Part III

Administrative, Procedural, and Miscellaneous

26 CFR 301.7121-1: Closing Agreements.
(Also Part I, Section 7702.)

Rev. Proc. 2008-40

SECTION 1. PURPOSE

This revenue procedure provides a procedure by which an issuer of a life insurance contract may remedy the failure of one or more contracts to meet the definition of a life insurance contract under § 7702(a) or to satisfy the requirements of § 101(f) of the Internal Revenue Code. Rev. Rul. 91-17, 1991-1 C.B. 190, is superseded in part; Notice 99-48, 1999-2 C.B. 429, is superseded.

SECTION 2. BACKGROUND

.01 Definition of a life insurance contract.

(1) Section 7702(a) provides that, for a contract to qualify as a life insurance contract for Federal income tax purposes, the contract must be a life insurance contract under the applicable law and must either--

(a) satisfy the cash value accumulation test of § 7702(b), or

(b) both meet the guideline premium requirements of § 7702(c) and fall within the cash value corridor of § 7702(d).

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

(3) A contract meets the guideline premium requirements of § 7702(c) if the sum of the premiums paid under the contract does not at any time exceed the guideline premium limitation as of that time. The guideline premium limitation as of any date is the greater of the guideline single premium, or the sum of the guideline level premiums to that date. The guideline single premium is the premium that would be required on the date the contract is issued to fund the future benefits under the contract.

(4) A contract falls within the cash value corridor of § 7702(d) if the death benefit under the contract at any time is not less than the applicable percentage of the cash surrender value, based on the table set forth in § 7702(d)(2).

(5) Section 7702 is effective for contracts issued after December 31, 1984, in tax years ending after that date.

.02 Tax treatment of a contract that does not meet the requirements of § 7702(a). Section 7702(g)(1)(A) provides that if at any time a contract that is a life insurance contract under the applicable law does not meet the definition of a life insurance contract under § 7702(a), the income on the contract for any taxable year of the policyholder is treated as ordinary income received or accrued by the policyholder during such year. Further, § 7702(g)(1)(C) provides that if, during any taxable year of the policyholder, a contract that is a life insurance contract under the applicable law ceases to meet the definition of a life insurance contract under § 7702(a), the income on the contract for all prior taxable years is treated as received or accrued during the taxable year in which such cessation occurs.

.03 Definition and treatment of a flexible premium life insurance contract. A flexible premium life insurance contract is a life insurance contract that provides for the payment of one or more premiums that are not fixed by the insurer as to both timing and amount. Section 101(f) provides that any amount paid by reason of the death of the insured under a flexible premium life insurance 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), or (2) the cash value test of § 101(f)(1)(B). The limitations of § 101(f) generally apply to contracts issued before January 1, 1985.

.04 Recordkeeping, reporting, withholding, and deposit requirements for failed contracts. The issuer of a contract that fails to satisfy the requirements of § 7702(a) or § 101(f) may have recordkeeping, reporting, withholding, and deposit obligations.

An issuer that fails to meet these obligations also may be subject to penalties. See Rev. Rul. 91-17 (concerning failures to satisfy the requirements of § 7702(a)).

.05 Authority to enter into closing agreements. Under § 7121, the Secretary is authorized to enter into an agreement in writing with any person relating to the liability of such person (or of the person or estate for whom he acts) in respect of any internal revenue tax for any period. Such an agreement is generally final and conclusive, except upon a showing of fraud or malfeasance, or misrepresentation of a material fact.

.06 Correction procedure for failures to satisfy the requirements of § 7702(a).

Rev. Rul. 91-17, concludes that if a contract fails to meet the definition of a life insurance contract under § 7702(a), then the holder of the contract is deemed to have received a nonperiodic distribution as ordinary income under § 7702(g) or (h), and the issuer is subject to the recordkeeping, reporting, withholding, and deposit requirements applicable to nonperiodic distributions. In addition, Rev. Rul. 91-17 states that the Internal Revenue Service (Service) will waive civil penalties for an issuer's failure to satisfy those requirements if, prior to June 3, 1991, the issuer requested and, in a timely fashion, executed a closing agreement under which the issuer agreed to pay a specified amount. Notice 99-48, indicated that since June 3, 1991, the Service has continued to exercise its authority under § 7121 to enter into closing agreements as set out in Rev. Rul. 91-17. Notice 99-48 also set forth the rates to be used for the purpose of computing the amount due pursuant to such a closing agreement. As a matter of practice, the Service has entered into closing agreements to address contracts that failed to satisfy the requirements of § 101(f), as well.

.07 Changes to correction procedures. In Notice 2007-15, 2007-1 C.B. 503, the Service requested comments as to how various correction procedures -- including those for correcting the failure of a contract to satisfy the requirements of § 7702(a) -- may be improved. This revenue procedure incorporates a number of changes that taxpayers suggested in response to Notice 2007-15. Most significantly, this revenue procedure (1) sets forth a model closing agreement for issuers that seek relief, and (2) provides alternative calculations of the amount due under the closing agreement.

SECTION 3. SCOPE

This revenue procedure applies to any issuer of one or more contracts that qualified as life insurance contracts under the applicable law, but otherwise failed to meet the definition of a life insurance contract under § 7702(a) or to meet the requirements of § 101(f). For purposes of this revenue procedure, the term "issuer" is any company that issues a contract that is intended to satisfy the definition of a life insurance contract under § 7702 or § 101(f). The term also includes a company that insures a contract holder under a contract originally issued by another company.

SECTION 4. PROCEDURE

.01 Request for ruling. An issuer that seeks relief under this revenue procedure must submit a request for a ruling that meets the requirements of Rev. Proc. 2008-1, 2008-1 I.R.B. 1 (or any successor). Additionally, the submission must contain the following information:

(1) the policy number for each contract;

(2) a description of the defects that caused the contracts to fail to comply with § 7702 or § 101(f); and

(3) a description of the administrative procedures the issuer has implemented to prevent additional failures to meet the requirements of § 7702 or § 101(f) in the future.

.02 Closing agreement. In the case of a failure to meet the guideline premium requirements of § 7702(c), the issuer must submit a proposed closing agreement, in triplicate, executed by the issuer, in the same form as the model closing agreement in section 5 of this revenue procedure. The amount shown in Section 1(A) of the proposed closing agreement is the amount required to be paid (as determined under section 4.03 of this revenue procedure) for all of the contracts covered by the agreement. In the case of any other failure, the issuer may propose amendments to the proposed closing agreement set forth in section 5 of this revenue procedure, including the amount required to be paid, as appropriate on a case-by-case basis.

.03 Determination of amount required to be paid with regard to a contract.

(1) In general. The amount required to be paid with regard to a contract under this section 4.03 of this revenue procedure depends on the amount of excess earnings with respect to the contract. For a contract with excess earnings greater than $5,000, the amount required to be paid is the amount determined based on income on the contract under section 4.03(2) of this revenue procedure; for a contract with excess earnings less than or equal to $5,000, the amount required to be paid is the amount determined based on excess earnings under section 4.03(3) of this revenue procedure. In lieu of the amount determined under section 4.03(2) or section 4.03(3) of this revenue procedure, however, the issuer may elect to pay the amount determined based on excess premiums under section 4.03(4) of this revenue procedure.

(2) Amount determined based on income on the contract. The amount required to be paid with regard to a contract with excess earnings greater than $5,000 is the amount determined based on income on the contract. This amount is equal to (i) the amount of tax that would have been owed by the contract holder if the contract holder

were treated as receiving the income on the contract, plus (ii) any interest with regard to such tax. For this purpose, the income on the contract is determined in the manner set forth in section 4.03(5)(a) of this revenue procedure; the tax rate is assumed to equal the applicable percentage for the contract determined under section 3.11 of Rev. Proc. 2008-39, page ___, this Bulletin; and the amount of interest is the amount computed under § 6621(a)(2) as if the amounts treated as received by the contract holder as income on the contract caused underpayments of tax in the appropriate years.

(3) Amount determined based on excess earnings. The amount required to be paid with regard to a contract with excess earnings less than or equal to $5,000 is the amount determined based on excess earnings. This amount is equal to the amount of tax that would have been owed by the contract holder if the contract holder were treated as receiving the excess earnings on the contract. For this purpose, the excess earnings on the contract is the amount determined under section 4.03(5)(b) of this revenue procedure; the tax rate is assumed to equal the applicable percentage for the contract determined under section 3.11 of Rev. Proc. 2008-39, and the amount of interest is the amount computed under § 6621(a)(2) as if the amounts treated as received by the contract holder as excess earnings caused underpayments of tax in the appropriate years.

(4) Amount determined based on excess premiums. In lieu of the amount determined based on income on the contract set forth in section 4.03(2) of this revenue procedure or the amount determined based on excess earnings set forth in section 4.03(3) of this revenue procedure, as applicable, an issuer may elect to pay an amount

with regard to a contract equal to 100% of the excess premiums as defined in section 4.03(5)(c) of this revenue procedure.

(5) Definitions.

(a) Income on the contract. The income on the contract is the amount determined with regard to the contract under § 7702(g)(1)(B).

(b) Excess earnings. The excess earnings for a contract is equal to the amount obtained by multiplying—

(i) the sum of a contract's excess premiums for a contract year and its cumulative excess earnings for all prior contract years, by

(ii) the applicable earnings rate as set forth in section 3.07 of Rev. Proc. 2008-39. (For contract years before 1988, the applicable earnings rate is the rate determined in a manner consistent with the formulas set forth in section 3.07 of Rev. Proc. 2008-39 for contract years after 2007.)

(c) Excess premiums. The excess premiums with regard to a contract is equal to the highest amount by which the total premiums paid under the contract exceed the guideline premium limitations under § 7702(c) at any time the contract is in force.

.04 Payment of amount. The issuer is required to pay the amount determined under section 4.03 of this revenue procedure within 60 days of the date of execution of the closing agreement by the Service. Payment shall be made by check payable to the "United States Treasury" delivered, together with a fully executed copy of the closing agreement, to Internal Revenue Service, Receipt & Control Stop 31, 201 W. Rivercenter Blvd., Covington, KY 41011.

.05 Correction of contracts. With respect to each contract that is in force on the effective date of the closing agreement, to the extent necessary to bring the contract into compliance with § 7702, the issuer is required, no later than 90 days after the date of execution of the closing agreement with the Service, either (1) to increase the death benefit to not less than an amount that will ensure compliance with § 7702 or § 101(f), as applicable, or (2) to refund to the contract holder the excess of the sum of the premiums paid as of the effective date of the closing agreement over the guideline premium limitation as of that date. If the sum of the premiums paid does not exceed the guideline premium limitation, no corrective action is necessary.

.06 Required representations. The submission must include representations to the effect that (1) the issuer is within the scope of section 3 of this revenue procedure; (2) the issuer properly computed the amount required to be paid with regard to the contracts in accordance with section 4.03 of this revenue procedure; and (3) the issuer has brought the contracts into compliance with the requirements of § 7702 or § 101(f), as applicable, or will do so within the time period specified in the model closing agreement set forth in section 5 of this revenue procedure. The representations must be executed under penalties of perjury by an appropriate party (as set forth in section 7.01 of Rev. Proc. 2008-1 (or its successor). The issuer must retain documentation available for audit to support the representations.

.07 Electronic submissions. The information required under section 4.01 of this revenue procedure may be submitted to the Service electronically, in read-only format, on a CD-ROM. Adobe Portable Document format is a suitable format. Other formats may be arranged on a case-by-case basis. The issuer must provide a total of three CD-ROMs, one for each of the three copies of the closing agreement.

SECTION 5. MODEL CLOSING AGREEMENT

Effective as of date executed by Internal
Revenue Service _____________________

CLOSING AGREEMENT AS TO FINAL DETERMINATION
COVERING SPECIFIC MATTERS
UNDER § 7702 ***[Insert "or § 101(f)" if applicable]***

THIS CLOSING AGREEMENT ("Agreement") is made pursuant to § 7121 of the Internal Revenue Code (the "Code") by and between ***[Insert Taxpayer name, address and EIN number]*** ("Taxpayer") and the Commissioner of Internal Revenue (the "Service").

WHEREAS,

A. Taxpayer is the issuer of one or more contracts that were intended to qualify as life insurance contracts under § 7702 ***[Insert "or § 101(f)" if applicable].*** For each contract, however, Taxpayer accepted and retained premiums that exceeded the contract's guideline premium limitations. As a result, the contract[s] failed to satisfy the requirements of § 7702 ***[Insert "or § 101(f)" if applicable].***

B. Pursuant to Rev. Proc. 2008-40**,** 2008-29 I.R.B., the Service under certain circumstances will waive civil penalties for failure of a taxpayer to satisfy the recordkeeping, reporting, withholding, or deposit requirements for income received or deemed received under § 7702(g).

C. By letter dated ***[Insert date]*** Taxpayer submitted to the Service, pursuant to Rev. Proc. 2008-1, 2008-1 IRB 1 ***[or successor if applicable]***, a request for this Agreement covering ***[Insert number]*** of Taxpayer's life insurance contracts identified on Exhibit A attached to this Agreement (the "Contracts").

D. Taxpayer represents that the failure[s] described in A above are eligible for relief under Rev. Proc. 2008-40.

E. Taxpayer represents that the amount determined under section 4.03 of Rev. Proc. 2008-40 is $ ***[Insert amount].*** Taxpayer represents that this amount has been computed correctly under the provisions of Rev. Proc. 2008- 40.

F. To ensure that the Contracts satisfy the requirements of § 7702(a) ***[Insert "or § 101(f)" if applicable],*** Taxpayer and the Service have entered into this Agreement.

NOW THEREFORE IT IS HEREBY FURTHER DETERMINED AND AGREED BETWEEN TAXPAYER AND THE SERVICE AS FOLLOWS:

1. In consideration for the agreement of the Service as set forth in Section 2 below, Taxpayer agrees as follows:

(A) To pay the Service the amount of $ ***[Insert amount]*** at the time and in the manner described in Section 3 below.

(B) The amount paid pursuant to Section 1(A) above is not deductible, nor is such amount refundable, subject to credit or offset, or otherwise recoverable from the Service.

(C) For purposes of complying with Taxpayer's reporting and withholding obligations under the Code,

(i) neither the investment in the contract for purposes of § 72, nor the premiums paid, for purposes of § 7702 ***[Insert "or § 101(f)" if applicable]***, on any Contract can be increased by any portion of the amount set forth in Section 1(A) above. If any such increases are made, they are entitled to no effect.

(ii) neither the investment in the contract, for purposes of § 72, nor the premiums paid, for purposes of § 7702 ***[Insert "or § 101(f)" if applicable],*** on any Contract can be increased by any portion of the amount which Taxpayer represents to be the income on the contract for all of the Contracts in the aggregate. If any such increases are made, they are entitled to no effect.

(D) With respect to each Contract that is in force on the effective date of this Agreement, to the extent necessary in order to bring such Contract into compliance with § 7702 ***[Insert "or §101(f)" if applicable],*** no later than 90 days after the date of execution of this Agreement by the Service:

(i) If the sum of the premiums paid as of the effective date of this Agreement exceeds the guideline premium limitation as of such date, Taxpayer will take the following corrective action:

(a) Increase the death benefit to not less than an amount that will ensure compliance with § 7702 ***[Insert "or § 101(f)" if applicable]***, or

(b) Refund to the Contract holder the amount of such excess, with interest at the Contract's interest crediting rate; or

(ii) If the sum of the premiums paid as of the effective date of this

Agreement does not exceed the guideline premium limitation of § 7702 ***[insert "or § 101(f)" if applicable]*** as of such date, to take no corrective action.

(E) With respect to any Contract which terminated by reason of the death of the insured (i) prior to the date this Agreement is executed by the Service and Taxpayer and (ii) at a time when the premiums paid exceeded the amounts necessary to keep the Contracts in compliance with the requirements of § 7702 ***[Insert "or § 101(f)" if applicable]*** guideline premium limitation for the Contract, Taxpayer will pay the Contract holder, or the Contract holder's estate, the amount of such excess with interest.

2. In consideration of the agreement of Taxpayer set forth in Section 1 above, the Service agrees as follows:

(A) To treat each Contract that is still in force as of the effective date of this Agreement as having satisfied the requirements of § 7702 ***[Insert "or § 101(f)" if applicable]*** during the period from the date of issuance of the Contract through and including the later of (i) the date of the execution of this Agreement by the Service or (ii) the date of corrective action described in Section 1(D) with respect to that Contract;

(B) To treat each Contract that terminated prior to the effective date of this Agreement as having satisfied the requirements of § 7702 ***[Insert "or § 101(f), if applicable]*** during the period from date of issuance of the Contract through and including the date of the Contract's termination;

(C) To treat the failure(s) described above, and any corrective action described in Section 1(D) or 1(E) above, as having no effect on the date the Contract was issued, entered into, or purchased for purposes of any provision of the Code or regulations thereunder;

(D) To treat any amount paid prior to the effective date of this Agreement to any beneficiary under a Contract by reason of the death of the insured as paid under a life insurance contract for purposes of the exclusion from gross income under § 101(a)(1);

(E) To waive civil penalties for failure of Taxpayer to satisfy the reporting, withholding, or deposit requirements for income deemed received by Contract holders due to the Contract's failure to satisfy the requirements of § 7702 ***[Insert "or 101(f)" if applicable]***; and

(F) To treat no portion of the amount described in Section 1(A) above as income to the Contract holders.

3. Any action required of Taxpayer in Section 1(D) or 1(E) above shall be taken by Taxpayer no later than 90 days after the date of execution of this Agreement by the Service. Payment of the amount described in Section 1(A) above shall be made within

60 days after the date of execution of this Agreement by the Service by check payable to the "United States Treasury," delivered together with a copy of this executed Agreement, to Internal Revenue Service, Receipt & Control Stop 31, 201 W. Rivercenter Blvd., Covington, KY 41011.

4. This Agreement is, and shall be construed as being, for the benefit of Taxpayer. Contract holders of the Contracts covered by this Agreement are intended beneficiaries of this Agreement. This Agreement shall not be construed as creating any liability of Taxpayer to the Contract holders.

5. Neither the Service nor Taxpayer shall endeavor by litigation or other means to attack the validity of this Agreement.

6. This Agreement may not be cited or relied upon as precedent in the disposition of any other matter.

NOW THIS CLOSING AGREEMENT FURTHER WITNESSETH, that the Service and Taxpayer mutually agree that the matters so determined shall be final and conclusive, except as follows:

1. The matter to which this Agreement relates may be reopened in the event of fraud, malfeasance, or misrepresentation of material facts set forth herein.

2. This Agreement is subject to sections of the Code that expressly provide that effect be given to their provisions (including any stated exception for Code § 7122) notwithstanding any other law or rule of law.

3. To the extent this Agreement relates to any tax period after the date on which it is executed, it is subject to any law, enacted after such date, that applies to that tax period.

IN WITNESS WHEREOF, the parties have subscribed their names in triplicate. By signing, the above parties certify that they have read and agreed to the terms of this document.

[Insert Taxpayer name]

Date Signed: ______________ By: ___________________________

Title: __________________________

COMMISSIONER OF INTERNAL REVENUE

Date Signed: ______________ By: ___________________________

Title: __________________________

SECTION 6. EFFECTIVE DATE

This revenue procedure is effective July 21, 2008, the date of its publication in the Internal Revenue Bulletin.

SECTION 7. EFFECT ON OTHER DOCUMENTS

Rev. Rul. 91-17, 1991-1 C.B. 190, is superseded in part to set forth new terms and conditions under which the Service will enter into a closing agreement to remedy the failure of a contract to qualify as a life insurance contract; Notice 99-48 is superseded.

SECTION 8. PAPERWORK REDUCTION ACT

The collections of information in this revenue procedure have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1752.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

Books and records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally tax returns and return information are confidential, as required by 26 U.S.C. 6103.

DRAFTING INFORMATION

The principal author of this revenue procedure is Melissa S. Luxner of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this revenue procedure contact Branch 4 of that office at (202) 622-3970 (not a toll-free call).