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PLR-102502-06
PLR-102504-06
Date:
August 03, 2006

Company A =

Company B =

Parent =

Date A =

Date B =

Date C =

Date D =

Date E =

Date F =

Number 1 =

Number 2 =

Number 3 =

Number 4 =

Number 5 =

PLR-102502-06
PLR-102504-06

2

Number 6 =

Number 7 =

Number 8 =

Number 9 =

Number 10 =

Number 11 =

Number 12 =

State A =

State B =

X =

Y =

A =

B =

System 1 =

System 2 =

System 3 =

System 4 =

Dear :

This is in response to your letter of Date A and supplemented and modified by letters of Date B and Date C, requesting a waiver pursuant to sections 101(f)(3)(H) and 7702(f)(8) of the Internal Revenue Code for Number 1 insurance contracts (Failed Contracts) issued by Companies A and B that failed to meet the requirements of sections 101(f) and 7702(a), as applicable.

FACTS

The information submitted indicates that Companies A and B (Companies) are life insurance companies within the meaning of section 816(a). Company A is a stock life insurance company organized under the laws of State A and licensed to conduct insurance business in X. Company A is a subsidiary of Parent. Company B is a stock life insurance company organized under the laws of State B. Company B is licensed to engage in the life insurance business in Y. Company B is a wholly owned subsidiary of Company A. Companies A and B join in the filing of a consolidated federal income tax return with Parent and other eligible affiliates on an accrual accounting, calendar year basis.

Parent acquired Companies A and B in Date D. Companies began issuing the Failed Contracts in Date E. The Companies or predecessors issued the Failed Contracts on Number 2 different policy forms. The Failed Contracts issued before January 1, 1985, were intended to comply with section 101(f) by satisfying both the “guideline premium limitation” of sections 101(f)(1)(A)(i) and (f)(2) and the “applicable percentage” requirements of sections 101(f)(1)(A)(ii) and (f)(3)(C). The Failed Contracts issued on or after that date were intended to comply with section 7702 by satisfying both the “guideline premium requirements” of sections 7702(a)(2)(A) and (c) and by falling within the “cash value corridor” of sections 7702(a)(2)(B) and (d).

Certain of the Failed Contracts are universal life insurance contracts (UL) and variable universal life (VUL) insurance contracts. The Companies relied primarily on two computer-based administrative systems, System 1 and System 2, to monitor the UL and VUL contracts’ compliance with the requirements of sections 101(f) and 7702, as applicable. System 3 was a successor system developed to monitor the UL and VUL contracts.

The remaining Failed Contracts are interest sensitive life insurance contracts (ISL). Companies relied primarily on a third computer-based administrative system, System 4, to monitor the ISL contracts’ compliance with the requirements of sections 101(f) and 7702, as applicable.

After Parent acquired Companies, Companies undertook a comprehensive review of the compliance systems and retained A and B to assist them in that review. As a result of that review, Number 12 UL/VUL Contracts have been identified as having failed to comply with the guideline premium requirements of section 101(f) or 7702, as applicable. These failures represent less than Number 3 percent of the approximately Number 4 contracts administered on System 3. The Companies’ review of System 4 identified Number 5 ISL Contracts that fail to comply with the guideline premium tests. These failures represent Number 3 percent of the approximately Number 6 contracts

administered on System 4. Number 1 of those Failed Contracts are the subject of this waiver request.

Companies have identified five errors that caused the Contracts to fail to comply with sections 101(f) or 7702, as applicable.

Error 1: Companies have determined that the guideline premiums for some Failed Contracts were inadvertently and incorrectly calculated using mortality charges based on the 1958 CSO mortality tables rather than the 1980 CSO mortality tables. Error 1 arose because of the failure of the Companies' IT personnel to follow correctly the Companies' directions regarding the manner in which the Contracts were to be administered under section 7702. The IT personnel, when programming certain policy forms on Systems A and B, either failed to load the correct table of guaranteed mortality charges or failed to change a reference to point to the correct table of guaranteed mortality charges. Error 1 only affected contracts issued prior to Date F. This error resulted in the noncompliance of Number 7 UL/VUL contracts.

Error 2: Certain contracts designed to satisfy the guideline premium test requirements of section 7702(a) (GPT) were coded incorrectly on System 3 as contracts intended to satisfy the cash value accumulation test (CVAT). Error 2 arose because of the failure of the Companies' IT personnel to follow correctly the Companies' directions with respect to the manner in which these contracts were to be administered under section 7702 on System 3. The Companies' IT personnel, in making a programming change, inadvertently disabled the GPT testing of certain Contracts that were designed to comply with the GPT. As a result, Number 8 Contracts failed to comply with the GPT.

Error 3: The Companies developed correct specifications that described the Attained-Age Adjustment Method for both sections 101(f) and 7702(a) as part of the System 3 specifications, and then directed their IT personnel to follow those specifications in creating System 3. However, System 3 did not accurately apply the Attained-Age Adjustment Method because of a programming error by IT personnel that prevented System 3 from retrieving the data needed to perform the adjustment event calculations properly. In addition, when the Companies later implemented certain manual procedures in an attempt to ensure that the Attained-Age Adjustment Method was applied properly, the Companies' employees did not follow those manual procedures correctly in all instances. Error 3 resulted in Number 9 Contracts that failed to comply with the requirements of section 101(f) or section 7702, as applicable.

Error 4: System 3 does not allow any premiums to be applied or credited to a contract in excess of the guideline premium limitation that the system calculates for that contract. If such a premium is received and if an employee attempts to credit it, System 3 automatically rejects the premium and places it into a premium deposit fund or in some other suspense arrangement outside of the contract. However, the Companies

discovered that employees released premiums from a premium deposit account or other suspense arrangement and credited those premiums when permitted by the GPT, but with an effective date that preceded the actual date on which the premiums were credited. Error 4 resulted in Number 10 contract failures.

Error 5: This error resulted from the failure of the Companies' IT personnel to follow the Companies' instructions regarding the manner in which System 4 was to be programmed to apply the GPT. Upon receipt of full payment of all scheduled premiums for a contract year, System 4's programming incorrectly increased an ISL Contract's guideline premium limitation to the limitation that would apply on the following policy anniversary. This error resulted in Number 11 Contracts failing to comply with the requirements of section 101(f) or section 7702, as applicable.

Companies propose to remedy the non-compliance of each Failed Contract that is in force on the effective date of this waiver, and under which the sum of the premiums paid as of that date exceeds the guideline premium limitation as of that date, by (1) increasing the death benefit payable under a Contract which has failed to not less than an amount that will ensure compliance with section 101(f) or section 7702, as applicable, or, (2) refunding to policyholders the amount of such excess premiums with interest (using rates at least as high as those applied for purposes of crediting interest to each Contract's cash value, or in the case of a VUL Contract, rates at least as high as those applied for purposes of crediting interest to the Contract's fixed account), or a combination of (1) and (2).

With respect to each Failed Contract that terminates by reason of the death of the insured prior to or on the effective date of this waiver ruling with respect to that Failed Contract, and at a time when the premiums paid exceed the guideline premium limitation for the Failed Contract, the Companies will pay the policyholders, the policyholders' estates or the beneficiaries such excess, with interest (using rates at least as high as those applied for purposes of crediting interest to each Failed Contract's cash value, or in the case of a VUL Contract, rates at least as high as those applied for purposes of crediting interest to the Failed Contracts' fixed account).

LAW AND ANALYSIS

In general, for flexible premium life insurance contracts entered into before January 1, 1985, section 101(f) requires the contract to satisfy either of two tests in order for the death benefit to be excludable as the proceeds of a life insurance contract under section 101(a): a guideline premium limitation set forth in section 101(f)(1)(A), or a cash value test set forth in section 101(f)(1)(B). These requirements differ slightly from those applicable to contracts issued after that date, but not in a manner material to this letter.

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), a contract must also either (1) meet the cash value accumulation test of subsection 7702(b), or (2) satisfy the guideline premium requirements of section 7702(c) and fall within the cash value corridor test of section 7702(d).

Section 7702(b) provides that a contract meets the cash value accumulation test if, by the terms of the contract, the cash surrender value of the contract may not at any time exceed the net single premium which would have to be paid at such time to fund future benefits under the contract.

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). Section 7702(c)(3)(B) specifically provides the guideline single premium is based on (i) reasonable mortality charges which meet the requirements (if any) prescribed in regulations and which (except as provided in the regulations) do not exceed the mortality charges specified in the 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 actually be paid; and (iii) interest at the greater of an annual effective rate of 6% or the rate or rates guaranteed on issuance of the contract.

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% 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.

If premiums paid exceed the guideline premium limitation, section 101(f)(3)(B) and section 7702(f)(1)(B) allow 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 sections 101(f)(3)(H) and 7702(f)(8), the Secretary of Treasury may waive a failure to satisfy the requirements of section 101(f) or section 7702, as applicable. These waivers are 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 the failure of the (Number 1) Contracts to satisfy the requirements of section 101(f) or 7702, as applicable, is due to reasonable error. Companies' compliance systems and procedures, if properly followed, would have prevented the errors described. Upon discovery of possible errors, Companies timely reviewed their procedures, discovered failures, and requested a waiver of their errors. Finally, Companies' proposed method of correcting the errors is reasonable.

We express no opinion as to the tax treatment of the Contracts under the provisions of any other sections of the Code and the Income Tax Regulations that may be applicable thereto.

The rulings contained in this letter are based on information submitted by the Companies 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 a ruling, it is subject to verification on examination.

This ruling is directed only to the taxpayers requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent. A copy of this letter must be attached to any income tax return to which it is relevant.

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

Sincerely,

/S/

Donald J. Drees, Jr.
Senior Technician Reviewer, Branch 4
Office of Associate Chief Counsel
(Financial Institutions & Products)