

## Internal Revenue Service

Department of the Treasury

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Date:

March 8, 2002

### Legend

Trust =  
Fund =  
State =  
Date 1 =  
Manager =

Dear \_\_\_\_\_ :

This ruling responds to a letter dated September 19, 2001, submitted on behalf of the Trust requesting a ruling concerning the look-through rule of section 817(h)(4) of the Internal Revenue Code and § 1.817-5(f) of the regulations.

### FACTS

The Trust, a State law business trust, is an open-end management investment company. The Trust is registered under the Investment Company Act of 1940 (the "1940 Act"), and its shares are registered under the Securities Act of 1933. The sole current series of the Trust is the Fund. The Fund utilizes the accrual method of accounting and is a calendar year taxpayer. Under section 851(g), the Fund is treated as a separate corporation for federal income tax purposes. The Fund has qualified and elected to be treated as a regulated investment company ("RIC") since Date 1, and has since computed its income under section 852 of the Code for each taxable year. Manager is a registered investment adviser under the Investment Advisers Act of 1940, and acts as investment adviser to the Fund pursuant to an Investment Management Agreement between the Trust and Manager.

The Fund serves as an investment vehicle for variable contracts ("Variable Contracts") as defined under section 817(d) of the Code. These Variable Contracts are funded by segregated asset accounts ("Separate Accounts") of life insurance companies. The Fund may offer its shares to certain qualified persons or retirement plans, but has sold shares only to Manager and to the Separate Accounts that fund certain Variable Contracts. No shares have been sold to the general public.

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Each Separate Account is a segregated asset account. The assets of each Separate Account are owned by various life insurance companies. None of the life insurance companies is affiliated with the Trust or Manager. Each Separate Account is divided into sub-accounts, each of which invests its assets in a particular open-end investment company registered under the 1940 Act, or series thereof, including the Fund.

Purchasers of the Variable Contracts may allocate premiums under their Variable Contracts to one or more sub-accounts of the Separate Accounts supporting those Variable Contracts. The income, gains or losses, realized or unrealized, of each sub-account are credited to or charged against the assets held in the sub-account without regard to the relevant insurance company's other income, gains, or losses. Manager and the Separate Accounts hold all the interests in the Fund. There is no public access to the Fund other than through the purchase of Variable Contracts. The Separate Accounts look-through to the assets of the Fund for purposes of determining whether the diversification requirements of section 817(h) are met.

## PROPOSED TRANSACTION

The Fund proposes to offer and sell its shares directly to individual retirement accounts described in sections 408(a) (individual retirement accounts), 408(p) (simple retirement accounts), and 408A (Roth IRAs) and annuity contracts described in section 403(b).

## LAW AND ANALYSIS

Section 851(a) defines a RIC, in part, as a domestic corporation, which at all times during the taxable year is registered under the 1940 Act as a management company or unit investment trust. Section 851(b) limits the definition of a RIC to a corporation meeting certain election, gross income, and diversification requirements.

Section 851(g)(1) provides that each fund of a RIC shall be treated as a separate corporation for federal income tax purposes. Section 851(g)(2) defines the term "fund" for this purpose as a segregated portfolio of assets, the beneficial interests in which are owned by holders of a class or series of stock of the RIC that is preferred over all other classes or series in respect of such portfolio of assets.

Section 817(d) defines the term variable contract as a contract that meets three requirements. First, the contract must provide for the allocation of all or part of the amounts received under the contract to an account that is segregated from the general asset accounts of the company under state law. Second, the contract must be an annuity contract, a life insurance contract, or a contract that provides funding of insurance on retired lives as described in section 807(c)(6). Third, in the case of an annuity contract, the amounts paid in (or the amount paid out) must reflect the investment return and the market value of the segregated asset account; in the case of a life insurance contract, the amount of the death benefit (or the period of coverage)

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must be adjusted on the basis of the investment return and the market value of the account; and, in the case of a contract for funding of insurance on retired lives, the amounts paid in (or the amount paid out) must reflect the investment return and the market value of the account.

Section 817(h) provides that a variable contract based on a segregated asset account shall not be treated as an annuity, endowment, or life insurance contract unless it is adequately diversified in accordance with regulations prescribed by the Secretary. Under § 1.817-5(b) of the regulations, (a) no more than 55% of the value of the total assets of the account may be represented by any one investment; (b) no more than 70% of the value of the total assets of the account may be represented by any two investments; (c) no more than 80% of the value of the total assets of the account may be represented by any three investments; and (d) no more than 90% of the value of the total assets of the account may be represented by any four investments.

Regulation § 1.817-5(f)(1) provides that, if the look-through rule applies, a beneficial interest in a RIC will not be treated as a single investment of a segregated asset account for purposes of testing diversification. Instead, a pro-rata portion of each asset of the investment company will be treated as an asset of the segregated asset account. Regulation § 1.817-5(f)(2)(i) provides that the look-through rule of § 1.817-5(f) applies to any 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 in § 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 is determined without regard to section 817(h) of the Code and § 1.817-5 of the regulations.

Regulation § 1.817-5(f)(3) provides that satisfaction of the requirements of § 1.817-5(f)(2)(i) is not prevented by reason of beneficial interests in a RIC that are:

(i) Held by the general account of a life insurance company or a corporation related to a life insurance company under section 267(b), but only if the return on such interest is computed in the same manner as the return on an interest held by a segregated asset account is computed, there is no intent to sell such interests to the public, and a segregated asset account of such life insurance company also holds or will hold a beneficial interest in the RIC;

(ii) Held by the manager, or a corporation related to the manager under section 267(b), but only if the holding of the interest is in connection with the creation or management of the RIC, the return on such interest is computed in the same manner as the return on an interest held by a segregated asset account is computed, and there is no intent to sell such interests to the public;

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(iii) Held by the trustee of a qualified pension or retirement plan; or

(iv) Held by the public, or treated as owned by the policyholders pursuant to Rev. Rul. 81-225, 1981-2 C.B. 12, but only if (A) the RIC 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.

Rev. Rul. 94-62, 1994-2 C.B. 164, lists the following types of arrangements that are considered qualified plans for purposes of section 1.817-5(f)(3)(iii) of the regulations:

- 1) A plan described in section 401(a) that includes a trust exempt from tax under section 501(a);
- 2) An annuity plan described in section 403(a);
- 3) An annuity contract described in section 403(b), including a custodial account described in section 403(b)(7);
- 4) An individual retirement account described in section 408(a);
- 5) An individual retirement annuity described in section 408(b);
- 6) A governmental plan within the meaning of section 414(d) or an eligible deferred compensation plan within the meaning of section 457(b);
- 7) A simplified employee pension of an employer that satisfies the requirements of section 408(k);
- 8) A plan described in section 501(c)(18);
- 9) Any other trust, plan, account, contract, or annuity that the Internal Revenue Service has determined in a letter ruling to be within the scope of § 1.817-5(f)(3)(ii) of the regulations.

In the present case, the Fund proposes to offer and sell its shares directly to four new types of investors. Two of those types of investors - individual retirement accounts described in section 408(a) and annuity contracts described in section 403(b) - are explicitly identified in Rev. Rul. 94-62 as “qualified plans” for purposes of § 1.817-5(f)(3)(iii) of the regulations. The other two types of investors - simple retirement accounts under section 408(p) and Roth IRAs under section 408A - did not exist in 1994 when the Rev. Rul. 94-62 was published.

RULINGS

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Based on the facts as presented by the Trust, we rule that an investment in the Fund by an individual retirement account described in section 408(a), a simple retirement account described in section 408(p), a Roth IRA described in section 408A, or an annuity contract described in section 403(b) will not prevent a Separate Account from looking through to the Fund's underlying assets for purposes of meeting the diversification requirements of section 817(h) of the Code and § 1.817-5(f) of the regulations.

#### CAVEATS

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. This ruling concerns only the facts and arrangements identified by the taxpayer, and no opinion is expressed concerning investment in the Fund by type of investor other than those described in sections 408(a), 408(p), 408A, or 403(b).

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.

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,  
Mark Smith  
Chief, Branch 4  
Office of Associate Chief Counsel  
Financial Institutions and Products