



FINANCIAL SERVICES

- Insurance Tax Bulletin

PRICEWATERHOUSECOOPERS 

Insurer Granted Waiver for Failed Insurance Contracts

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The IRS recently ruled in PLR 200819003 that the failure of a stock life insurance company's policies to meet the definition of a life insurance contract under Section 7702(a) was due to a reasonable error and granted the company a waiver under Section 7702(f)(8) for any contracts that are cured within 90 days of the ruling.

Taxpayer is a stock life insurance company. Taxpayer has approximately Number F policies currently in force, of which Number G are universal life policies. Although Taxpayer intended that each of its life insurance policies meet the definition of a life insurance contract under Section 7702 by satisfying the guideline premium limitation, Taxpayer later discovered errors which resulted in the failure of Number H Contracts all of which were issued after 1985. Taxpayer had previously used a manual system of ensuring that its contracts were in compliance with Section 7702, but has since converted to using an automated administrative system to improve compliance. Taxpayer will also bring the contracts into compliance by making refunds of premium (including interest on the premium amount calculated at the contract rate) to each contract holder.

For contracts issued after December 31, 1984, Section 7702 provides a definition of the term "life insurance contract" for all purposes of the Code. To satisfy this definition, a life insurance or endowment contract must be treated as such under the applicable law. In addition, life insurance contract must satisfy either:

- the cash value accumulation test of Section 7702(a) and Section 7702(b); or
- both the "guideline premiums requirements" of Section 7702(a) and Section 7702(c), and fall within the "cash value corridor test" of Section 7702(a) and Section 7702(d).

Section 7702(f)(1)(B) generally provides that, if the premiums paid exceed the guideline premium limitation, and the issuer refunds the excess (with interest) within 60 days after the end of the policy year, then the amount returned (without interest) is deemed to reduce the sum of the premium paid under the contract during the year.

Pursuant to 7702(f)(8), the Secretary of the Treasury may waive a failure to satisfy the requirements of Section 7702, if a taxpayer establishes that the statutory requirements were not satisfied because of reasonable error and that reasonable steps are being taken to remedy the error. According to the IRS, in this case the failure of Number H Contracts to satisfy the requirements of Section 7702(a) was caused by reasonable error. In addition, Taxpayer has instituted procedures to reduce or eliminate the likelihood that such errors will recur and has taken reasonable steps to remedy the failure of the Contracts. Accordingly, the failure of the contracts to satisfy the requirements of Section 7702(a) is waived pursuant to Section 7702(f)(8). However, contracts not cured within 90 days of the IRS's notice are not covered by the waiver.

PwC Observes: As it has done in the past, the IRS continues to grant waivers to taxpayers who fail to meet certain requirements of an insurance contract where the taxpayer shows that they have acted reasonably and in good faith, and that reasonable steps are being taken to remedy the error.

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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