

Each Contract provides for the payment of certain premiums, the amount or frequency of which may be changed by the owner, subject to various restrictions. Certain charges (the "Charges") are assessed against the premiums paid for each Contract. Premiums paid by a Contract owner, net of the Charges and other applicable fees, are allocated to a fixed account and/or one or more variable sub-accounts. Amounts allocated to the fixed account are held in Company X's general account and earn interest at a rate no less than a guaranteed rate specified in the Contract. Amounts allocated to a variable sub-account are held as units in a separate account maintained by Company X pursuant to state law or regulation and reflect the investment return and market value of the units held in connection with that variable sub-account.

The Contracts are designed to satisfy either (i) the cash value accumulation test of § 7702(b) (the "CVA test") or (ii) the guideline premium requirements of § 7702(c) and the cash value corridor requirements of § 7702(d) (collectively, the "GP test"). Each Contract provides for a minimum death benefit (the "Minimum Death Benefit") that is intended to equal the amount required by the CVA test or the cash value corridor requirement of the GP test, as applicable.

A Contract's "accumulation value" or "cash value" (hereinafter collectively referred to as "Accumulation Value") reflects (i) net premium payments made under the Contract, (ii) cost of insurance charges, (iii) interest credited under the fixed account, (iv) any increases or decreases as a result of market performance in the variable sub-accounts, (v) the amount of any partial surrenders, (vi) policy indebtedness, and (vii) all other fees, deductions, and charges assessed under the Contract.

Under certain Contract forms, a Contract owner may borrow up to 90 percent of the Contract's Net Accumulation Value, which is an amount equal to the Contract's Accumulation Value less any outstanding policy indebtedness. Under other Contract forms, such a loan can be taken to the extent that the total of all loans with interest plus the total of all previous partial surrenders does not exceed 90 percent of the sum of the Net Accumulation Value plus the amount of all partial surrenders. Interest is charged on policy loans.

If an owner requests a partial surrender of a Contract, the Accumulation Value is reduced by the amount of the partial surrender plus an administrative fee. If the owner of a Contract surrenders the Contract in full, Company X will pay the owner on the date of surrender the Contract's Net Accumulation Value. However, in circumstances involving the early surrender of a Contract, certain amounts (the "Remittance") in addition to the Net Accumulation Value are paid to a Contract owner upon the full surrender of the Contract.

For some Contracts forms, the Remittance equals (i) _____ percent of the Charges that are not intended to cover applicable state taxes and federal income tax liabilities of Company X (the "Non-Tax Charges") if the Contract is surrendered during the

, (ii) percent of all Non-Tax Charges if the Contract is surrendered during _____, and (iii) _____ is payable if the Contract is surrendered after _____. For some Contract forms, the Remittance equals (i) percent of all Non-Tax Charges if the Contract is surrendered during the _____, (ii) percent of all Non-Tax Charges if the Contract is surrendered during _____, (iii) percent of all Non-Tax Charges if the Contract is surrendered during _____, and (iv) _____ if the Contract is surrendered _____. For some Contract forms, the Remittance equals (i) percent of all Non-Tax Charges if the Contract is surrendered during _____, (ii) percent of all Non-Tax Charges if the Contract is surrendered during _____, and (iii) _____ if the Contract is surrendered _____.

_____. The amount of the Remittance for a specific Contract is subject to a minor variation of a few percentage points based on negotiations with the Contract owner.

LAW AND ANALYSIS

The first issue is whether the Remittance that could be payable under a Contract is part of the Contract's cash surrender value within the meaning of § 7702(f)(2)(A).

In general, for contracts issued after December 31, 1984, § 7702 provides a definition of the term "life insurance contract" for all purposes of the Code. To satisfy this definition, a life insurance contract must be treated as such under the applicable law. Under § 7702(a), the contract must also either (1) meet the cash value accumulation test of § 7702(b), or (2) satisfy the guideline premium requirements of § 7702(c) and fall within the cash value corridor test of § 7702(d).

Section 7702(b) provides that a contract meets the cash value accumulation test if, by the terms of the contract, the cash surrender value of the contract may not at any time exceed the net single premium which would have to be paid at such time to fund future benefits under the contract.

Section 7702(c) provides that a contract meets the guideline premium requirements if the sum of the premiums paid under such contract does not at any time exceed the guideline premium limitation as of such time.

Section 7702(d) provides that a contract falls within the cash value corridor if the death benefit under the contract at any time is not less than the applicable percentage of the cash surrender value.

Section 7702(f)(2)(A) provides that, for purposes of § 7702, the cash surrender value of any contract shall be its cash value determined without regard to any surrender charge, policy loan, or reasonable termination dividends.

The common definition of cash surrender value is “the amount made available, contractually, to a withdrawing policyowner who is terminating his or her protection.” Kenneth Black, Jr. & Harold D. Skipper, Jr., *LIFE & HEALTH INSURANCE* 46 (13th ed. 2000); see also John H. Magee, *LIFE INSURANCE* 599 (3rd ed. 1958) (“The cash value represents the amount available to the policyholder upon the surrender of the life insurance contract.”).

The legislative history of §7702 defines cash surrender value as the “cash value of any contract (i.e., any amount to which the policyholder is entitled upon surrender and against which the policyholder can borrow) determined without regard to any surrender charge, policy loan, or a reasonable termination dividend.” S. PRT. NO. 98-169, at 573 (1984); H.R. REP. NO. 98-432, at 1444 (1984).

Section 1.7702-2(b)(1) of the proposed Income Tax Regulations provides that, for purposes of § 7702, the cash value of a contract generally equals the greater of (i) the maximum amount payable under the contract (determined without regard to any surrender charge or policy loan), or (ii) the maximum amount that the policyholder can borrow under the contract. 57 Fed. Reg. 59319 (Dec. 15, 1992).

Section 1.7702-2(h)(2) of the proposed regulations provides that the cash surrender value of a contract generally equals its cash value, as defined in section 1.7702-2(b)(1) of the proposed regulations.

In Notice 93-37, 1993-2 C.B. 331, the Service announced that the effective dates of the proposed regulations under § 7702 would be no earlier than the date of publication of final regulations in the Federal Register. The Notice also stated that it is anticipated that insurance companies generally will be allowed a period of time after final regulations are published to bring their policy forms into compliance with any new rules.

We conclude that the Remittance that could be payable under a Contract is part of the Contract’s cash surrender value within the meaning of § 7702(f)(2)(A).

The second issue is whether Company X’s error in not treating the Remittance that could be payable under a Contract as part of the Contract’s cash surrender value within the meaning of § 7702(f)(2)(A) is an error that can be waived pursuant to § 7702(f)(8).

Section 7702(f)(8) provides that the Secretary may waive the failure to satisfy the statutory requirements under § 7702(a) for a life insurance contract for any contract year if such failure was due to reasonable error and reasonable steps are taken to remedy the error.

Because Notice 93-37 stated that the effective dates of the proposed regulations under § 7702 would be no earlier than the date of publication of final regulations and because the proposed regulations do not contain language identical to the definition of cash surrender value in the legislative history of §7702, we conclude that the failure of the Contracts to satisfy the requirements of § 7702 because the Remittance that could be payable under a Contract was not treated as part of the Contract's cash surrender value within the meaning of § 7702(f)(2)(A) is due to reasonable error.

The remedial actions proposed by Company X are (i) for each in-force Contract under which a Remittance could become payable after the 90th day from the date this ruling is issued, Company X will amend the terms of the Contract so the amount of the Remittance is included as part of the value that is used to determine such Contract's Minimum Death Benefit during the period that the Remittance could become payable, and (ii) for each Contract under which the insured dies or has died at a time a Remittance is or was payable upon a full surrender of the Contract, Company X will calculate the death benefit under the Contract by taking the Remittance into account as part of the value that is used to determine the Minimum Death Benefit. If a death benefit already has been paid with respect to such a Contract, Company X will pay the beneficiary the difference between the required death benefit and the death benefit actually paid.

Company X represents that if they issue any insurance contract in the future with features similar to the Remittance features that exist in the Contracts, Company X will include the Remittance that could be payable under the contract as part of the contract's cash surrender value within the meaning of § 7702(f)(2)(A).

We conclude that Taxpayer's proposed method of remedying the errors is reasonable.

We express no opinion as to the tax treatment of the Contracts under the provisions of any other sections of the Code and Income Tax Regulations that may also be applicable thereto.

The rulings contained in this letter are based upon information and representations submitted by Company X and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

/S/

Donald J. Drees, Jr.
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Office of Associate Chief Counsel
(Financial Institutions & Products)