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Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

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LEGEND:

Company A	=
Policyholder	=
Policy A	=
Annuity	=
Policy B	=
Policy C	=
Date A	=
State A	=
Number C	=

Dear :

This is in reply to a letter dated Date A requesting rulings, on behalf of Company A and Policyholder, concerning the federal income tax treatment under § 72 and § 1035 of the Internal Revenue Code and the regulations thereunder of the exchange of one annuity contract for two annuity contracts.

FACTS

Company A is a stock life insurance company, as defined in section 816(a) and is subject to taxation under Part I of Subchapter L of the Code. Company A is organized and operated under the laws of State A and is licensed to engage in the insurance business in Number C states.

Policyholder will exchange Policy A for Policy B and Policy C in a single transaction with Company A. All three policies are deferred annuity contracts. Company A and Policyholder represent that Policy A, Policy B and Policy C qualify as annuity contracts under §§ 72(s) and 1035(b)(2). Upon the exchange, part of the amount transferred will be applied to the first scheduled payment of Policy B and the balance will be applied to Policy C. The exchange of Policy A for Policy B and Policy C will not involve a change in the insured.

Policy B is specifically aimed at providing retirement income. Policy B will offer a Guaranteed Minimum Income payment feature, under which a specified level of monthly annuity payments beginning at the contract's Annuity Commencement Date will be guaranteed by Company A upon issuance regardless of the investment performance of the assets supporting Annuity, provided certain conditions are met. The Guaranteed Minimum Income payments will apply only to Policy B. The Guaranteed Minimum Income payments will be guaranteed for the greater of the annuitant's life or a minimum period certain of ten years. The Guaranteed Minimum Income payments are contingent on Policyholder making each scheduled purchase installment when due until the Annuity Commencement Date, which is at least 10 years from the date of issuance. The Guaranteed Minimum Income payment feature is fixed upon issuance of Policy B and cannot be changed without giving up the right to the Income payment. Company A will be able to provide a guaranteed minimum level of monthly annuity payments despite the variable investment risks associated with the underlying assets because the payments will be available only if amounts are invested in the variable subaccount supporting Policy B in level monthly installments over the period from Policy B's date of issuance until the Annuity Commencement Date. Policyholder may satisfy the scheduled purchase installment by making a series of these payments in a specified amount until the Annuity Commencement Date or by making unscheduled purchase payments. The unscheduled purchase payments will be placed in a separate account and predetermined amounts will be transferred from this separate account to the variable subaccount. Company A represents that all of these segregated asset accounts will satisfy the diversification requirements of §817(h) and the regulations thereunder. Policyholder may surrender Policy B rather than annuitize Policy B.

Policy C is a variable annuity issued by Company A. Policy C will invest in equity securities, debt securities, and foreign securities. Policyholder will have the option of choosing one of the investment options available under Policy C. The investment risks associated with Policy C's variable investment options will be borne by Policyholder. Scheduled monthly amounts will be transferred from Policy C to Policy B.

Company A represents that with respect to Policy B and Policy C there is a single aggregate investment. Transfers between Policy C and Policy B will not result in any change in the investment in the aggregated investment. Thus, amounts includible in Policyholder's income will be determined on the basis that there is a single aggregate investment in Policy B and Policy C.

On the Annuity Commencement Date, Policy B's Contract Value will be converted into a variable monthly income benefit that will have been selected by the contract owner at the time Policy B is issued, which must be a life annuity plan with a period certain feature of at least ten years, or if there are joint annuitants, a joint life and survivor income plan with a period certain feature of at least ten years. Policy C's Contract Value will also be converted to either a fixed or variable monthly income plan beginning on the Annuity Commencement Date. Under Policy C, a policyholder may generally select one of the following plans: (1) a life income with a period certain, (2) income for a fixed period not longer than 30 years, (3) income of a definite amount paid until the proceeds are exhausted, with any remaining balance paid to the estate of the payee on the payee's death, or (4) a joint and last survivor income with a ten-year period certain. Distributions from Policy B and Policy C will be aggregated in accordance with the provisions of § 1.72-2. The proportionate part of the amounts received as an annuity and which is not taxable will be determined under the provisions of §§ 1.72-4, 1.72-5 and 1.72-6 of the regulations. Specifically, in a situation where a fixed monthly income plan is selected for Policy C and variable annuity payments are made under Policy B § 1.72-4(e)(2) with respect to determining the exclusion ratio will apply.

The Annuity Commencement Date will be the same for both Policy B and Policy C. Policyholder will be required to sign a declaration upon issuance of Policy B and Policy C that the Annuity Commencement Date will be the same. The Annuity Commencement Date for Policy B may not be changed after issuance. The Annuity Commencement Date for Policy C may be changed after issuance. It is also possible to accelerate the annuitization of Policy B. In the event that the annuitization of Policy B is accelerated, the policyholder would lose the right to the Guaranteed Minimum Income payments. The declaration will advise policyholder that either changing the

Annuity Commencement Date of Policy C or accelerating the annuitization of

Policy B may have adverse tax consequences. No opinion is offered, however, regarding the adverse tax consequences that may arise with respect to either Policy C or Policy B.

Policy B and Policy C will have two different policy numbers. However, Policy B and Policy C will be tracked together as a single contract for tax reporting purposes.

LAW & ANALYSIS

Section 72 of the Code prescribes the tax treatment of amounts received under an annuity contract. Generally, the rules under section 72 provide that amounts subject to the provisions of section 72 are includible in the recipient's gross income to the extent they represent amounts earned on the purchaser's investment. For this purpose, the provisions § 72 distinguish between "amounts received as an annuity" and "amounts not received as an annuity". Section 72(b) provides that a certain portion of each "amount received as an annuity" will be excluded from gross income.

Section 1.72-2(a)(2) of the Income Tax Regulations provides, in part, that if two or more annuity obligations or elements to which § 72 applies are acquired for a single consideration for both obligations (whether paid by one or more persons in equal or different amounts, and whether paid in a single sum or otherwise) such annuity elements will be considered to comprise a single contract for the purpose of the application of § 72 and the regulations thereunder. Therefore, the movement of funds within the underlying annuity obligations supporting the single contract does not result in a distribution under the contract nor a receipt of monies by a policyholder. As a result of the application of this regulation, Policy B and Policy C will be treated as comprising one single contract (Annuity). Furthermore, any transfer of funds from Policy C to Policy B will not be treated as "amounts received" but rather an internal transfer from one element of Annuity to another element of Annuity.

Section 1.72-2(b)(2)(i) provides that amounts subject to section 72 are considered "amounts received as an annuity" only in the event that the amounts are received on or after the annuity starting date and if the amounts are payable in periodic installments at regular intervals over a period of more than one full year from the annuity starting date.

Section 1.72-4(b)(1)(i) defines the annuity starting date as the first day of the first period for which an amount is received as an annuity. The first day of the first period for which an amount is received as an annuity is the later of the date upon which the obligations under the contract become fixed or the first day of the period which ends on the date of the first annuity payment.

Section 72(b) provides an exclusion ratio for determining the proportionate part of the total amount received each year as an annuity which is excludable from the gross income of a recipient in the taxable year of receipt. Generally, the exclusion ratio is determined by dividing the investment in the contract by the expected return of the contract. Section 1.72-4 further provides that in the situation where a single consideration is given for a particular contract which provides for two or more annuity elements, an exclusion ratio is determined for the contract as a whole by dividing the investment in the contract by the aggregate of the expected returns under all the annuity elements.

If an amount is received prior to annuitization of the contract, then under § 72(e)(2)(B) such amount is considered an "amount not received as an annuity" and it is included in income to the extent of the excess of the cash value in the annuity contract over the investment in the contract. Thus, any payments received by a taxpayer prior to the annuity starting date will be taxed under the provisions of § 72(e).

An "amount not received as an annuity" after an annuity has begun is taxed under §72(e)(2)(A) and §1.72-1(d). Specifically, these provisions provide that an amount not received as an annuity and received on or after the annuity starting date is included in gross income of the recipient.

Section 72(e)(11)(ii) provides that with respect to "amounts not received as an annuity", in determining the amount includible in gross income, all annuity contracts issued by the same company to the same policyholder during any calendar year shall be treated as one annuity contract. This provision is consistent with the application of §1.72-2(a)(2) to the facts of this ruling. Accordingly, section 72(e)(11) applies.

Section 1035(a)(3) of the Code provides that no gain or loss is recognized on the exchange of an annuity contract for an annuity contract. For this purpose, § 1035(b)(2) defines an annuity contract. Section 1.1035-1 of the regulations provides that a tax-free exchange of an annuity contract for another annuity contract under § 1035 of the Code is limited to cases where the same person or person is the obligee or obligees under the contract received in exchange as under the original contract.

The House Committee Report to the Internal Revenue Code of 1954 indicates that § 1035 was designed to eliminate the taxation of individuals "who merely exchanged one insurance policy for another better suited to their needs but who have actually recognized no gain." H.R. Rep. No. 1337, 83rd Cong., 2d Sess. 81 (1954). Thus, § 1035 operates as the insurance analogue to §1031, which relates to like-kind exchanges of certain types of property held for productive use in a trade or business or for investment. The similarity of § 1031 and § 1035 are evidenced in § 1035(c)(1), which provides that the recognition of gain or loss on an exchange that is not solely like-kind will be made under the terms of § 1031(b) and (c).

Section 1031 permits exchanges of one property for more than one property. See 1.1031(j)-1 (relating to exchanges of multiple properties). See also Rev. Rul. 85-

135, 1985-2 C.B. 181 (exchange of assets of two television stations for the assets of another television station).

Because § 1035(a)(3) is written in the singular, one might argue that it does not apply to exchanges of one annuity contract for two annuity contracts. Section 7701(n)(1),however, cross-references Title I, § 1 of the United States Code, which provides that "[i]n determining the meaning of any Act of Congress, unless the context indicates otherwise, words importing the singular includes and apply to several persons, parties, and things." Thus, just as § 1031 applies to exchanges of multiple properties, § 1035(a)(3) applies to exchanges of multiple annuities.

RULINGS

Accordingly, based on the facts, representations, law and arguments presented we conclude the following:

1) the exchange of Policy A for Policy B and Policy C will qualify as a tax-free exchange under § 1035; and

2) Policy B and Policy C will be treated as one annuity contract for purposes of § 72 and the regulations thereunder;

3) the transfer of funds within Annuity, that is from Policy C to Policy B, will not be treated as a taxable distribution under §72(e) of the Code.

We express no opinion as to the tax treatment of the Policies under the provisions of any other sections of the Code and Regulations that may also be applicable thereto.

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

A copy of this letter should be attached to the next federal income tax return to be filed by Company A and Policyholder.

Sincerely yours,

/S/

MARK S. SMITH
Chief, Branch 4
Office of Associate Chief Counsel
(Financial Institutions & Products)