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Department of the Treasury
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Date:
March 17, 2011

Taxpayer =
Issuer =

Contract =

Sponsor =

Dear :

This is in response to your request for a letter ruling regarding the application of the Internal Revenue Code to a transaction you contemplate undertaking.

FACTS

The following is represented:

The Issuer is a corporation taxable under part I of subchapter L of the Internal Revenue Code. The Issuer intends to offer the Contract to individuals[1] (Customer) who have an ownership interest in an investment account (Account) established at a financial institution.[2] In exchange for a Fee, the Contract obligates the Issuer to pay the Customer a benefit (Contract Benefit) for the life of the Covered Life if the value of the Account falls below a Specified Minimum Account Value while the Contract is in force. The Covered Life is the Customer or, if joint lives are elected, the Customer and the

[1] Consistent with § 72(u).
[2] This institution may or may not be an affiliate of Issuer.

Customer's spouse.[3] The Contract has a specified expiration date, on which the Contract will terminate unless the Customer elects the annuity purchase option.

The Customer will deposit money in the Account. Consistent with a permitted investment profile established by the Issuer and the Sponsor,[4] the Account will be invested in certain regulated investment companies ("mutual funds"); the profile may be limited to funds advised by the Sponsor.

To keep the Contract in-force, the Customer must pay the Fee and the Account must at all times be invested consistent with then current permitted investment profile; the profile will specify the eligible mutual funds and the portion of the Account permitted in each such fund.

The Contract Benefit is determined by reference to a Value Marker. At the time of issuance of the Contract, the Value Marker is the value of the Account. The Value Marker is increased by additional deposit(s) into the Account (subject to the Contract's limit on the amount deposited) and decreased by certain withdrawals from the Account (explained below). On each anniversary of the Contract, the Marker Value is redetermined to be the greater of the current Value Marker and the value of the Account at the close of the business day prior to the anniversary.

The Customer is allowed to access the value of the Account at any time. Withdrawals from the Account are classified as either Permitted Annual Withdrawals or Forbidden Withdrawals; Forbidden Withdrawals are any withdrawal other than a Permitted Annual Withdrawal and decrease the Value Marker by the percentage that the amount of the Forbidden Withdrawal bears to the value of the Account.

At any time after the younger of the covered lives attains the minimum age specified in the Contract, the Customer can elect to begin Permitted Annual Withdrawals of the Permitted Annual Withdrawal Amount, which is determined by a two-step process. First, the Value Marker is redetermined to be the greater of the current Value Marker or the value of the Account at the close of the business day prior to the election. Second, a Withdrawal Factor is applied to this redetermined Value Marker. If less than the Permitted Annual Withdrawal Amount is withdrawn, the untaken balance is not added to a subsequent year's Permitted Annual Withdrawal Amount. The Permitted Annual Withdrawal Amount is redetermined on each Contract anniversary by another two step process. First, if during the just completed Contract year more than the Permitted Annual Withdrawal Amount is withdrawn – a Forbidden Withdrawal – the Permitted Annual Withdrawal Amount is reduced by the percentage that the amount of the Forbidden Withdrawal bears to the value of the Account. Second, the value of the Account at the close of the business day prior to the anniversary is multiplied by the

[3] Distributions under the Contract will be consistent with § 72(s).
[4] Sponsor is an affiliate of Issuer within the meaning of § 1563(a).

greater of the Withdrawal Factor used in the prior year and the Withdrawal Factor that would apply to the current year. The Permitted Annual Withdrawal Amount for the next year will be the greater of the amounts determined by the two steps, with a corresponding adjustment to the Value Marker.

The Issuer will notify the Customer if the value of the Account falls below the Specified Minimum Account Value before the expiration date. The Customer will have a specified period of time to increase the value of Account above the Specified Minimum Account Value.[5] If at the expiration of the specified period the value of the Account remains below the Specified Minimum Account Value, the Account will be liquidated and proceeds remitted to the Issuer[6] and the Issuer will begin paying the Contract Benefit to Customer. If the Customer has not yet elected to begin Permitted Annual Withdrawals, the annual Contract Benefit equals the Value Marker at the end of the prior business day multiplied by the current Withdrawal Factor. If the Customer has elected to begin Permitted Annual Withdrawals, the annual Contract Benefit equals the Value Marker at the end of the prior business day multiplied by the Withdrawal Factor used to determine the current Permitted Annual Withdrawal Limit; i.e., the annual Contract Benefit equals the Permitted Annual Withdrawal Amount, assuming no Forbidden Withdrawal that year.

At any time prior to the commencement of payment of the Contract Benefit or the Contract's specified expiration date, the Customer may apply the Account Value to the purchase of annuity payments for the life of the Customer (or the later of the Customer's spouse, if elected) based on an annuity purchase rate guarantee specified in the Contract (Annuity Benefit).

The Fee for the Contract is imposed quarterly resulting from the application of a formula and is a function of the Value Marker. The Fee may increase, in which case the Customer has the option of cancelling the Contract rather than pay the increased Fee. The Fee is paid out of the Account, but such payment is not counted as either a Permitted Annual Withdrawal or a Forbidden Withdrawal.

The Contract terminates upon the earliest of, among other things:

1. the date the Customer notifies the Issuer of intention to cancel the Contract;
2. closing of the Account;
3. failure to timely correct allocation of the Account consistent with the permitted investment profile;
4. failure to timely pay the Fee;
5. the Account Value is reduced to zero by a Forbidden Withdrawal;
6. the death of the Customer; or,

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[5] This can be done by either returning that year's Permitted Annual Withdrawal or making an additional deposit.
[6] This, and all other transactions involving the Account, are taxable consistent with the tax rules applicable to the Account.

7. the specified expiration date.

The Contract does not have any cash value and the ownership rights, including the right to the Contract Benefit or right to purchase annuity payments, cannot be assigned or transferred.

Taxpayer is contemplating becoming a Customer.

REQUESTED RULINGS

Taxpayer requests rulings that:

1. the Contract will be treated as an annuity contract within the meaning of § 72 of the Internal Revenue Code;
2. the Contract will not create a right to reimbursement for losses realized on assets in the Account for purposes of § 165(a) and thus will not prevent the Customer from currently deducting such losses;
3. the Contract will not be treated as diminishing the Customer's risk of loss on assets in the Account for purposes of applying the holding period requirements of § 1(h)(11);
4. the Contract and the assets in the Account will not, either at the time of issuance of the Contract or subsequently, be viewed as components of a straddle within the meaning of § 1092;
5. the Fee paid to the Company will be taken into account in the determination of the Customer's "investment in the contract" for the Contract under § 72 and the Customer's adjusted basis in the Contract under § 1011;
6. the provisions of § 1233(b) will not apply to the computation of the Customer's holding period for the assets in the Account; and,
7. if the Company becomes liable to pay the Contract Benefit, or the optional annuity payments, such payments will be "amounts received as an annuity" under § 72(a).

LAW and ANALYSIS

Requested Ruling #1

Section 72(a) provides that except as otherwise provided, gross income includes any amount received as an annuity (whether for a period certain or during one or more lives) under an annuity, endowment, or life insurance contract. The Code does not otherwise define an annuity contract or "any amount received as an annuity."

Section 1.72-2(a)(1) of the Income Tax Regulations provides that the contracts under which amounts paid will be subject to the provisions of § 72 include contracts which are considered to be life insurance, endowment, and annuity contracts in accordance with the customary practice of life insurance companies. Under §§ 1.72-1(b) and (c), as a general matter "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, a proportionate part of which is considered to represent a return of premiums or other consideration paid. Under § 1.72-2(b), amounts are considered as "amounts received as an annuity" only if all of the following tests are met: 1) the amounts must be received on or after the annuity starting date, 2) the amounts must be payable in periodic installments at regular intervals over a period of more than one full year from the annuity starting date, and 3) the amounts payable must be determinable either directly from the terms of the contract or indirectly from the use of either mortality tables or compound interest computations, or both (if the contract is a variable contract, § 1.72-2(b)(3) provides an alternative formulation of this requirement). Under § 1.72-4(b)(1), the annuity starting date is 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 shall be the later of 1) the date upon which the obligations under the contract became fixed or 2) the first day of the period which ends on the date of the first annuity payment.

Explaining imposition of an "income-out-first" rule under §72(e) for withdrawals prior to the annuity starting date, the Senate report described a commercial annuity as

> a promise by a life insurance company to pay the beneficiary a given sum for a specified period, which period may terminate at death. Annuity contracts permit the systematic liquidation of an amount consisting of principal (the policyholder's investment in the contract) and income….An individual may purchase an annuity by payment of a single premium or by making periodic payments. A deferred annuity contract may, at the election of the individual, be surrendered before annuity payments begin, in exchange for the cash value of the contract….The committee believes that the use of deferred annuity contracts to meet long-term investment goals, such as income security, is still a worthy ideal.

S. Rep. No. 97-494 at 349-50 (1982)(footnote omitted). The report also explains § 72's utilization of an exclusion ratio regime: "[a] portion of each amount paid to a policyholder as an annuity generally is taxed as ordinary income under an 'exclusion ratio' (§ 72(b)) computed to reflect the projected nontaxable return of investment in the contract and the taxable growth on the investment." Id. As described in Samuel v. Commissioner, 306 F.2d 682, 687 (1st Cir. 1962), aff'g Archibishop Samuel Trust v. Commissioner, 36 T.C. 641 (1961), acq., 1964-2 C.B. 3

> [i]nherent in the concept of an annuity is a transfer of cash or property from one party to another in return for a promise to pay a specific periodic sum for a stipulated time interval….Again, in the normal annuity situation, once the annuitant has transferred the cash or property to the obligor and has received his contractual right to periodic payments, he is unconcerned with the ultimate disposition of the property transferred once it is in the obligor's hands.

In Life & Health Insurance, Black and Skipper state that "[i]n the broadest sense, an annuity is simply a series of periodic payments" and while "[l]ife insurance has as its principal mission the creation of a fund [, t]he annuity, on the contrary, has as its basic function the systematic liquidation of a fund." Accordingly,

> [e]ach payment under an annuity may be considered to represent a combination of principal and interest income and a survivorship element. Although not completely accurate, one can view the operation of an annuity as follows: If a person exactly lives out his or her life expectancy, he or she would have neither gained nor lost through utilizing the annuity contract.

Kenneth Black, Jr. and Harold D. Skipper, Jr., Life & Health Insurance 161-62 (13th ed. 2000).

Elsewhere an annuity has been described as "a right to receive fixed, periodic payments, for a specified period of time" and an annuity contract as

> a contract under which, in exchange for the payment of a premium or premiums, the recipient thereof is bound to make future payments, typically at regular intervals, in amounts, to payees, and conditions specified in the parties' agreement. The determining characteristic of an annuity is that the annuitant has an interest only in the periodic payments and not in any principal fund or source from which they may be derived. Although an individual who purchases an annuity remains the technical owner of the asset, he or she does not retain total control over that asset and does not have unfettered access to the full amount of his or her own "property".

4 Am. Jur. 2d Annuities, § 1 (2008). Moreover, "[t]he purchaser of an annuity surrenders all rights to the money paid, and therefore installment payments of a debt, or payments of interest on a debt, do not constitute an annuity." Id., § 2.

Whether an annuity contract allows the owner to access the value of the contract through other than periodic ("annuity") payments is a product of state statute, Appleman on Insurance § 182:05[B][7] and [8] (2d ed. 2008).

Here, on balance the Contract possess the essential attributes of an annuity. It is true that the Contract may not, "at the election of the [holder], be surrendered before annuity payments begin, in exchange for the cash value of the contract", S. Rep. No. 97-464 at 349. It is also true that because the annuity starting date is contingent upon the value of the Account being reduced while the Customer is alive, it is not the case that "if [Customer] exactly lives out his or her life expectancy, he or she would have neither gained nor lost through utilizing the annuity contract", Life & Health Insurance, at 162, but these conditions are not dispositive.

The Contract and the amounts paid under the Contract meet the requirements of §§ 1.72-1(b) and (c), 1.72-2(a)(1) and (b)(3), and 1.72-4(b)(1) as annuity contracts and annuity payments. Additionally, the Contract is purchased "by making periodic payments" of premium for "a promise by a life insurance company to pay the beneficiary a given sum for a specified period, which period may terminate at death", and is "used to provide long-term income security." S. Rep. No. 97-464 at 349. Moreover, it has "the determining characteristic … that the annuitant has an interest only in the periodic payments and not in any principal fund or source from which they may be derived." 4 Am. Jur. 2d Annuities, §1. The Customer will have "surrender[ed] all rights to the money paid", thereby distinguishing the Contract from "installment payments of a debt, or payments of interest on a debt", which are not annuities. Id.

The Contract is not a contract to pay interest. See § 1.72-14(a)[7].

Accordingly, the Contract will be treated as an annuity contract within the meaning of § 72.[8]

Requested Ruling #2

Section 165(a) allows as a deduction any loss not compensated for by insurance or otherwise.

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[7] The Certificate is not a debt instrument because it is issued by an insurance company subject to tax under subchapter L in a transaction in which there is no consideration other than cash. Section 1275(a)(1)(B)(ii).

[8] Customer is considered the owner of the Account. Rev. Rul. 2003-92, 2003-2 C.B. 350; Rev. Rul. 81-225, 1981-2 C.B. 12.

Section 1.165-1(d)(2)(i) provides that if a casualty or other event occurs which may result in a loss, and in that year there exists a claim for reimbursement with respect to which there is a reasonable prospect of recovery, no portion of the loss with respect to which reimbursement may be received is sustained until it can be ascertained with reasonable certainty whether or not the reimbursement will be received. Whether a reasonable prospect of recovery exists with respect to a claim for reimbursement of a loss is a question of fact to be determined upon an examination of all facts and circumstances.

In Dunne v. Commissioner, 29 B.T.A. 1109 (1934), aff'd, 75 F.2d 255 (2d Cir. 1935), the taxpayer and two others were the beneficial owners of three brokerage accounts that were opened at the recommendation of a wealthy friend who, desiring to assist them in making money on the stock market, guaranteed the accounts. The court held that the taxpayer's subsequent losses were not deductible because of the guarantee.

In Boston Elevated Railway Co. v. Commissioner, 16 T.C. 1084, 1111-1112 (1951), aff'd on another issue, 196 F.2d 923 (1st Cir. 1952), the Service argued that loss resulting from the abandonment of an elevated railway structure was compensated for by legislation (the Public Control Act) guaranteeing the taxpayer operating profits sufficient to pay dividends. The court disagreed, stating that “regardless of the amounts of any possible losses sustained by petitioner, no payments would be forthcoming to it if its income were sufficiently high, after absorbing the losses and other charges, to pay the required dividends.” 16 T.C. at 1112.

Johnson v. Commissioner, 66 T.C. 897 (1976), aff'd, 574 F.2d 189 (4th Cir. 1978), involved a business partnership formed by the taxpayer and an associate. The taxpayer purchased an insurance policy on his partner's life. After his partner's accidental death, the taxpayer and his partner's widow were unsuccessful in continuing the business and terminated the partnership. The court upheld the disallowance of a loss on the termination because the taxpayer was compensated by the proceeds of the insurance policy. The court pointed out that the amount of the policy was approximately equal to the taxpayer's investment in the partnership. Thus, although it was not the partnership interest itself that was insured, the life insurance acted to compensate the loss of the partnership interest.

In Forward Communications Corp. v. United States, 608 F.2d 485 (Ct. Cl. 1979), the taxpayer, a local television station, claimed a loss based on termination of its affiliation agreement with CBS, the television network. The trial judge upheld disallowance of the deduction on the theory that increased revenues from affiliation with ABC, another television network, compensated taxpayer for loss of the CBS affiliation. Reversing this finding, the Court of Claims stated, "[t]he statute does not bar a deduction for a loss actually incurred merely because the taxpayer is able to effect an offsetting gain on a different although contemporaneous transaction." 608 F.2d at 611-12.

In Shanahan v. Commissioner, 63 T.C. 21 (1974), which involved federal disaster relief payments, the Tax Court, interpreting the words "insurance or otherwise" in § 165, determined that the general term "or otherwise" must be construed consistently with the specific term "insurance." The court stated that the general purpose of insurance is to spread the risk of loss from any peril among a large number of those who are exposed to a similar peril.

In Estate of Bryan v. Commissioner, 74 T.C. 725 (1980), the court, citing Shanahan, determined that the phrase "insurance or otherwise" in an analogous provision, § 2054, contemplates that the type of compensation received must be such that it was "structured to replace what was lost." 74 T.C. at 727. The court held that a disbursement from a trust fund established by a state bar association, in compensation for losses incurred due to an attorney's unethical behavior, was in the nature of insurance.

Rev. Rul. 87-117, 1987-2 CB 61, involves a regulated public utility that abandons a partially-completed nuclear plant; the ratemaking authority allows a rate increase that takes into account the cost of the abandoned plant. The ruling holds that the rate increase does not reduce the taxpayer's abandonment-loss deduction because the rate increase was structured to serve the utilities' customers at a fair charge and ensure a reasonable return to investors, not to reimburse the loss.

In the present situation, the Contract Benefit may appear at first blush to be "structured to replace what was lost," in that the Contract Benefit takes effect upon the overall value of the Account falling below the Specified Minimum Account Value, and is based on the Value Marker. Similarly, as a case like Johnson illustrates, it is possible for a contractual arrangement to be treated as compensation for § 165 purposes even though it compensates for a loss indirectly, not directly.

In this case, however, the relationship between any individual market loss on the Account and any eventual payment of the Contract Benefit is too tenuous and too contingent on a number of factors for the payments to be considered compensation for any given market loss. For example, the covered life(ves) may end before the Account is depleted, in which case the Contract Benefit will never take effect. Even if the recipient of the Contract Benefit (the Customer or, if elected upon purchase, the second to die of the Customer and the Customer's spouse) begins receiving the Contract Benefit, the recipient is entitled to the Contract Benefit only while he or she is alive and, thus, there is no certainty that the recipient will live long enough to be fully compensated for market losses on the Account before recovering associated Fees.

There is no close correlation between any given loss and any eventual payments that Issuer may make. Once determined at the time of the initial withdrawal from the Account, the Permitted Annual Withdrawal Amount, which the Contract Benefit is based on, may be increased but may not be decreased except for Forbidden Withdrawals. Withdrawals from the Account, and not just investment losses, will contribute significantly to depletion of the Account; in fact, the arrangement is structured primarily to insure against longevity risk, not market risk, and the permitted investment profile(s) is intended to minimize the effect of excessive volatility and market risk. Should the recipient live long enough and if the withdrawals from the Account do not constitute Forbidden Withdrawals, the Contract Benefit could become payable even if no losses were sustained.

Thus, the facts are similar to those considered in Boston Elevated Railway Co., where the court noted that, “regardless of the amounts of any possible losses sustained by petitioner, no payments would be forthcoming to it if its income were sufficiently high, after absorbing the losses … ." 16 T.C. at 1112. The fact, amount, and timing of the Contract Benefit are contingent on a number of factors, including not only a particular market loss, but also other market losses, offsetting market gains, the Customer's withdrawal rate, Forbidden Withdrawals, and – most significantly – the Customer's life span. The contract is structured, not as reimbursement for market losses, but rather as a contingent, deferred annuity that begins to pay benefits on the occurrence of an event the timing of which may be influenced by market performance. The Contract is not structured to replace or reimburse either individual or overall market losses on the Account. Cases such as Dunne and Johnson are distinguishable because the nexus between the losses and the compensation for the losses was more direct than is the case here.

Therefore, the Contract will not create a right to reimbursement for losses realized in the Account for purposes of § 165(a) and thus will not prevent the Customer from currently deducting such losses, assuming the Customer’s losses otherwise meet the requirements of § 165.

Requested Ruling #3

Under § 1(h)(11)(A), for purposes of § 1(h), the term “net capital gain” means net capital gain (determined without regard to § 1(h)(11)) increased by qualified dividend income. In defining qualified dividend income, § 1(h)(11)(B)(iii) provides that the term shall not include any dividend on any share of stock with respect to which the holding period requirements of § 246(c) are not met, determined by substituting in § 246(c) “60 days” for “45 days” each place it appears and by substituting “121-day period” for “91-day period”.

Section 246 provides rules applicable to deductions for dividends received, among them a required holding period. See, § 246(c). Under § 246(c)(4), this holding period is reduced for any period (during such periods) in which (A) the taxpayer has an option to sell, is under a contractual obligation to sell, or has made (and not closed) a short sale of, substantially identical stock or securities, (B) the taxpayer is the grantor of an option to buy substantially identical stock or securities, or (C) under regulations a taxpayer has diminished his risk of loss by holding 1 or more other positions with respect to substantially similar or related property.

The applicable regulation is § 1.246-5, which provides that property is substantially similar or related to stock when (i) the fair market value of the stock and the property reflect the performance of (A) a single firm or enterprise; (B) the same industry or industries; or (C) the same economic factor or factors such as (but not limited to) interest rates, commodity prices, or foreign-currency exchange rates; and (ii) changes in the fair market value of the stock are reasonably expected to approximate, directly or inversely, changes in the fair market value of the property, a fraction of the fair market value of the property, or a multiple of the fair market value of the property. Sec. 1.246-5(b)(1). A position is an interest (including a futures or forward contract or an option) in property or any contractual right to a payment, whether or not severable from stock or other property, § 1.246-5(b)(3). Moreover, a taxpayer has diminished its risk of loss on stock by holding a position in substantially similar or related property if the taxpayer is the beneficiary of a guarantee, surety agreement, or similar arrangement and the guarantee, surety agreement, or similar arrangement provides for payments that will substantially offset decreases in the fair market value of the stock. § 1.246-5(c)(4).

The Conference Report to the Deficit Reduction Act of 1984, H. Rep. No. 98-861, at 818, 1984-3 C.B. (Vol. 2) 1, 72, indicates that "[t]he substantially similar standard is not satisfied merely because the taxpayer … is an investor with diversified holdings and acquires a [regulated futures contract] or option on a stock index to hedge general market risks."

The purchase of the Contract will not cause the Customer to have an option to sell, to be under a contractual obligation to sell, or to have made (and not closed) a short sale of, substantially identical stock or securities. The Contract is not substantially similar or related property because the fair market value of the Account and the Contract do not reflect the performance of a single firm or enterprise, the same industry or industries, or the same economic factors; because the predominant risk the Contract protects against is longevity risk (i.e., the benefit under the Contract is contingent upon the survival of the covered life(ves)), and because the changes in the fair market value of the Account are not reasonably expected to approximate, directly or inversely, changes in the fair market value of the Contract, a fraction or multiple thereof. Finally, the benefits that may be ultimately paid under the Contract are not closely correlated with, and do not substantially offset, decreases in the fair market value of the Account. Thus, we conclude that the Contract does not diminish Customer's risk of loss on Account assets for purposes of applying the holding period requirements of § 1(h)(11).

Requested Ruling #4

Section 1092 imposes special rules that effectively suspend losses with respect to positions that are held as part of a straddle.

A straddle is defined in § 1092(c)(1) as "offsetting positions with respect to personal property." A taxpayer holds "offsetting positions with respect to personal property" if there is a substantial diminution of the taxpayer's risk of loss from holding any position by reason of his holding one or more other positions with respect to personal property (whether or not of the same kind). See § 1092(c)(2)(A). Section 1092(d) provides that the term "personal property" means any personal property of a type which is actively traded and that the term "position" means an interest in personal property. The Contract, however, is not an "offsetting position" with respect to the Customer's interest in the assets in the Account. See also § 1092(d)(3). Accordingly, § 1092 does not apply.

Requested Ruling #5

Section 72(c)(1) provides that, for purposes of the exclusion ratio under § 72(b), the "investment in the contract" as of the annuity starting date is the aggregate amount of premiums or other consideration paid for the contract, minus the aggregate amount received under the contract before such date, to the extent that such amount was excludable from gross income. Under § 72(c)(2), this amount is then reduced by the value of the refund feature, if any.

Section 72(e)(6) provides that for purposes of § 72(e), the "investment in the contract" as of any date is the aggregate amount of premiums or other consideration paid for the contract before such date, minus the aggregate amount received under the contract before such date, to the extent that such amount was excludable from gross income.

Section 1011(a) provides that the adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis (determined under § 1012 or other applicable sections), adjusted as provided in § 1016.

Accordingly, the Fee paid to Issuer will be taken into account in the determination of a Customer's "investment in the contract" for the Contract under § 72 and the Customer's adjusted basis in the Contract under § 1011. See, e.g., Rev. Rul. 2003-76, 2003-2 C.B. 355 (addressing the allocation of the investment in the contract and the basis in the contract after the exchange of a portion of an annuity contract under § 1035(a)(3)).

Requested Ruling #6

Section 1233 provides rules as to the tax consequences of a short sale of property if gain or loss from the short sale is considered a gain or loss from the sale or exchange of a capital asset. Section 1.1233-1(c)(1).

Section 1233(b) provides that:

> If gain or loss from a short sale is considered as gain or loss from the sale or exchange of a capital asset under subsection (a) and if on the date of such short sale substantially identical property has been held by the taxpayer for not more than 1 year (determined without regard to the effect, under paragraph (2) of this subsection, of such short sale on the holding period), or if substantially identical property is acquired by the taxpayer after such short sale and on or before the date of the closing thereof--
>
> **(1)** any gain on the closing of such short sale shall be considered as a gain on the sale or exchange of a capital asset held for not more than 1 year (notwithstanding the period of time any property used to close such short sale has been held); and
>
> **(2)** the holding period of such substantially identical property shall be considered to begin (notwithstanding § 1223, relating to the holding period of property) on the date of the closing of the short sale, or on the date of a sale, gift, or other disposition of such property, whichever date occurs first. This paragraph shall apply to such substantially identical property in the order of the dates of the acquisition of such property, but only to so much of such property as does not exceed the quantity sold short.
>
> For purposes of this subsection, the acquisition of an option to sell property at a fixed price shall be considered as a short sale, and the exercise or failure to exercise such option shall be considered as a closing of such short sale.

The Contract is neither a short sale of, nor an option to sell the assets in the Account. No other aspect of the transaction would qualify as a short sale of, or an option to sell, these assets. Therefore the provisions of § 1233(b) will not apply to the computation of the Customer's holding period for these assets.

Requested Ruling #7

Section 72(a) provides that gross income includes any amount received as an annuity (whether for a period certain or during one or more lives) under an annuity, endowment, or life insurance contract.

Section 72(b)(1) provides that gross income does not include that part of any amount received as an annuity under an annuity, endowment, or life insurance contract which bears the same ratio to such amount as the investment in the contract (as of the annuity starting date) bears to the expected return under the contract (as of such date).

Section 72(c)(4) defines "annuity starting date" as the first day of the first period for which an amount is received as an annuity under the contract.

Section 1.72-2(b)(2) defines "amounts received as an annuity" as only those amounts that meet all of the following tests:

a. they must be received on or after the 'annuity starting date' as that term is defined in § 1.72-4(b);
b. 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
c. except as indicated in § 1.72-2(b)(3), 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 use of either mortality tables or compound interest computations, or both, in conjunction with such terms and in accordance with sound actuarial theory.

Section 1.72-4(b) defines "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 shall be whichever of the following is the later:

a. the date upon which the obligations under the contract became fixed, or
b. the first day of the period (year, half-year, quarter, month, or otherwise, depending on whether payments are to be made annually, semiannually, quarterly, monthly, or otherwise) which ends on the date of the first annuity payment.

Here, with respect to the Contract Benefit, when the Contract Benefit becomes payable the obligations under the Contract become fixed: no additional Fee is due and the benefit obligation of Issuer is fixed at paying the Contract Benefit until the annuitant(s)' demise. Hence, the Contract Benefit will be received on or after the annuity starting date.

Second, the Contract Benefit will be paid periodically at regular intervals over a period of more than one full year from the annuity starting date (unless death occurs).

Third, the total amount payable is determinable from the Contract using mortality tables and sound actuarial theory.

Accordingly, the Contract Benefit will be an "amount received as an annuity."

With respect to the Annuity Benefit, if the Customer exercises that option the obligations under the Contract become fixed: no additional Fee is due and the benefit obligation of Issuer is to pay the annuity settlement option consistent with the rate guarantee. Hence, the Annuity Benefit will be received on or after the annuity starting date.

Second, the Annuity Benefit will be paid periodically at regular intervals over a period of more than one full year from the annuity starting date, consistent with the annuity settlement option.

Third, the total amount payable is determinable from the Contract's rate guarantee using mortality tables and sound actuarial theory.

Accordingly, the Annuity Benefit will be "an amount received as an annuity."

Either the Annual Benefit or the Annuity Benefit[9] will be taxable under § 72(a) as an amount received as an annuity, subject to the exclusion of the amount allocable to the investment in the contract determined under § 72(b).

RULINGS

Accordingly, we rule that:

1. the Contract will be treated as an annuity contract within the meaning of § 72 of the Internal Revenue Code;
2. the Contract will not create a right to reimbursement for losses realized on assets in the Account for purposes of § 165(a) and thus will not prevent the Customer from currently deducting such losses;

[9] The Customer cannot receive both.

3. the Contract will not be treated as diminishing the Customer's risk of loss on assets in the Account for purposes of applying the holding period requirements of § 1(h)(11);
4. the Contract and the assets in the Account will not, either at the time of issuance of the Contract or subsequently, be viewed as components of a straddle within the meaning of § 1092;
5. the Fee paid to the Company will be taken into account in the determination of the Customer's "investment in the contract" for the Contract under § 72 and the Customer's adjusted basis in the Contract under § 1011;
6. the provisions of § 1233(b) will not apply to the computation of the Customer's holding period for the assets in the Account; and,
7. if the Company becomes liable to pay the Contract Benefit of the optional annuity payments, such payments will be "amounts received as an annuity" under § 72(a).

The ruling contained in this letter are based upon information and representations submitted by Issuer and accompanied by a penalty of perjury statement executed by an appropriate party. This office has not verified any of the material submitted in support of the request for rulings and 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. This ruling is directed only to Issuer. Section 6110(k)(3) 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.

Sincerely,

/S/

Sheryl B. Flum
Chief, Branch 4
Office of the Associate Chief Counsel
Financial Institutions & Products