



# FINANCIAL SERVICES

## - Insurance Tax Bulletin

PRICEWATERHOUSECOOPERS 

### IRS Issues Directive on Separate Account DRD

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The IRS Large and Midsize Business Division has issued an industry Directive (LMSB-04-0308-010) to provide guidance to agents on the examination of the Dividends Received Deduction (DRD) incurred in connection with separate accounts of life insurance companies.

Rev. Rul. 2007-54, released on August 16, 2007, in part addressed the interest rate used under § 812(b)(2) to calculate required interest on the reserves held in the separate account of Life Insurance companies. However, the ruling was subsequently suspended and taxpayers were informed that the issues considered in the Revenue Ruling would more appropriately be addressed by Regulations (Rev. Rul. 2007-61; 2007-42 I.R.B. 799). The Regulations project was added to the 2007-2008 Priority Guidance Plan.

Although the IRS states that the DRD on separate accounts of Life Insurance companies issue is not a mandatory examination item, it encourages agents to consider the issue in their Risk Analysis and develop the issue if the Risk Analysis indicates that it is material. However, it strongly cautions agents against applying Rev. Rul. 2007-54, which has been suspended. According to the IRS, in making a decision on whether to pursue the DRD on separate account issue, examiners should consider materiality as a key factor. If the Risk Analysis indicates that this issue is material, it should be developed.

In two attachments to the Directive, the IRS provides guidelines for issuing an Information Document Request (IDR). Of specific importance in these guidelines is a request in Attachment 1 to identify the nature, amount, and statement location of any additional statutory variable contract reserves, a guaranteed minimum withdrawal benefit (GMWB), a guaranteed income benefit (GIB) or a combination of such benefits and the corresponding tax reserves that are held for each year under audit. Attachment 2 requests a listing of tax reserves by issue year showing the corresponding interest rates used under section 807(d) for each issue year. According to the IRS, if the responses to the questions listed in Attachment 1 indicate that the applicable reserve method for variable life or variable annuity contracts is the reserve computed under section 807(d)(2) and/or that required interest for separate accounts may need to be recomputed, an IDR may also be issued requesting the information that is listed in attachment 2.

**PwC Observes:** Unfortunately the Directive does not clearly call off the IRS from this issue. To the contrary, it states that where the issue is material, the issue should be pursued. In addition, it notes that the Regs promised with the suspension of Rev. Rul. 2007-54 in Rev. Rul. 2007-61 have been added to the Priority Guidance Plan. For those who thought the issue was over, be warned.

For additional information please call Anthony DiGilio at (202) 414-1702 or contact your local insurance tax professional. Please visit us at: <http://www.pwc.com/us/insurance/tax>

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