

Internal Revenue Service

Number: **200438005**
Release Date: 9/17/04
Index Number: 7702.02-00, 7702.20-00,
7702.22-00

Department of the Treasury
Washington, DC 20224

[Third Party Communication:
Date of Communication: Month DD, YYYY]

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:FIP:B04
PLR-103070-04

Date:
May 14, 2004

Legend

Taxpayer =

Date A =

Number V =

State W =

Place X =

Number Y =

Number Z =

Date B =

Date C =

Dear :

This is in reply to your letter dated Date A, in which you requested, on behalf of Taxpayer, a waiver under section 7702(f)(8) of the Internal Revenue Code for Number V life insurance contracts (the "Contracts") that inadvertently failed to meet the requirements of section 7702.

FACTS

Taxpayer is a mutual life insurance company, as defined in section 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 W and is licensed to engage in the insurance business

in Place X. Taxpayer is the common parent of a life-nonlife affiliated group and files its returns on an accrual accounting, calendar year basis.

The Contracts that are the subject of this request are both fixed and variable life insurance contracts. All of the policies were issued after Date B and were intended to comply with section 7702 by satisfying the cash value accumulation test set forth in section 7702(b). During the period from Date B to Date A, Taxpayer issued approximately Number Y policies and had approximately Number Z policies in force.

Each Contract provides for a basic death benefit which is equal either to its face amount or to its face amount plus its cash value, but in the event that the Contract's account value grows to a point where it exceeds the net single premium for the basic death benefit, the Contract pays a minimum "corridor" death benefit equal to the Contract's account value multiplied by a cash value accumulation factor. Cash value accumulation factors are actuarially computed for each attained age of the insured and are intended to specify the death benefit for which the net single premium would be equal to one dollar. When multiplied by the actual account value of a Contract, the cash value accumulation factors, if accurately computed, would yield the death benefit for which the account value is equal to the net single premium.

Cash value accumulation factors are set forth in an endorsement ("CVAT Endorsement") to each Contract for each attained age and underwriting classification. Originally computed by the Taxpayer's contract administration system to an accuracy of eight decimal places, the cash value factors set forth in the CVAT Endorsement have been rounded, up or down, to the nearest two decimal places.

In administering the Contracts, the Taxpayer represents that it has uniformly and consistently relied on its contract administration system, which performs calculations internally to an accuracy of eight decimal places. To calculate corridor death benefits, the Taxpayer has relied on the contract administration system with its eight decimal place accuracy. The Taxpayer has not multiplied the two decimal place cash value accumulation factors set forth in the applicable CVAT Endorsement form to calculate corridor death benefits. The Taxpayer represents that, due to the accuracy of the contract administration system's internal calculations, the corridor death benefits so calculated are well within the tolerance recognized in the relevant legislative history of one dollar per thousand dollars of face amount. The Taxpayer further represents that the contract administration system's corridor death benefit calculations satisfy the requirements of section 7702(b)(2) and are otherwise actuarially sound.

In addition, the Taxpayer represents that it has always intended to pay and has always paid, as corridor death benefits under the Contracts, amounts that were computed by its contract administration system to an accuracy of eight decimal places, not the amounts produced by multiplying the rounded cash value accumulation factors shown in the applicable CVAT Endorsement form by a Contract's account value.

Moreover, annual reports furnished by the Taxpayer to owners of the Contracts, which show, among other items, the current death benefit under the applicable Contract, have consistently shown current death benefits generated by the Taxpayer's administration system, not death benefits produced by multiplying the rounded cash value accumulation factors shown in the CVAT Endorsement forms multiplied by the account value. The account values shown in the annual reports have also consistently been amounts calculated by the Taxpayer's contract administration system and thus have reflected cost of insurance charges based on death benefits and, ultimately, cash value accumulation factors internally computed to eight decimal places. Thus, the Taxpayer's administrative practices have uniformly and consistently reflected corridor death benefits satisfying the cash value accumulation test at all durations.

ERROR AND TIMELY CORRECTION

In Date C, the Taxpayer discovered the problem when it became aware that the cash value accumulation factors set forth in the CVAT Endorsement forms that were rounded down might draw into question the Contracts' compliance with the cash value accumulation test. At that time, the Taxpayer was seeking to transfer part of the Contracts to another life insurance company in an assumption reinsurance transaction. Immediately upon becoming aware of the compliance issue, the Taxpayer halted further sales of contracts with the CVAT Endorsement in which cash value accumulation factors were rounded to two decimal places. Since then, newly issued cash value accumulation test contracts issued on the same policy forms as the Contracts have a cash value accumulation test endorsement in which cash value accumulation factors are rounded to six decimal places. These factors comply with the requirements of the cash value accumulation test and the applicable legislative history.

LAW AND ANALYSIS

Section 7702 defines the term "life insurance contract" for all purposes of the Code. Under section 7702(a), a life insurance contract must qualify as such under the applicable law and must satisfy either the cash value accumulation test of section 7702(a)(1) and section 7702(b), or both the "guideline premium requirements" of section 7702(a)(2)(A) and section 7702(c) and the "cash value corridor" of section 7702(a)(2)(B) and section 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.

The legislative history for the Deficit Reduction Act of 1984, Pub. Law 98-369, in its discussion of the computational rules under section 7702(e), includes the following with respect to permissible rounding differences:

Finally, it was understood that in computing actual cash surrender values that rounding differences or other computational variations could produce minor variations in results. For example, it has been standard practice for most companies to round all cash values up to the next whole dollar per thousand of face amounts. This simplifies displays and assures compliance with minimum nonforfeiture standards under State law. Thus, it is expected that, in addition to the application of the above described computational rules, reasonable approximations (e.g. \$1.00 per \$1,000 of face amount) in the calculation of the net single premium or the guideline premiums will be permitted.

Joint Committee on Taxation Staff, General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984, 98th Cong., 2d Sess. 653 (1985).

Pursuant to section 7702(f)(8), the Secretary of Treasury may waive a failure to satisfy the requirements of section 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.

Under the facts submitted and representations made, in the absence of regulations and in light of the legislative history, we conclude that the failure of the Contracts as a result of rounding variations was due to reasonable error. Further, upon discovery of the errors, Taxpayer immediately corrected the problem by issuing cash value accumulation test contracts issued on the same policy forms as the Contracts with a cash value accumulation test endorsement in which cash value accumulation factors are rounded to six decimal places. Taxpayer has also instituted new procedures that will avoid the prior rounding errors and no further discrepancies should occur.

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(s) 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 your taxpayer.

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.

Sincerely,
/S/

Thomas M. Preston
Senior Counsel, Branch 4
Office of Associate Chief Counsel
(Financial Institutions & Products)

cc: