**Internal Revenue Service**

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May 03, 2016

Legend

Taxpayer =

State A =
Company B =

Jurisdictions =

Dear

This is in reply to your letter requesting certain rulings under § 72 of the Internal Revenue Code (the "Code").

## FACTS

Taxpayer is a life insurance company incorporated under the laws of State A. It files a consolidated tax return with Company B on a calendar year basis using the accrual method of accounting. Taxpayer is a life insurance company as defined by § 816(a) and is licensed to conduct business in Jurisdictions.

Taxpayer issues a non-qualified, individual, flexible premium deferred variable annuity contract (the "Contract"). The Contract provides an accumulation period and a payout period. During the accumulation period, the owner can take withdrawals from the Contract's "Accumulation Value," which is the sum of the values attributable to the investment options offered under the Contract which the owner has selected. Taxpayer plans to offer the Contract with a deferred income annuity ("DIA") payout rider (the "Rider"). The Rider will allow the owner to apply some or all of the Contract's

Accumulation Value to the annuity option described in the Rider. The DIA option will provide a series of life annuity payments commencing on a scheduled future date. Once the Accumulation Value is transferred to the Rider, that amount is no longer available for withdrawal. However, any Accumulation Value that is not transferred to the Rider will remain available for withdrawal. Taxpayer has requested rulings under §§ 72(a), (b), and (e) regarding the treatment of withdrawals and annuity payments in these circumstances.

The Contract provides for flexible premium payments, subject to certain restrictions. Premiums cannot be paid at any time after the earliest of (a) the date the accumulation period ends, (b) the date the Accumulation Value is zero, or (c) the owner's death (unless the owner's surviving spouse continues the Contract in accordance with § 72(s)).

During the accumulation period, the owner can surrender the Contract or take withdrawals from the Accumulation Value. Surrender charges and certain state taxes may apply to surrenders and withdrawals.

A death benefit is payable if the owner of the Contract dies during the accumulation period. The amount of the death benefit equals the Accumulation Value on the applicable valuation date, plus the amount of any additional death benefit provided by a rider to the Contract. If the owner dies during the payout period, the remaining portion (if any) of the interest in the Contract will be distributed at least as rapidly as under the method of distribution being used as of the date of death.

The owner may add the Rider to the Contract when the Contract is issued. The owner, annuitant, and beneficiary under the Rider are identical to those under the Contract. When added to the Contract, the Rider becomes part of the Contract and is subject to all applicable, non-conflicting terms of the Contract.

The Rider amends the Contract to provide the owner with an option to allocate some or all of the Accumulation Value towards an annuity payout (the "DIA Payments") that will commence on a specified future date, and may choose to make multiple allocations of Accumulation Value over time. Each allocation of Accumulation Value to the Rider will entitle the owner to DIA Payments that are calculated using Taxpayer's annuity purchase rates for DIAs as of the date of the allocation applicable to the age and gender of the annuitant, the date the DIA Payments are scheduled to begin (the "DIA Start Date"), and other relevant factors. The DIA Start Date cannot extend beyond a specified age of the annuitant, and the annuitant cannot be changed after the initial allocation to the Rider.

The DIA Payments are life-contingent, fixed annuity payments that will be made at least annually and under which the owner can choose to include a period certain or other refund feature. Regardless of the number or timing of allocations made to the Rider, all DIA Payments will commence on the same DIA Start Date, will be payable under the same life-contingent annuity option, will be based on the same annuitant's life, and will be paid at the same frequency.

The owner cannot change the DIA payment option after the first allocation to the Rider is made. However, prior to the DIA Start Date the owner can change the frequency at which DIA Payments will be made, e.g., from monthly to quarterly. After the DIA Start Date, the payment frequency cannot be changed. The owner also can change the DIA Start Date before DIA Payments begin, subject to certain restrictions.

To the extent that the entire amount of the Accumulation Value is not applied to the Rider, all contractual benefits continue to apply to the remaining Accumulation Value, including the right to apply that Accumulation Value to another annuity option under the Contract or to withdraw the remaining Accumulation Value in part or in full. However, after any amount of the Accumulation Value is transferred to the Rider, that amount is no longer part of the Contract's Accumulation Value and cannot be accessed; the Rider does not provide a withdrawal or surrender right of amounts transferred to it.

If the annuitant (or an owner who is not the annuitant) dies before the DIA Start Date, no DIA Payments will be made but the Rider may provide for a lump sum death benefit. If applicable, the death benefit will equal the sum of all amounts previously allocated to the Rider, without any subsequent interest or earnings. This amount is added to the Contract's Accumulation Value at death, and then is governed by the death benefit provisions in the Contract. After the DIA Start Date, any death benefit is governed by the DIA payment option the owner chose.

## ADDITIONAL REPRESENTATIONS

1. The Contract will comply with § 72(s).

2. The Contract will be treated as an annuity contract under the state insurance laws and regulations of any state in which it is issued.

## REQUESTED RULINGS

1. Section 72(a)(2) will apply each time Accumulation Value is transferred from the Contract to the Rider if, immediately after the transfer, the Contract continues to have an Accumulation Value.

2. At the time a transfer to which § 72(a)(2) applies is made from the Contract to the Rider:

a. Pursuant to § 72(a)(2)(A), the portion of the Contract from which the DIA Payments associated with that transfer will be made will be treated as a separate contract for purposes of § 72;

b. Pursuant to § 72(a)(2)(B), for purposes of applying §§ 72(b), (c), and (e) a pro rata portion of the investment in the contract with respect to the Contract will be allocated between the Contract and the separate contract that is treated as having arisen by virtue of such transfer, with the pro rata allocation determined as of the transfer date based on the percentage of Accumulation Value transferred; and

c. Pursuant to § 72(a)(2)(C), a separate annuity starting date will be determined with respect to each separate contract that is treated as having arisen by virtue of the transfer to the Rider.

## LAW AND ANALYSIS

Section 72(a)(1) provides that, except as otherwise provided in Chapter 1 of the Code, 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(a)(2), in relevant part, provides that if any amount is received as an annuity for a period of 10 years or more or during one or more lives under any portion of an annuity, the rules of subparagraphs (A)-(C) of § 72(a)(2) shall apply. Subparagraph (A) of § 72(a)(2) provides that such portion shall be treated as a separate contract for purposes of § 72. Subparagraph (B) of § 72(a)(2) provides that for purposes of applying subsections (b), (c), and (e) of § 72, the investment in the contract shall be allocated pro rata between each portion of the contract from which amounts are received as an annuity and the portion of the contract from which amounts are not received as an annuity. Subparagraph (C) of § 72(a)(2) provides that a separate annuity starting date under § 72(c)(4) shall be determined with respect to each portion of the contract from which amounts are received as an annuity.

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).

Under § 1.72-2(b) of the Income Tax Regulations, amounts are considered as "amounts received as an annuity" only if all of the following tests are met: (1) the amounts are received on or after the annuity starting date, (2) the amounts are 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 are 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).

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. Under § 1.72-4(b)(1), the first day of the first period for which an amount is received as an annuity is 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.

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.

Here, to the extent that an irrevocable election to allocate Accumulation Value to the Rider is made with respect to less than all of the Accumulation Value under the Contract, the DIA Payments will be made under a portion of the Contract while the remaining portion of the Contract’s Accumulation Value is administered according to the terms of the Contract. As a result, the election to allocate a portion of the Accumulation Value to the Rider will be a transaction to which § 72(a)(2) applies. Accordingly, at the time of such transfer, (A) a separate contract will be treated as arising for purposes of § 72, (B) a pro rata portion of the investment in the contract will be allocated between that separate contract and the Contract, based on the percentage of Accumulation Value to which the allocation applied, and (C) a separate annuity starting date under § 72(c)(4) will be determined with respect to the resulting DIA Payments.

Hence, if the Contract owner takes a withdrawal from the Contract following an election to allocate Accumulation Value to the Rider, the withdrawal will be taxable under § 72(e) without regard to the investment in the contract that was allocated to the Rider, i.e., to the separate contract that § 72(a)(2)(A) treated as arising when such transfer was made. If one or more additional transfers to the Rider are made after the first, each of the subsequent allocations will be treated as another transaction to which § 72(a)(2) applies if made with respect to less than all of the Accumulation Value in the Contract. In such case, the same treatment described above will apply to each of the subsequent allocations of Accumulation Value to the Rider.

**RULINGS**

Based on the facts submitted and the representations made, we hold as follows:

(1) Section 72(a)(2) will apply each time that Accumulation Value is irrevocably allocated from the Contract to the Rider if, immediately after the transfer, the Contract continues to have an Accumulation Value.

(2) At the time § 72(a)(2) applies to an irrevocable allocation from the Contract to the Rider:

(a) Pursuant to § 72(a)(2)(A), the portion of the Contract from which the DIA Payments associated with that allocation will be made will be treated as a separate contract for purposes of § 72;

(b) Pursuant to § 72(a)(2)(B), for purposes of applying §§ 72(b), (c), and (e) a pro rata portion of the investment in the contract with respect to the Contract will be apportioned between the Contract and the separate contract that is treated as having arisen by virtue of such allocation, with the pro rata allocation determined as of the allocation date based on the percentage of Accumulation Value allocated; and

(c) Pursuant to § 72(a)(2)(C), a separate annuity starting date will be determined with respect to each separate contract that is treated as having arisen by virtue of the allocation to the Rider.

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. In particular, no opinion is expressed regarding the meaning of the terms “cash value” or “cash surrender value” as they appear in § 72 or as applicable to the Contract and Rider, on the application of § 72(u) (including § 72(u)(4)), or whether the Contract complies with § 72(s).

Temporary or final regulations pertaining to one or more of the issues addressed in this ruling have not yet been adopted. Therefore, this ruling will be modified or revoked by the adoption of temporary or final regulations, to the extent the regulations are inconsistent with any conclusion in the letter ruling. *See,* § 11.04 of Rev. Proc. 2016-1, 2016-1 I.R.B. 1, 59. However, when the criteria in § 11.06 of Rev. Proc. 2016-1, 2016-1 I.R.B. 1, 60 are satisfied, a ruling is not revoked or modified retroactively except in rare or unusual circumstances.

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.

This ruling is directed only to the taxpayer 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,

Rebecca L. Baxter
Senior Technician Reviewer, Branch 4
(Financial Institutions & Products)

cc: