**Internal Revenue Service**

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Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:FIP:4-PLR-155189-01
Date:
February 7, 2002

Legend:

Taxpayer =

State A =
Company B =
Year C =
Year D =
Year E =
Year F =
Year G =
Amount H =
Amount I =
Amount J =
Amount K =
Amount L =
Type M =
Type N =
Type O =
Type P =
Type Q =
Item R =
Modification S =

Dear

This is in reply to your letter of October 4, 2001, as supplemented by letter dated January 28, 2002, requesting a waiver pursuant to Internal Revenue Code section 7702(f)(8) for certain insurance contracts issued by Taxpayer which failed to meet the requirements of section 7702(a). For the reasons discussed below, we conclude with respect to Amount I contracts that such failures were due to reasonable errors and that reasonable steps have and are being taken to remedy such errors; therefore, the waiver will be granted. We are still considering your request for waiver with respect to the remaining Amount J contracts.

FACTS

Taxpayer is a stock life insurance company incorporated under the laws of State A. It is a subsidiary of Company B and is a life insurance company as defined by section 816(a). Taxpayer is licensed to conduct business in, among other places, Amount H states.

Beginning in Year C, Taxpayer issued Type M contracts. Taxpayer intended that these Type M contracts would qualify as life insurance contracts by satisfying section 7702(a)(2). Amount I of Type M contracts issued during Year D subsequently failed to satisfy the requirements of section 7702(a) in Years E and F. When Amount I of the contracts were issued, Taxpayer maintained a Type N database and a Type O database for each contract. The critical part of the Type N database was Item R, on which was recorded the fundamental terms of the contract.

When section 7702A was enacted, Taxpayer recognized that several of the Type M contracts issued during Year D might meet the statutory definition of a modified endowment contract. Accordingly, Taxpayer undertook to review the outstanding contracts to verify that the characterization of the contract was acceptable to the contract holder. If the contract holder did not want the contract to be characterized as a modified endowment contract, Taxpayer and the contract holder would agree to make Modification S to the contracts. In such event, Taxpayers' procedures called for its employee to update the databases, in particular Item R of Type N database. For Amount I of the Type M contracts issued during Year D, Item R was inadvertently not properly updated, although the Type O database apparently was updated.

Within Amount J years after the Amount I contracts were issued, Taxpayer had changed from using the Type O database to using the Type P database to monitor the financial aspects of each contract. The Type P database was programmed to reject the posting of any premium payment to the contract if such premium payment would result in the application of premiums to the contract in excess of the guideline premium limitation for that contract. Taxpayer's procedure in the event of a rejection called for employees to ascertain the reason for the rejection. If the employees determined that in fact the application of the premium would not exceed the guideline premium limitation, the Type P database could be overridden and the premium posted to the contract.

During Year E, Amount K contract holders made submitted premium payments for their contracts. Initially, the Type P database rejected these payments because it determined that the payments would exceed the applicable guideline premium limitation. Upon the rejection, Taxpayer's employees consulted the Type N database, specifically Item R. Although a thorough review of the Type N database might have revealed Modification S, the employees apparently looked no further than Item R. Because Item R did not reflect Modification S, the employees tested the premium payment against a guideline premium limitation computed without accounting for Modification S. The employees therefore concluded, erroneously, that the rejected payment would not exceed the guideline premium limitation, and manually overrode the

Type P database and posted the payment to the contract.

In fact, however, the posting of these payments to the contracts resulting in the guideline premium limitation being exceeded. In Year F, the same events occurred with respect to Amount L contracts. Since Year F, no transactions which would require testing have occurred with respect to the Amount I contracts. In Year G, Taxpayer implemented Type Q database which should reduce or eliminate the chance of future errors in properly updating its records.

Taxpayer proposes to remedy the errors with respect to the Amount I contracts by either increasing the death benefit for each contract or refunding the excess premiums, with interest, in the amount(s), if any, necessary to cure these errors. Taxpayer represents this cure will be implemented within 90 days of the effective date of the requested waiver.

LAW

Section 7702 defines the term “life insurance contract” for all purposes of the Code. Under section 7702(a), in order to be a life insurance contract for federal income tax purposes, a contract must qualify as such under the applicable law and must satisfy, inter alia, the “guideline premium requirements” of sections 7702(a)(2)(A) and 7702(c) and fall within the “cash value corridor” of sections 7702(a)(2)(B) and 7702(d).

The guideline premium requirement is satisfied if the sum of the premiums paid under the contract do not at any time exceed the greater of the guideline single premium or the sum of the guideline level premiums as of that date. The guideline single premium is the premium needed to fund the future benefits of the contract as described in section 7702(c)(3). The guideline level premium is the level annual amount, payable over a period not ending before the insured attains age 95, computed on the same basis as the guideline single premium with the exception of the interest rate as defined in section 7702(c)(4). Additionally, to qualify as a life insurance contract, the policy must also be within the cash value corridor, i.e., the death benefit must not be less than a stated percentage of the cash surrender value, as set forth in section 7702(d).

Under section 7702(f)(8), the Secretary of the Treasury may waive the failure to satisfy the requirements of section 7702 if the taxpayer establishes that the requirements were not satisfied due to a reasonable error(s) and that reasonable steps have are being taken to remedy the error(s).

In the present case, Amount I of Taxpayer’s Type M contracts failed to satisfy the requirements of section 7702(a). After considering all of the facts and circumstances, we conclude that these failures were due to reasonable errors and that Taxpayer is taking reasonable steps to remedy them.

CONCLUSION

Accordingly, based on the information submitted, the failure of the Amount I contracts to satisfy the requirements of section 7702(a) is waived pursuant to section 7702(f)(8). To the extent necessary to bring the Amount I contracts, or any portion thereof, into compliance with section 7702(a), Taxpayer will refund to the contract holder any excess premiums with interest calculated as of the date of the cure, and/or revise the death benefits of such contract(s) as of the date of the cure. Any contracts that are not cured within 90 days of the date of this letter are not covered by this waiver.

Except as expressly provided herein, 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. 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 the Taxpayer.

Sincerely,
Mark Smith
Chief, Branch 4
Office of Associate Chief Counsel
(Financial Institutions & Products)