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Date:
September 20, 2024

Taxpayer	=
Issuer	=
Parent	=
V	=
W	=
X	=
Y	=
Z	=

Dear :

Taxpayer has requested several rulings concerning a contingent deferred annuity contract (the "Contract") that Issuer plans to issue to, or for the benefit of, Taxpayer. This letter ruling is being issued electronically in accordance with section 7.02(2) of Rev. Proc. 2024-1, 2024-1 I.R.B. 1.

FACTS

Taxpayer and Issuer represents that:

Issuer is a life insurance company within the meaning of § 816(a). Issuer files a consolidated federal income tax return on behalf of itself and its subsidiary insurance

companies. Parent is Issuer's ultimate parent corporation and is not part of the federal income tax returns Issuer files.

Taxpayer is an individual who is V years old, which is typical of other anticipated purchasers of the Contract. In that regard, Issuer plans to issue the Contract to individuals between the ages W and X, with most falling between the ages of Y and Z.

Taxpayer will own assets in a taxable brokerage or similar investment account (the "Account"). The Account will be established and maintained by an unrelated entity that Issuer approves for use with the Contract (the "Financial Institution"). Issuer will have no legal or equitable ownership in the Account or any of the assets in the Account, and Issuer will not treat the Account or any of the assets in the Account as assets of Issuer for any purpose.

Issuer will issue the Contract in consideration for the payment of periodic fees ("Contract Fees"). Contract Fees will be paid with after-tax money, either by liquidating assets in the Account and remitting the after-tax cash proceeds to Issuer, or by Taxpayer using another after-tax source of funds to pay the Contract Fees. Taxpayer's investments within the Account must be made in asset tiers designated by Issuer. Each asset tier will result in the Account holding assets representing multiple asset classes (e.g. fixed income, equities, commodities, real estate, cash, and cash equivalents) and/or in different investment categories within one or more asset cases (e.g. domestic large-cap, mid-cap, and small-cap within the equity asset class). Taxpayer will be required to rebalance these allocations periodically in order to comply with investment allocation requirements. Taxpayer or Financial Institution must provide Issuer with the information necessary to monitor the investments in the Account.

Issuer and Taxpayer expect that the Account will hold assets that will be understood to be "diversified" in the ordinary sense of the term. In that regard, the Account will not consist solely of shares of stock of a single firm or enterprise.[1] The investment allocation requirements are intended to help maintain a consistent level of volatility in the Account's investment returns, thereby reducing Issuer's risk that it will be required to start making "Guarantee Payments" under the Contract, as defined and discussed below.

When the Contract is linked to the Account, the Contract will be issued to Taxpayer or to a trust for Taxpayer's benefit.[2] The Contract is designed to support Taxpayer's retirement needs by guaranteeing Taxpayer's ability to receive a specified amount of retirement income each year for Taxpayer's life. If Taxpayer withdraws only the guaranteed minimum amount defined in the Contract, or less, from his Account each year, and the Account is reduced to zero in Taxpayer's lifetime for reasons other than

[1] For this purpose, share or other interests in a regulated investment company or similar pooled investment vehicle will not be considered a "single firm or enterprise."

[2] Taxpayer represents that, if issued to a trust, the Contract will be issued to the trust in a manner such that § 72(u)(1) will not apply to the Contract.

an early or excess withdrawal, then a series of periodic payments in guaranteed minimum amounts will be payable under the Contract each year for the remainder of Taxpayer's life (the "Guarantee Payments").

The amount of each Guarantee Payment will be based on the Contract's "Coverage Amount". The Coverage Amount will initially be determined on the date Taxpayer first makes a withdrawal from the Account that is not considered an early withdrawal (the "Lock-In Date") and will be re-determined on each subsequent Contract anniversary. The Coverage Amount will be determined by multiplying the Contract's "Coverage Base" by a "Payment Percentage" multiplier. The Coverage Base will be based on the Contract's initial account value, certain contributions, and excess withdrawals. The Contract will include a step-up basis feature that applies if the account value on the Contract anniversary is higher than the Coverage Base on the immediately preceding anniversary. In such case, the Coverage Base will be increased to equal the account value, subject to a specified maximum. The Payment Percentage multiplier will be based on the age of the covered life (or lives) on the date that Taxpayer takes the first withdrawal from the Account, whether a single life or joint life has been elected, the years elapsed between the Contract's issue date and the Lock-In Date, and which of the "Coverage Plans" Taxpayer has purchased.

There are three potential Coverage Plans. Two of the coverage plans (Plans A and B) will use a level Payment Percentage while the Account is greater than $0 in order to ensure that level Coverage Amounts are withdrawn from the Account each year, subject only to potential upward adjustment for the step-up basis feature and potential downward adjustment for excess withdrawals. The third plan, Plan C, will adjust the Payment Percentage in the current Contract year, while the account is still greater than $0, based on the ten-year Constant Maturity U.S. Treasury rate and a percentage specified in a table set forth in the Contract (the "Treasury Rate"). Under Plan C, in addition to a potential upward adjustment for the step-up basis and downward adjustment for excess withdrawals, the Coverage Amount may fluctuate with the Treasury Rate.

The Coverage Plans will be used to determine the dollar amount of the Guarantee Payments. Plan A will multiply the Coverage Base as of the date the account value reaches zero by the Payment Percentage that was determined on Lock-In Date, reduced by 1%, in order to determine the Guarantee Payments amount. Plan B will multiply the Coverage Base as of the date the account value reaches zero by the Payment Percentage that was determined on the Lock-In Date without the 1% reduction in order to determine the Guarantee Payments amount. Plan C will multiply the Coverage Base as of the date the account value reaches zero by the Payment Percentage that was determined on the Lock-In Date, as adjusted by any positive Treasury Rate in effect at that time.

Once the amount of the Guarantee Payments is initially determined, the payments will continue in that amount for Taxpayer's life.

Upon Taxpayer's death, the Contract terminates unless the joint life benefit was selected. If the joint life benefit was selected and Taxpayer dies before Guarantee Payments have commenced, then the Taxpayer's surviving spouse may continue the Contract in accordance with the terms of the Contract and § 72(s)(3). If the joint life benefit was selected and Taxpayer dies after the Guarantee Payments commence, such payments will continue for the remainder of the spouse's life and will be made at least as rapidly as they were being made when Taxpayer died.

The Contract does not have a cash value. If Taxpayer chooses to terminate the Contract, no amount will be payable by Issuer. Taxpayer will not be able to receive a loan from Issuer or its affiliates by using the Contract as collateral. Further, Taxpayer may not assign or transfer any ownership rights under the Contract, including with respect to the Guarantee Payments.

Issuer's actuaries have analyzed the actuarial and economic characteristics of the Guarantee Payment features of the Contract, reaching the following conclusions:

1. Like a traditional payout annuity, the cost of the Contract to Issuer and its value to Taxpayer increase as life expectancy increases.

2. From an actuarial pricing and annuity reserving perspective, the longevity risk protection under the Contract is indistinguishable from that of a traditional variable annuity contract with a life-contingent fixed annuity payout.

3. The Guarantee Payments protect primarily against longevity risk, rather than market risk.

4. The effectiveness of the Guarantee Payments as a hedge against market performance is limited for reasons that include the facts that (1) Taxpayer is required to invest the assets of the Account consistently with the diversified asset tiers[3] set by Issuer; (2) the Contract, not being liquid, will have its value realized, if at all, only over a long period[4]; and (3) Guarantee Payments may be made under the Contract even without market losses if Taxpayer lives for a sufficiently long period of time.

Issuer will hold reserves for its liabilities under the Contract. It will report these reserves on the National Association of Insurance Commissioners ("NAIC") annual statement that Issuer files with the insurance regulatory authorities in each of the states and other jurisdictions in which Issuer conducts its insurance business. Issuer will determine the

[3] For example, if there is a loss on some assets in the Account offset by gains in other assets in the Account, the benefits under the Contract would provide no protection against the loss. Similarly, if the Account in the aggregate experiences a loss and then recovers, the benefits under the contract would provide no protection against the loss.

[4] Issuer's actuaries note that the Contract's payment features cannot be sold to offset investment losses, unlike a put option in the capital markets.

reserves under the applicable requirements of state law and regulation. The reserves will reflect the liabilities that Issuer has with respect to Guarantee Payments. Such reserves will reflect the fact that Issuer does not own the assets in the Account. If Issuer did own the assets in the Account, the aggregate amount of reserves it would be required to maintain with respect to the Contract would be substantially larger.

Taxpayer makes the following additional representations:

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

2. The Contract will be treated as an annuity contract under state law in all states in which it is offered.

3. Taxpayer will have legal title in, and full control over, the assets held in the Account, although the Contract may terminate if Taxpayer does not invest those assets in accordance with the prescribed investment tiers.

4. Issuer will account for the Contract on its books and records as an annuity contract, and not as some other type of financial instrument.

5. Taxpayer will purchase the assets in the Account in transactions entered into for profit.

6. Taxpayer will include income associated with the Account in gross income, including income from any gain realized upon disposition of assets in the Account.

7. For purposes of Issuer's federal income tax returns, annual regulatory statements and filings to the NAIC, and state premium tax obligations, Issuer will treat Contract Fees in the same manner as charges for guaranteed lifetime withdrawal benefits under a traditional deferred annuity contract.

8. The marketing materials for the Contract will not include any explicit or implicit representations that changes in the fair market value of the Account or any assets therein are expected to approximate, directly or inversely, changes in the fair market value of the Contract.

REQUESTED RULINGS

Taxpayer requests the following rulings:

1. The Contract will be treated as an annuity contract under § 72.

2. The Guarantee Payments will be taxable as "amounts received as an annuity" under § 72(b).

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 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 Contract Fees paid to Issuer.

5. Dividends that Taxpayer receives from the assets in the Account will not fail to be treated as "qualified dividend income" “(QDI”) within the meaning of § 1(h)(11)(B) merely because Taxpayer also owns the Contract.

6. Taxpayer’s ownership of the Contract and the Account will not be treated as a straddle under § 1092.

7. The Guarantee Payments will not constitute insurance or other compensation for Taxpayer for any prior deductible losses in the Account for purposes of § 165, and the “investment in the contract” portion of each Guarantee Payment will not be includible in Taxpayer’s gross income by virtue of the “tax benefit rule.”

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 § 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) of the Income Tax Regulations 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 the 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 payment of a premium or premiums, the recipient thereof is bound to make future payments, typically at regular intervals, in amounts, to payees, and on 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, such individual does not retain total control over that asset and does not have unfettered access to the full amount of the individual's own property.

4 Am. Jur. 2d Annuities, § 1 (2024). 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 [Taxpayer], 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 Guarantee Payments is contingent upon the value of the Account being exhausted while Taxpayer is alive, it is not the case that "if [Taxpayer] 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 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 (2024). Taxpayer 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).

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) 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 1.72-4(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.

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

Second, the Guarantee 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, the total amount payable is determinable from the Contract using mortality tables and sound actuarial theory.

Accordingly, the Guarantee Payments will be "amounts received as an annuity."

The Guarantee Payments 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).

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."[5] 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 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 Taxpayer other than through receipt of Guarantee 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 Issuer. The connection to the Account is unlike that in the ruling - the Account's value is used only to pay the Contract Fees. Taxpayer 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 Taxpayer are not consistent with the investment options approved by Issuer.

Although the Contract (1) has utility only in conjunction with an eligible Account, (2) controls, to some extent, Taxpayer'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.

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[5] Cf. proposed § 1.7702-2(b)(2), which provides certain exclusions from cash value, none of which are relevant to this discussion.

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 Guarantee Payments, the Contract Fees should be taken into account in the determination of Taxpayer's "investment in the contract" for the Contract under § 72.

Requested Ruling # 5

Section 1(h)(11)(A) provides that, for purposes of § 1(h), the term "net capital gain" means net capital gain (determined without regard to § 1(h)(11)) increased by QDI.

Section 1(h)(11)(B)(iii) provides in relevant part that QDI shall not include any dividend on any share of stock with respect to which the holding period requirements of § 246(c) are not met, determined by substituting in § 246(c) "60 days" for "45 days" each place it appears and by substituting "121-day period" for "91-day period."

Section 246 provides rules applicable to deductions for dividends received, among them a required holding period under § 246(c). Section 246(c)(4) provides that this holding period is reduced for any period (during such periods) in which (A) a taxpayer has an option to sell, is under a contractual obligation to sell, or has made (and not closed) a short sale of, substantially identical stock or securities (SISS), (B) the taxpayer is the grantor of an option to buy SISS, or (C) under regulations the taxpayer has diminished its risk of loss by holding one or more other positions with respect to substantially similar or related property (SSRP).

Section 1.246-5(b)(1) provides that the term SSRP is applied according to the facts and circumstances of each case. In general, property is substantially similar or related to stock if (i) the fair market value of the stock and the property primarily reflect the performance of (A) a single firm or enterprise; (B) the same industry or industries; or (C)

the same economic factor or factors such as (but not limited to) interest rates, commodity prices, or foreign-currency exchange rates; and (ii) changes in the fair market value of the stock are reasonably expected to approximate, directly or inversely, changes in the fair market value of the property or a fraction or multiple thereof.

Section 1.246-5(b)(3) provides that a position with respect to property is an interest (including a futures or forward contract or an option) in property or any contractual right to a payment, whether or not severable from stock or other property. A position does not include traditional equity rights to demand payment from the issuer, such as the rights traditionally provided by mandatorily redeemable preferred stock.

Section 1.246-5(b)(4) provides that, for purposes of § 1.246-5(b)(1)(i), (b)(2), or (c)(1)(vi), reasonable expectations are the expectations of a reasonable person, based on all the facts and circumstances at the later of the time the stock is acquired or the positions are entered into. Reasonable expectations include all explicit or implicit representations made with respect to the marketing or sale of the position.

Section 1.246-5(c)(4) provides that a taxpayer has diminished its risk of loss on stock by holding a position in SSRP if the taxpayer is the beneficiary of a guarantee, surety agreement, or similar arrangement and the guarantee, surety agreement, or similar arrangement provides for payments that will substantially offset decreases in the fair market value of the stock.

The Conference Report to the Deficit Reduction Act of 1984, H. Rept. No. 98-861, at 818, 1984-3 C.B. (Vol. 2) 1, 72-73 indicates that “[t]he substantially similar standard is not satisfied merely because the taxpayer ... is an investor with diversified holdings and acquires a [regulated futures contract] or option on a stock index to hedge general market risks.”

The purchase of the Contract will not cause Taxpayer to have an option to sell, to be under a contractual obligation to sell, or to have made (and not closed) a short sale of, SISS. The Contract will not be SSRP because the fair market value of the assets in the Account and the Contract will not both reflect, directly or inversely, the performance of a single firm or enterprise, the same industry or industries, or the same economic factors; because the predominant risk the Contract protects against is longevity risk (i.e., the benefit under the Contract is contingent upon Taxpayer's survival); and because the changes in the fair market value of the assets in the Account are not reasonably expected to approximate, directly or inversely, changes in the fair market value of the Contract, or a fraction or multiple thereof.

Based on Taxpayer's representations, the benefits that may be ultimately paid under the Contract will not be closely correlated with, and will not substantially offset, decreases in the fair market value of the assets in the Account.

Accordingly, we conclude that the Contract will not diminish Taxpayer's risk of loss on Account assets for purposes of applying the holding period requirements of § 1(h)(11) and, therefore, will not cause dividends received by Taxpayer from stocks held in the Account to fail to be treated as QDI.

Requested Ruling # 6

Section 1092 imposes special rules that effectively suspend losses with respect to positions that are held as part of a straddle. Section 1092(c)(1) defines a straddle as offsetting positions with respect to personal property.

Section 1092(c)(2)(A) provides that a taxpayer holds offsetting positions with respect to personal property if there is a substantial diminution of the taxpayer's risk of loss from holding any position with respect to personal property by reason of the taxpayer's holding one or more other positions with respect to personal property (whether or not of the same kind).

Section 1092(d)(1) provides that the term “personal property” means any personal property of a type which is actively traded.

Section 1092(d)(2) provides that the term “position” means an interest (including a futures or forward contract or option) in personal property.

Section 1092(d)(3)(A) provides that, in the case of stock, the term “personal property” includes stock only if, in relevant part — (i) the stock is of a type which is actively traded and at least one of the positions offsetting such stock is a position with respect to such stock or SSRP; or (ii) such stock is of a corporation formed or availed of to take positions in personal property which offset positions taken by any shareholder.

The Contract will not be an offsetting position with respect to Taxpayer's interest in the assets in the Account within the meaning of § 1092(c)(2)(A) because holding the Contract will primarily mitigate Taxpayer's longevity risk and will not substantially diminish Taxpayer's risk of loss from holding the assets in the Account. See also § 1092(d)(3)(A). Accordingly, § 1092 will not apply.

Requested Ruling # 7

Section 165(a) allows as a deduction any loss not compensated for by insurance or otherwise.

Section 1.165-1(d)(2)(i) provides that if a casualty or other event occurs which may result in a loss, and in that year there exists a claim for reimbursement with respect to which there is a reasonable prospect of recovery, no portion of the loss with respect to which reimbursement may be received is sustained until it can be ascertained with reasonable certainty whether or not the reimbursement will be received. Whether a

reasonable prospect of recovery exists with respect to a claim for reimbursement of a loss is a question of fact to be determined upon an examination of all facts and circumstances.

In Dunne v. Commissioner, 29 B.T.A. 1109 (1934), aff'd, 75 F.2d 255 (2d Cir. 1935), the taxpayer and two others were the beneficial owners of three brokerage accounts that were opened at the recommendation of a wealthy friend who, desiring to assist them in making money on the stock market, guaranteed the accounts. The court held that the taxpayer's subsequent losses were not deductible because of the guarantee.

In Boston Elevated Railway Co. v. Commissioner, 16 T.C. 1084, 1111-1112 (1951), aff'd on another issue, 196 F.2d 923 (1st Cir. 1952), the Service argued that loss resulting from the abandonment of an elevated railway structure was compensated for by legislation (the Public Control Act) guaranteeing the taxpayer operating profits sufficient to pay dividends. The court disagreed, stating that "regardless of the amounts of any possible losses sustained by petitioner, no payments would be forthcoming to it if its income were sufficiently high, after absorbing the losses and other charges, to pay the required dividends." 16 T.C. at 1112.

Johnson v. Commissioner, 66 T.C. 897 (1976), aff'd, 574 F.2d 189 (4th Cir. 1978), involved a business partnership formed by the taxpayer and an associate. The taxpayer purchased an insurance policy on his partner's life. After his partner's accidental death, the taxpayer and his partner's widow were unsuccessful in continuing the business and terminated the partnership. The court upheld the disallowance of a loss on the termination because the taxpayer was compensated by the proceeds of the insurance policy. The court pointed out that the amount of the policy was approximately equal to the taxpayer's investment in the partnership. Thus, although it was not the partnership interest itself that was insured, the life insurance acted to compensate the loss of the partnership interest.

In Forward Communications Corp. v. United States, 608 F.2d 485 (Ct. Cl. 1979), the taxpayer, a local television station, claimed a loss based on termination of its affiliation agreement with CBS, the television network. The trial judge upheld disallowance of the deduction on the theory that increased revenues from affiliation with ABC, another television network, compensated taxpayer for loss of the CBS affiliation. Reversing this finding, the Court of Claims stated, "[t]he statute does not bar a deduction for a loss actually incurred merely because the taxpayer is able to effect an offsetting gain on a different although contemporaneous transaction." 608 F.2d at 611-12.

In Shanahan v. Commissioner, 63 T.C. 21 (1974), which involved federal disaster relief payments, the Tax Court, interpreting the words "insurance or otherwise" in § 165, determined that the general term "or otherwise" must be construed consistently with the specific term "insurance." The court stated that the general purpose of insurance is to spread the risk of loss from any peril among a large number of those who are exposed to a similar peril.

In Estate of Bryan v. Commissioner, 74 T.C. 725 (1980), the court, citing Shanahan, determined that the phrase "insurance or otherwise" in an analogous provision, § 2054, contemplates that the type of compensation received must be such that it was "structured to replace what was lost." 74 T.C. at 727. The court held that a disbursement from a trust fund established by a state bar association, in compensation for losses incurred due to an attorney's unethical behavior, was in the nature of insurance.

Rev. Rul. 87-117, 1987-2 C.B. 61, involves a regulated public utility that abandons a partially-completed nuclear plant; the ratemaking authority allows a rate increase that takes into account the cost of the abandoned plant. The ruling holds that the rate increase does not reduce the taxpayer's abandonment-loss deduction because the rate increase was structured to serve the utilities' customers at a fair charge and ensure a reasonable return to investors, not to reimburse the loss.

The Guarantee Payments will not constitute insurance or other compensation for purposes of § 165(a) and thus will not prevent Taxpayer from deducting losses realized in the Account, assuming Taxpayer's losses otherwise meet the requirements of § 165.

The tax benefit rule allays some of the inflexibilities of the annual accounting system under specific circumstances. Generally, the tax benefit rule requires a taxpayer who received a tax benefit from a deduction in an earlier year to recognize income in a later year if there occurs an event that is fundamentally inconsistent with the premise on which the deduction was initially based. See Hillsboro National Bank v. Commissioner, 460 U.S. 370, 383 (1983). The tax benefit rule will "cancel out" an earlier deduction when the later event is fundamentally inconsistent with the premise on which the deduction was initially based, even if there is no actual recovery of funds. Id.

Because the Guarantee Payments will not constitute insurance or other compensation for purposes of § 165(a), the portion of the Guarantee Payments that otherwise constitutes a return of Taxpayer’s “investment in the contract” for purposes of § 72(c)(1) and § 72(e)(6) will not be includable in Taxpayer’s gross income as a recovery of previously deducted losses realized in the Account pursuant to application of the tax benefit rule.

RULINGS

1. The Contract will be treated as an annuity contract under § 72.

2. The Guarantee Payments will be taxable as “amounts received as an annuity” under § 72(b).

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 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 Contract Fees paid to Issuer.

5. Dividends that Taxpayer receives from the assets in the Account will not fail to be treated as "qualified dividend income" within the meaning of § 1(h)(11)(B) merely because Taxpayer also owns the Contract.

6. Taxpayer’s ownership of the Contract and the Account will not be treated as a straddle under § 1092.

7. The Guarantee Payments will not constitute insurance or other compensation for Taxpayer for any prior deductible losses in the Account for purposes of § 165, and the “investment in the contract” portion of each Guarantee Payment will not be includible in Taxpayer’s gross income by virtue of the “tax benefit rule.”

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
Office of Associate Chief Counsel
(Financial Institutions & Products)

cc: