



Taxpayer represents that all Number B Policies are life insurance policies under the laws of the state in which they are issued and that the errors which are the subject of this ruling were unintentional. Taxpayer represents that the Policies will, if the errors described herein are waived, meet the federal tax definition of a life insurance contract under § 7702(a).

The Policies were intended to qualify as life insurance contracts under § 7702 by satisfying the guideline premium requirement of § 7702(a)(2)(A) and (c) and by falling within the cash value corridor of § 7702(a)(2)(B) and (d), and the taxpayer has so administered them since they were issued. Because the Policies are universal life policies, which allow for variable payments, the Taxpayer instituted monitoring procedures to ensure compliance with the guideline premium requirement and the cash value corridor. Whenever an amount paid into a contract causes the total premiums paid to exceed the guideline premium, the Taxpayer's computer system produces a coded error report and automatically rejects the premium with a guideline violation error message. The remittance area receives the error report and personnel in that area determine whether to refund the whole premium or apply the amount which is permissible. Thus, once the computer produces an error report, life administration personnel manually review the report and consult with other personnel within the line of business to determine what corrective action should be taken. There are two business areas that are responsible to monitor compliance error reports, one in Location C and one in Location D.

The death benefit under each of the Policies was decreased at the policyowner's request. At the time of the decrease, the necessary adjustments were properly made under § 7702(f). This adjustment produced a reduced guideline single premium and a negative guideline level premium. Since the premiums paid for each of the Policies at the time of the adjustment did not exceed the guideline premium limitation at the time of the death benefit reduction, no refund of premiums paid was required at that time.

However, the adjustment did result in a negative guideline annual premium which caused the guideline premium limitation to grow smaller in each subsequent Policy year until such time as there was an excess of premiums paid over the recomputed guideline premium limitation. At that time, the system generated a code alerting personnel of a guideline error.

Due to miscommunication between personnel in Location C and Location D when the error code was generated, personnel at neither location did anything to bring the Policies into compliance. This failure to remedy the Policies was made, despite a compliance system designed to prevent such failure, when personnel at Locations C and D failed to bring the Policies into compliance.

Each of the policies was written on the same policy form. The Policies are part of a group of Number E similarly situated life insurance policies (written on the same policy form) where a decrease in death benefit in conjunction with negative guideline level premium resulted in an excess of premiums paid over the guideline premium limitation many years after the original request for decrease. Except for the Number B Policies, all other policies were brought into compliance within the timeframe mandated under § 7702(f)(1)(B).

We note that with respect to this policy form, this group of policies is the first instance to date where a decrease in death benefit in conjunction with a negative guideline level premium has resulted in an excess of premiums paid over the guideline premium limit in some policy year following the policy year of the decrease.

The Taxpayer has refunded excess premiums (with interest) as required by § 7702(f)(8)(b) and the Taxpayer is instituting procedures to reduce the likelihood that such errors will recur. The previous manual compliance procedures have been changed to require a responsible manager to confirm on a daily basis, the disposition of each coded error report on the list of daily reports and to promptly follow up with responsible personnel in the event that any alert remains unconfirmed.

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..

Section 7702(f)(8) provides 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 § 7702.

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

As required by § 7702(f)(8)(B), Taxpayer will bring the Policies into compliance with § 7702 by refunding premiums paid (with interest) in excess of the guideline premium limitation with respect to the Policies so that there is no excess. Additionally, 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 § 7702(a) for the reasonable errors described above is waived pursuant to § 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,

/S/

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Sheryl B. Flum  
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Office of Associate Chief Counsel  
(Financial Institutions & Products)