

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact:
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CC:FIP:B04 – PLR-115508-08

Date:
January 15, 2009

Taxpayer =

Parent =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Year 1 =

Year 2 =

Year 3 =

Year 4 =

State A =

Place B =

Company C =

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Company D =

Company E =

Company F =

System G =

Charge H =

Charge I =

Feature J =

Premium K =

Number 1 =

Number 2 =

Number 3 =

Number 4 =

Number 5 =

Number 6 =

Number 7 =

Number 8 =

Number 9 =

Dear _____ :

This is in response to your letter of Date 1 and supplemented by letter of Date 2, requesting a waiver pursuant to section 7702(f)(8) of the Internal Revenue Code for Number 1 insurance contracts (Contracts) issued by Taxpayer that failed to meet the requirements of sections 7702(a).

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Taxpayer is a stock life insurance company, as defined in section 816(a), and is subject to taxation under Part I of Subchapter L of the Code. Taxpayer is organized and operated under the laws of State A and is licensed to engage in the insurance business in Place B. Taxpayer joins in the filing of a consolidated federal income tax return with its ultimate Parent.

DESCRIPTION OF CONTRACTS

The Contracts that are the subject of this waiver request are either universal life insurance contracts or variable universal life insurance contracts. The Contracts were issued by Taxpayer, Company C, Company D, Company E or Company F. Taxpayer came to be the obligor on the contracts issued by Companies C, D, E, & F by corporate merger or assumption reinsurance.

Generally, the Contracts were issued after December 31, 1984, and were intended to comply with section 7702 by satisfying both the “guideline premium requirement” of section 7702(a)(2)(A) and (c) and by falling within the “cash value corridor” of section 7702(a)(2)(B) and (d).

As is typical of universal life insurance policies, flexible premium payments are allowed, and the cash value of each of the Contracts reflects the premiums paid, cost of insurance, other expense charges, withdrawals, interest and other credits.

COMPLIANCE PROGRAM AND ERRORS

ERROR 1

Error 1 arose from transferring the administration of Contracts issued by Company E or assumed from Company F by Company E. Taxpayer determined that the “guideline single premium” and “guideline level premium” information reflected on the computer-based administration system to which Taxpayer transferred those Contracts for the purpose of monitoring compliance with the requirement of section 7702 (System G) was incorrect. Taxpayer’s programmers inadvertently transferred information with respect to those Contracts to System G in such a manner as to cause System G to erroneously increase their guideline premiums on the next contract anniversary following their conversion to System G. As a result of this Error, Number 3 Contracts failed.

ERROR 2

Taxpayer determined that, for certain of the Contracts, System G was not properly modified pursuant to the Taxpayer’s instructions to reflect in the calculation of guideline premiums the duration for which certain expense charges were expected to be imposed

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under the Contracts. As a result, the guideline premiums calculated by System G for such Contracts were incorrect. Taxpayer discovered that, for certain policy forms, the Charge H used by System G for calculating the guideline premium was inconsistent with the policy specifications that the Taxpayer had developed for these forms. For those policy forms, Taxpayer determined that System G incorrectly included in its calculation of guideline premiums Charge H that was expected to be imposed for the first Number 4 years, rather than for Number 5 years as actually expected by the Taxpayer. As a result of this Error, Number 6 Contracts failed.

ERROR 3

The Taxpayer discovered that its employees incorrectly modified System G to reflect a Feature J in calculating guideline premiums. That modification caused System G to reflect incorrect guideline single premiums once the Feature J was credited. In Year 1, Taxpayer developed a policy form that provided for the crediting of a Feature J to a Contract's cash value in contract year Number 5 if certain conditions were met. In Year 4, Taxpayer discovered that its employees had not implemented the modification in System G to reflect the Feature J in calculating guideline premiums until Year 2, and that those modifications were not implemented properly. Specifically, System G, as modified, correctly calculated guideline premiums at issue reflecting the Feature J as an interest rate guarantee. However, because of an inadvertent programming error arising from the programming project to address the Feature J in year Number 5, System G incorrectly treated such Contracts as if all of the Contracts had undergone an adjustment event under section 7702(f)(7)(A) in year Number 5, even though no change may have occurred. As a result of this Error, Number 7 Contracts failed the guideline premium test.

ERROR 4

When Company D issued certain Contracts, it assumed that premiums would be paid only to the extent of Premium K under each Contract and, accordingly, assessed Charge I on all such Contracts. Company D calculated the guideline level premium using that assumption. This assumption was confirmed by studies conducted by Company D. However, these studies also showed that, for certain Contracts, premiums were paid in excess of Premium K and accordingly, the guideline single premium was incorrectly calculated for those Contracts. Taxpayer determined that Company D erred in assuming that all premiums would be subject to Charge I. Taxpayer recalculated the guideline level premiums in accordance with section 7702(c)(3)(B)(ii), based on the assumption that, in the first year, Charge I will be applied only to the extent of Premium K portion of each single premium and against all subsequent level premiums paid in subsequent years.

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Taxpayer's investigation of this Error revealed an additional error in connection with Charge H. Taxpayer has determined that Company D's assumption as to the amount of Charge H was not in accordance with section 7702(c)(3)(B)(ii) because the assumed amount was not imposed; the amount imposed was a lesser amount. Taxpayer determined that Company D erred in concluding that the assumed amount would reasonably be expected to be paid under section 7702(c)(3)(B)(ii) and, accordingly, that Company D erred in reflecting Charge H in calculations of guideline premiums for Company D Contracts. As a result, Number 8 Contracts failed.

ERROR 5

Taxpayer has established various procedures for its employees to follow in interacting with System G, which is one of the computer-based administration systems used to test Contracts for compliance with the guideline premium test. Taxpayer's employees erred in processing certain changes to contracts that constituted adjustment events under section 7702(f)(7) where the adjustment resulted in the premiums paid for the Contract exceeding the recalculated guideline premium limitation; in analyzing certain premium payments to the Contract prior to the date on which the premiums were to be applied to the Contract; in applying certain premiums after the guideline premium limitation has been reached though the premium was not necessary to keep the Contract in force; and by manually overriding the System G calculated guideline premiums. As a result, Number 9 Contracts failed.

TIMELY CURES AND CORRECTION

Taxpayer has corrected the errors in two ways. With regard to Errors 1, 2, 3, and 4, Taxpayer has recalculated the guideline premiums to reflect the requirements of section 7702 properly and has entered those recalculated guideline premiums on the appropriate administrative systems, and made the necessary modifications to the appropriate administrative systems.

In addition, to prevent a recurrence of Error 5, Taxpayer has modified its procedures to 1) ensure that appropriate steps are taken following adjustment events that reduce guideline premiums; 2) emphasize to employees that a premium should not be applied to a Contract with an effective date prior to the date on which the premium is applied to such Contract; 3) ensure that the requirements of section 7702(f)(6) are followed; and 4) ensure that additional review and approval is required before the Taxpayer's employees can override the guideline premiums calculated by System G.

Taxpayer proposes to remedy the non-compliance of each failed Contract that is in force on the effective date of the requested waiver ruling and, under which, the sum of the premiums paid as of that date exceeds the guideline premium limitation as of that

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date, by refunding to the policyholder the amount of such excess premiums with interest.

For each failed Contract which terminates by reason of the death of the insured prior to or on the effective date of the request waiver ruling, and, at a time when the premiums paid exceed the guideline premium limitation for the failed Contract, the Taxpayer will pay the policyholder, the policyholder's estate or the beneficiaries such excess, with interest.

LAW & ANALYSIS

In general, for contracts issued after December 31, 1984, section 7702 provides a definition of the term "life insurance contract" for all purposes of the Code. To satisfy this definition, a life insurance or endowment contract must be treated as such under the applicable law. Pursuant to section 7702(a), contract must also either (1) meet the cash value accumulation test of section 7702(b) or (2) satisfy the guideline premiums requirements of subsection 7702(c) and fall within the cash value corridor test of section 7702(d).

Section 7702(c)(1) provides that a contract meets the guideline premium requirements if the sum of the premiums paid under such contract does not at any time exceed the guideline premium limitation as of such time.

Section 7702(c)(2) provides that the term "guideline premium limitation" means, as of any date, the greater of (A) the guideline single premium, or (B) the sum of the guideline level premiums to such date.

The guideline single premium is the single premium at issue that is needed to fund the future benefits under the contract using the mortality and other charges specified in section 7702(c)(3)(B). The guideline level premium is the level annual equivalent of the guideline single premium payable until a deemed maturity date between the insured's attained ages 95 and 100, with interest at the greater of an annual effective rate of 4 percent or the rate or rates guaranteed on issuance of the contract. Section 7702(c)(4). The computational rules of section 7702(e) and the definitions of section 7702(f) apply for purposes of determining both the guideline single and guideline level premium.

With respect to the guideline premium requirements, section 7702(c) requires that the premium paid under the contract at any time must not exceed the greater of the guideline single premium or the sum of the guideline level premium to that date. The guideline single premium is the single premium at issue that is needed to fund the "future benefits" under the contract determined on the basis of the following three elements enumerated in section 7702(c)(3)(B)(i)- (iii):

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(i) reasonable mortality charges which meet the requirements (if any) prescribed in regulations and which (except as provided in regulations) do not exceed the mortality charges specified in the prevailing commissioners' standard tables (as defined in section 807(d)(5)) as of the time the contract is issued,

(ii) any reasonable charges (other than mortality charges) which (on the basis of the company's experience, if any, with respect to similar contracts) are reasonably expected to be actually paid, and

(iii) interest at the greater of an annual effective rate of 6 percent or the rate or rates guaranteed on issuance of the contract.

Charges contemplated by section 7702(c)(3)(B)(ii) are deemed reasonable only if they reflect the amount expected to be actually paid, which typically correlates to a company's actual charges.

If premiums paid exceed the guideline premium limitation, section 7702(f)(1)(B) allows the issuer 60 days after the end of the policy year in which to refund the excess premiums as may be necessary to cure a failure.

Pursuant to section 7702(f)(8), the Secretary of Treasury may waive a failure to satisfy the requirements of section 7702. This waiver is granted if a taxpayer establishes that the statutory requirements were not satisfied due to reasonable error and that reasonable steps are being taken to remedy the error.

Based on all of the facts, law, and arguments presented, we conclude that Errors 1 through 5 were reasonable and, accordingly, the failure of the Contracts to satisfy the requirements of section 7702 was due to reasonable error. Taxpayer's compliance system and procedures would, if properly followed, have prevented the errors described. Upon discovery of possible errors, Taxpayer timely reviewed its procedures, discovered failures, and requested a waiver of its errors. Further, Taxpayer has instituted additional methods by which to avoid future errors. Finally, Taxpayer's proposed method of correcting the errors is reasonable.

Except as set forth above, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

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In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

A copy of this letter must be attached to any income tax return to which it is relevant. Taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for this ruling, it is subject to verification on examination.

Sincerely,

/S/

JOHN E. GLOVER
Assistant to the Branch Chief, Branch 4
Office of the Associate Chief Counsel
Financial Institutions & Products