Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

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Date:
January 12, 2001

Legend

Trust =

Fund 1 =

Fund 2 =

Fund 3 =

Trust =

State 1 =

This is in response to the letter of your authorized representative dated August 28, 2000, and supplementary submission, requesting rulings on behalf of Fund 1, Fund 2, and Fund 3 (collectively, the "Funds") concerning the "look-through rule" of § 1.817-5(f) of the Income Tax Regulations for satisfying the diversification requirements of § 817(h) of the Internal Revenue Code.

FACTS

As will be described in more detail below, Fund 2 and Fund 3 are currently available as investment vehicles for variable life and variable annuity contracts (the "Variable Contracts") that are funded by segregated assets accounts. Fund 1 has been established, but its shares are not being sold pending the issuance of this ruling.

Each of the Funds is or will be operated as a separate series of Trust, which is an open-end management investment company organized as a State 1 business trust. Trust is registered under the Investment Company Act of 1940, as amended, and its shares are registered under the Securities Act of 1933, as amended, pursuant to an effective registration statement.

The Funds are each treated as a separate corporation for federal income tax purposes, pursuant to § 851(g) of the Code. Each Fund's annual accounting period ends on December 31, and each uses the accrual method of accounting.

Fund 2 and Fund 3 have each, since their inception, continuously qualified and elected to be treated as a regulated investment company ("RIC") under Subchapter M (§ 851 et seq) of the Code, and each has been eligible to compute, and has computed, its tax as provided by § 852. Fund 1 will also qualify and elect to be treated as a RIC, which computes its tax as provided by § 852.

Interests in Fund 2 and Fund 3 are available only to segregated asset accounts that fund Variable Contracts and to trustees of qualified pension and retirement plans. No shares of Fund 2 or Fund 3 have ever been publicly available.

The Funds represent that all beneficial interests in Fund 1 will be held only by segregated asset accounts that fund Variable Contracts (except as otherwise permitted under § 1.817-5(f)(3) of the regulations). Additionally, the Funds represent that public access to Fund 1 will be available (directly or indirectly) exclusively (except as otherwise permitted under § 1.817-5(f)(3)) through the purchase of a Variable Contract.

Fund 1 proposes to invest a portion, or all, of its assets in Fund 2 and Fund 3. The Funds represent that, after the proposed transaction, all beneficial interests in Fund 2 and Fund 3 (except as otherwise permitted under § 1.817-5(f)(3) of the regulations) will be held only by segregated asset accounts that fund Variable Contracts and that (except as otherwise permitted under § 1.817-5(f)(3)) public access to each of the Funds will remain available (directly or indirectly) exclusively through the purchase of a Variable Contract.

Fund 1 is also considering investing in RICs other than Fund 2 and Fund 3. All beneficial interests in such other RICs (except as otherwise permitted under § 1.817-5(f)(3) of the regulations) will be held by segregated asset accounts that fund Variable Contracts and public access to such other RICs will be available (directly or indirectly) exclusively (except as otherwise permitted under § 1.817-5(f)(3)) through the purchase of a Variable Contract.

STATUTORY AND REGULATORY PROVISIONS

Section 817(h)(1) of the Code provides that, for purposes of subchapter L, § 72 (relating to annuities), and § 7702(a) (relating to the definition of life insurance contract), a variable contract (other than a pension plan contract), which is otherwise described in § 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 1.817-5 of the regulations contains the diversification requirements for variable contracts based on segregated asset accounts. Generally, the investments of a segregated asset account will be considered to be "adequately diversified" for purposes of § 817(h) of the Code and § 1.817-5 of the regulations 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. See § 1.817-5(b)(1).

Section 1.817-5(f) of the regulations provides a look-through rule for the application of the diversification requirements of § 1.817-5. 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 § 1.817-5, as an asset of the segregated asset account.

Section 1.817-5(f)(2)(i) of the regulations provides that the look-through rule of § 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 § 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 under § 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 § 817(h) of the Code and § 1.817-5 of the regulations.

The beneficial interests described in § 1.817-5(f)(3) are (i) under specified circumstances, the general account of a life insurance company or a corporation related in a manner specified in § 267(b) of the Code to a life insurance company; (ii) under specified circumstances, the manager, or a corporation related in a manner specified in § 267(b) to the manager of the investment company; (iii) the trustee of a qualified pension or retirement plan; (iv) the public or policyholders that are treated as owners of beneficial interests in the investment company under Rev. Rul. 81-225, 1981-2 C.B. 12, but only if (A) the investment company was closed to the public in accordance with Rev. Rul. 82-55, 1982-1 C.B. 12, or (B) all the assets of the segregated asset account are attributable to premium payments made by policyholders prior to September 26, 1981, to premium payments made in connection with a qualified pension or retirement plan, or to any combination of such premium payments.

Section 1.817-5(e) of the regulations provides that “[f]or purposes of section 817)(h) of the Code and [§ 1.817-5 of the regulations], 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."

REQUESTED RULING 1

Currently, all interests in Fund 2 and Fund 3 are held by segregated asset accounts that fund Variable Contracts (except as otherwise permitted under § 1.817-5(f)(3) of the regulations). Thus, the requirement set forth in § 1.817-5(f)(2)(i)(A) for application of the look-through rule to Fund 2 and Fund 3 is satisfied. It is proposed that Fund 1 acquire shares of Fund 2 and Fund 3. All interests in Fund 1 are to be held by segregated asset accounts that fund Variable Contracts (except as otherwise permitted under § 1.817-5(f)(3)). Therefore, after Fund 1 invests in Fund 2 and Fund 3, all beneficial interests in Fund 2 and Fund 3 (except as otherwise permitted under § 1.817-5(f)(3)) will continue to be held by one or more segregated asset accounts of one or more insurance companies, satisfying the requirement of § 1.817-5(f)(2)(i)(A).

REQUESTED RULINGS 2 and 3

The Funds represent that all beneficial interests in Fund 1 will be held only by segregated asset accounts that fund Variable Contracts (except as otherwise permitted under § 1.817-5(f)(3) of the regulations) and that public access to Fund 1 will be available (directly or indirectly) exclusively (except as otherwise permitted under § 1.817-5(f)(3)) through the purchase of a Variable Contract. Therefore, the requirements of § 1.817-5(f)(2)(i) for applying the look-through rule to Fund 1 will be satisfied and a pro rata portion of each asset of Fund 1 will be treated as an asset of a segregated asset account investing in Fund 1.

We have concluded above in our consideration of Requested Ruling (1) that, after Fund 1 invests in Fund 2 and Fund 3, the requirement in § 1.817-5(f)(2)(i)(A) of the regulations for applying the look-through rule to Fund 2 and Fund 3 will continue to be met. Further, the Funds represent that after Fund 1 invests in Fund 2 and Fund 3 public access to Fund 2 and Fund 3 will be available (directly or indirectly) exclusively (except as otherwise permitted under § 1.817-5(f)(3)) through the purchase of a Variable Contract. Thus, both conditions for applying the look-through rule of § 1.817-5(f) to Fund 2 and Fund 3 will be satisfied. Accordingly, for purposes of determining whether a segregated asset account investing in Fund 1 complies with the diversification requirements of § 1.817-5, a pro rata portion of each asset of Fund 2 and Fund 3 will be taken into account.

Fund 1 is considering investing in RICs other than Fund 2 and Fund 3. Taxpayer represents that all beneficial interests (except as otherwise permitted under § 1.817-5(f)(3) of the regulations) in such other RICs will be held only by segregated asset accounts that fund Variable Contracts and that public access to such other RICs will be

available (directly or indirectly) exclusively (except as otherwise permitted under § 1.817-5(f)(3)) through the purchase of a Variable Contract. Thus, both requirements of § 1.817-5(f)(2)(i) for the application of the look-through rule will be satisfied with respect to such other RICs. Therefore, Fund 1's investment in such other RICs, will not prevent a segregated asset account holding shares of Fund 1 from looking through to the assets of such other RICs for purposes of determining compliance with the diversification requirements of § 1.817-5 of the regulations.

CONCLUSIONS

1. Fund 2 and Fund 3 will not fail to satisfy the requirement of § 1.817-5(f)(2)(i)(A) of the regulations by reason of Fund 1 investing in Fund 2 and Fund 3.

2. After Fund 1 invests in Fund 2 and Fund 3, segregated asset accounts investing in Fund 1 will take into account their pro rata share of the assets of Fund 2 and Fund 3 for purposes of determining whether they comply with the diversification requirements of § 1.817-5 of the regulations.

3. Investment by Fund 1 in RICs other than Fund 2 and Fund 3 will not prevent segregated asset accounts holding shares of Fund 1 from looking through to the assets of such other RICs, for purposes of determining whether such other RICs comply with the diversification requirements of § 1.817-5 of the regulations, as long as all beneficial interests (except as otherwise permitted under § 1.817-5(f)(3)) in such other RICs are held by segregated asset accounts that fund Variable Contracts and public access to such other RICs is available (directly or indirectly) exclusively (except as otherwise permitted under § 1.817-5(f)(3)) through the purchase of a Variable Contract.

The rulings contained in this letter are based upon information and representations submitted by the taxpayers 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.

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 this letter. Specifically, no opinion is expressed regarding the application of the investor control rules 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, 1981-2 C.B. 12, as modified by Rev. Proc. 99-44, 1999-2 C.B. 598; Rev. Rul. 80-274, 1980-2 C.B. 27; Rev. Rul. 77-85, 1977-1 C.B. 12.

This ruling is directed only to the taxpayers 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 must be attached to any income tax return to which it is relevant.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

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