

PLR 200917002—IS THE IRS STILL IN THE BUSINESS OF ISSUING WAIVERS?

By Daniela Stoia

On April 24, 2009, the Internal Revenue Service (the “Service”) released PLR 200917002¹ (the “PLR”). The PLR provides a waiver, pursuant to section 7702(f)(8), for a number of contracts that failed to satisfy the requirements of section 7702 (the “Failed Contracts”) due to certain errors, described below. This article begins with a review of the PLR and the waiver that was issued. The article then summarizes the types of errors eligible for correction under Rev. Proc. 2008-42² and finishes with a discussion of what conclusions can be drawn, if any, about the status of the traditional the waiver request process based on the release of this PLR after the effective date of the Auto Waiver Procedure.

The PLR

In order for a taxpayer to receive a waiver pursuant to section 7702(f)(8), the taxpayer must demonstrate to the Service that the failure to satisfy the requirements of section 7702 was due to “reasonable error” and that “reasonable steps” are being taken to remedy the error.

Reasonable Errors

The PLR addressed Failed Contracts that were intended to satisfy the requirements of section 7702 by meeting the “guideline premium test” (the “GPT”).³ However, due to the five errors described below, the Failed Contracts did not satisfy the GPT.

- *Errors 1, 2, and 3 – Programming Errors.* The PLR describes three programming errors that caused certain of the Failed Contracts not to comply with the requirements of the GPT. The first programming error occurred during the conversion of some of the Failed Contracts to the taxpayer’s administration system, which also monitors the taxpayer’s contracts for compliance with the require-

ments of the GPT (the “GPT System”). As part of that process, the taxpayer’s programmers inadvertently converted the contracts in such a manner as to cause the GPT System to increase erroneously the guideline premium limitation used by the system to monitor the contracts’ compliance with the GPT. Effectively, the error prevented the GPT System from identifying premiums that were paid in excess of the correctly calculated guideline premium limitation. This programming error is similar to other programming errors relating to conversions that the Service has waived in the past.⁴ The second programming error was a failure of the taxpayer’s programmers to program the specifications developed for certain policy forms as related to the duration for which certain expense charges were expected to be imposed. This error is also consistent with other programming errors that the Service has waived relating to the implementation of specifications for a policy form.⁵ The third programming error was made by the taxpayer’s programmers when they modified the taxpayer’s GPT System to reflect a contract feature as an interest rate guarantee, which resulted in unintended consequences in the manner in which the system treated the contracts with this feature. This error is also consistent with prior waivers issued by the Service in the case of programming errors arising when modifications were made to a system to reflect a new product or a new product feature.⁶

- *Error 4 – Application of Reasonable Expense Charge Rule.* Although the precise nature of the fourth error addressed by the PLR is uncertain, it appears to have related to the assumptions that were made in reflecting certain expense charges in calculating guideline premiums. The reasonable expense charge rule of section 7702(c)(3)(B)(ii) provides that in calculating guideline premiums “any reasonable charges (other than mortality charges) which (on the basis of the company’s experience, if any, with respect to similar contracts) are reasonably expected to be actually paid” may be reflected. In this case, it appears that the assumptions that were made regarding the collection of certain expense charges were inconsistent with the requirements of the reasonable expense charge rule. Although very few waivers have been issued by the Service relating to the reasonable expense charge rule, this PLR is consistent with an earlier PLR issued by the Service in a circumstance where that taxpayer’s assumptions about its expense charges were inconsistent with the reasonable expense charge rule.⁷

- *Error 5 – Clerical Errors.* Like most insurers, the taxpayer seeking the PLR had in place procedures for its employees to follow in interacting with the GPT System. Nonetheless, the taxpayer discovered that its employees failed to follow these procedures, e.g., they overrode the guideline premiums calculated by the GPT System. Historically, such errors have been characterized as “clerical errors” and they are the classic types of errors that the Service has waived since waiver private letter rulings were first issued in the late 1980s.⁸ One could even go as far as to say that it was these types of clerical errors that were the impetus for the issuance of the Auto Waiver Procedure.

After evaluating each of the five errors described above, the Service concluded that the errors were “reasonable errors” within the meaning of section 7702(f)(8). This conclusion was not surprising because, as described above, the Service has issued waivers for similar errors in the past.

Reasonable Steps to Correct

The taxpayer took a number of steps to minimize the possibility that any of its life insurance contracts would fail to satisfy the requirements of the GPT in the future. For example, the taxpayer corrected the programming errors by recalculating guideline premiums in accordance with the requirements of section 7702, entering those amounts into its GPT System, and making the necessary modifications to the coding of the GPT System to correct the programming errors. The taxpayer also took certain additional steps to strengthen its procedures to minimize the possibility of further clerical errors causing compliance issues. In addition to the foregoing, the taxpayer also corrected the Failed Contracts by refunding excess premiums with interest to bring them back into compliance with the requirements of section 7702. After evaluating the taxpayer’s corrective actions, the Service concluded that the taxpayer’s actions satisfied the requirements of section 7702(f)(8).

In light of the foregoing, the Service granted the taxpayer a waiver because the errors causing the Failed Contracts were determined to be “reasonable errors” and the taxpayer’s corrective actions were determined to be “reasonable steps” to remedy the errors.

Eligible Reasonable Errors Addressed by Rev. Proc. 2008-42

In relevant part, Rev. Proc. 2008-42 applies to any issuer of a life insurance contract that fails to satisfy the requirements

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of section 7702 due to an “eligible reasonable error” if reasonable steps are taken to remedy the error.⁹ The revenue procedure specifically provides that an “eligible reasonable error” exists if three criteria are satisfied. First, 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 section 7702. Second, an employee or independent contractor of the issuer acted, or failed to act, in accordance with those procedures. Third, such act or failure to act was inadvertent, and was the sole reason that the contract failed to satisfy the requirements of section 7702.

The revenue procedure also provides some specific examples of errors causing failures under section 7702 that are not eligible for correction under the Auto Waiver Procedure. Specifically, neither a defective legal interpretation nor a computer programming error would be eligible reasonable errors under the Auto Waiver Procedure. This is because these errors would not satisfy the requirements of the revenue procedure that the issuer’s compliance procedures, if followed, would have prevented the error. Nonetheless, if a defective legal interpretation or a computer programming error is reasonable, the issuer may request a traditional waiver by private letter ruling under the procedures set forth in Rev. Proc. 2009-1.¹⁰ If such errors are not reasonable, an issuer may request a closing agreement under the procedures set forth in Rev. Proc. 2008-40¹¹ to correct any failures resulting from the error.

Conclusions to be Drawn from the PLR

As various individuals from the Service have said on countless occasions, it is dangerous to draw too many conclusions from private letter rulings because they are issued to address a taxpayer’s specific facts and the pertinent facts may be redacted in the version of the private letter rulings released to the public. In this case, taxpayers may quickly jump to the conclusion that this PLR indicates that the Service is as willing as it was prior to the release of the Auto Waiver Procedure to issue waivers pursuant to section 7702(f)(8). That conclusion may be premature in light of the fact that the request for the PLR may have predated the release of the Auto Waiver Procedure. In fact, one might speculate that the request for the PLR was submitted prior to the release of the Auto Waiver Procedure because one of the types of errors covered by the PLR—the clerical error—seems to be an example of an eligible reasonable error that the Auto

Waiver Procedure was intended to correct. However, that is not certain because the PLR primarily focuses on the types of errors that cannot be corrected under the Auto Waiver Procedure, *e.g.*, programming errors. Only time will tell if the number of waiver private letter rulings issued by the Service will decrease because more and more taxpayers will avail themselves of the Auto Waiver Procedure. This, in part, will depend on whether taxpayers find that errors causing section 7702 compliance failures satisfy the eligible reasonable error criteria of Rev. Proc. 2008-42. ◀

END NOTES

- ¹ Jan. 15, 2009. A private letter ruling is issued to a particular taxpayer and can be relied upon only by that taxpayer. See section 6110(k)(3). Unless otherwise indicated, all references to “section” are to sections of the Internal Revenue Code of 1986, as amended.
- ² 2008-29 I.R.B. 160, *amplifying* Rev. Rul. 91-17, 1991-1 C.B. 190. Rev. Proc. 2008-42 provides the procedures under which taxpayers may automatically obtain a waiver pursuant to section 7702(f)(8) for certain “eligible reasonable errors” (the “Auto Waiver Procedure”). The Auto Waiver Procedure became effective on July 21, 2008.
- ³ In order for a life insurance contract that is treated as such under state law to satisfy the GPT it must both meet the “guideline premium requirements” set forth in section 7702(a)(2)(A) and (c) and fall within the “cash value corridor” of section 7702(a)(2)(B) and (d).
- ⁴ See, *e.g.*, PLR 200044016 (Aug. 1, 2000) (waiving programmers’ inadvertent disabling of the code in the taxpayer’s administration system which indicated that the contracts should be monitored for compliance with the GPT during the conversion of contracts to the taxpayer’s administration system).
- ⁵ See, *e.g.*, PLR 200646002 (Aug. 3, 2006) (waiving a number of inadvertent errors by programmers, such as the failure to load the correct table of guaranteed mortality charges or to change a reference point to the correct table of guaranteed mortality charges); PLR 200027030 (Apr. 10, 2000) (waiving various programming and coding errors such as the incorrect coding of a plan as a 1958 CSO plan).
- ⁶ *Id.*
- ⁷ See, *e.g.*, PLR 9517042 (Jan. 31, 1995) (addressing the reasonable expense charge rule and stating: “None of the contracts issued as the result of intracompany exchanges, including the dd contracts here, were subject to the charges taken into account by Taxpayer in the calculation of the guideline premium limitation. The same charges were reasonably expected to be actually paid under all other contracts issued on the same policy forms. Contracts issued in intracompany exchanges are not ‘similar’ to contracts that are original issue or received in an intercompany exchange, if each class of contracts is treated differently for charge purposes. In the absence of regulations defining the term ‘similar contracts,’ however, we find that Taxpayer’s interpretation of the parenthetical phrase to include the company’s experience with respect to other contracts using the same policy form was a reasonable error.”).
- ⁸ See, *e.g.*, PLR 200749005 (Aug. 24, 2007) (waiving contract failures resulting from employees failing to follow the company’s procedures for addressing adjustment events and from employees “[m]anually overriding the system to backdate a premium to the date it was received rather than the date the system indicated was permissible”); PLR 200646002 (waiving contract failures resulting from employees failing to follow the company’s procedures for addressing adjustment events and from employees releasing premiums from a premium deposit account or other suspense arrangement and crediting those premiums when permitted by the GPT, but with an effective date that preceded the actual date on which the premiums were credited).
- ⁹ The Auto Waiver Procedure also applies to section 101(f) failures. See Rev. Proc. 2008-42 section 3.01.
- ¹⁰ 2009-1 I.R.B. 1.
- ¹¹ 2008-29 I.R.B. 151, *superseding* in part Rev. Rul. 91-17, 1991-1 C.B. 190, and *superseding* Notice 99-48, 1992-2 C.B. 429.