Internal Revenue Service

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Person To Contact:
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Telephone Number:

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Date:
August 24, 2007

Date A
Taxpayer

Number B
Entity C
Jurisdiction E
Number F
Number G
Number H
Number J
Number K
Number L

Dear :

This is in reply to your letter dated Date A in which you requested a ruling on Taxpayer's behalf with respect to Number B contracts (the Policies) intended to meet the requirements of §101(f) or meet the definition of a life insurance contract under § 7702(a) of the Internal Revenue Code. The material information provided in that request and in subsequent correspondence is summarized below. Specifically, Taxpayer asks for a waiver of reasonable errors under §§ 101(f)(3)(H) and 7702(f)(8) of the Internal Revenue Code such that the Policies will be treated as life insurance contracts for federal tax purposes. The policy numbers for the Policies are set forth in Exhibit D hereto.

Taxpayer is a stock life insurance company, as defined by § 816(a), and is subject to taxation under Part I of Subchapter L of the Code. Although Taxpayer is a wholly owned subsidiary of Entity C, Taxpayer's federal income tax return is not consolidated with those of any other entity. Taxpayer is licensed to engage in the life insurance business in Jurisdiction E.

Taxpayer represents that all Number B Policies are life insurance contracts under the laws of the state in which they are issued. Further Taxpayer represents that the Policies will, if the errors described herein are waived, meet the federal tax definition of a flexible premium life insurance contract under § 101(f) or the definition of a life insurance contract under § 7702(a), as applicable.

Taxpayer's compliance system has evolved from a largely manual system prior to the enactment of § 101(f) which first provided a federal tax definition of a life insurance contract to its present sophisticated computerized system. Further extensive training was conducted for all employees involved with compliance and written procedures were both provided and regularly updated. Taxpayer has adequately demonstrated that its procedures, if properly followed, would have ensured compliance of each of the Policies with the relevant Code definition of a life insurance contract. Each of the systems used, however, requires a certain amount of data entry or reprogramming by human beings and, upon routine periodic checks for compliance, Number B Policies were found to have ceased qualifying under the Code.

Most of the errors causing the Policies to fail may be broadly defined as clerical errors caused by actions taken in direct contravention of detailed and clearly stated policies designed to ensure compliance of the contracts with all provisions of the federal tax laws.

The clerical errors were made, despite a compliance system designed to prevent such errors, when Customer Service Representatives failed to follow established procedures by:

(1) Processing a required return of excess premiums as a withdrawal from a Policy rather than reversing the excess premium payment (which also takes out any associated earnings) in Number F cases.

(2) Crediting an excess premium to a Policy pending approval of a coverage increase rather than reversing the excess premium payment (together with earnings) and holding the excess in a suspense account until the increase had been approved in Number G cases.

(3) Failing to process a "force-out" in a declining premium situation in Number H cases.

(4) Failing to sequence properly the entry of data into the system with respect to a death benefit option change in Number J cases.

(5) Manually overriding the system to backdate a premium to the date it was received rather than the date the system indicated was permissible in number K cases.

A sixth category of errors (which occurred in Number L cases) occurred during the manual entry of a formula required in the programming of an update to the computerized portion of Taxpayer's compliance system.

Section 101(f) was added to the Code by § 221 of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), 1982-2 C.B. 462. Under § 101(f), any amount paid by reason of the death of the insured under a life insurance contract described as a flexible premium contract is excluded from gross income only if the contract satisfies either (1) the guideline premium limitation and the applicable percentage of cash value test of § 101(f)(1)(A)(i) and (ii), respectively, or (2) the cash value test of § 101(f)(1)(B). The limitations of § 101(f) are applicable generally only to contracts issued before January 1, 1985.

Section 7702 provides a statutory definition that a life insurance policy must meet to be treated as a life insurance contract for federal tax purposes. More specifically, a contract must be a life insurance contract under applicable law and must also meet either of two alternative tests: (1) the cash value accumulation test of § 7702(b), or (2) the guideline premium and cash value corridor test of § 7702(c) and (d). In general, § 7702 applies to contracts issued after December 31, 1984..

Sections 101(f)(3)(H) and 7702(f)(8) provide that, 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, the Secretary of the Treasury may waive a failure to satisfy the requirements of §§ 101(f) and 7702.

After considering all the facts and circumstances, we find that failure of the Policies to satisfy the requirements of §§ 101(f) and 7702 was due to reasonable error.

Taxpayer proposes to bring the Policies into compliance with §§ 101(f) and 7702 by increasing death benefits or refunding premiums. In order to prevent future errors, Taxpayer has implemented a new system to administer compliance with §§ 101(f) and 7702. The new system eliminates much of the manual processing that was the source of the errors under prior systems and to the extent that the new system relies on manual processing, the Taxpayer has implemented new safeguards and additional oversight to prevent future compliance failures.

After considering all the facts and circumstances, we find that the Taxpayer is taking reasonable steps to remedy the error.

Accordingly, based on the information submitted, it is held that the failure of the Number B Policies to satisfy the requirements of §§ 101(f) or 7702(a) for the reasonable errors described above is waived pursuant to §§ 101(f)(3)(H) and 7702(f)(8).

The rulings contained in this letter are 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.

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.

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

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.

Sincerely yours

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