

Part III

Administrative, Procedural, and Miscellaneous

26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.
(Also Part 1, §§ 101, 7702.)

Rev. Proc. 2008-42

SECTION 1. PURPOSE

This revenue procedure provides a procedure by which an issuer of a life insurance contract may automatically obtain a waiver, under § 7702(f)(8) or § 101(f)(3)(H) of the Internal Revenue Code, for certain reasonable errors that caused the contract to fail to satisfy the requirements of § 7702 or § 101(f), as applicable. Rev. Rul. 91-17, 1991-C.B. 190, 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 and tax 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.

.03 Correction procedure for reasonable errors. Section 7702(f)(8) provides that if a taxpayer establishes to the satisfaction of the Secretary that the requirements of § 7702(a) for any contract year were not satisfied due to reasonable error, and reasonable steps are being taken to remedy the error, the Secretary may waive the failure to satisfy those requirements. The Internal Revenue Service (Service) may waive civil penalties for failure to satisfy the reporting, withholding, and deposit requirements for income deemed received under § 7702(g) and (h), as well. See Rev. Rul. 91-17. Section 101(f)(3)(H) provides similar authority for the Secretary to waive the failure to satisfy the requirements of § 101(f). In order to request a waiver under § 7702(f)(8) or § 101(f)(3)(H), a taxpayer generally must request a letter ruling from the Service under the procedures set forth in Rev. Proc. 2008-1, 2008-1 I.R.B. 1 (or any successor).

.04 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 obtaining a waiver with respect to errors that are reasonable within the meaning of § 7702(f)(8) or § 101(f)(3)(H) -- may be improved. This revenue procedure incorporates a number of changes that taxpayers suggested in response to Notice 2007-15. Specifically, this revenue procedure provides a simplified procedure under which a

taxpayer may obtain a waiver for a limited class of errors under these provisions without incurring the cost of requesting a letter ruling.

SECTION 3. SCOPE

.01 In general. This revenue procedure applies to any issuer of a life insurance contract that failed to satisfy the requirements of § 7702 or § 101(f), as applicable, due to an eligible reasonable error, provided reasonable steps are taken to remedy the error.

.02 Issuer. For purposes of this revenue procedure, the term "issuer" is any company that issues a contract that is intended to satisfy the requirements of § 7702 or § 101(f). The term also includes a company that insures a contract holder under a contract originally issued by another company.

.03 Eligible reasonable error. An eligible reasonable error for purposes of this revenue procedure exists if: (1) the issuer has compliance procedures with specific, clearly articulated provisions that if followed would have prevented the contract from failing to satisfy the requirements of § 7702 or § 101(f); (2) an employee or independent contractor of the issuer acted, or failed to act, in accordance with the compliance procedures; and (3) such act or failure to act was inadvertent, and was the sole reason that the contract failed to satisfy the requirements of either § 7702 or § 101(f). Thus, for example, the term eligible reasonable error includes an employee's incorrect recording of the age or gender of the insured, or of the incorrect amount or time of payment of the insured's premium payment.

.04 Reasonable steps to remedy. The requirement that reasonable steps be

taken to remedy the eligible reasonable error is satisfied for purposes of this revenue procedure if the issuer refunds excess premium with interest and/or increases the death benefit on the contract no later than the date on which the issuer files the federal income tax return to which the tax return attachment described in section 4.03 of this revenue procedure is affixed. The remedy required under this section 3.04 of this revenue procedure does not include changes to the issuer's compliance procedures, since the definition of an eligible reasonable error under section 3.03 of this revenue procedure requires that the system already have specific, clearly articulated procedures that if followed would have prevented the error.

.05 Non-eligible errors. Although the automatic waiver provided under this revenue procedure is not available with respect to an error that is not described in section 3.03 of this revenue procedure, relief may be available under other correction procedures. For example, neither a defective legal interpretation nor a computer programming error would satisfy the requirement of section 3.03(1) of this revenue procedure that the issuer's compliance procedures, if followed, would have prevented the error. If such an error is reasonable, however, the issuer may request a waiver by letter ruling under the procedures set forth in Rev. Proc. 2008-1 (or any successor). In addition, errors that are not reasonable may be eligible for correction by closing agreement under the procedure set forth in Rev. Proc. 2008-40, page ____, this Bulletin.

SECTION 4. PROCEDURE

.01 Automatic waiver. The failure of one or more life insurance contracts to satisfy the requirements of § 7702 or § 101(f), as applicable, due to reasonable error will

be treated as waived pursuant to the authority of § 7702(f)(8) or § 101(f)(3)(H), as applicable, provided the issuer (1) is within the scope of section 3.01 of this revenue procedure, and (2) files both the waiver statement described in section 4.02 and the tax return attachment described in section 4.03 of this revenue procedure.

.02 Waiver statement. An automatic waiver for a reasonable error described in Section 3 of this revenue procedure is available to an issuer only if it files with the Service, in duplicate, a statement entitled "Automatic Waiver Request under Rev. Proc. 2008-42" in which the issuer (1) provides a brief description of the error and the steps taken to remedy the error; (2) lists the policy numbers of the life insurance contracts for which it seeks an automatic waiver; and (3) provides the representations described in section 4.04 of this revenue procedure. This statement should be signed and dated, and submitted to the Commissioner of Internal Revenue, Attn: CC:FIP:4, Room 3550, 1111 Constitution Avenue, NW, Washington, DC 20224, no later than the date on which the issuer files the federal income tax return to which the tax return attachment described in section 4.03 of this revenue procedure is affixed.

.03 Tax return attachment. In addition, the issuer must attach to its timely-filed (including extensions) Federal income tax return, for the taxable year during which the issuer relies upon this revenue procedure to obtain a § 101(f)(3)(H) or § 7702(f)(8) waiver, a statement that reads: "Issuer has submitted an Automatic Waiver Request under section 4.02 of Rev. Proc. 2008-42 for certain errors that caused one or more life insurance contracts it issued to fail to comply with § 7702(f)(8) or § 101(f) of the Internal Revenue Code. An issuer filing its return electronically should attach this statement as

an Adobe Portable Document format (PDF) file named "Rev. Proc. 2008-42."

.04 Representations. The waiver statement required under section 4.02 of this revenue procedure must include representations to the effect that the issuer is within the scope of section 3 of this revenue procedure and that the issuer is otherwise entitled to the requested waiver. 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.

.05 Electronic submissions. The waiver statement required under section 4.02 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 two CD-ROMs.

SECTION 5. EFFECTIVE DATE

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

SECTION 6. EFFECT ON OTHER DOCUMENTS

Rev. Rul. 91-17, 1991-C.B. 190, is amplified to provide an automatic procedure by which an issuer of a life insurance contract may automatically obtain a waiver for certain reasonable errors that caused the contract to fail to satisfy the requirements of § 7702 or § 101, as applicable.

SECTION 7. 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 Josephine H. Firehock 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).