

MEMO# 22310

March 14, 2008

Treasury Issues Final Regulations On Diversification Requirements for Variable Contracts

[22310]

March 14, 2008

TO: 529 PLAN MEMBERS No. 3-08

PENSION MEMBERS No. 16-08

TAX MEMBERS No. 6-08

VARIABLE INSURANCE PRODUCTS ADVISORY COMMITTEE No. 12-08 RE: TREASURY
ISSUES FINAL REGULATIONS ON DIVERSIFICATION REQUIREMENTS FOR VARIABLE
CONTRACTS

Treasury has issued final regulations (attached) modifying the diversification requirements for variable contracts under Code section 817(h). Effective March 7, 2008, the regulations generally adopt proposed regulations published last year [\[1\]](#), with one technical modification regarding the expansion of permitted investors to include certain Puerto Rican accounts.

The regulations expand the list of permitted investors that may hold beneficial interests in a regulated investment company ("RIC"), real estate investment trust ("REIT"), partnership or trust also owned by a segregated asset account. Permitted investors now also include:

1. qualified tuition programs ("529 Plans");
2. trustees of foreign pension or retirement plans primarily for the benefit of nonresident aliens; and
3. accounts that are segregated from the general assets of the life insurance company that owns the account under Puerto Rican law.

Being permitted investors means that 529 Plans and foreign pension accounts can hold

interests in the same investment vehicles as a segregated asset account without precluding the segregated account from looking through to the underlying assets of the RIC, REIT, partnership or trust to satisfy section 817(h)'s diversification requirements.

The regulations also eliminate a sentence in Reg. § 1.817-5(a)(2) that provides that the amount required to be paid to remedy an inadvertent diversification failure "shall be an amount based upon the tax that would have been owed by the policyholders if they were treated as receiving the income on the contract." This sentence was stricken to eliminate confusion regarding the scope of IRS authority to deviate from the plain language of the regulations and to give the IRS flexibility to impose remedies of lesser amounts.

The final regulations do not address certain other issues, including (1) procedures for correcting an inadvertent diversification failure; (2) procedures for verifying that an entity is a permitted investor; (3) consequences of an entity losing its status as a permitted investor; and (4) further expansion of the list of permitted investors to include segregated asset accounts of any foreign issuer that elects to be treated as a domestic corporation for U.S. tax purposes. Treasury is considering these issues and may address them in additional guidance.

Lisa Robinson
Associate Counsel

[Attachment](#)

endnotes

[\[1\]](#) See Institute [Memorandum](#) (21417) to 529 Plan Members No. 8-07, Pension Members No. 45-07 and Tax Members No. 32-07, dated August 1, 2007; and Institute Memorandum (21409) to Variable Insurance Products Advisory Committee No. 11-07, dated August 1, 2007.

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.