Internal Revenue Service

Number: **202250012**
Release Date: 12/16/2022
Index Number: 72.00-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:FIP:B04
PLR-114089-21
Date:
January 03, 2022

Legend:

Taxpayer =
Individual =
X =
Y =
Z =

Dear :

Taxpayer has requested several rulings regarding whether and how § 72 of the Internal Revenue Code applies to a contingent deferred annuity contract ("the Contract") Individual plans to purchase from Taxpayer. This letter ruling is being issued electronically in accordance with section 6 of Rev. Proc. 2020-29, 2020-21 I.R.B. 859. A paper copy will not be mailed.

<u>FACTS</u>:

Taxpayer represents that:

Taxpayer is a life insurance company within the meaning of § 816(a).

Individual will own assets in a taxable investment account ("Account"). Taxpayer will have no legal or equitable interest in any assets owned by Individual in the Account, and Taxpayer will not treat the Account or any of the assets in the Account as Taxpayer's assets for any purpose. Individual will be free to liquidate all or any portion of the assets in the Account at any time without Taxpayer's consent.

Taxpayer intends to issue the Contract to Individual. The Contract will provide certain benefits in the event the value of the Account is depleted before Individual's death. Specifically, if the Account's value reaches zero or some other minimum threshold amount for reasons other than withdrawals in excess of the prescribed limit, Taxpayer will begin making annual payments to Individual under the contract on either a fixed ("Fixed Method") or a fluctuating ("Fluctuating Method") basis (collectively, "Protected Income Payments"). The payments will continue for Individual's life or for the joint lives of Individual and Individual's spouse. Alternatively, prior to the point at which annual payments begin under the Contract, Individual can elect to liquidate the Account and transfer the proceeds to Taxpayer in exchange for fixed payments at minimum purchase rates guaranteed in the Contract ("Annuity Payments").

Individual can make withdrawals from the Account. Once Individual begins making "Protected Income Withdrawals" from the Account, the maximum amount Individual may withdraw from the Account is set each year by reference to the performance of the assets in the Account. "Excess Withdrawals" in excess of the maximum amount reduce maximum withdrawal amounts going forward. Too many Excess Withdrawals can also result in termination of the Contract. The Contract may include a feature whereby unused withdrawal amounts for a given year are carried forward to subsequent years to increase the maximum withdrawal amounts in those years.

Though Taxpayer's exposure to investment risk is limited due to the fluctuating limit placed on maximum withdrawals from the Account, Taxpayer also may, but does not currently plan to, restrict permissible asset holdings in the Account. For instance, certain kinds of "exotic" investments may be restricted. Exotic investments may include private securities, investments that are not priced daily, and investments that are not registered with the Securities and Exchange Commission.

Unless Individual liquidates the Account and transfers the proceeds to Taxpayer in exchange for Annuity Payments, annual payments will begin under the Contract once the Account's value reaches zero or otherwise falls below a minimum threshold amount. Individual can select either fixed payments under the Fixed Method or fluctuating payments under the Fluctuating Method.

Each payment option differs in the following respects. If Individual selects the Fixed Method (which is the default option), the Contract's annual payments will commence when the Account's value is reduced to zero (for reasons other than Excess Withdrawals) and will be equal to the maximum withdrawal amount in effect as of that time. If Individual selects the Fluctuating Option before the Account falls below a minimum threshold amount (for reasons other than Excess Withdrawals), then payments will commence once the Account's value falls below a minimum threshold amount and the Contract's annual payments will initially be equal to the maximum withdrawal amount in effect as of the time that Contract payments commence but will thereafter fluctuate with investment performance.

If Individual selects the Fluctuating Option, then once the value of the Account reaches a minimum threshold amount, the remaining assets in the Account must be liquidated and the proceeds transferred to Taxpayer before payments commence. Individual may then allocate those transferred proceeds among one or more separate sub-accounts. The investment performance of the sub-account(s) that Individual selects is used solely to generate a rate of return. That rate of return is then applied to adjust the annual payouts under the Contract.

Individual will not be able to access the amounts in the sub-account(s) in any way, and the amounts will not give rise to any cash value. Any amounts allocated to the sub-account(s) are, as indicated above, used solely to generate a rate of return to use in determining annual payments under the Contract under the Fluctuating Method.

The Contract may be issued with a feature guaranteeing a payment to Individual at the age of 95 in certain circumstances ("Cumulative Income Minimum"). Specifically, if Individual reaches the age of 95 and has not had the opportunity, either through permissible withdrawals from the Account or through payments under the Contract, to recover Individual's net deposits into the Account at the time of the first Protected Income Withdrawal (proportionally reduced by any Excess Withdrawals taken after the first Protected Income Withdrawal), Taxpayer will make a one-time payment to Individual making up the difference.

Individual will periodically pay consideration for the Contract either out of the Account (on an after-tax basis) or out of other sources of after-tax funds. Additionally, as indicated above, Individual may transfer a final amount of cash proceeds to Taxpayer once the Account reaches a minimum threshold amount, which Taxpayer will treat as additional consideration for the Contract.

Amounts Individual pays for the Contract will not give rise to any cash value, and the Contract will not otherwise have any cash value accessible by Individual. The Contract is not assignable or transferable by Individual. The Contract will not serve as collateral for any loan from Taxpayer or Taxpayer's affiliates.

Individual is X years old. It is anticipated that Individual will be X years old at the time Taxpayer issues the Contract to Individual. In general, Taxpayer anticipates that Individual's age will be typical of other customers. Taxpayer intends to restrict the availability of the Cumulative Income Minimum feature to customers who are Y-Z years old at the time of Contract issuance.

The Contract will terminate if Individual dies prior to the commencement of Annuity Payments or Protected Income Payments, unless continued by Individual's spouse pursuant to § 72(s).

The Contract will be treated as an annuity contract for state law purposes and will be registered as a security with the Securities and Exchange Commission. Taxpayer will

maintain reserves for its liabilities under the Contract. Taxpayer will treat the consideration Individual pays for the Contract (whether the periodic fees or any transfer of proceeds from the Account after liquidation of the Account's assets) as premiums for state premium tax purposes and will account for the consideration as annuity premiums both on its National Association of Insurance Commissioners annual statement and for federal income tax purposes.

REQUESTED RULINGS

Taxpayer requests the following rulings:

1. The Contract will constitute an annuity contract for purposes of § 72.

2. The Protected Income Payments that are made using the Fixed Method and the Annuity Payments will be taxable as "amounts received as an annuity" under § 72(b). In addition, a portion of each Protected Income Payment that is made using the Fluctuating Method will be treated as an "amount received as an annuity," as follows:

(a) The portion of each such Protected Income Payment that will be treated as an amount received as an annuity will be excludable from gross income pursuant to § 72(b)(1) and §§ 1.72-2(b)(3) and 1.72-3 of the Income Tax Regulations, subject to the limitation imposed by § 72(b)(2); and

(b) The excess (if any) of each such Protected Income Payment over the portion determined in (a) above will be treated as an amount not received as an annuity on or after the annuity starting date and will be includible in gross income as provided in § 72(e)(2)(A) and §§ 1.72-1(d), 1.72-4(a)(3), (d)(3), and 1.72-11(b)(2).

3. The Account will not cause the Contract to have a "cash value" or "cash surrender value" for purposes of § 72, and will not otherwise be part of the Contract for federal income tax purposes.

4. For purposes of § 72(c)(1) and § 72(e)(6) (each defining "investment in the contract"), the "aggregate amount of premiums or other consideration paid" for the Contract will equal the sum of all charges Individual paid under the Contract plus any proceeds Individual paid to Taxpayer upon liquidation of the Account as consideration for Protected Income Payments or Annuity Payments.

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.

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(b)(2) provides that the portion of any amount received as an annuity which is excluded from gross income under section 72(b)(1) shall not exceed the unrecovered investment in the contract immediately before the receipt of such amount.

Section 1.72-2(a)(1) 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:

> Inherent 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 Insurance, Black and Skipper state that "[i]n general financial terms, 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." Kenneth Black, Jr., Harold D. Skipper, and Kenneth D. Black, III, Life Insurance, 144-45 (15th ed. 2015). Accordingly, "[e]ach payment under a life annuity is 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 dies precisely at his or her life expectancy, he or she would have neither gained nor lost through utilizing a life annuity." Life Insurance at 46. 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 (2021). 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 the terms of the contract. 8 New Appleman on Insurance Law Library Edition § 91.02[6][b] (2009).

Here, on balance the Contract possesses the essential attributes of an annuity. It is true that the Contract may not, “at the election of [Individual], 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 for the Fixed Method and Fluctuating Method is contingent upon the value of the Account being exhausted or reduced to a minimum threshold amount while Individual is alive, it is not the case that “if [Individual] exactly lives out his or her life expectancy, he or she would have neither gained nor lost through utilizing the annuity contract,” Life Insurance at 46. However, these conditions are not dispositive.

The Contract and the amounts paid (other than any one-time Cumulative Income Minimum payment)[1] 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 an annuity contract 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 (2021). Individual 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).

Accordingly, the Contract will constitute an annuity contract for purposes of § 72.

Requested Ruling # 2

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.

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).

---

[1] The payment of the Cumulative Income Minimum would be an amount not received as an annuity under § 72(e).

Section 72(b)(2) provides that the portion of any amount received as an annuity which is excluded from gross income under section 72(b)(1) shall not exceed the unrecovered investment in the contract immediately before the receipt of such amount.

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:

> (i) They must be received on or after the "annuity starting date" as that term is defined in § 1.72-4(b);
>
> (ii) 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
>
> (iii) 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 1.72-2(b)(3) provides in pertinent part that notwithstanding the determinability requirement stated immediately above, if amounts are to be received for a definite or determinable time (whether for a period certain or for a life or lives) under a contract which provides that the amount of the periodic payments may vary in accordance with investment experience (as in certain profit-sharing plans), cost of living indices, or similar fluctuating criteria, each such payment received shall be considered as an amount received as an annuity only to the extent that it does not exceed the amount computed by dividing the investment in the contract, as adjusted for any refund feature, by the number of periodic payments anticipated during the time that the periodic payments are to be made. If payments are to be made more frequently than annually, the amount so computed shall be multiplied by the number of periodic payments to be made during the taxable year for the purpose of determining the total amount which may be considered received as an annuity during such year. To this extent, the payments received shall be considered to represent a return of premium or other consideration paid and shall be excludable from gross income in the taxable year in which received. To the extent that the payments received under the contract during the taxable year exceed the total amount thus considered to be received as an annuity during such year, they shall be considered to be amounts not received as an annuity and shall be included in the gross income of the recipient.

Section 1.72-3 provides that, in general, amounts received under contracts described in paragraph (a)(1) of § 1.72-2 are not to be included in the income of the recipient to the

extent that such amounts are excludable from gross income as the result of the application of section 72 and the regulations thereunder.

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:

> (i) The date upon which the obligations under the contract became fixed, or
>
> (ii) 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.

Section 72(e)(2)(A) provides the general rule for amounts not received as an annuity. If an amount is an amount not received as an annuity and is an amount to which § 72(e) applies as provided by the rule in § 72(e)(1), then, if received on or after the annuity starting date, the amount shall be included in gross income. If the amount is received before the annuity starting date, the amount shall be included in gross income to the extent provided by the rule in § 72(e)(2)(B).

Section 1.72-1(d) provides in pertinent part that in the case of amounts not received as an annuity, if such amounts are received after an annuity has begun and during its continuance, amounts so received are generally includible in the gross income of the recipient.

Section 1.72-4(a)(3) provides in pertinent part that the exclusion ratio shall be applied only to amounts received as an annuity within the meaning of that term under paragraph (b)(2) and (3) of § 1.72-2. Where the periodic payments increase in amount after the annuity starting date in a manner not provided by the terms of the contract at such date, the portion of such payments representing the increase is not an amount received as an annuity.

Section 1.72-4(d)(3) provides in pertinent part that if a contract provides for payments to be made to a taxpayer in the manner described in paragraph (b)(3) of § 1.72-2, the investment in the contract shall be considered to be equal to the expected return under such contract and the resulting exclusion ratio (100%) shall be applied to all amounts received as an annuity under such contract. For any taxable year, payments received under such a contract shall be considered to be amounts received as an annuity only to the extent that they do not exceed the portion of the investment in the contract which is properly allocable to that year and hence excludable from gross income as a return of premiums or other consideration paid for the contract. The portion of the investment in the contract which is properly allocable to any taxable year shall be determined by dividing the investment in the contract (adjusted for any refund feature in the manner described in paragraph (d) of § 1.72-7) by the applicable multiple (whether for a term

certain, life, or lives) which would otherwise be used in determining the expected return for such a contract under § 1.72-5. The multiple shall be adjusted in accordance with the provisions of the table in paragraph (a)(2) of § 1.72-5, if any adjustment is necessary, before making the above computation. If payments are to be made more frequently than annually and the number of payments to be made in the taxable year in which the annuity begins are less than the number of payments to be made each year thereafter, the amounts considered received as an annuity (as otherwise determined under this subdivision) shall not exceed, for such taxable year (including a short taxable year), an amount which bears the same ratio to the portion of the investment in the contract considered allocable to each taxable year as the number of payments to be made in the first year bears to the number of payments to be made in each succeeding year.

Section 1.72-11(b)(2) provides in pertinent part that if dividends or payments in the nature of dividends are paid under a contract to which section 72 applies and such payments are received on or after the annuity starting date, such payments shall be fully includible in the gross income of the recipient. Section 1.72-11(b)(2) shall apply to amounts received under a contract described in paragraph (b)(3)(i) of § 1.72-2 to the extent that the amounts received exceed the portion of the investment in the contract allocable to each taxable year in accordance with paragraph (d)(3) of § 1.72-4. Hence, such excess is fully includible in the gross income of the recipient.

Here, with respect to the Protected Income Payments, when the Protected Income Payments become payable the obligations under the Contract become fixed: no additional Contract charges are due and Taxpayer is obligated to pay the Protected Income Payments until Individual's death (or the death of Individual's spouse). Hence, the Protected Income Payments will be received on or after the annuity starting date.

Second, the Protected Income Payments 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, under the Fixed Method, the total amount payable is determinable from the Contract using mortality tables and sound actuarial theory. Accordingly, the Protected Income Payments under the Fixed Method will be "amounts received as an annuity."

Fourth, under the Fluctuating Method, the total amount payable is not determinable at the annuity starting date but will fluctuate with investment experience. Accordingly, the Protected Income Payments under the Fluctuating Method will be "amounts received as an annuity" only to the extent provided by §§ 1.72-2(b)(3) and 1.72-4(d) and will be "amounts not received as an annuity" to the extent the payments are not "amounts received as an annuity."

With respect to Annuity Payments, if Individual exercises that option the obligations under the Contract become fixed: no additional Contract charges are due and Taxpayer

is obligated to pay the annuity settlement option consistent with the rate guarantee. Hence, the Annuity Payments will be received on or after the annuity starting date.

Second, the Annuity Payments 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 Payments will be "amounts received as an annuity."

Either the Protected Income Payments payable under the Fixed Method or the Annuity Payments[2] will be taxable under § 72(a) as amounts received as an annuity, subject to the exclusion of the amount of each payment allocable to the investment in the contract determined under § 72(b).

As for Protected Income Payments payable under the Fluctuating Method, the portion of each Protected Income Payment under the Fluctuating Method treated as an "amount received as an annuity" will be excludable from gross income pursuant to § 72(b)(1) and §§ 1.72-2(b)(3), 1.72-3, and 1.72-4(d), subject to the limitation imposed by § 72(b)(2). The portion of each Protected Income Payment under the Fluctuating Method treated as an "amount not received as an annuity" will be treated as an amount not received as an annuity on or after the annuity starting date and will be includible in gross income. See § 72(e)(2)(A) and §§ 1.72-1(d), 1.72-4(a)(3), (d)(3), and 1.72-11(b)(2).

Requested Ruling # 3

Section 72 does not define the terms "cash value" or "cash surrender value" with regard to an annuity contract. With regard to a life insurance contract, § 7702(f)(2)(A) defines "cash surrender value" as "cash value determined without regard to any surrender charge, policy loan, or reasonable termination dividend." Section 1.7702-2(h)(2) of the Proposed Income Tax Regulations defines "cash surrender value" of a life insurance contract as generally equaling its "cash value," which in turn is defined by proposed § 1.7702-2(b)(1) as the greater of "(i) [t]he maximum amount payable under the contract (determined without regard to any surrender charge or policy loan); or (ii) [t]he maximum amount that the policyholder can borrow under the contract."[3] See also H.R. Rep. No. 98-432 at 1444.

The term "cash value" commonly connotes the amount available to a policyholder for withdrawal or upon surrender of the contract. See, e.g., Life Insurance, at 41-42; see

---

[2] Individual must elect either Protected Income Payments (whether on the Fixed Method or Fluctuating Method) or Annuity Payments; Individual cannot elect both.
[3] Cf. proposed § 1.7702-2(b)(2), which provides certain exclusions from cash value, none of which are relevant to this discussion.

also John H. Magee, Life Insurance 599 (3d ed. 1958) (“The cash value represents the amount available to the policyholder upon the surrender of the life insurance contract.”)

Rev. Rul. 77-85, 1977-1 C.B. 12, addressed an arrangement involving an ”investment annuity policy” that has some features similar to Taxpayer’s proposed arrangement. In the ruling, the policyholder could not receive any amount directly from the account and could not receive a distribution of assets in kind. At any time prior to the annuity starting date, however, the policyholder could make a full or partial surrender of the policy to the insurance company. If such a surrender were made, the custodian was directed by the agreement to sell all or part of the assets as appropriate and to pay over the necessary proceeds to the insurance company. The insurance company in turn would make the full or partial cash surrender payment to the policyholder in an amount equal to the proceeds received by the insurance company from the account, less any cash surrender charges.

The ruling does not address whether the underlying account created any “cash value” or “cash surrender value” for the investment annuity policy. Nonetheless, the contrast in the mechanics illustrates the loose connection between the Account and the Contract. The Contract cannot be monetized at the discretion of Individual other than through receipt of Protected Income Payments or exercise of the option to receive Annuity Payments. It cannot be assigned, cannot be surrendered in whole or part in exchange for cash, and cannot be used as collateral against a loan from Taxpayer. The connection to the Account is unlike that in the ruling - the Account’s value is used only to pay the Contract charges or to purchase the Annuity Payments if that option is exercised. Individual can access the Account’s value without operation of the Contract, though with consequences if, for example, such access produces a withdrawal that exceeds the maximum withdrawal amount (an Excess Withdrawal) or if the assets selected by Individual are outside any limits that Taxpayer might set on permissible assets.

Although the Contract (1) has utility only in conjunction with an eligible Account, (2) controls, to some extent, Individual’s activities with regard to that Account, and (3) cannot be alienated or otherwise monetized, the Account is not so intertwined with the Contract as to be effectively part of the Contract. Cf. Rev. Rul. 77-85; Rev. Rul. 2003-97, 2003-2 C.B. 380.

Accordingly, the Account will not cause the Contract to have a “cash value” or “cash surrender value” for purposes of § 72, and will not otherwise be part of the Contract for federal income tax purposes.

Requested Ruling # 4

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.

As mentioned, Rev. Rul. 77-85 addressed an arrangement with some similar features. That ruling held that the issuer should include in its premium income only the premiums and charges paid each year.

Accordingly, with regard to Protected Income Payments, the Contract charges (including any final proceeds paid upon final liquidation of the Account should the Account’s value fall below the minimum threshold amount) should be taken into account in the determination of Individual’s “investment in the contract” for the Contract under § 72; with regard to Annuity Payments, both the Contract charges and the amount remitted to Taxpayer upon exercise of the option to receive Annuity Payments should be taken into account in the determination of Individual’s “investment in the contract” for the Contract under § 72.

RULINGS

1. The Contract will constitute an annuity contract for purposes of § 72.

2. The Protected Income Payments that are made using the Fixed Method and the Annuity Payments will be taxable as “amounts received as an annuity” under § 72(b). In addition, a portion of each Protected Income Payment that is made using the Fluctuating Method will be treated as an “amount received as an annuity,” as follows:

(a) The portion of each such Protected Income Payment that will be treated as an amount received as an annuity will be excludable from gross income pursuant to § 72(b)(1) and §§ 1.72-2(b)(3) and 1.72-3, subject to the limitation imposed by § 72(b)(2); and

(b) The excess (if any) of each such Protected Income Payment over the portion determined in (a) above will be treated as an amount not received as an annuity on or after the annuity starting date and will be includible in gross income as provided in § 72(e)(2)(A) and §§ 1.72-1(d), 1.72-4(a)(3), (d)(3), and 1.72-11(b)(2).

3. The Account will not cause the Contract to have a “cash value” or “cash surrender value” for purposes of § 72, and will not otherwise be part of the Contract for federal income tax purposes.

4. For purposes of § 72(c)(1) and § 72(e)(6) (each defining “investment in the contract”), the “aggregate amount of premiums or other consideration paid” for the Contract will equal the sum of all charges Individual paid under the Contract plus any proceeds Individual paid to Taxpayer upon liquidation of the Account as consideration for Protected Income Payments or Annuity Payments.

CAVEATS

The rulings contained in this letter are based upon information and representations submitted by Taxpayer and accompanied by penalty of perjury statements executed by appropriate parties. 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.

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, including but not limited to issues under Subchapter D (§ 401 et seq.), the computation of the exclusion ratio under § 72(b), the characterization of the reserve under § 816(b), or the computation of the amount of any reserve.

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

Taxpayer must attach a copy of this letter ruling to any tax return to which it is relevant.

In accordance with a power of attorney on file in this office, a copy of this ruling is being furnished to your authorized representatives.

Sincerely,

John E. Glover
Senior Counsel, Branch 4
Associate Chief Counsel
(Financial Institutions and Products)

cc: