

US-Tax deferral for Swiss Variable Annuities

The legal information we provide below gives more details. All efforts have been made to ensure that it is accurate at the date of its publication. It does not constitute investment, legal, tax or other advice nor is it to be relied upon in making an investment decision. We advise our clients to seek the services of their legal advisors.

No „debt instrument”

The inside build-up on variable annuities continues to be tax-free, even under the section 1275 rules, **because a variable annuity is not a “promise to pay a sum certain”** and is not, therefore, a debt instrument. Note that, according to treasury Department attorneys, a variable annuity under which the issuer guaranteed to return the owner’s investment, or guaranteed a certain investment return, might be a debt instrument subject to section 1275. **But as long as the risk of loss lies with the owner**, section 1275 does not apply and the annuity **income is tax deferred**. (The fact that the issuer invests the premiums in very safe investments does not mean that it guarantees repayment or a certain return – **payment is guaranteed only where the issuer contractually obligates itself to return money or to pay a certain return on money regardless of what happens to the underlying investments.**)

Diversification rule

The inside build-up of variable annuities is tax-free only if the account underlying the annuities is adequately diversified within the meaning of the tax code. An account meets the diversification requirements if:

- A. **No more than 55%** of the value of the total asset of the account is represented by any **one** investment;
- B. **No more than 70%** of the value of the total asset of the account is represented by any **two** investment;
- C. **No more than 80%** of the value of the total asset of the account is represented by any **three** investment;
- D. **No more than 90%** of the value of the total asset of the account is represented by any **four** investment;

When the variable annuity is issued by an insurance company which invests the underlying account in a segregated asset account maintained just for its policyholders (or just for its policyholders and the policy holders of other insurance companies), then for purposes of the diversification rules the account is treated as invested in each asset in the segregated account (i.e., assuming that the segregated asset account is prudently diversified, the diversification requirements are automatically met). But if the insurance company invests the account in mutual funds generally available to the public, then each mutual fund is considered to be one asset for purposes of the diversification requirements (i.e., you would have to be sure that the account was **spread over at least five mutual funds or other investments within the limitations set forth above**).

No self-direction

Finally, the inside build-up of variable annuities is tax free **only if he owner (or his investment adviser) is not managing the investments himself** (a so-called “self-directed” annuity). Owners are permitted to choose amount categories of investments offered by insurance companies (such as fixed income investments or bond funds or equity funds) and to alter those categories, but under the self-directed annuity rules they may not choose the actual investments. If they do, they are treated as the owners of the underlying assets and are taxable currently on the income which is generated by those assets.