Office of Chief Counsel
Internal Revenue Service

memorandum

CC:SER:GEO:ATL:TL-N-4561-00
CLRountree

date: September 18, 2000

to: Mr. Harvey Kuykendall
Manager, LMSB Group 1711
Koger Center, Stop 615-D

from: District Counsel, Georgia District, Atlanta

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subject: **Request for Determination Letter on Tax Treatment of Cash Build-up Values and Death Benefits Related to Proposed Variable Universal Life Insurance Policies on Employees' Lives**
Taxpayer: [redacted]
E.I.N.: [redacted]
Taxable Year Ended [redacted]

DISCLOSURE STATEMENT

This advice constitutes return information subject to I.R.C. §6103. This advice contains confidential information subject to attorney-client and deliberative process privileges and if prepared in contemplation of litigation, subject to the attorney work product privilege. Accordingly, the Examination or Appeals recipient of this document may provide it only to those persons whose official tax administration duties with respect to this case require such disclosure. In no event may this document be provided to Examination, Appeals, or other persons beyond those specifically indicated in this statement. This advice may not be disclosed to taxpayers or their representatives.

This advice is not binding on Examination or Appeals and is not a final case determination. Such advice is advisory and does not resolve Service position on an issue or provide the basis for closing a case. The determination of the Service in the case is to be made through the exercise of the independent judgment of the office with jurisdiction over the case.

This is in response to the memorandum dated August 4, 2000 from LMSB Group Manager Harvey Kuykendall requesting review of the request of [redacted] for a determination letter on the tax treatment of the cash value build-up and death benefits related to variable universal life

insurance policies to be purchased on the lives of [redacted] subsidiaries' managers. Specifically, assuming that the policies constitute life insurance contracts under I.R.C. §7702, [redacted] requests the following determinations:

a. The build-up of cash values will grow tax-deferred.

b. Death benefits paid to [redacted] are excludible from income under I.R.C. §101.

In the following discussion, we conclude that the Internal Revenue Service (Service) cannot issue the requested determination letter. Consequently, we recommend that you take actions set forth below on page 6 of this memorandum.

Issue

Whether the Service may issue a determination letter on the tax consequences of cash value build-up and receipt of death benefits from proposed variable universal life insurance policies on the lives of [redacted] managers. U.I.L.: 9999.98-00

Facts

During [redacted], [redacted] plans to purchase from [redacted] variable universal life insurance policies on the lives of approximately [redacted] employees holding full-time supervisory or management positions ([redacted] managers).

[redacted] asserts the following:

a. That each policy will satisfy the insurable interest requirements of the relevant states.

b. [redacted] will not take out any loans against the policies or related cash values.

c. The policies will result in [redacted] ability to direct the policies' investment element into separate accounts in lieu of automatic investment in [redacted]'s general investment account.

d. [redacted] will hold the policies until the employee's death and will use the cash values and death benefits to offset the costs of employee benefits provided at [redacted] expense to its managers.

e. Regardless of applicable state law, [redacted] intends to procure the policies with the managers' consent.

By letter signed on [redacted], [redacted] requested that the Service issue a determination letter holding that if the proposed policies qualify as life insurance contracts under I.R.C. §7202, (a) the cash value build-up will grow tax-deferred; and (b) death benefits paid to [redacted] will be nontaxable under I.R.C. §101.

The letter failed to provide information that would assist in determining whether the proposed policies constitute life insurance contracts and result in tax-exempt income. This information includes the following:

a. The extent of [redacted] control, if any, over the related investment accounts.

b. Facts showing that the policies will satisfy the seven-pay test and avoid being treated as a modified endowment contract under I.R.C. §7702A subject to income recognition under I.R.C. §72.

c. Facts relevant as to whether the policies constitute variable contracts that satisfy the diversification requirements of I.R.C. §817(h).

[redacted] did not provide copies of any material documents, including proposed policies, riders, endorsements, private placement memoranda, or any other relevant documents.

The letter did not specifically request that the Service determine that the policies will satisfy the requirements for life insurance contracts under I.R.C. §7702. By assuming the satisfaction of such requirements, [redacted] limited the requested determination to its ability to defer recognition of the policies' cash value build-up and exclude death benefits from income under I.R.C. §101.

[redacted] supported its conclusion with three general principles related to taxation of life insurance contracts. The first asserted principle was that recognition of income from a life insurance contract under I.R.C. §7702(a) for any taxable year is deferred. The second was that the policy beneficiary receives benefits payable by reason of an insured's death free from income tax. I.R.C. §101. The third was that the status of an insurance contract under I.R.C. §7702 is determined by (i) the definition of a life insurance contract under applicable state law; and (b) satisfaction of either (i) the cash value accumulation test or (ii) the test consisting of the guideline premium requirements and the cash value corridor. I.R.C. §7702(a), §7702(b), §7702(c), and §7702(d).

Although [redacted] limits the requested determination to issues outside of I.R.C. §7702, [redacted] supported its request with general legislative history of the tests involving (a) cash value accumulation and (b) guideline premium and cash value corridor. JCS-41-84, General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984 (H.R. 4170, 98th Congress) (December 31, 1984); P.L. 98-369 (December 31, 1984). However, [redacted] admitted that it lacked information, such as premium amounts and mortality charges, to provide details as to how the proposed policies would meet the requirements of the tests.

Despite the lack of relevant information, [redacted] represented that the policies would comply with (a) the cash value accumulation test and (b) the test consisting of guideline premium and cash value corridor.

In lieu of providing pertinent contrary law precluding income deferral and nonrecognition, [redacted] cites authority disallowing deductions for interest expenses and administrative fees associated with leveraged corporate-owned life insurance (COLI). Winn-Dixie Stores, Inc. v. Commissioner, 113 T.C. No. 21 (1999); Priv. Ltr. Rul. 98-12-005 (Jan. 22, 1998); Priv. Ltr. Rul. 99-01-005 (Sept. 29, 1998). Under such authority, [redacted] asserts that it will not engage in any borrowing activities that would make the Tax Court's opinion in Winn-Dixie Stores, Inc. applicable to the proposed policies.

Neither the federal courts nor the Service's National Office have spoken on the issues involved in [redacted] request in the context of variable universal life insurance policies on the lives of a taxpayer's employees. Chief Counsel's COLI specialists and the Service's Corporate Tax Shelter and COLI Issue Specialists have advised us that they believe that the proposed policies constitute a new insurance product involving complicated, undeveloped facts for which the Service has not developed a position. In addition, Chief Counsel's COLI Specialists are particularly concerned about issues involving investor control and compliance with I.R.C. §817(h) and §7702; Christofferson v. United States, 729 F.2d 513 (8th Cir. 1985), cert. denied., 473 U.S. 905 (1985); Rev. Rul. 77-85, 1977-1 C.B. 12; Rev. Rul. 80-274, 1980-2 C.B. 27; Rev. Rul. 81-225, 1981-2 C.B. 12, clarified by, Rev. Rul. 82-55, 1982-1 C.B. 12; Rev. Proc. 99-44, 199-48 I.R.B. 598.

Legal Discussion

Section 2.03 of Revenue Procedure 2000-1 defines a determination letter as

> ... a written statement ... that applies the principles and precedents previously announced by the Service's National Office to a specific set of facts. It is issued only when a determination can be made based on clearly established rules in the statute, a tax treaty, or the regulations, or a conclusion in a revenue ruling, opinion, or court decision published in the Internal Revenue Bulletin that specifically answers the questions presented.

Rev. Proc. 2000-1, 2000-1 I.R.B. at 4, 11, 19.

When the facts and circumstances of a specific case reflect that a letter is not appropriate or in the interest of sound tax administration, a determination letter is not issued unless the taxpayer demonstrates unique and compelling reasons that justify issuance. Rev. Proc. 2000-1, 2000-1 I.R.B. at 21.

Relevant Contents of Request

A request for a determination letter must include true copies of all pertinent documents. Rev. Proc. 2000-1, 2000-1 I.R.B. at 22.

Application of Revenue Procedure 2000-1 to [redacted] Request

A determination letter cannot be issued to [redacted] on the requested matters for at least four reasons. First, in the context of variable universal life insurance policies purchased to fund employee benefits, there are no clearly established rules in any legal precedent that specifically answers the questions presented. Specifically, the Service's National Office has not issued any rulings or procedures that specifically apply to such policies. Rev. Proc. 2000-1, 2000-1 I.R.B. at 11, 19.

Second, issuance of the requested letter is inappropriate and not in the interest of sound tax administration. [redacted] seeks a determination letter on the ultimate issues relevant to the tax consequences of cash value build-up and death benefits of variable universal life insurance policies without providing sufficient facts necessary to answer all underlying factual and legal questions and specifically addressing the crucial issues of investor control and compliance with I.R.C. §7702. However, the Service is particularly concerned about investor control and compliance with I.R.C. §7702 and has not spoken on the underlying

issues relevant to the tax consequences of variable universal life insurance policies. [redacted] also has not provided any compelling reason to issue the requested letter. In light of these circumstances, it would be particularly inappropriate for the Service to issue a determination letter on the ultimate issues.

Third, because the transaction involves a future transaction, the Service cannot determine whether the policies will possess economic substance. Issuance of a letter may preclude the Service from challenging the substance of the policies at a later date.

Fourth, [redacted] request omits documents required by Revenue Procedure 2000-1. These documents include proposed [redacted] policies and written approvals of state insurance officials.

Conclusion and Recommended Action

The Service lacks authority to issue the requested determination letter. The issues related to the tax consequences of the proposed policies are more appropriately addressed in a private letter ruling (PLR) preceded by a presubmission conference. Rev. Rul. 2000-1 (Section 11. 07), 2000-1 I.R.B. at 44 - 45.

Consequently, we recommend that the LMSB advise [redacted] in writing of the following:

a. The Service lacks authority to issue the requested determination letter.

b. The issues related to the proposed policies are more appropriately addressed in a PLR preceded by a presubmission conference.

c. [redacted] should request a presubmission conference followed by a PLR. If [redacted] wishes to make its request for a presubmission conference by telephone, [redacted] may contact the Office of the Action Associate Chief Counsel (Financial Institutions and Products) at 202/622-3900.

Because no further action is required by this office at this time, we are closing our file.

Attached is [redacted] original request for a determination letter (consisting of original and deleted copy).

If you have any questions, please contact me at 404/338-7943.

CAROLYN L. ROUNTREE
Special Litigation Assistant

Attachment:
As stated above

cc: TL Cats

cc: Mr. Roy Allison
Assistant Regional Counsel (TL)
Room 2110, Stop 180-R