

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:FIP:4 PLR-107955-00

Date: August 1, 2000

Legend

Taxpayer =

Company A =

State X =

State Y =

Date 1 =

Date 2 =

Date 3 =

Amount B =

Amount C =

Dear :

This responds your letter of Date 1, as supplemented, on behalf of Taxpayer requesting a ruling granting a waiver under § 101(f)(3)(H) of the Internal Revenue Code. You ask that certain flexible premium universal life insurance policies identified in your submissions be treated as life insurance contracts for federal tax purposes.

FACTS

The information submitted indicates that Taxpayer is a stock life insurance company subject to Subchapter L of the Code and organized under the laws of State X and subject to the audit jurisdiction of the District Director in State Y.

On Date 2, Taxpayer entered into an assumption reinsurance agreement (Agreement) with Company A pursuant to which Taxpayer assumed all liabilities of Company A with respect to certain life insurance contracts. Pursuant to that Agreement, Taxpayer undertook the administration of Amount B reinsured life insurance contracts on Date 2. Of those Amount B contracts, Taxpayer has identified Amount C contracts (Failed Policies) that fail to qualify as life insurance contracts under the applicable provisions of § 101(f)(1) of the Internal Revenue Code.

The Failed Policies were issued on one flexible premium universal life insurance contract form, a copy of which was attached to the initial submission as Exhibit A. The Failed Policies were issued prior to January 1, 1985, and have a variable premium structure that allows the policyholder to select and vary the amount of premium paid. The Failed Policies reserve the right of the insurer to refuse premiums and to return premiums with interest, if such premiums would disqualify the policy for favorable tax treatment under § 101(a) of the Internal Revenue Code. The attached Endorsement provides that the policies are intended to qualify for treatment as a life insurance policy under §§ 72 and 101(a) of the Internal Revenue Code and the insurer reserves the right to endorse the policies with respect to remaining qualified for treatment as a life insurance policy under those Code sections.

Nevertheless, amounts in excess of the guideline premium were accepted under each of the Failed Policies. Because Taxpayer was to assume the administrative responsibilities for Amount B life insurance contracts issued by Company A as of Date 2, Taxpayer engaged the services of independent contractors to convert those contracts from Company A's administrative system to Taxpayer's system. The independent contractors were former employees of the vendor of the computer software that Taxpayer uses for its administrative system. The independent contractors wrote a program that extracted data and transferred it to Taxpayer's system.

Taxpayer's system compares the premiums paid under a life insurance contract with the "guideline premium limitation" for the contract: (1) on each monthly anniversary day; (2) before bills or reminder notices for premium payments are sent; (3) each time a premium payment is received; and (4) any

time that an adjustment to the contract's Premium Limitation is required, such as when there is an increase or decrease in the death benefit of a contract. Taxpayer represents that, if a policyholder attempts to make a premium payment in excess of a contract's Premium Limitation, its system will not allow the premium payment to be credited under the contract.

If Taxpayer's system determines that excess premiums have been paid, the system will generate a notice to Taxpayer's employees that a refund of excess premium is necessary. Taxpayer's procedures require that all excess premiums paid under a life insurance contract must be refunded with interest to the policyholder within 60 days of the end of the contract year in which received, in accordance with § 101(f)(3)(B). In addition, Taxpayer's system generates audit reports that identify all contracts that do not comply with § 101(f). These reports are reviewed to determine the reason for the noncompliance. Prior to the discovery that the policies in question were out of compliance, these audit reports were generated on a quarterly basis.

With respect to each life insurance contract subject to § 101(f), Taxpayer's system includes certain codes indicating whether the contract should be monitored for compliance with the Guideline Premium Test of § 101(f)(1)(A) or the Cash Value Accumulation Test of § 101(f)(1)(B). Taxpayer represents that the converted contracts, including the Failed Policies, were intended to comply with the Guideline Premium Test by satisfying both the "guideline premium limitation" under §§ 101(f)(1)(A)(i) and (f)(2) and the "applicable percentage" requirements under §§ 101(f)(A)(ii) and (f)(3)(C).

During the conversion, the independent contractors inadvertently disabled the code indicating that the contracts should be monitored for compliance with the Guideline Premium Test. Consequently, although the system still determined the Premium Limitation for each converted contract, it did not compare the contract's Premium Limitation with the premiums paid under the contract. As a result, if a policyholder paid excess premiums under his life insurance contract, the system would credit the excess premiums under the contract, but would not notify Taxpayer's employees that excess premiums had been credited under the contract, and would not list the contract on the audit reports.

Taxpayer represents that the independent contractors were not instructed to modify the coding of the contracts during the conversion in any manner. If the contractors had not modified this code, the failures would not have occurred. As a result of the coding error, Taxpayer's system allowed the crediting of excess premiums under the Failed Policies. Although Amount B life insurance contracts were converted to Taxpayer's system, the programming error resulted in the

crediting of excess premiums under only Amount C life insurance policies.

Taxpayer represents that immediately after discovering the programming error, it corrected the coding of the Failed Policies so that its system would function as intended so as to prevent the crediting of excess premiums under the Failed Policies. Taxpayer also represents that it has not subsequently engaged the services of the independent contractors and that it will not engage them in the future in connection with another conversion. It indicates that all of the converted contracts which are in force currently are being monitored under Taxpayer's system for compliance with the requirements of the Guideline Premium Test. In addition, the audit reports are now generated monthly.

Taxpayer further represents that it has refunded all excess premiums that exceed the Premium Limitation. It also represents that as of Date 3, the sum of the premiums paid with respect to each of the Failed Policies is equal to or less than the Premium Limitation for that policy.

LAW AND ANALYSIS

Section 101(f) of the Internal Revenue Code excludes from gross income any amount paid by reason of the death of the insured under a life insurance contract known as a flexible premium contract only if the contract satisfies either (1) the guideline premium limitation and the applicable percentage limitation of §§ 101(f)(1)(A)(i) and (ii), or (2) the cash value test of § 101(f)(1)(B). Section 101(f) applies to contracts issued before January 1, 1985.

Pursuant to § 101(f)(3)(H), the Secretary of the Treasury may waive a failure to satisfy the requirements of § 101(f). This waiver is granted if a taxpayer establishes that the statutory requirements were not satisfied because of a reasonable error and that reasonable steps are being taken to remedy the error.

Under the facts as submitted, the failure of Amount C life insurance contracts to satisfy the requirements of § 101(f) was caused by reasonable error. The errors were the result of inadvertent human error in the conversion of the Company A policies to the system used by Taxpayer. Taxpayer has instituted procedures to reduce or eliminate the likelihood that such error will recur. Taxpayer also has taken reasonable steps to cure the failure in accordance with § 101(f).

CONCLUSION

Accordingly, based on the information submitted, the failure of Amount C contracts to satisfy the requirements of § 101(f) is waived pursuant to

§ 101(f)(3)(H).

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 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.

Sincerely,
Acting Associate Chief Counsel
(Financial Institutions and Products)
By: Donald J. Drees, Jr.
Senior Technician Reviewer