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November 3, 2008

VIA ELECTRONIC MAIL

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Re: Request for Additional Guidance on Partial Exchanges of Annuity Contracts

Dear Mark and Sheryl:

We are writing on behalf of the American Council of Life Insurers (the “ACLI”) and the Committee of Annuity Insurers (the “Committee”) regarding the item in the 2008-2009 Priority Guidance Plan stating that the Treasury Department and Internal Revenue Service (the “Service”) intend to issue guidance addressing the tax treatment of a “partial exchange or partial annuitization” of a non-qualified deferred annuity contract.¹ The ACLI and the Committee respectfully request that this guidance include clarification of Rev. Proc. 2008-24, 2008-13 I.R.B. 684. Rev. Proc. 2008-24 provides that the exchange of a portion of the cash value of a non-qualified deferred annuity contract for a new annuity contract will be treated as a tax-free exchange under section 1035, and the contracts will be treated as separate annuity contracts, if (1) no amounts are withdrawn from either of the contracts during the 12 months following the exchange, or (2) certain events described in section 72(q)² (e.g., attainment of age 59½ or disability), or any similar life events (such as divorce or loss of employment), “occurred between” (i) the date of the exchange, and (ii) the date of the withdrawal or surrender.

¹ The Committee is a coalition of 33 life insurance companies representing more than two-thirds of the annuity business in the United States. A list of the Committee’s member companies is attached. The ACLI represents 373 member companies accounting for 93 percent of the life insurance industry’s total assets, 91 percent of the life insurance premiums, and 95 percent of annuity considerations in the United States.

² Except as otherwise stated, all section references in this letter are to the Internal Revenue Code of 1986, as amended and in effect on the date of this letter.

For the reasons described below, the ACLI and the Committee request that the Service and the Treasury Department clarify as soon as possible that the tax-free exchange and separate contract treatment described in Rev. Proc. 2008-24 applies where (1) the events described in the revenue procedure are present *as of the time of* any subsequent distribution from either contract, or (2) annuity payments commence within 12 months after the exchange from one or both of the contracts for a minimum period specified by the Service, *e.g.*, life or joint lives, or for a period certain that is not less than the shorter of life expectancy or a specified term, such as 5 or 10 years.

The ACLI and the Committee expect to submit comments regarding the treatment of a partial annuitization, *i.e.*, a transaction in which a portion of the cash value of a deferred annuity contract is applied to an annuity option provided under the deferred annuity contract. We respectfully submit, however, that the requested clarifications of Rev. Proc. 2008-24 can and should be made without waiting for guidance addressing a partial annuitization transaction.

I. Rev. Proc. 2008-24

Rev. Proc. 2008-24 provides generally that the exchange of a portion of the cash value of a non-qualified deferred annuity contract for a new annuity contract will be treated as a tax-free exchange under section 1035, and the contracts will be treated as separate annuity contracts for purposes of section 72, if (1) “no amounts are withdrawn from, or received in surrender of,” either of the contracts during the 12 months following the date of the partial exchange, or (2) certain events have “occurred between” the date of the partial exchange and the date of the withdrawal or surrender. The events enumerated in section 4.01 of Rev. Proc. 2008-24 are “one of the conditions described by § 72(q)(2)(A), (B), (C), (E), (F), (G), (H), or (J), or any similar life event (such as divorce or loss of employment).” If a withdrawal or surrender is made within 12 months after a partial exchange, and one of these qualifying events has not occurred during this period, the transfer to the new contract is treated as a taxable distribution from the existing contract that is includible in gross income to the extent of the gain on the existing contract under section 72(e), followed by the payment of after-tax money for the purchase of the new contract.

Section 2.06 of Rev. Proc. 2008-24 states that “the rule treating a transfer as a tax-free exchange if one of the § 72(q)(2) conditions is met cannot be satisfied based on a payment described in §§ 72(q)(2)(D) (distribution that is part of a series of substantially equal periodic payments) or (I) (distribution under an immediate annuity).” In addition, section 3.02 of Rev. Proc. 2008-24 states that the revenue procedure does not apply to “transactions (sometimes referred to as ‘partial annuitizations’) in which the holder of an annuity contract irrevocably elects to apply only a portion of the contract to purchase a stream of annuity payments under the contract, leaving the remainder of the contract to accumulate income on a tax-deferred basis.”

II. The tax-free exchange and separate contract treatment under Rev. Proc. 2008-24 should apply where the specified qualifying events, e.g., attainment of age 59½, disability, divorce or loss of employment, are present as of the date of any subsequent distribution from either contract

As described above, Rev. Proc. 2008-24 states that, if a withdrawal or surrender occurs within 12 months following a partial exchange, the tax-free exchange and separate contract treatment under Rev. Proc. 2008-24 will not apply unless a qualifying event has “occurred between” the date of the partial exchange and the date of the withdrawal or surrender. In that regard, it is possible to interpret the “occurred between” language in the guidance to mean that only those “conditions” that first arise after the partial exchange will permit a taxpayer to receive a post-exchange distribution within the 12-month waiting period without triggering adverse tax consequences. These qualifying events include certain conditions set forth in section 72(q)(2) (such as attaining age 59½, death, or disability), and certain life events (such as divorce or loss of employment).

For the reasons discussed in our letter to you dated May 19, 2008 (a copy of which is attached), we believe that Rev. Proc. 2008-24 should be clarified to require that a qualifying event must be present *as of the time of* a withdrawal or surrender that takes place within the 12-month waiting period, irrespective of whether the event first arose prior to or after the partial exchange. This interpretation is consistent with how these events apply in the context of the section 72(q)(1) penalty tax. For example, any distribution from an annuity contract which is made on or after the date the taxpayer attains age 59½ is not subject to the penalty tax imposed under section 72(q)(1). Also, requiring that a qualifying event must occur after the partial exchange can produce very odd results. For example, if an individual happens to turn 59½ a few months after the transfer and then takes a withdrawal, the transfer is treated as a tax-free partial exchange, but if the individual had already turned age 59½ at the time of the transfer, and makes a withdrawal during the ensuing 12-months, the transfer would be treated as a taxable withdrawal of the monies transferred to the new annuity.

We respectfully submit that our proposed approach is particularly sound policy given current economic conditions. There are many older Americans, including annuity owners, whose income and savings have been substantially reduced by the recent turmoil in the stock market and the banking system.³ Making the requested clarification will provide these older annuity owners with the freedom to exchange a portion of their annuity contract for a new annuity contract with the knowledge and comfort that if the need for emergency funds or additional income arises in the following year (because, for example, the markets fall even lower), they will be able to make a withdrawal or begin a series of annuity payments from one or

³ There are more than 9 million owners of non-qualified annuity contracts, and their average age is 66. (The number of non-qualified annuity contract owners has been computed based on publicly available information, including the NAVA, 2008 ANNUITY FACT BOOK (7th ed. 2008). With respect to the average age of non-qualified annuity contract owners, *see* THE GALLUP ORGANIZATION AND MATHEW GREENWALD & ASSOCIATES, 2005 SURVEY OF OWNERS OF NON-QUALIFIED ANNUITY CONTRACTS 6 (2005), <http://www.annuity-insurers.org/pdfs/Gallup.Survey.2005.FINAL.pdf>.)

both of the contracts without the exchange being recharacterized as a taxable withdrawal. In this regard, as we have discussed, there are many good reasons an individual may wish to exchange a part of his or her existing annuity contract for another contract, including the desire to diversify annuity investments among different insurers or to take advantage of benefits and guarantees not available in the existing contract. Providing older individuals and individuals experiencing significant life events with this flexibility when there is considerable economic uncertainty is consistent with a variety of other recent actions of the Service and the Treasury Department.

III. Tax-free exchange and separate contract treatment under Rev. Proc. 2008-24 also should apply to a partial exchange where annuity payments commence within 12 months after the date of the exchange from one or both of the contracts for a minimum period specified by the Service, e.g., for life (or joint lives) or for a period certain that is not less than the shorter of life expectancy or a specified term (e.g., 5 or 10 years), irrespective of whether one of the events set forth in section 4.01(b) of Rev. Proc. 2008-24 has occurred at the time of the exchange

The ACLI and the Committee believe that there are circumstances in which tax-free exchange and separate contract treatment under Rev. Proc. 2008-24 should apply to annuity payments commencing on a date within 12 months following a partial exchange, even though a qualifying event, e.g., reaching age 59½ or disability, has not occurred as of that date. We recognize, of course, that the Treasury Department and the Service have expressed concerns that taxpayers might enter into partial exchanges “as a means of reducing or avoiding tax that would otherwise be imposed under § 72(e).”⁴ However, the income out first rule under section 72(e)(2)(B), which applies to amounts “not received as an annuity,” was enacted by Congress in 1982 to discourage the use of annuities as short term investments and to encourage their use for long term retirement security.⁵ This rule is directed at non-periodic payments, e.g., a partial withdrawal or surrender providing the taxpayer with a lump-sum. The ACLI and the Committee believe that a partial exchange that results in annuity payments being made under a new annuity contract⁶ for an extended period of time cannot reasonably be characterized as being used to avoid the purpose of the section 72(e)(2)(B) income first rule.

Clearly, annuity payments that are made for life (or joint lives), or for a period certain equal to the taxpayer’s life expectancy, are made for a duration that is consistent with the Congressional goal that annuities be used for long term retirement purposes. There are circumstances, however, such as poor health, in which individuals may need or desire the certainty of payments guaranteed to continue only for a specific period of years that is unrelated to their life expectancy, particularly in these times of economic uncertainty. As a result, we

⁴ Rev. Rul. 2003-76, 2003-2 C.B. 355, 356.

⁵ STAFF OF JT. COMM. ON TAX’N, 97TH CONG., GENERAL EXPLANATION OF THE REVENUE PROVISIONS OF THE TAX EQUITY AND FISCAL RESPONSIBILITY ACT OF 1982, at 361 (Comm. Print 1982).

⁶ The new annuity contract might be either an immediate annuity or a deferred annuity which is then annuitized.

think that if a new annuity contract is issued as a result of a partial exchange and annuity payments are made under one of the contracts for a minimum term of 5 or perhaps 10 years, it is appropriate to recognize the exchange as tax-free and the new contract as a separate contract even though the annuity payments begin within 12 months after the exchange. A period of 10 years, for example, would be consistent with the treatment of distributions under the rollover rules applicable to “eligible retirement plans” within the meaning of section 402(c)(8)(B). These rollover rules were designed to prevent “preretirement cashouts” of pension savings in lump-sum distributions, and to facilitate “the preservation of retirement benefits for retirement purposes,” by requiring qualified plans to transfer “eligible rollover distributions” directly to an IRA or another qualified plan.⁷ Payments that are made for life (or life expectancy), joint lives (or joint life expectancy), or a specified period of 10 years or more are treated under these rules as providing retirement benefits, and not as a “cashout” of benefits.⁸

While our proposed approach would be sound policy even if economic conditions were quite rosy, it makes even more sense given actual conditions. There are many Americans whose income and savings have been substantially reduced by the recent turmoil in the stock market and the banking system. One specific example, which was recently discussed with you, involved a 70-year-old retired woman whose primary source of income was dividends from her Freddie Mac stock. When Freddie Mac was placed in conservatorship, she lost that source of steady income. She now is in need of an alternative source of income and has considered exchanging a portion of the cash value of a deferred annuity contract that she owns for a new annuity contract and taking annuity payments from one of the contracts. In this case, however, the tax-free exchange and separate contract treatment under Rev. Proc. 2008-24 would not apply unless the individual were to wait for one year after the exchange to begin annuity payments. If she were to begin receiving annuity payments immediately following the exchange, the cash value transferred to purchase the new contract would be includible in gross income to the extent of the gain on the existing deferred annuity contract. This treatment would dramatically increase the portion of the deferred annuity contract that would have to be exchanged in order to produce the replacement income that is needed, further deplete retirement savings, and penalize annuity owners for accessing a portion of their annuity contracts to help them weather their financial difficulties. This situation is not limited to a particular demographic; other Americans, including working families, could find themselves in similar circumstances.

For these reasons, we believe that the tax-free exchange and separate contract treatment under Rev. Proc. 2008-24 should apply where annuity payments commencing within

⁷ 138 Cong. Rec. S8177, 8180 (daily ed. June 15, 1992) (statement of Sen. Bentsen).

⁸ Accordingly, these long-term payment streams are excluded from the definition of “eligible rollover distributions” under section 402(c)(4), and thus are excluded from this direct rollover requirement.

Similarly, an annuity period of 5 years is often used as an income bridge between retirement at age 65 and the beginning of social security payments at age 70. (Individuals who delay beginning their social security payments until a later age will receive higher payments.)

Mr. Mark S. Smith and Ms. Sheryl Flum
November 3, 2008
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12 months after the date of a partial exchange are made for life (or joint lives), or for a period certain that is not less than the shorter of life expectancy or a specified term (e.g., 5 or 10 years).

IV. Conclusion

For the reasons described above, the ACLI and the Committee request that the tax-free exchange and separate contract treatment set forth in Rev. Proc. 2008-24 be extended as soon as possible to apply where (1) the events described in the revenue procedure are present *as of the date of* any subsequent distribution from either contract, or (2) annuity payments commence within 12 months after the exchange from one or both of the contracts for a minimum period specified by the Service, e.g., life or joint lives, or for a period certain that is not less than the shorter of life expectancy or a specified term, such as 5 or 10 years.

As noted above, the ACLI and the Committee expect to submit additional comments regarding the treatment of a partial annuitization in which a portion of the cash value of a deferred annuity contract is applied to an annuity option provided under the deferred annuity contract. In the interim, we respectfully request that the requested clarifications of Rev. Proc. 2008-24 be issued.

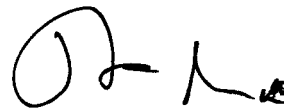
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If you have any questions or if we can be of any assistance, please contact either of the undersigned. Mr. McKeever can be reached *via* telephone at 347-2252 or *via* electronic mail at jfmckeever@davis-harman.com, while Mr. Welsh can be reached *via* telephone at 624-2157 or *via* electronic mail at walterwelsh@acli.com.

Sincerely,



Walter C. Welsh
ACLI



Joseph F. McKeever, III
Committee of Annuity Insurers

Attachments

cc: Donald J. Drees, IRS
John Glover, IRS
Mandana Parsazad, ACLI
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AXA Equitable Life Insurance Company, New York, NY
Commonwealth Annuity and Life Insurance Co.
(a Goldman Sachs Company), Southborough, MA
Conseco, Inc., Carmel, IN
Fidelity Investments Life Insurance Company, Boston, MA
Genworth Financial, Richmond, VA
Great American Life Insurance Co., Cincinnati, OH
Guardian Insurance & Annuity Co., Inc, New York, NY
Hartford Life Insurance Company, Hartford, CT
ING North America Insurance Corporation, Atlanta, GA
Jackson National Life Insurance Company, Lansing, MI
John Hancock Life Insurance Company, Boston, MA
Life Insurance Company of the Southwest, Dallas, TX
Lincoln Financial Group, Fort Wayne, IN
MassMutual Financial Group, Springfield, Massachusetts
Merrill Lynch Life Insurance Company, Princeton, NJ
Metropolitan Life Insurance Company, New York, NY
Nationwide Life Insurance Companies, Columbus, OH
New York Life Insurance Company, New York, NY
Northwestern Mutual Life Insurance Company, Milwaukee, WI
Ohio National Financial Services, Cincinnati, OH
OM Financial Life Insurance Company, Baltimore, MD
Pacific Life Insurance Company, Newport Beach, CA
The Phoenix Life Insurance Company, Hartford, CT
Protective Life Insurance Company, Birmingham, AL
Prudential Insurance Company of America, Newark, NJ
RiverSource Life Insurance Company (an
Ameriprise Financial Company), Minneapolis, MN
Sun Life of Canada, Wellesley Hills, MA
Symetra Financial, Bellevue, WA
USAA Life Insurance Company, San Antonio, TX

The Committee of Annuity Insurers was formed in 1982 to participate in the development of federal tax and securities law policies with respect to annuities. The member companies of the Committee represent over two-thirds of the annuity business in the United States.

01/11/2008



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May 19, 2008

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Re: Committee of Annuity Insurers and ACLI Comments on Revenue Procedure 2008-24

Dear Mark and Sheryl:

On behalf of the Committee of Annuity Insurers and the American Council of Life Insurers, we are writing to express our appreciation to the Treasury Department and the Internal Revenue Service for issuing Rev. Proc. 2008-24, and to respectfully request additional clarification on one important aspect of the guidance.¹ Rev. Proc. 2008-24 provides much needed guidance on the tax consequences of a partial exchange involving non-qualified annuity contracts and significantly improves upon the interim guidance of Notice 2003-51. In particular, by eliminating the “subjective” component of the interim guidance regarding whether a post-exchange distribution was contemplated at the time of the exchange, the new guidance provides annuity owners, life insurers, and the Service with much greater certainty regarding the tax consequences of partial exchange transactions. Likewise, the reduction of the “waiting period” for post-exchange distributions from 24 months to 12 months and the clarification that the same rules apply to partial exchanges involving the same or different insurers are very positive developments that we believe are grounded in sound tax policy. We also are pleased that Rev. Proc. 2008-24 provides additional clarity on the tax consequences of a transaction that falls outside the scope of the guidance. All of these changes to the interim guidance help achieve the right policy result and provide clear standards that will help taxpayers and the Service better understand and implement the rules governing partial exchanges.

¹ The Committee is a coalition of 33 life insurance companies representing more than two-thirds of the annuity business in the United States. A list of the Committee’s member companies is attached. The ACLI represents 373 member companies accounting for 93 percent of the life insurance industry’s total assets, 91 percent of the life insurance premiums, and 95 percent of annuity considerations in the United States.

There is one particular aspect of Rev. Proc. 2008-24, however, for which we believe additional clarification is needed in order to provide annuity owners and life insurers with the guidance they need to properly structure and report their transactions, as well as for the Service to administer the applicable rules. This need for clarification relates to section 4.01(b) of the revenue procedure, which addresses circumstances where a distribution occurs during the 12-month waiting period described above, but the taxpayer demonstrates that any “condition” described in section 72(q)(2), other than subparagraph (D) or (I) thereof, “occurred between” the date of the partial exchange and the date of the distribution.

Some of the conditions set forth in section 72(q)(2) could literally “occur between” the date of a partial exchange and a distribution. For example, an individual could attain age 59½ or become disabled during that period. However, other conditions described in section 72(q)(2) appear to be unable to “occur between” the date of a partial exchange and a distribution. For example, one of the conditions referenced in the guidance is section 72(q)(2)(F), which describes distributions “allocable to investment in the contract before August 14, 1982.” Seemingly, this “condition” would “occur” on the date the investment in the contract was made, *i.e.*, sometime before August 14, 1982. Thus, because the revenue procedure is effective only for partial exchanges completed on or after June 30, 2008, it appears that the section 72(q)(2)(F) condition can only occur *prior to* any partial exchange covered by the revenue procedure, and that the condition could never “occur between” the date of such a partial exchange and a subsequent distribution.

In that regard, it is possible to interpret the “incurred between” language in the guidance to mean that only those “conditions” that first arise after the partial exchange will permit a taxpayer to receive a post-exchange distribution within the waiting period without triggering adverse tax consequences. However, we believe that the more reasonable interpretation is that the reference to section 72(q)(2) “conditions” that “occurred between” the date of the partial exchange and the date of the distribution means simply that the condition *must be present* as of the time of the distribution, irrespective of whether the condition first arose prior to or after the partial exchange.

We believe that resolution of this ambiguity is critical, especially for individuals who would like to rely upon the section 72(q)(2)(A) “condition” of attaining age 59½ in taking a distribution during the 12-month waiting period. Such individuals who turn age 59½ prior to their partial exchange transactions will need to know whether they can take distributions from their contracts within the 12-month waiting period or whether they need to wait until the end of that period. In light of the fact that the average non-qualified annuity owner is 66 years old, the answer to this question could affect a significant number of the more than 9 million owners of non-qualified annuity contracts. For the reasons summarized below, we respectfully submit that Rev. Proc. 2008-24 should be clarified to indicate that the enumerated “conditions” of section 72(q)(2) need only exist as of the date of a distribution:

- The exceptions to the 12-month waiting period should be interpreted consistently with how those exceptions apply in the context of the section 72(q) penalty tax. In that context, the exceptions apply irrespective of when the “condition” first arose. For example, once a person attains age 59½ or becomes disabled, the penalty tax does not apply to *any* subsequent distributions. Allowing distributions during the 12-month waiting period in these circumstances would be generally consistent with the congressional intent in allowing the penalty-free withdrawal of monies from a non-qualified annuity at any time after an event occurs that gives rise to one of the conditions described in section 72(q)(2).
- To the extent possible, published guidance should be read in a manner that gives meaning to all of its provisions. If section 4.01(b) of Rev. Proc. 2008-24 is read to provide that the conditions enumerated therein must first arise *after* the partial exchange, the exception in section 72(q)(2)(F) would appear to be unavailable in all cases for the reasons discussed above. An interpretation that precludes use of one of the express exceptions provided in the guidance should be avoided.
- Similarly, to the extent possible, published guidance should be read in a manner that does not produce odd results. If Rev. Proc. 2008-24 requires that the conditions set forth in section 4.01(b) literally must occur after the partial exchange and before the distribution, an individual who happens to attain age 59½ within that narrow window can exchange monies from a deferred annuity into an immediate annuity, but a 70-year-old cannot. Likewise, a person who was already disabled at the time of a partial exchange could not rely upon the section 72(q)(2)(C) exception, but an individual who happened to become disabled during the waiting period could. Such results are difficult to rationalize, and would be avoided under the interpretation we support.
- Our interpretation is not inconsistent with the provisions of Rev. Proc. 2008-24 that “carve out” the section 72(q)(2)(D) and (I) exceptions from those that will allow a distribution during the 12 months following a partial exchange. This is because the various exceptions enumerated in the guidance, like the various 10% penalty tax exceptions on which they are based, apply *independently* of one another. Thus, under our interpretation, a taxpayer will not be able to rely upon the section 72(q)(2)(D) exception for substantially equal periodic payments or the section 72(q)(2)(I) exception for immediate annuities. Rather, they will need to meet one of the exceptions explicitly enumerated in the guidance.

We believe that the foregoing considerations support the clarification we have requested. In any event, we believe that additional guidance is needed on this question, and we would welcome any clarification that the Treasury Department or the Service could provide. Given that Rev. Proc. 2008-24 is effective for exchanges completed on or after June 30, 2008, taxpayers will need to know the answer to this question soon so that they can plan their affairs accordingly. Thus, we hope that the Treasury Department and the Service can clarify this issue as soon as possible.

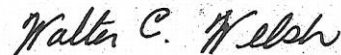
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May 19, 2008
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Sincerely,



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Attachment

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John Glover, IRS