

MEMO# 18626

March 4, 2005

IRS FINALIZES MODIFICATIONS TO REGULATIONS ON DIVERSIFICATION REQUIREMENTS FOR VARIABLE CONTRACTS

[18626] March 4, 2005 TO: TAX MEMBERS No. 6-05 VARIABLE INSURANCE PRODUCTS ADVISORY COMMITTEE No. 2-05 RE: IRS FINALIZES MODIFICATIONS TO REGULATIONS ON DIVERSIFICATION REQUIREMENTS FOR VARIABLE CONTRACTS The Internal Revenue Service has finalized modifications to regulations regarding diversification requirements for variable annuity, endowment and life insurance contracts.¹ Specifically, the regulations modify Treas. Reg. 1.817-5(f), which provides a special look-through rule for assets held through certain investment companies, partnerships and trusts ("look-through investments"). Under these regulations, look-through treatment is available only if all of the beneficial interests in the look-through investments are held by one or more segregated asset accounts of one or more insurance companies. Prior to amendment, Treas. Reg. 1.817-5(f) provided separate rules regarding the ownership of unregistered partnerships and the ownership of other look-through investments. Treas. Reg. 1.817-5(f)(i) specifically provided that, with respect to investment companies, partnerships and trusts, public access to the look-through investments must be available to the public only through the purchase of a variable contract. Treas. Reg. 1.817-5(f)(ii) provided that the look-through rule also applies to a partnership interest that is not registered under a Federal or state law regulating the offering or sale of securities. However, this section did not explicitly condition look-through treatment of unregistered partnerships on limiting the ownership interests in the unregistered partnership to certain specified holders. The finalized modifications to the regulations eliminate Treas. Reg. 1.817-5(f)(ii) and an accompanying example. The effect of these changes is to clarify that look-through treatment is available to unregistered partnerships, as it is to registered partnerships, only if all beneficial interests in the unregistered partnership are held by one or more segregated asset accounts of one or more insurance companies, and public access is available only through the purchase of a variable contract. The regulations also clarify that the definition of "security" includes an unregistered partnership. The final regulations are effective March 1, 2005. Arrangements in existence on March 1, 2005 will be considered diversified if (1) those arrangements were adequately diversified within 1 Go to <http://a257.g.akamaitech.net/7/257/2422/01jan20051800/edocket.access.gpo.gov/2005/pdf/05-3825.pdf> to access the final regulations. 2 the meaning of Code section 817(h) prior to March 1, 2005, and (2) by December 31, 2005, the arrangements are brought into compliance with the final regulations. Lisa Robinson Associate Counsel

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