

Internal Revenue Service

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LEGEND

TAXPAYER =

STATE =

COUNTRY =

LIFEINSCO =

INVESTCO =

OWNER =

OWNERGROUP =

INVESTOR =

INDIVIDUAL1 =

INDIVIDUAL2 =

MGR1 =

MGR2 =

EXEC =

FUND =

BUSINESS1 =

BUSINESS2 =

=

Dear _____ :

This responds to a April 18, 2014 letter from your authorized representative requesting a ruling that a proposed taxable investment transaction will not, under the investor control doctrine, cause TAXPAYER to be treated as the owner of the separate account assets related to two variable life insurance contracts. Additional information was submitted in a letter dated September 12, 2014.

The rulings contained in this letter are based upon facts and representations submitted by Taxpayer accompanied by a penalties 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. Verification of the information, representations, and other data may be required as part of the audit process.

FACTS

Universal Variable Life Insurance Policies

TAXPAYER, a STATE1 limited partnership, is a calendar year taxpayer on the cash method of accounting. OWNER is a general partner, and members of OWNERGROUP are limited partners, of TAXPAYER. INDIVIDUAL1, a member of OWNERGROUP, is the EXEC of TAXPAYER. OWNER pays INDIVIDUAL2 as a consultant.

LIFEINSCO is a COUNTRY corporation that made a § 953(d) election to be taxed as a domestic corporation for federal income tax purposes. TAXPAYER owns two LIFEINSCO universal variable life insurance policies on the life of INDIVIDUAL1. The LIFEINSCO segregated asset accounts supporting these policies invest in insurance dedicated funds (IDFs). The IDFs invest in subaccount assets.

TAXPAYER allocated part of the premium it paid to LIFEINSCO to a new INVESTCO IDF product. INVESTCO offers this product to variable annuity and variable life insurance contracts only, not to the general public. Initially, the INVESTCO IDF will invest in five subaccounts, including BUSINESS1 and BUSINESS2 limited partnerships. INVESTCO may increase or decrease the number of subaccounts in the INVESTCO IDF but these investments will meet the diversification requirements of § 817 and

related regulations. MGR1 is the lead portfolio manager for the INVESTCO IDF and will manage the subaccount that invests in several BUSINESS1 limited partnerships. Other managers will manage the four other INVESTCO IDF subaccounts. MGR1 and the other four managers of the INVESTCO IDF subaccounts will have sole discretion to make all investment decisions concerning their subaccounts independently, uninfluenced by TAXPAYER.

TAXPAYER represents that the managers (individuals and entities) of all LIFEINSCO IDFs are not related to, or controlled by, TAXPAYER or any of its affiliates.

INVESTCO FUND

OWNER is a general partner, and INDIVIDUAL1's family members and TAXPAYER are limited partners, in INVESTOR, a STATE limited partnership. INVESTOR may invest in a new INVESTCO fund (FUND) to which it would provide seed capital. In exchange, INVESTCO will give INVESTOR an ownership interest in FUND and enter a related revenue sharing agreement. However, when FUND is offered for sale to the public, INVESTCO's initial ownership interest will dilute to less than # percent and it will be a passive investor with no control over FUND.

MGR2 will manage FUND but will not manage any of the INVESTCO IDF subaccounts.

Prior to offering FUND for sale to the public, INDIVIDUAL1, OWNER, and MGR2 may have discussions that influence the structure and investment objectives of FUND and they may have on-going general investor discussion with others at FUND. However, these discussions will not have any influence on the LIFEINSCO IDF.

The LIFEINSCO IDF and FUND may invest in some of the same stocks. However, TAXPAYER represents that the LIFEINSCO IDF will not invest in FUND and that the FUND will be substantially different from any of the INVESTCO managed IDF subaccounts.

REPRESENTATIONS

The following representations are made with respect to INVESTCO IDF:

1. Except as otherwise permitted by § 1.817-5(f)(3), all of the beneficial interests in the INVESTCO IDF are held directly or indirectly by one or more segregated asset accounts of one or more insurance companies and access to the INVESTCO IDF is available exclusively through the purchase of a variable contract within the meaning of § 817(d).
2. The life insurance companies whose segregated asset accounts hold or will hold shares of the INVESTCO IDF are life insurance companies within the meaning of

§ 816(a).

3. Each segregated asset account that will hold shares of the INVESTCO IDF will be a separate account registered with the SEC as a unit investment trust under the 1940 Act or will be exempt from registration under the 1940 Act.
4. Each INVESTCO IDF will satisfy the diversification requirements of § 817(h) of the Code and § 1.817-5(b) of the regulations.
5. There is not, and there will not be, any arrangement, plan, contract or agreement between MGR1, or any other manager of the INVESTCO IDF subaccounts, and any contract holder regarding the availability of INVESTCO IDF as a subaccount under the variable contract or the specific assets to be held by the INVESTCO IDF.
6. Other than a variable contract holder's ability to allocate variable contract premiums, and transfer amounts in the insurance company segregated asset account to and from the insurance company subaccount corresponding to a particular IDF, all investment decisions concerning the INVESTCO IDF will be made by MGR1 or another manager of the INVESTCO IDF subaccounts. The percentage of an INVESTCO IDF's assets invested in a particular subaccount will not be fixed in advance of any variable contract holder's investment and will be subject to change by MGR1, or another manager of the INVESTCO IDF subaccounts, at any time.
7. A variable contract holder will not be able to direct an INVESTCO IDF investment in any particular asset or recommend a particular investment or investment strategy, and there will not be, any agreement or plan between MGR1, or another manager of the INVESTCO IDF subaccounts, and a variable contract holder regarding a particular investment of any INVESTCO IDF subaccounts.
8. No variable contract holder will be able to communicate directly or indirectly with MGR1, or another manager of the INVESTCO IDF subaccounts, concerning the selection, quality or rate of return on any specific investment or group of investments held by the INVESTCO IDF.
9. A variable contract holder will not have any current knowledge of the INVESTCO IDF's specific assets.
10. A variable contract holder will not have any legal, equitable, direct or indirect ownership interest in any of the assets of the INVESTCO IDF. A variable contract holder only will have a contractual claim against the insurance company offering the variable contract to receive cash from the insurance company under the terms of his or her variable contract.

11. All shares of each INVESTCO IDF will be held directly or indirectly by segregated asset accounts of life insurance companies that are held in connection with variable contracts, or other permitted holders described in Treas. Reg. § 1.817-5(f)(3), and each INVESTCO IDF therefore intends to qualify for the exception from federal excise tax provided by § 4982(f), unless a variable contract holder is treated as a shareholder of the relevant INVESTCO IDF pursuant to the investor control requirements of Rev. Rul. 81-225, 1981-2 C.B. 12, Rev. Rul. 82-54, 1982-1 C.B. 11, Rev. Rul. 2003-91, 2003-2 C.B. 347, and Rev. Rul. 2003-92, 2003-2 C.B. 350.

LAW

In general, the insurance company that issues variable life insurance or annuity contracts, not the policyholder, is considered the owner of the underlying separate account assets for federal income tax purposes. Therefore, policyholders are not taxed on the investment gains of the separate account assets that support their policies and increase in their cash value.

The courts attribute ownership of property for tax purposes to the person, other than the holder of legal title, who possesses the “benefits and burdens” or “incidence” of ownership.¹ In *Corliss v. Bowers*, 281 U.S. 376, 378, 50 S.Ct. 336, 74 L.Ed. 916 (1930), the Supreme Court summarized this principle stating:

Taxation is not so much concerned with the refinements of title as it is with actual command over the property taxed -- the actual benefit for which the tax is paid.

The Service applied these general tax ownership principles in a series of “investor control” rulings.²

The premise of the investor control doctrine is that policyholders will be treated as the tax owners of the separate account investment assets if (1) they possess significant control (or other benefits and burdens of contract ownership) over the underlying assets, even if the insurance company retains possession of, and legal title to, those assets; or (2) the assets are available to the general public and not exclusively through the purchase of a life insurance or annuity contract. As the owner of the underlying assets in the account, the contract holders are taxed on the income of the assets supporting the contract.³

¹ See, e.g., *Frank Lyon Company v. United States*, 435 U.S. 561 (1978); *Helvering v. Clifford*, 309 U.S. 331 (1940).

² Rev. Rul. 77-85, 1977-1 C.B. 12; Rev. Rul. 80-274, 1980-2 C.B. 27; Rev. Rul. 81-225, 1981-2 C.B. 12; and Rev. Rul. 82-54, 1982-1 C.B. 12. See also Rev. Proc. 99-44, 1999-2 C.B. 598.

³ Rev. Rul. 77-85; See also, Rev. Rul. 80-274, 1980-2 C.B. 27 (depositors/policyholders own the certificates of deposit transferred to the insurance company in exchange for an annuity contracts because the insurance company invests in certificates of deposit for a term designated by the depositors); Rev. Rul. 81-255, 1981-2 C.B. 13 (policyholders of certain variable annuity contracts, whose purchase payments were invested in publicly available mutual fund shares, would be treated as the owners of the mutual fund shares. But see, Rev. Rul. 82-54, 1982-1 C.B. 11 (policyholders do not have sufficient control over individual investment decisions

In Rev. Rul. 2003-92, 2003-2 C.B. 350, the Service held that separate account assets of variable contracts may be invested only in insurance-dedicated hedge funds and funds-of-funds.

In Rev. Rul. 2003-91, 2003-2 C.B. 347, the Service concluded that, based on all the facts and circumstances, the insurance company, not the contract holder, owned the assets underlying a variable contract. The Service considered the following factors:

- There was no arrangement, plan, contract, or agreement between the contract holder and the insurance company or between the contract holder and the investment advisor regarding the availability of a particular subaccount, the investment strategy of any subaccount, or the assets to be held by a particular subaccount;
- Contract holders could allocate premiums and transfer funds among available subaccounts but all investment decisions concerning the subaccounts were made by the insurance company or the investment advisor in their sole and absolute discretion;
- The contract holder could not communicate directly or indirectly with any investment officer of the insurance company or its affiliates or with the investment advisor regarding the selection, quality, or rate of return of any specific investment or group of investments held in a subaccount;
- The insurance company, in its sole and absolute discretion, chose the investment advisor and insurance company's investment officers involved in the investment activities of the separate account or of the subaccounts;
- The contract holders could not communicate directly or indirectly with the insurance company concerning the selection or substitution of an investment advisor or the choice of any of the insurance company's investment officers that are involved in the investment activities of the separate account or of any of the subaccounts.

In *Christoffersen v. United States*, 749 F.2d 513 (8th Cir. 1984), the 8th Circuit considered a contract that gave the contract holders the right, but not the obligation, to purchase an annuity contract. Under the contract, the purchaser decided in which mutual funds, offered by the insurer, to invest and could change to another fund at any time. The Court decided that a contract was not a § 72 annuity because the contract holders (1) surrendered few of their ownership rights or control over the assets of the

when they may choose among three broad, general investment strategies -- stocks, bonds and money market instruments), Rev. Rul. 82-55, 1982-1 C.B. 12 (policyholders of annuity contracts were not the owners of separate account assets invested in a mutual fund whose shares were no longer available to the public), and Rev. Rul. 2003-91.

subaccount; (2) bore the entire investment risk; (3) could withdraw any or all of the investment upon seven days' notice; and (4) might never annuitize the contract.

Shortly after the *Christoffersen*, Congress enacted § 817(h) requiring that segregated asset accounts supporting variable contracts be "adequately diversified" as defined in Treasury regulations.

Describing § 817(h), the conference agreement:

... allows any diversified fund to be used as the basis of variable contracts so long as all shares of the fund are owned by one or more segregated asset accounts of insurance companies, but only if access to the fund is available exclusively through the purchase of a variable contract from an insurance company. The fact that a similar fund is available to the public will not cause the segregated asset fund to be treated as being publicly available.

In authorizing Treasury to prescribe diversification standards, the conferees intend that the standards be designed to deny annuity or life insurance treatment for investments that are publicly available to investors and investments which are made, in effect, at the direction of the investor.⁴

Approximately two years after enactment of § 817(h), the Treasury Department issued proposed and temporary regulations prescribing the minimum level of diversification that must be met for an annuity or life insurance contract to be treated as a variable contract within the meaning of § 817(d). The preamble to the regulations stated as follows:

The temporary regulations ... do not provide guidance concerning the circumstances in which investor control of the investments of a segregated asset account may cause the investor, rather than the insurance company, to be treated as the owner of the assets in the account. For example, the temporary regulations provide that in appropriate cases a segregated asset account may include multiple sub-accounts, but do not specify the extent to which policyholders may direct their investments to particular sub-accounts without being treated as owners of the underlying assets. Guidance on this and other issues will be provided in regulations or revenue rulings under section 817(d), relating to the definition of variable contracts.⁵

Section 4982(a) imposes a tax on every regulated investment company for each calendar year equal to 4 percent of the excess (if any) of -- the required distribution for such calendar year, over (2) the distributed amount for such calendar year.

Section 4982(f) provides an exemption from such excise tax as follows:

⁴ H.R. Conf. Rep. No. 861, 98th Cong., 2d Sess. 1055, 1984-3 (Vol. 2) C.B. 309P.L. 98-369, Deficit Reduction Act of 1984

⁵ T.D. 8101, 1986-2 C.B. 97 [51 FR 32633] (Sept. 15, 1986). The text of the temporary regulations served as the text of proposed regulations in the notice of proposed rule-making. See LR-295-84, 1986-2 C.B. 801 [51 FR 32664] (Sept. 15, 1986). The final regulations adopted, with certain revisions not relevant here, the text of the proposed regulations.

This section shall not apply to any regulated investment company for any calendar year if at all times during such calendar year each shareholder in such company was either – (1) a trust described in section 401 and exempt from tax under section 501(a), or (2) a segregated assets account of a life insurance company held in connection with variable contracts (as defined in section 817(d)).

For purposes of the preceding sentence, any shares attributable to an investment in the regulated investment company (not exceeding \$250,000) made in connection with the organization of such company shall not be taken into account.

ANALYSIS

The Service treats the holders of a variable life insurance policy or variable annuity contract as the owners of the underlying assets for federal income tax purposes if they possess sufficient incidents of ownership over the assets supporting the policy or contract. Accordingly, they lose the tax benefits of the insurance or annuity contract and are currently taxed on income generated by the separate account assets. Whether the contract holder possesses sufficient incidents of ownership over the assets of the separate account depends on all the relevant facts and circumstances.

The segregated asset accounts supporting TAXPAYER's LIFEINSCO universal variable life insurance policies invest only in IDF's. Also, the facts and circumstances indicate that TAXPAYER did not possess significant control over the INVESTCO IDF assets.

CONCLUSION

Based on the legal authority and the facts and representations presented by the TAXPAYER, LIFEINSCO, not TAXPAYER, is the owner of the INVESTCO IDF assets for federal income tax purposes.

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 the taxpayer 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,

DONALD J. DREES, JR.
Senior Technician Reviewer, Branch 4
Office of the Associate Chief Counsel
(Financial Institutions & Products)

cc: