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CC:FIP:B04
PLR-112168-25

Date:
January 21, 2026

Legend

Taxpayer =
Parent =
A =
B =

Dear _____ :

Taxpayer has requested several rulings concerning a universal life insurance contract (the "Base Contract") with a single premium immediate annuity (the "Annuity Rider") that Taxpayer plans to issue. This letter ruling is being issued electronically in accordance with section 7.02(2) of Rev. Proc. 2025-1, 2025-1, I.R.B. 1.

FACTS

Taxpayer represents that:

Taxpayer is a stock life insurance company organized and operated under the laws of A. Taxpayer is licensed to engage in the life insurance business in B. Taxpayer is a life insurance company within the meaning of § 816(a) of the Internal Revenue Code (the "Code"). Taxpayer joins in the filing of a consolidated federal income tax return with Parent.

The Base Contract will be a life insurance contract under applicable state laws, regulations, and other state law guidance ("State Law"). The Base Contract will be filed with and approved by the applicable state insurance department and/or the Interstate

Insurance Product Regulation Compact (each, an “Insurance Department”) under State Law governing life insurance contracts. The Base Contract will be subject to the State Law requirements for policy forms, reserves, and nonforfeiture values that govern life insurance contracts. To obtain the Base Contract, satisfactory evidence of insurability must be provided to Taxpayer. For federal tax purposes, the Base Contract is designed to satisfy the Code’s definition of a “life insurance contract” in § 7702. A “Specifications Page” that is part of the Base Contract will indicate whether the cash value accumulation test of § 7702(a)(1) and (b) or the guideline premium limitation and cash value corridor requirements of § 7702(a)(2), (c), and (d) applies to the Base Contract.

Premiums for the Base Contract will be calculated using interest rates and other actuarial assumptions that are comparable to those used in determining premiums and benefits for other universal life insurance contracts that are offered without an annuity rider. The Base Contract provides a cash value that the owner may receive upon a full surrender or use as collateral for a loan from Taxpayer.

The Annuity Rider will provide for term certain annuity payments without any life contingency. The Annuity Rider is designed to provide periodic payments (the “Annuity Payments”) that the owner will use to pay premiums for the Base Contract. Taxpayer plans to offer two versions of the Annuity Rider. One version (the “NQ-Annuity Rider”) will not be part of any qualified retirement plan within the meaning of § 4974(c). The other version will be an individual retirement annuity under § 408(b) (the “IRA-Annuity Rider”).

The Annuity Rider’s annuitant will be the same individual whose life is insured under the Base Contract. For the IRA-Annuity Rider, the annuitant under the Annuity Rider must be the individual who owns the Base Contract and Annuity Rider. The Annuity Rider will be treated as an annuity contract under State Law and will be filed with and approved by the applicable Insurance Department under State Law governing the terms and benefits of annuity contracts. The Annuity Rider will be subject to the State Law requirements for policy forms, reserves, and nonforfeiture values that govern immediate annuities. The NQ-Annuity Rider includes statements designed to ensure that it complies with the after-death distribution requirements of § 72(s). The IRA-Annuity Rider contains provisions reflecting the requirements of federal tax law that pertain to individual retirement annuities, such as the required minimum distribution rules of § 401(a)(9). Because the Annuity Rider will be filed with and approved by the applicable Insurance Department as a rider to a life insurance contract, it cannot be purchased separately from the Base Contract. The Annuity Rider can be added only when the Base Contract is issued; it cannot be added later.

The Annuity Rider will be purchased with a single premium that will be calculated using interest rates and other actuarial assumptions that are comparable to those used in determining premiums and benefits for other stand-alone single premium immediate annuities that are offered without a life insurance contract. For the NQ-Annuity Rider, the single premium could be paid with after-tax money or be paid through a § 1035

exchange of a non-qualified annuity contract the purchaser already owns. For the IRA-Annuity Rider, the single premium generally will be paid only in a tax-free direct rollover, trustee-to-trustee transfer, or indirect "60-day" rollover that is not subject to the Code's annual contribution limits for individual retirement annuities.

The Annuity Rider will provide for Annuity Payments in fixed, level amounts that are not dependent on the survival of the annuitant. The Annuity Payments will start within one year of the purchase date of the Annuity Rider and will continue over a fixed term of years (the "Guaranteed Period"). The Annuity Payments will be made in annual installments during the Guaranteed Period. The Guaranteed Period will be a minimum of 10 years but could be longer if requested by the owner at inception. Each Annuity Payment will consist of a "Designated Annuity Payment" and a "Secondary Annuity Payment." The Designated Annuity Payment will be paid directly into the Base Contract as a premium that is intended not to cause the Base Contract to fail the "7-pay test" of § 7702A(b). The payment of Designated Annuity Payments into the Base Contract does not guarantee that the Base Contract will stay in force. The Secondary Annuity Payment will be the excess, if any, of the amount of the Annuity Payment over the Designated Annuity Payment and will be paid to the owner or otherwise at the owner's direction, but not into the Base Contract. If the Guaranteed Period ends while the Base Contract is still in effect, the Annuity Rider will not be extended and will terminate. The Annuity Payments are intended to be taxable under the normal rules governing periodic payments from a non-qualified annuity or individual retirement annuity, as applicable.

The Annuity Rider will provide no cash value, no right to a partial or full withdrawal, and no right to obtain a policy loan using the Annuity Rider as collateral. It will provide only for the payment of Annuity Payments and, in limited circumstances, a "Commutation Value" if the Annuity Rider terminates before all scheduled Annuity Payments are made. If the Base Contract terminates before the end of the Guaranteed Period (including upon the death of the insured), the Annuity Rider will terminate, and the Commutation Value generally will be paid from the Annuity Rider. Taxpayer will determine the Commutation Value in an actuarially appropriate manner. Neither the Annuity Payments nor the Commutation Value are reflected in the rights granted under the Base Contract regarding full surrenders and policy loans. No part of the Annuity Rider or amounts paid from the Annuity Rider will serve as collateral for any policy loan under the Base Contract or increase the amount of any policy loan the owner may receive from Taxpayer.

The terms of the Base Contract and Annuity Rider are comparable to stand-alone life insurance and annuity contracts, respectively, that are available in the marketplace. Taxpayer would be willing to issue the same amount of coverage to any insured who would be covered by the Base Contract, based on the same guaranteed cost of insurance rates for such coverage, even if the individual did not also purchase the Annuity Rider. The total reserves that State Law requires Taxpayer to maintain will not be less than the reserves Taxpayer would have been required to maintain had the Base Contract and Annuity Rider been issued as separate stand-alone contracts.

In cases where the NQ-Annuity Rider is issued in a § 1035 exchange for a non-qualified annuity contract the purchaser already owns, the purchaser will assign to Taxpayer some or all of the purchaser's rights under the contract the purchaser already owns. Taxpayer then will surrender its interest in the assigned contract and apply the proceeds to a single premium for the NQ-Annuity Rider. None of those surrender proceeds will be paid into the Base Contract.

Taxpayer makes the following additional representations:

1. The states in which the Base Contract and Annuity Rider are sold would allow the Base Contract to be issued without the Annuity Rider.
2. Taxpayer is willing to issue the Base Contract without the Annuity Rider.
3. The states in which the Base Contract and Annuity Rider are sold would allow the Annuity Rider to be sold with another life insurance contract.
4. Taxpayer is willing to issue the Annuity Rider in connection with another life insurance contract.
5. The Base Contract is considered a life insurance contract under State Law. If issued as a separate contract, it would comply with § 7702 and otherwise would be treated as a life insurance contract for federal tax purposes.
6. The Annuity Rider is considered an immediate annuity contract under State Law. If issued as a separate contract, the NQ-Annuity Rider would satisfy § 72(s) and otherwise would be treated as an annuity contract for federal tax purposes. Likewise, if issued as a separate contract, the IRA-Annuity Rider would qualify as an individual retirement annuity within the meaning of § 408(b).
7. State Law in each state in which the Base Contract will be issued requires that the reserves maintained with respect to the Base Contract be maintained under such State Law's valuation law for life insurance contracts, which differs from the requirements of State Law governing reserves for immediate annuities.
8. State Law in each state in which the Annuity Rider will be issued requires that the reserves maintained with respect to the Annuity Rider be maintained under such State Law's valuation law for immediate annuities, which differs from the requirements of State Law governing reserves for life insurance contracts.
9. State Law in each state in which the Base Contract and Annuity Rider will be issued will not permit Taxpayer to maintain the entire amount of reserves it is required to maintain in connection with its liabilities under both, either as life insurance reserves or as annuity reserves.

10. The Base Contract and Annuity Rider do not provide a single integrated death benefit under State Law, and together they do not constitute a single integrated life insurance contract under State Law.

REQUESTED RULINGS

Taxpayer requests the following rulings:

1. The Base Contract and the Annuity Rider each will be treated as a separate contract for federal tax purposes.
2. No portion of the single premium paid for the Annuity Rider will be treated as “premiums paid” within the meaning of § 7702(f)(1) or “amounts paid” within the meaning of § 7702A(e)(1) under the Base Contract.
3. For purposes of §§ 72, 101, 408(d), 7702, and 7702A, (1) all amounts received from the Base Contract will be treated as having been paid under a life insurance contract, and (2) all amounts received from the Annuity Rider will be treated as having been paid under an annuity contract (or paid under an individual retirement annuity, in the case of the IRA-Annuity Rider).
4. Designated Annuity Payments from the Annuity Rider that are used to pay premiums under the Base Contract (1) will be treated as “premiums paid” within the meaning of § 7702(f)(1) and “amounts paid” within the meaning of § 7702A(e)(1) under the Base Contract; and (2) will give rise to “investment in the contract” under §§ 72(c)(1) and 72(e)(6) for the Base Contract.
5. No amounts or values attributable to the Annuity Rider, including any Commutation Value, will be treated as part of the “cash value,” “cash surrender value,” or “net surrender value,” of the Base Contract for purposes of applying §§ 72, 7702, and 7702A to the Base Contract.
6. No part of any policy loan with respect to the Base Contract will be treated as a loan with respect to the Annuity Rider.
7. Each Annuity Payment made under the NQ-Annuity Rider will be treated as an “amount received as an annuity” that is taxable under the “exclusion ratio” methodology of § 72(b).
8. If the NQ-Annuity Rider is issued in an exchange for part or all of another non-qualified annuity contract, the issuance of the Base Contract with the NQ-Annuity Rider will not be treated as the receipt of money or property that is not permitted to be received without the recognition of gain under § 1035 for purposes of §§ 1035(d)(1) and 1031(b).

9. The Base Contract will not be treated as lacking sufficient risk shifting and risk distribution to qualify as “insurance” for federal income tax purposes merely because the Base Contract is issued with the Annuity Rider.
10. The IRA-Annuity Rider will not fail to be treated as an individual retirement annuity under § 408(b) merely because it is issued with the Base Contract.

LAW AND ANALYSIS

Ruling Request Number 1

Section 7702 provides that, in order for a contract to be considered a life insurance contract for federal tax purposes, it must be a life insurance contract under applicable law and must either meet the “cash value accumulation test” (“CVAT”) as defined in § 7702(b) or both meet the guideline premium requirements of § 7702(c) and fall within the cash value corridor of § 7702(d) (the “guideline premium test” or “GPT”). The legislative history for § 7702 provides that the “applicable law” referenced in § 7702(a) is “the applicable State or foreign law.” S. Prt. No. 169, Vol. 1, 98th Cong., 2d Sess. 572 (1984). The legislative history also states,

The term “life insurance contract” does not include that portion of any contract that is treated under State law as providing any annuity benefits other than as a settlement option. Thus, although a life insurance contract may provide by rider for annuity benefits, the annuity portion of the contract is not part of the life insurance contract for tax purposes. . . . Thus, an insurance arrangement written as a combination of term life insurance with an annuity contract . . . is not a life insurance contract . . . because all of the elements of the contract are not treated under State law as providing a single integrated death benefit. As a result, only the term [insurance proceeds] . . . can . . . be treated as life insurance proceeds upon the insured’s death. However, any life insurance contract that is treated under State law as a single, integrated life insurance contract and that satisfies . . . [the § 7702] guidelines will be treated for Federal tax purposes as a single contract of life insurance and not as a contract that provides separate life insurance and annuity benefits.

Id.

The Base Contract is considered a life insurance contract under State Law. The Annuity Rider provides annuity benefits other than as a settlement option with respect to the Base Contract. The Base Contract and Annuity Rider do not provide a single integrated death benefit and do not together constitute a single integrated life insurance contract.

The Base Contract and Annuity Rider are treated as a life insurance contract and annuity contract, respectively, under the applicable state laws and associated rules. As

represented by Taxpayer, the Base Contract is subject to the state laws and regulations relating to life insurance contracts, including the legal requirements pertaining to life insurance forms, nonforfeiture values, and reserves. Those rules differ from the rules applicable to the Annuity Rider. The Annuity Rider is subject to the state laws and regulations relating to immediate annuities, including the legal requirements pertaining to annuity forms, nonforfeiture values, and reserves.

The states in which the Base Contract and Annuity Rider will be sold would allow the Base Contract to be issued without the Annuity Rider and the Annuity Rider to be sold with another life insurance contract. Taxpayer is willing to issue the Base Contract without the Annuity Rider and is willing to issue the Annuity Rider with other life insurance contracts. Taxpayer also offers similar stand-alone single premium immediate annuities without the Base Contract.

Separate premiums will be paid for the Base Contract and the Annuity Rider. Premiums for the Annuity Rider will be calculated using interest rates and other actuarial assumptions that are comparable to those used in determining premiums and benefits for other stand-alone single premium immediate annuities that are offered without a life insurance contract. Premiums for the Base Contract will be calculated using interest rates and other actuarial assumptions that are comparable to those used in determining premiums and benefits for other universal life insurance contracts that are offered without an annuity rider.

The payment of Designated Annuity Payments into the Base Contract does not guarantee that the Base Contract will stay in force. Neither the Annuity Payments nor the Commutation Value are reflected in the rights granted under the Base Contract regarding full surrenders and policy loans.

Accordingly, the Base Contract and the Annuity Rider each will be treated as a separate contract for federal tax purposes.

Requested Ruling Number 2

Section 7702(c)(1) provides that a contract meets the guideline premium requirements if the sum of the premiums paid under such contract does not at any time exceed the guideline premium limitation, as defined in § 7702(c)(2), as of such time.

Section 7702(f)(1)(A) provides that, for purposes of § 7702, “premiums paid” are the premiums paid under the contract less amounts (other than amounts includible in gross income) to which § 72(e) applies and less any excess premiums with respect to which there is a distribution described in §§ 7702(f)(7)(B) or (E) and any other amounts received with respect to the contract which are specified in regulations.

Section 7702A(a)(1) provides that, for purposes of § 72, a “modified endowment contract” includes any contract that meets the requirements of § 7702 and is entered

into on or after June 21, 1988, and fails to meet the 7-pay test of § 7702A(b). Section 7702A(a)(2) provides that any contract meeting the requirements of § 7702 that is received in exchange for a contract described in § 7702A(a)(1) or (2) is a modified endowment contract.

Section 7702A(b) provides that a contract fails to meet the 7-pay test if the accumulated amount paid under the contract at any time during the first seven contract years exceeds the sum of the net level premiums which would have been paid on or before such time if the contract provided for paid-up future benefits after the payment of seven level annual premiums.

Section 7702A(e)(1)(A) provides that, for purposes of § 7702A, the term “amount paid” means the premiums paid under the contract, reduced by amounts to which § 72(e) applies (determined without regard to paragraph (4)(A) thereof) but not including amounts includible in gross income.

Here, the Base Contract and the Annuity Rider each will be treated as a separate contract for federal tax purposes. The single premium paid for the Annuity Rider will fund only the Annuity Rider, not the Base Contract, which will be funded by Designated Annuity Payments and any other amounts the owner separately pays as premiums for the Base Contract. Accordingly, no portion of the single premium paid for the Annuity Rider will be treated as “premiums paid” within the meaning of § 7702(f)(1) or “amounts paid” within the meaning of § 7702A(e)(1) under the Base Contract.

Requested Ruling Number 3

Section 72 generally governs the taxation of distributions from non-qualified annuities. 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) (the “exclusion ratio” methodology).

Section 101(a)(1) provides that gross income generally does not include amounts received (whether in a single sum or otherwise) under a life insurance contract, if such amounts are paid by reason of the death of the insured. One of the exceptions to this general rule is set forth in § 101(d), which provides for the taxation of certain amounts received under an agreement to pay life insurance proceeds at a date later than death.

Section 408(d) governs the tax treatment of distributions from individual retirement annuities and provides that any amount paid or distributed out of an individual retirement plan shall be included in gross income by the payee or distributee, as the case may be, in the manner provided under § 72, except as otherwise provided by § 408(d).

Section 72(e) applies to and governs the taxation of amounts that are received under an annuity, endowment, or life insurance contract that are not received as an annuity. For purposes of § 7702, amounts (other than amounts includible in gross income) to which § 72(e) applies reduce premiums paid and therefore affect the application of the GPT to a contract. For purposes of § 7702A, amounts to which § 72(e) applies (determined without regard to paragraph (4)(A) thereof) reduce the amount paid and therefore affect the application of the 7-pay test of § 7702A(b).

Here, the Base Contract and Annuity Rider each will be treated as a separate contract for federal tax purposes. Taxpayer has represented that the Base Contract is considered a life insurance contract under State Law and, if issued as a separate contract, would comply with § 7702 and otherwise would be treated as a life insurance contract for federal tax purposes. Taxpayer has represented that the Annuity Rider is considered an immediate annuity contract under State Law; that the NQ-Annuity Rider, if issued as a separate contract, would satisfy § 72(s) and otherwise would be treated as an annuity contract for federal tax purposes; and that the IRA-Annuity Rider, if issued as a separate contract, would qualify as an individual retirement annuity within the meaning of § 408(b). Accordingly, for purposes of §§ 72, 101, 408(d), 7702, and 7702A, all amounts received from the Base Contract will be treated as having been paid under a life insurance contract, and all amounts received from the Annuity Rider will be treated as having been paid under an annuity contract (or paid under an individual retirement annuity, in the case of the IRA-Annuity Rider).

Requested Ruling 4

Section 72(c)(1) provides that, for purposes of § 72(b), the investment in the contract as of the annuity starting date is (A) the aggregate amount of premiums or other consideration paid for the contract, minus (B) the aggregate amount received under the contract before such date, to the extent that such amount was excludable from gross income under this subtitle or prior income tax laws.

Section 72(e)(2)(A) provides that any amount received under an annuity, endowment, or life insurance contract that is not received as an annuity shall, if received on or after the annuity starting date, be included in gross income. Section 72(e)(2)(B) provides that any amount received under an annuity, endowment, or life insurance contract that is not received as an annuity, if received before the annuity starting date: (i) shall be included in gross income to the extent allocable to income on the contract, and (ii) shall not be included in gross income to the extent allocable to the investment on the contract.

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

Under § 7702(f)(1), the premiums paid under a life insurance contract are included in “premiums paid” for purposes of determining whether the contract meets the guideline premium requirements of § 7702(c)(1). Under § 7702A(e)(1), the premiums paid under a contract that is intended to be a life insurance contract are included in “amounts paid” for purposes of determining whether the contract meets the requirements of the 7-pay test of § 7702A(b).

Here, the Base Contract and the Annuity Rider each will be treated as a separate contract for federal tax purposes. Taxpayer has represented that the Base Contract is considered a life insurance contract under State Law and, if issued as a separate contract, would comply with § 7702 and otherwise would be treated as a life insurance contract for federal tax purposes. The Base Contract will be funded by the Designated Annuity Payments made from the Annuity Rider into the Base Contract and any other amounts the owner separately pays as premiums for the Base Contract. The Annuity Payments will be taxable under the normal rules governing periodic payments from a non-qualified annuity or individual retirement annuity, as applicable. Accordingly, Designated Annuity Payments from the Annuity Rider that are used to pay premiums under the Base Contract (1) will be treated as “premiums paid” within the meaning of § 7702(f)(1) and “amounts paid” within the meaning of § 7702A(e)(1) under the Base Contract; and (2) will give rise to “investment in the contract” under §§ 72(c)(1) and (e)(6) for the Base Contract.

Requested Ruling 5

Section 72(e)(3)(A) provides, for purposes of § 72(e)(2)(B), which governs the taxation of certain distributions from life insurance contracts, that any amount to which § 72(e) applies shall be treated as allocable to income on the contract to the extent that such amount does not exceed the excess (if any) of: (i) the cash value of the contract (determined without regard to any surrender charge) immediately before the amount is received, over (ii) the investment in the contract at such time. Section 72 does not define the term “cash value” for this purpose.

Sections 7702 and 7702A may require the determination of a life insurance contract’s “cash surrender value.” For instance, the CVAT set forth in § 7702(b) and the cash value corridor component of the GPT set forth in § 7702(d)(1) both require a determination of a contract’s cash surrender value. Section 7702A(c)(3)(B), which may apply if there is a material change in the benefits under (or in other terms of) a contract, requires appropriate adjustments to take into account the cash surrender value under the contract in determining whether the contract meets the 7-pay test of § 7702A(b). Section 7702 may also require the determination of a contract’s “net surrender value.” See, e.g., §§ 7702(g)(1)(B) and (2).

With regard to a life insurance contract, § 7702(f)(2)(A) defines “cash surrender value” as the contract’s “cash value determined without regard to any surrender charge, policy loan, or reasonable termination dividend.” Section 7702(f)(2)(B) provides that a

contract's "net surrender value" shall be determined with regard to surrender charges but without regard to any policy loan. The legislative history of § 7702 indicates that the cash value of a contract is "any amount to which the policyholder is entitled upon surrender and against which the policyholder can borrow." S. Prt. No. 169, Vol. 1, 98th Cong., 2d Sess. 573 (1984).

Here, the Base Contract and the Annuity Rider will be treated as separate contracts for federal tax purposes. No part of the Annuity Rider will give rise to an amount payable under the Base Contract upon a surrender of the Base Contract, and there will be no part of the Annuity Rider that the policyholder will be able to borrow under the Base Contract. Neither the Annuity Payments nor the Commutation Value under the Annuity Rider are reflected in the rights granted under the Base Contract regarding full surrenders and policy loans. Accordingly, no amounts or values attributable to the Annuity Rider, including any Commutation Value, will be treated as part of the "cash value," "cash surrender value," or "net surrender value," of the Base Contract for purposes of applying §§ 72, 7702, and 7702A to the Base Contract.

Requested Ruling 6

Section 72(e)(4)(A) provides that, for purposes of § 72(e)(2)(B), if an individual, during any taxable year, either (i) receives (directly or indirectly) any amount as a loan under any contract to which § 72(e) applies, or (ii) assigns or pledges (or agrees to assign or pledge) any portion of the value of any such contract, such amount or portion shall be treated as received under the contract as an amount not received as an annuity.

Section 408(e)(3) provides that if during any taxable year the owner of an individual retirement annuity borrows any money under or by use of such contract, the contract ceases to be an individual retirement annuity as of the first day of such taxable year. Such owner shall include in gross income for such year an amount equal to the fair market value of such contract as of such first day.

Here, the Base Contract and the Annuity Rider each will be treated as a separate contract for federal tax purposes. The Base Contract provides a cash value that the owner may use as collateral to obtain a loan from Taxpayer. The Annuity Rider provides no cash value and no right to obtain a loan using the Annuity Rider as collateral. Neither the Annuity Payments nor the Commutation Value under the Annuity Rider are reflected in the rights granted under the Base Contract regarding policy loans. No part of the Annuity Rider or amounts paid from the Annuity Rider will serve as collateral for any policy loan under the Base Contract or increase the amount of any policy loan the owner may receive from Taxpayer. Since the Annuity Rider and the Base Contract will be treated as two separate contracts for federal tax purposes, no part of any policy loan with respect to the Base Contract will be treated as a loan with respect to the Annuity Rider.

Requested Ruling 7

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 § 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) of the Income Tax Regulations provides that amounts subject to § 72 are “amounts received as an annuity” only if all of the following tests are met:

- (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 1.72-4(b) provides that the “annuity starting date” generally is the first day of the first period for which an amount is received as an annuity. Section 1.72-4(b) further provides that 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.

Here, the Base Contract and the Annuity Rider will be treated as separate contracts for federal tax purposes. The Annuity Rider is considered an immediate annuity contract under State Law. If issued as a separate contract, the NQ-Annuity Rider would satisfy § 72(s) and otherwise would be treated as an annuity contract for federal tax purposes.

First, the Annuity Payments made under the Annuity Rider will be received on or after the annuity starting date. The Annuity Payments will be made annually, starting within one year of the purchase date, which is, accordingly, 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 (unless the Base Contract terminates). The Annuity Payments will be made in annual installments during the Guaranteed Period. The Guaranteed Period will be a minimum of 10 years but could be longer if requested by the owner at inception.

Third, the total amount payable is determinable at the annuity starting date directly from the terms of the contract. The Annuity Payments are fixed, level amounts paid over a fixed term of years.

Accordingly, each Annuity Payment made under the NQ-Annuity Rider will be treated as an "amount received as an annuity" that is taxable under the "exclusion ratio" methodology of § 72(b).

Requested Ruling 8

Section 1035(a) provides that no gain or loss shall be recognized on the exchange of an annuity contract for an annuity contract.

Section 1035(d)(1) provides that if an exchange is not solely in kind, the rules of §§ 1031(b) and (c) should apply.

Section 1031(b) and (c) apply if an exchange would be within the provisions of § 1035(a), if it were not for the fact that the property received in exchange consists not only of property permitted by such provision to be received without the recognition of gain, but also of other property or money. Section 1031(b) provides that the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such property. Section 1031(c) provides that no loss from the exchange shall be recognized.

Here, the Base Contract and the Annuity Rider will be treated as separate contracts for federal tax purposes. If an NQ-Annuity Rider is issued under a § 1035 exchange for a non-qualified annuity contract, the only property the owner will receive in exchange for the annuity is the NQ-Annuity Contract. None of the proceeds from the exchanged contract will be paid into the Base Contract. Accordingly, if the NQ-Annuity Rider is issued in an exchange for part or all of another non-qualified annuity contract, the

issuance of the Base Contract will not be treated as the receipt of money or property that is not permitted to be received without the recognition of gain under § 1035 for purposes of §§ 1035(d)(1) and 1031(b).

Requested Ruling 9

Neither the Code nor the regulations thereunder define “insurance” or “insurance contract.” To determine if an arrangement qualifies as insurance, the Supreme Court has stated that insurance is a transaction that involves “an actual insurance risk” and that “[h]istorically and commonly insurance involves risk-shifting and risk-distributing.” Helvering v. LeGierse, 312 U.S. 531, 539 (1941).

In LeGierse, the taxpayer purchased a single premium life insurance contract and a single premium life annuity simultaneously. The insured was elderly, and the insurance company did not require any evidence of insurability. The total consideration was prepaid and exceeded the face value of life insurance policy. Because the insurance contract would not have been issued without the annuity, the Court concluded the two contracts must be considered together and determined that, considered together, the contracts failed to “spell out any element of insurance risk.” Id. at 541. The Court concluded that any risk that the prepayment would earn less than the amount paid as an annuity was an investment risk, not an insurance risk. The Court found that “annuity and insurance are opposites; in this combination, the one neutralizes the risk customarily inherent in the other.” Id.

Although the Supreme Court concluded that no insurance risk was shifted and distributed in the arrangement at issue in LeGierse, it does not necessarily follow that risk shifting and risk distribution are lacking whenever a life insurance contract and annuity are issued simultaneously. The legislative history of § 7702 states that “although a life insurance contract may provide by rider for annuity benefits, the annuity portion of the contract is not part of the life insurance contract for tax purposes.” S. Prt. No. 169, Vol. 1, 98th Cong., 2d Sess. 572 (1984). Thus, Congress must have contemplated that a life insurance contract could include an annuity rider that would be respected as an annuity.

Here, although the Base Contract and Annuity Rider will be issued together, the Annuity Rider, unlike the annuity at issue in LeGierse, will have no life contingency. Rather, the Annuity Rider will provide for Annuity Payments in fixed, level amounts annually that are not dependent on the survival of the annuitant. These payments will continue over a fixed term of years or, if the Base Contract terminates before all scheduled Annuity Payments are made, an actuarially-determined Commutation Value will be paid. Also, unlike in LeGierse, satisfactory evidence of insurability must be provided to Taxpayer to obtain the Base Contract. Taxpayer would be willing to issue the same amount of coverage to any insured who would be covered by the Base Contract, based on the

same guaranteed cost of insurance rates for such coverage, even if the insured did not purchase the Annuity Rider.

Accordingly, the Base Contract will not be treated as lacking sufficient risk shifting and risk distribution to qualify as “insurance” for federal income tax purposes merely because the Base Contract is issued with the Annuity Rider.

Requested Ruling 10

Section 408(b) provides that for purposes of § 408, the term “individual retirement annuity” means an annuity contract, or an endowment contract (as determined under regulations prescribed by the Secretary), issued by an insurance company which meets the following requirements:

- (1) The contract is not transferable by the owner.
- (2) Under the contract; (A) the premiums are not fixed, (B) the annual premium on behalf of any individual will not exceed the dollar amount in effect under § 219(b)(1)(A), and (C) any refund of premiums will be applied before the close of the calendar year following the year of the refund toward the payment of future premiums or the purchase of additional benefits;
- (3) Under regulations prescribed by the Secretary, rules similar to the rules of § 401(a)(9) and the incidental death benefit requirements of § 401(a) shall apply to the distribution of the entire interest of the owner; and
- (4) The entire interest of the owner is nonforfeitable.

Section 408(b) provides that an individual retirement annuity does not include such an annuity contract for any taxable year of the owner in which it is disqualified on the application of § 408(e) or for any subsequent tax year.

Section 408(e)(3) provides that if during any taxable year the owner of an individual retirement annuity borrows any money under or by use of such contract, the contract ceases to be an individual retirement annuity as of the first day of such taxable year. Such owner shall include in gross income for such year an amount equal to the fair market value of such contract as of such first day.

The Base Contract and the IRA-Annuity Rider will be treated as separate contracts for federal tax purposes. Taxpayer has represented that if the IRA-Annuity Rider were issued as a separate contract, it would satisfy all the statutory requirements of § 408(b). Accordingly, the IRA-Annuity Rider will not fail to be treated as an individual retirement annuity under § 408(b) merely because it is issued with the Base Contract.

HOLDINGS

1. The Base Contract and the Annuity Rider each will be treated as a separate contract for federal tax purposes.
2. No portion of the single premium paid for the Annuity Rider will be treated as “premiums paid” within the meaning of § 7702(f)(1) or “amounts paid” within the meaning of § 7702A(e)(1) under the Base Contract.
3. For purposes of §§ 72, 101, 408(d), 7702, and 7702A, (1) all amounts received from the Base Contract will be treated as having been paid under a life insurance contract, and (2) all amounts received from the Annuity Rider will be treated as having been paid under an annuity contract (or paid under an individual retirement annuity, in the case of the IRA-Annuity Rider).
4. Designated Annuity Payments from the Annuity Rider that are used to pay premiums under the Base Contract (1) will be treated as “premiums paid” within the meaning of § 7702(f)(1) and “amounts paid” within the meaning of § 7702A(e)(1) under the Base Contract; and (2) will give rise to “investment in the contract” under §§ 72(c)(1) and 72(e)(6) for the Base Contract.
5. No amounts or values attributable to the Annuity Rider, including any Commutation Value, will be treated as part of the “cash value,” “cash surrender value,” or “net surrender value,” of the Base Contract for purposes of applying §§ 72, 7702, and 7702A to the Base Contract.
6. No part of any policy loan with respect to the Base Contract will be treated as a loan with respect to the Annuity Rider.
7. Each Annuity Payment made under the NQ-Annuity Rider will be treated as an “amount received as an annuity” that is taxable under the “exclusion ratio” methodology of § 72(b).
8. If the NQ-Annuity Rider is issued in an exchange for part or all of another non-qualified annuity contract, the issuance of the Base Contract with the NQ-Annuity Rider will not be treated as the receipt of money or property that is not permitted to be received without the recognition of gain under § 1035 for purposes of §§ 1035(d)(1) and 1031(b).
9. The Base Contract will not be treated as lacking sufficient risk shifting and risk distribution to qualify as “insurance” for federal income tax purposes merely because the Base Contract is issued with the Annuity Rider.
10. The IRA-Annuity Rider will not fail to be treated as an individual retirement annuity under § 408(b) merely because it is issued with the Base Contract.

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 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,

Kathryn Sneade
Branch Chief, Branch 4
Office of Associate Chief Counsel
(Financial Institutions & Products)

cc: