

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

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Person To Contact:

, ID No.

Telephone Number:

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PLR-150417-04

Date

March 22, 2005

Legend

Taxpayer =

Parent =

State =

Year X =

Date Y =

Period Z =

Number A =

Number B =

Dear :

This is in reply to the ruling request filed by your representative, dated September 22, 2004, and supplementary submissions. The letter requests that we grant a waiver under § 7702(f)(8) of the Internal Revenue Code for Number B contracts (the Failed Contracts) that failed to meet the requirements of § 7702(a).

Taxpayer is a stock life insurance company, as defined in § 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. Taxpayer was originally organized to provide life insurance products to members of Parent and their dependents. Since Year X, Taxpayer has sold life insurance services and products to the general public. Taxpayer

joins in the filing of a consolidated federal income tax return with Parent and other eligible affiliates on an accrual accounting, calendar year basis.

As of Date Y, Taxpayer represents that it had approximately Number A individual life insurance contracts in force. Taxpayer has identified Number B of those contracts as failing to qualify as life insurance contracts under § 7702(a). Taxpayer further represents that each of the Failed Contracts were issued on Taxpayer's Variable Universal Life (VUL) Insurance Policy form, and are variable contracts as defined in § 817(d). The segregated asset accounts which Taxpayer uses to invest all VUL contract premiums reportedly satisfy the diversification requirements of § 817(h) and the Regulations thereunder.

Taxpayer represents that it had intended all VUL contracts to qualify as life insurance contracts for federal tax purposes under § 7202(a)(2), by satisfying the guideline premium requirements of § 7702(c). Taxpayer used a computerized administration system (Administration System) to monitor the premium payments made under each VUL policy to compare the accumulated premiums paid with the Guideline Premium Limitation (GPL) pursuant to § 7702(c)(2). Taxpayer's VUL contracts include an annual target premium that, if paid, is intended to fund the contract sufficiently for coverage to continue through its maturity at the insured's age 95. It also specifies a scheduled annual or modal premium, based on what the owner has planned to pay, which may be greater or less than the target premium calculated for the VUL contract. Additionally, the VUL contract permits payment of unscheduled premiums at the owner's option.

Taxpayer has the right to refuse any premiums, scheduled or unscheduled, that would cause the contract to fail to meet the GPL. Taxpayer represents that its Administration System tests each VUL contract for compliance with the GPL as premiums are paid. Should a premium payment cause a VUL contract to exceed the GPL, the Administration System generates a warning message that appears on a daily log. However, the Administration System will complete the processing of the premium payment.

Taxpayer had personnel assigned to the task of analyzing all warning messages generated by the Administration System. Taxpayer provided its personnel with written instructions regarding warning messages. These written instructions included procedures to remedy a potential GPL violation. The written instructions provide that when the Administration System generates a warning regarding a GPL violation, Taxpayer's personnel should contact the contract owner to determine whether the owner prefers to increase the death benefit or have the excess premium returned, with interest, within the 60-day time limit permitted by § 7702(f)(1)(B). Notwithstanding those procedures, Number B contracts failed to meet the GPL during Period Z, and Taxpayer neither increased the contract's death benefit nor returned the excess premiums for these Failed Contracts.

Taxpayer reports that its Administration System, in addition to testing for GPL failures pursuant to § 7702, also identified guideline limitations under §§ 101(f) and 7702A. Taxpayer represents that its personnel misidentified the § 7702 GPL failures as Modified Endowment Contracts pursuant to § 7702A. Consequently, Taxpayer's personnel failed to follow the written procedures in place to remedy GPL violations under § 7702 for the Failed Contracts.

Taxpayer represents that it has already modified the manner in which its Administration System identifies warnings for potential GPL violations under § 7702. The Administration System now specifically titles warnings as relating to GLP violations or MEC status changes. In addition, Taxpayer represents that it has provided training to its personnel explaining the difference between MECs and GPL violations, and how each should be handled. Taxpayer reportedly adjusted its procedures for handling potential GPL violations and now, to the extent permitted under Securities and Exchange Commission rules applicable to variable insurance products, holds an excess premium until the anniversary date. If a premium is received five or more days prior to the anniversary date, Taxpayer attempts to obtain the contract owner's instruction as to whether to hold or refund the excess premium. In the absence of such instructions, Taxpayer refunds the excess premium with any interest due.

Taxpayer proposes to remedy the compliance failure of each Failed Contract that is in force on the date that the requested ruling is issued (Ruling Date) and under which the sum of the premiums paid exceed the Failed Contract's GPL as of the Ruling Date. Taxpayer further proposes to refund any excess premium, with interest, to the Failed Contract holders within 90 days after the Ruling Date. If the GPL for any Failed Contract is not exceeded by the premiums paid thereon as of the Ruling Date, Taxpayer will not make a correction with respect thereto.

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

If premiums paid exceed the GPL, § 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 § 7702(f)(8), the Secretary of Treasury may waive a failure to satisfy the requirements of § 7702. 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 Number B contracts to satisfy the requirements of § 7702 was due to reasonable error. Taxpayer’s compliance system and procedures would have, if properly followed, prevented the errors described. Upon discovery of the GPL violations, Taxpayer timely reviewed its procedures, modified its system for handling potential GPL violations, and requested a waiver of its errors. Taxpayer’s proposed method of correcting the errors is reasonable.

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

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 rulings, it is subject to verification on examination.

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.

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

A copy of this letter must be attached to any income tax return to which it is relevant.

Sincerely,

/S/

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

cc: