

Part III

Administrative, Procedural, and Miscellaneous

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

Rev. Proc. 2008-38

SECTION 1. PURPOSE

This revenue procedure provides a procedure by which an issuer of a life insurance contract may remedy a failure to account for charges for qualified additional benefits (QABs) under the expense charge rule of § 7702(c)(3)(B)(ii) of the Internal Revenue Code. Rev. Rul. 2005-6, 2005-1 C.B. 471, is amplified.

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 Definition of a modified endowment contract (MEC).

(1) Section 7702A(a) provides that a life insurance contract is a MEC if the contract--

(a) is entered into on or after June 21, 1988, and fails to meet the 7-pay test of § 7702A(b), or

(b) is received in exchange for a contract described in paragraph (a) of this section 2.02(1).

(2) A contract fails to meet the 7-pay test if the accumulated amount paid under the contract at any time during the first 7 contract years exceeds the sum of the net level premiums that would have to be paid on or before such time if the contract were to provide for paid-up future benefits after the payment of 7 level annual premiums.

(3) Section 72(e)(12) provides that, for purposes of determining amounts includible in gross income, all MECs issued by the same company to the same contract holder during any calendar year are treated as one MEC.

.03 Accounting for charges for QABs. Section 7702(f)(5) identifies five categories of benefits as QABs: guaranteed insurability; accidental death or disability benefit; family term coverage; disability waiver benefit; or other benefits prescribed under regulations. These benefits are not treated as future benefits under the contract, but charges for the benefits are treated as future benefits. For purposes of the cash value accumulation test of § 7702(b), § 7702(b)(2)(B) requires that charges for QABs be accounted for using the expense charge rule of § 7702(c)(3)(B)(ii), rather than the mortality charge rule of § 7702(c)(3)(B)(i). Section 7702A(c)(1) requires that the same rule be used for purposes of the 7-pay test as well. Although § 7702 is silent on the treatment of charges for QABs for purposes of applying the guideline premium requirements, Rev. Rul. 2005-6 concludes that charges for such benefits are to be taken into account under the expense charge rule of § 7702(c)(3)(B)(ii) for that purpose as well.

.04 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 agreement is generally final and conclusive, except upon a showing of fraud, malfeasance, or misrepresentation of a material fact.

.05 Correction procedure for QABs. Rev. Rul. 2005-6 sets forth three alternatives for issuers whose compliance systems do not currently account for charges for QABs under the expense charge rule of § 7702(c)(3)(B)(ii):

(1) Alternative A provides that, if an issuer's compliance system does not properly account for charges for QABs but no contracts have failed to satisfy the requirements of § 7702(a) as a result of the system's deficiency, the issuer may correct its compliance system to account for those charges using the expense charge rule without contacting the Internal Revenue Service (Service).

(2) Alternative B provides a correction procedure for closing agreements that were requested on or before February 7, 2006.

(3) Alternative C provides that an issuer whose compliance system does not properly account for charges for QABs may request a closing agreement under terms and conditions that are enumerated in Rev. Rul. 2005-6.

.06 Changes to correction procedure. In Notice 2007-15, 2007-1 C.B. 503, the Service requested comments as to how various correction procedures -- including those for improper accounting for charges for QABs under Rev. Rul. 2005-6 -- 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 sets forth a model closing agreement and explains in more detail the terms and conditions that apply under Alternative C of Rev. Rul. 2005-6.

SECTION 3. SCOPE

This revenue procedure applies to any issuer of one or more contracts that failed to meet the definition of a life insurance contract under § 7702(a) or to meet the requirements of § 7702A by reason of a compliance system that does not account for charges for QABs under the expense charge rule of § 7702(c)(3)(B)(ii). For this purpose, the term "issuer" means any company that issues a contract that is intended to satisfy the definition of a life insurance contract under § 7702. 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 a 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 an exhibit setting forth the policy number for each contract for which relief is requested.

.02 Closing Agreement. The issuer also 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 (determined under section 4.03 of this revenue procedure) for all of the contracts covered by the agreement.

.03 Determination of amount required to be paid. The amount required to be paid is based on the aggregate number of contracts for which relief is requested, as set forth in the following schedule:

Number of Contracts	Amount Due
20 or fewer	\$1,500.00
21 to 50	\$2,000.00
51 to 100	\$5,000.00
101 to 500	\$10,000.00
501 to 1,000	\$16,000.00
1,001 to 5,000	\$30,000.00
5,001 to 10,000	\$40,000.00
Over 10,000	\$50,000.00

.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 and compliance system. With respect to each contract that is in force on the effective date of the closing agreement, the issuer must bring the contract into compliance with § 7702 (or § 7702A, as applicable), either by increasing the contract's death benefit or returning the contract's excess premiums and earnings thereon to the contract holder. The issuer also must correct its compliance system to account properly for charges for QABs as provided in Rev. Rul. 2005-6. The issuer must take the corrective action required under this section 4.05 within 90 days of

the date of execution of the closing agreement by the Service.

.06 Representations. The submission must include representations to the effect that the issuer is within the scope of section 3 of this revenue procedure and that the amount due to the Service under the closing agreement is computed correctly under section 4.03. 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 exhibit 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. See Notice 2005-35, 2005-1 C.B. 1087.

SECTION 5. MODEL CLOSING AGREEMENT

Effective as of date executed by Internal

Revenue Service _____

CLOSING AGREEMENT AS TO FINAL DETERMINATION COVERING SPECIFIC MATTERS UNDER REV. PROC. 2008-38

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]*** ("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 ***[;that were not intended to be treated as modified endowment contracts under § 7702A;]*** and that provided qualified additional benefits (QABs) within the meaning of § 7702(f)(5).

B. Pursuant to Rev. Proc. 2008-38, 2008-29 I.R.B., the Service under certain circumstances will waive civil penalties for failure of a taxpayer to satisfy the reporting, withholding and/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 I.R.B.1 **[or successor Rev. Proc., if applicable]**, a request for this Agreement covering **[Insert number]** life insurance contracts identified in Exhibit A attached to this Agreement (the "Contracts").

D. Taxpayer intended that each of the Contracts meet the definition of a life insurance contract under § 7702 **[and not be a modified endowment contract under § 7702A]**. Taxpayer, however, maintained a compliance system for the contracts that did not account properly for charges for qualified additional benefits (QABs) under § 7702(c)(3)(B)(ii). As a result, the Contracts identified in Exhibit A failed to satisfy the requirements of § 7702 or § 7702A.

E. Taxpayer represents that the errors described in D above qualify the Taxpayer for the remedy described in Rev. Proc. 2008-38.

F. Taxpayer represents that the amount determined under section 4.03 of Rev. Proc. 2008-38 is \$ **[Insert amount]**. Taxpayer represents that this amount has been computed correctly under the provisions of Rev. Proc. 2008-38.

G. Taxpayer represents that it has corrected its compliance system, or will correct the compliance system within the time limit prescribed in Section 1(F), to account properly for charges for QABs.

H. To ensure that the Contracts satisfy the requirements of § 7702 **[and § 7702A, 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 Taxpayer's complying with its 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, 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, 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 **[and § 7702A, if applicable]**:
 - (i) If the sum of the premiums paid as of the effective date of this Agreement exceeds the amount necessary to keep the Contracts in compliance with the requirements of § 7702 **[and § 7702A, if applicable]**, Taxpayer will take the following corrective action:
 - (a) Increase the death benefit to not less than an amount that will ensure compliance with § 7702 **[and § 7702A, if applicable]**, or
 - (b) Refund to the Contract holder the amount of such excess with interest; or
 - (ii) If the sum of the premiums paid as of the effective date of this Agreement does not exceed the amount necessary to keep the contracts in compliance with the requirements of § 7702 **[and § 7702A, if applicable]**, Taxpayer will 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 (ii) at a time when the premiums paid exceeded the guideline premium limitation for the Contract, Taxpayer will pay the Contract holder or the Contract holder's estate such excess with interest.
- (F) Taxpayer represents that it, if it has not already done so, will correct its compliance system within 90 days of the effective date of this Agreement to account properly for charges for QABs.

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 **[and § 7702A, if applicable]**, during the period from the date of issuance of the Contract through and including the latest of (i) the date this Agreement is executed by the Service, (ii) the date of any corrective action described in Section 1(D) above, or (iii) the date of any corrective action described in Section 1(F) above;
- (B) To treat each Contract that terminated prior to the effective date of this Agreement as having satisfied the requirements of § 7702 **[and § 7702A,**

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 failures 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 the regulations thereunder;
- (D) To treat any amount paid to any beneficiary prior to the effective date of this Agreement 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 that would be applicable but for the relief otherwise provided by this Agreement; 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 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. 2005-6 is amplified to provide terms and conditions and a model closing agreement for use by taxpayers seeking the relief described in Alternative C.

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 Katherine A. Hossofsky 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).