. Each Portfolio will be treated as directly owning the assets of its corresponding Dedicated Fund that is organized as an LLC for purposes of the diversification requirements of section 817(h).

Taxpayer represents that one or more of the Dedicated Funds will be structured as a portfolio series of a business trust taxable as a regulated investment company. Each of the Dedicated Funds taxable as a regulated investment company will be wholly owned by a single Portfolio. As noted above, Taxpayer represents that shares of each Portfolio are held exclusively by segregated asset accounts of one or more insurance companies (except as otherwise permitted under Treas. Reg. 1.817-5(f)(3)) and that public access to each Portfolio currently is available exclusively through the purchase of a variable contract (except as otherwise permitted under Treas. Reg. section 1.817-5(f)(3)). Under this structure, all beneficial interests in the Dedicated Funds will be held by segregated asset accounts of one or more insurance companies (except as

otherwise permitted under Treas. Reg. section 1.817-5(f)(3)), and public access to the Dedicated Funds will be available exclusively through the purchase of a variable contract (except as otherwise permitted under Treas. Reg. section 1.817-5(f)(3)). Therefore, the requirements of the look-through rule of Treas. Reg. section 1.817-5(f) will be met both with respect to the Portfolio and the Dedicated Fund. Accordingly, under Treas. Reg. section 1.817-5(f)(1), the assets of a Dedicated Fund taxable as a regulated investment company will be treated as the assets of the Portfolio which invests in the Dedicated Fund and, in turn, the assets of that Portfolio will be treated as the assets of the sub-account which invests in that Portfolio.

REQUESTED RULING (5) (INVESTOR CONTROL)

Rev. Rul. 81-225, 1981-2 C.B. 12, *clarified by* Rev. Rul. 82-54, 1982-1 C.B. 12 and *modified by* Rev. Proc. 99-44, 1999-48 I.R.B. 598, describes four situations in which investments in mutual funds pursuant to annuity contracts are considered to be owned by the policyholder, rather than by the insurance company issuing the annuity contracts, and one situation in which the insurance company is considered the owner of the mutual fund shares. In situation 1, the investment assets in the segregated account underlying the annuity contracts consist solely of shares in a single, publicly available mutual fund managed by an independent investment advisor. Situation 2 is similar to situation 1 except that the mutual fund is managed by the insurance company or one of its affiliates. Situation 3 also is similar to situation 1 except that the segregated asset account underlying the annuity contracts consists of five sub-accounts on which the performance of the annuity contract would depend. The policyholder retains the right to allocate or reallocate funds among the five sub-accounts during the life of the annuity contract. Situation 4 is similar to situation 2, except that the shares of the mutual fund are not sold directly to the public, but are available only through the purchase of an annuity contract or by participation in an investment plan account of the type described in Rev. Rul. 70-525, 1970-2 C.B. 144. Situation 5 also is similar to situation 2, except that the shares in the mutual fund are available only through the purchase of an annuity contract.

The ruling concludes that the policyholders in situations 1-4 have sufficient control and other incidents of ownership to be considered the owners of the mutual fund shares for federal income tax purposes. The ruling reaches the opposite conclusion in situation 5, stating that the sole function of the mutual fund in situation 5 is to provide an investment vehicle to allow the insurance company to meet its obligations under its annuity contracts and that the insurance company possesses sufficient incidents of ownership to be considered the owner of the underlying portfolio of assets of the mutual fund. Rev. Rul. 81-225 concludes that in situation 5, the insurance company, not the policyholder, is treated as the owner of the mutual fund shares for federal income tax purposes.

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 owners of the mutual fund shares.

For purposes of Requested Ruling 5, Taxpayer asks the Service to assume that the Contract owners do not currently possess sufficient investment control and other incidents of ownership over the sub-accounts' assets to be considered the owners of those assets for federal income tax purposes under the principles of Rev. Rul. 81-225. The issue presented is whether allowing the Portfolios to invest in one or more Central Funds or Dedicated Funds will cause the Contract owners, rather than Taxpayer, to be treated, under the principles of Rev. Rul. 81-225, as the owner of the sub-accounts' assets.

After the Portfolios' proposed investment in the Central Funds or Dedicated Funds, just as in situation 5 of Rev. Rul. 81-225, the shares of the Portfolios will continue to be unavailable to members of the general public; they will be available exclusively through the purchase of a variable contract (with the exception of those investors listed in Treas. Reg. section 1.817-5(f)(3)).

In Rev. Rul. 82-54, the amounts held in a segregated asset account under a variable contract were invested, as the policyholder directed, in shares of one or more of three open-end diversified management investment companies ("Mutual Funds"). Each Mutual Fund represented a different broad, general investment strategy, and the Mutual Fund shares were available only to insurance company segregated asset accounts. In Rev. Rul. 82-54, the Mutual Funds held common stocks, bonds, and money market instruments; assets that were available for purchase directly by members of the general public. The public availability of the assets of the Mutual Funds in Rev. Rul. 82-54 did not lead to the conclusion that the issuing insurance company was simply a conduit between the policyholders and their Mutual Funds. Instead, Rev. Rul. 82-54, citing Rev. Rul. 81-225 and its companion revenue rulings, held that the insurance company, not the policyholder, was the owner of the Mutual Funds for tax purposes. As was the case with the Mutual Funds in Rev. Rul. 82-54, the Portfolios in this case are available to the public only through the purchase of a variable contract.

Accordingly, assuming that the owner of a Contract does not otherwise have investment control over the sub-account's assets and possess sufficient other incidents of ownership within the meaning of Rev. Rul. 81-225 with respect to such assets to be considered the owner of such assets for federal income tax purposes, the owner of the Contract will not be treated as the owner of such assets under Rev. Rul. 81-225

because the Portfolio in which the sub-account invests, in turn, invests in shares of one or more Central Funds or Dedicated Funds.

RULINGS

Accordingly, based solely upon the information submitted and the representations made, we hold:

1. The diversification requirements of section 817(h) of the Code and Treas. Reg. section 1.817-5(b) will be applied to a sub-account that invests in a Portfolio that invests in one or more Central Funds and/or Dedicated Funds by treating as an asset of the sub-account a pro rata share of each asset of the Portfolio, in accordance with the "look-through rule" set forth in Treas. Reg. section 1.817-5(f).

2. For purposes of the diversification requirements of section 817(h) and Treas. Reg. section 1.817-5(b), partnership interests in or shares of the Central Funds are treated as assets of a Portfolio that invests in that Central Fund (and therefore assets of the sub-account that invests in the Portfolio). There is no look-through to the assets of the Central Funds.

3. For purposes of applying the diversification requirements of section 817(h) and Treas. Reg. section 1.817-5(b), a Portfolio will be treated as directly owning the assets of a Dedicated Fund in which it invests if such Dedicated Fund is organized as a single-member limited liability company and does not elect to be treated as a corporation for federal tax purposes under section 7701(a) and Treas. Reg. section 301.7701-3(a).

4. The diversification requirements of section 817(h) and Treas. Reg. section 1.817-5(b) will be applied to a Portfolio that invests in a Dedicated Fund organized as a regulated investment company by treating as an asset of the Portfolio a pro rata share of each asset of the Dedicated Fund in accordance with the "look-through rule" set forth in Treas. Reg. section 1.817-5(f), and thus as an asset of the sub-account that invests in such Portfolio as provided in Ruling (1).

5. Assuming that the owner of a Contract does not otherwise have investment control over the sub-account's assets and possess sufficient other incidents of ownership within the meaning of Rev. Rul. 81-225 with respect to such assets to be considered the owner of such assets for federal income tax purposes, the owner of the Contract will not be treated as the owner of such assets under Rev. Rul. 81-225 because the Portfolio in which the sub-account invests, in turn, invests in shares of one or more Central Funds and/or Dedicated Funds.

Except as specifically set forth above, no opinion is expressed as to the tax treatment of the Contracts under the provisions of any other section of the Code or regulations. Specifically, no opinion is expressed, except to the extent set forth above, as to the application of the investment control rules as set forth in *Christoffersen v.*

United States, 749 F.2d 513 (8th Cir. 1984), *cert. denied*, 473 U.S. 905 (1985); Rev. Rul. 81-225; Rev. Rul. 80-274, 1980-2 C.B. 27; Rev. Rul. 77-85, 1977-1 C.B. 12; and Rev. Proc. 99-44, 1999-48 I.R.B. 598.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

A copy of this letter should be attached to the Taxpayer's federal income tax returns for taxable year(s) in which any of the Portfolios invest in shares of any of the Central Funds that are covered by this letter.

Sincerely,
Assistant Chief Counsel
(Financial Institutions and Products)
By: Mark S. Smith
Chief, Branch 4