

Part I

Section 61.—Gross Income Defined

26 CFR 1.61-1

(Also § 817; § 1.817-5)

REV. RUL. [2007-7]

ISSUE

Is the holder of a variable annuity or life insurance contract treated as the owner, for federal income tax purposes, of an interest in a regulated investment company that funds the variable contract solely because interests in the same regulated investment company are also available to investors described in § 1.817-5(f)(3) of the Income Tax Regulations?

FACTS

A, an individual, purchases a variable contract (within the meaning of § 817(d) of the Internal Revenue Code) from IC, a life insurance company subject to tax under Part 1 of Subchapter L. All assets funding the contract are held in a segregated asset account that invests in RIC, a regulated investment company. All the beneficial interests in RIC are held by one or more segregated asset accounts of IC, or by investors described in § 1.817-5(f)(3). Public access to RIC is available exclusively either through the purchase of a variable contract, or to investors described in § 1.817-5(f)(3).

LAW AND ANALYSIS

In Rev. Rul. 2003-92, 2003-2 C.B. 350, a taxpayer purchased a variable "annuity" contract. The segregated asset account on which the contract was based was divided into 10 sub-accounts, each of which invested in a partnership. Interests in each partnership were sold in private placement offerings to qualified purchasers. The ruling concludes that, because interests in the partnerships were available for purchase by the general public, the taxpayer is considered the owner for federal tax purposes of the interests in the partnerships held by the

sub-accounts. The same analysis applies in the case of a variable life insurance contract. Rev. Rul. 2003-92 clarified and amplified Rev. Rul. 81-225, 1981-2 C.B. 12, which concluded that the policyholder is considered the owner of mutual fund shares that fund a variable "annuity" contract where those shares are also available directly or indirectly to the general public.

Section 817(h) and § 1.817-5 set forth diversification requirements for segregated asset accounts on which variable contracts are based. Section 817(h)(4) and § 1.817-5(f) provide a look-through rule for determining whether those diversification requirements are met. The look-through rule applies to a regulated investment company, partnership, or trust, but only if (A) all the beneficial interests in the investment company, partnership, or trust are held by one or more segregated asset accounts of one or more insurance companies, and (B) public access to the investment company, partnership or trust is available exclusively through the purchase of a variable contract. Under § 1.817-5(f)(3), the following four categories of beneficial interest are ignored for purposes of determining whether these two requirements are satisfied:

(1) Interests held by the general account of a life insurance company or a corporation related to a life insurance company, but only if the return on such interests 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 investment company, partnership, or trust;

(2) Interests held by a manager, or a corporation related to the manager, of the investment company, partnership or trust, but only if the holding of the interests is in connection with the creation or management of the investment company, partnership or trust, 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;

(3) Interests held by the trustee of a qualified pension or retirement plan;
or

(4) Interests held by the public, or treated as owned by the policyholders pursuant to Rev. Rul. 81-225, but only if (A) the investment company, partnership or trust 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 before September 26, 1981, to premium payments made in connection with a qualified pension or retirement plan, or to any combination of such premium payments.

The investors described in § 1.817-5(f)(3) are not members of the "general public" as that term is used in Rev. Rul. 2003-92 and Rev. Rul. 81-225. In the

present case, all the beneficial interests in RIC are held by one or more segregated asset accounts of IC, or by investors described in § 1.817-5(f)(3), and public access to RIC is available exclusively either through the purchase of a variable contract, or to investors described in § 1.817-5(f)(3). Accordingly, interests in RIC are not available to the "general public" as that term is used in Rev. Rul. 2003-92 and Rev. Rul. 81-225, and A is not treated as the owner of an interest in a regulated investment company that funds the variable contract.

HOLDING

The holder of a variable annuity or life insurance contract is not treated as the owner of an interest in a regulated investment company that funds the variable contract solely because interests in the same regulated investment company are also available to investors described in § 1.817-5(f)(3).

EFFECT ON OTHER REVENUE RULING(S)

Rev. Rul. 81-225, 1981-2 C.B. 12 and Rev. Rul. 2003-92, 2003-2 C.B. 350 are hereby clarified and amplified.

DRAFTING INFORMATION

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