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Note from the Editor

Welcome readers to this special supplement of *TAXING TIMES*. In this issue we present information on the five revenue procedures released by the Internal Revenue Service on June 30, 2008 dealing with contract corrections. The issue begins with an article offering an historic perspective on contract corrections and then presents a separate detailed article for each of the five revenue procedures. In addition, the supplement includes brief write-ups on the history of the use of tax rates in sections 7702 and 7702A closing agreements and a discussion of the earnings rates used under two of the new revenue procedures. We hope this information provides useful insights into these important revenue procedures.

Enjoy!
Brian G. King

The Road to the Remediation Revolution: A Short History of the Correction Procedures for Life Insurance and Annuity Contracts

by John T. Adney, Walter C. Welsh and Alison L. Reynolds

I. Release of the New Correction Procedures

On June 30, 2008, after a year of intensive effort following on more than a decade of incremental development, the Internal Revenue Service (the "Service") and the Department of the Treasury (the "Treasury") released five revenue procedures comprehensively addressing the correction of failures to comply with four provisions of the Internal Revenue Code: sections 101(f), 7702, 7702A, and 817(h).[1] Previously, in Notice 2007-15,[2] the Service and the Treasury requested comments on improvements that life insurers and others thought should be made to the procedures to correct the following: life insurance contracts that failed to satisfy the requirements of section 101(f) or 7702 (as applicable); contracts that inadvertently failed the "7-pay test" of section 7702A(b) and thus became modified endowment contracts ("MECs"); and failures to diversify variable separate account investments as required by section 817(h). In response to extensive comments submitted by the life insurance community, and in an effort to streamline tax administration and compliance, the government agencies completed new procedures—within the timeframe projected—and published the procedures in the Internal Revenue Bulletin last July.[3]

- Revenue Procedure 2008-38, elaborating on the "Alternative C" correction procedure under Revenue Ruling 2005-6 for errors relating to qualified additional benefits as defined in section 7702(f)(5) ("QABs").
- Revenue Procedure 2008-39, revising the correction procedure for inadvertent MECs.

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- Revenue Procedure 2008-40, addressing closing agreements for contracts failing to comply with section 101(f) or 7702.
- Revenue Procedure 2008-41, revising the closing agreement procedure for section 817(h) diversification failures.
- Revenue Procedure 2008-42, providing an automatic procedure for obtaining a waiver of clerical-type errors under section 101(f)(3)(H) or 7702(f)(8), as applicable.

These new revenue procedures represent a virtual revolution in the government's approach to the correction of contract and separate account errors, emphasizing simplification, cost reduction, and more generally, the enabling of compliance with complex tax rules. The new procedures also entail a shifting of audit-type responsibility from the Service's National Office to its field auditors; in most cases, this would be the Large and Mid-Size Business Division (LMSB) of the Service. Overall, in consequence of a useful collaboration between government and industry, the new procedures set forth a plan for tax compliance that is fair, equitable and beneficial to all parties.

In what follows, we provide a short history of the correction procedures previously developed to address compliance failures and the shortcomings of those procedures, laying the foundation for this sea change in the correction process. We end with a roadmap to the remaining articles in this special supplement of *TAXING TIMES*, which describe and provide commentary on the five new revenue procedures in detail.

II. History of the Correction Process

A. Enactment of Definitions and Waivers for Reasonable Errors

In 1982, in enacting section 101(f) as part of the Tax Equity and Fiscal Responsibility Act ("TEFRA"),[4] Congress established the first statutory definition of a life insurance contract for federal tax purposes. This definition limited the investment orientation of flexible premium life insurance contracts by requiring them to meet one of two actuarially based tests—a "guideline premium limitation" (coupled with a required risk corridor) or a "cash value" test—as a prerequisite to obtaining the tax-free death benefit accorded to life insurance contracts under section 101(a)(1). In the course of enacting section 101(f), Congress recognized that life insurance companies could well encounter trouble applying those tests, and so it included a rule, in section 101(f)(3)(H), permitting the Service to waive compliance errors if they were "reasonable" and if reasonable steps were being taken to remedy the errors. Also, with respect to the guideline premium limitation, section 101(f)(3)(A) provided that premiums paid in excess of the limitation that were returned to the policyholder with interest within 60 days of the end of the contract year would not be counted against the limitation (the "60-day rule"). Significantly, the interest returned with the excess premiums would be includible in the policyholder's income, without regard to the rules of section 72(e) that normally govern the taxation of predeath distributions from life insurance contracts. In this manner, the excess inside buildup would be returned and income tax would be paid on it.

Following the enactment of section 101(f), which was intentionally a temporary measure, Congress decided to expand the definitional requirements to cover all new life insurance contracts. Thus, in passing the Deficit Reduction Act of 1984 ("DEFRA"),[5] Congress added a new section to the Code, section 7702, which contained a definition of "life insurance contract" applicable to new contracts for all purposes of the Internal Revenue Code. The two tests of the temporary provision were carried forward into the new section, albeit with significant modifications. Further, in the case of a contract that did not satisfy either of the tests, the interest or earnings increments to the contract's cash value (the "inside buildup"), referred to as the "income on the contract," were expressly subjected to accrual taxation annually under the terms of new section 7702(g). At the same time, in section 7702(f)(8), Congress continued the policy of permitting the Service to waive reasonable errors that led to failures to satisfy the definition's requirements. Congress also continued the 60-day rule, permitting the retroactive correction of guideline premium test failures by distributions that returned the excess inside buildup as taxable amounts.

B. Diversification Requirements

As part of DEFRA, Congress also enacted section 817(h), effectively codifying the diversification tests for variable annuities and variable life insurance contracts set forth in private letter rulings issued in the early 1980s.[6] Prior to the issuance of these rulings, in the late 1970s and early 1980s[7] the Service issued rulings that held that the owner of a deferred variable annuity contract who was viewed as controlling the investments of the underlying separate account was to be taxed as if the owner held the separate account investments directly, essentially meaning that the contract's inside buildup would be taxable more or less on a current basis. In particular, Revenue Ruling 81-225 held that the owner of a deferred variable annuity contract based on a separate account or subaccount investing solely in the shares of a single mutual fund that were also available for purchase by the general public would be taxed as if those shares were owned by the contract owner. Section 817(h) required the investments of separate accounts supporting nonqualified variable life insurance and annuity contracts to be "adequately diversified," and authorized the issuance of regulations prescribing the specifics of the diversification to be required. According to section 817(h)(1), contracts based on a separate account not compliant with the diversification requirements are treated as noncompliant with section 7702 (in the case of life insurance) or section 72 (in the case of annuities), resulting in the current taxation of their inside buildup.

The regulations authorized under section 817(h), completed in 1989, provided for a correction procedure for separate accounts that failed to be adequately diversified.[8] The consequences of failing to meet the diversification requirements were unnecessarily harsh. When a separate account (or subaccount) did not meet any aspect of the requirements at the end of a quarterly period, contracts which offered that separate account as an investment option would not be treated as life insurance or annuity contracts at any time thereafter, even if the separate account returned to compliance in a subsequent period. For such contracts, according to the regulations, the "income on the contract" for any taxable year is treated as ordinary income of the contract owner under section 7702(g). The regulations, however, went on to provide relief from this income inclusion in the case of inadvertent failures to satisfy the diversification requirements. Specifically, the diversification failure could be remedied if the insurer (or a contract holder) demonstrated to the Service that the failure to diversify was inadvertent and if, within a reasonable time after discovery of the failure, the separate account investments were brought into compliance with the diversification requirements. Further, under the regulations as originally issued, the insurer (or holder) must agree to pay to the Service "an amount based upon the tax that would have been owed by the policyholders if they were treated as receiving the income on the contract" as defined in section 7702(g) (except for the income arising in periods prior to the beginning of the diversification failure).[9] This "toll charge," equating to tax on the inside buildup of the affected contracts during the period of nondiversification, was described as "making the government whole."

C. Modified Endowment Contracts

The next significant legislative enactment affecting life insurance policyholder taxation occurred in 1988. In the Technical and Miscellaneous Revenue Act ("TAMRA"),[10] Congress made more onerous the tax treatment of predeath distributions from a life insurance contract for which premiums were paid in, as it were, too rapidly. Under section 7702A as enacted by TAMRA, a contract meeting the requirements of section 7702 but failing the 7-pay test is considered to be a MEC,[11] with the result that distributions from the contract during the lifetime of the insured (including policy loans) are taxed on an income-first basis[12] and may be subject to a 10 percent penalty tax.[13] The 7-pay test provides, in essence, that the premiums paid for the contract during each of its first seven years cannot exceed the level annual amount necessary to fund the life insurance contract fully, disregarding expense charges. In other words, predeath distributions from a section 7702-compliant contract that is more investment-oriented than allowed by the 7-pay test are taxed under rules applicable to deferred annuities, not life insurance, although the death benefit paid from such a contract remains tax free under section 101(a)(1).

The 7-pay test came onto the life insurance scene rather abruptly, effective for contracts issued after June 20, 1988 even though TAMRA was not signed into law until the following November. At the time, life insurance companies were continuing to refine their contract administration systems to assure that proper section 7702 testing was being performed, and to comply with this new 7-pay test, companies

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needed to implement (quickly) still newer administration systems, applying the subtle complexities of section 7702A's premium limit even to the most traditional whole life contracts. As with section 7702(f)(1)(B), section 7702A(e)(1)(B) contained a 60-day rule, under which excess premiums returned with interest would not be counted under the 7-pay test, but the TAMRA statute made no provision for the waiver of reasonable errors.

D. Round One: Early Waivers and Closing Agreements

During the late 1980s, private letter rulings waiving errors under section 7702, of both a clerical and an interpretative nature, began to appear. Even so, there was little such activity, as life insurers were still contemplating the interpretation of sections 7702 and 7702A and developing administration systems to implement them fully, and in any event the guideline single premium rule of section 7702 (and section 101(f)) adequately covered the premiums paid for flexible premium contracts for the time being. In some instances, however, insurers requested waivers for compliance errors that, in the eyes of the Service, were not thought to be "reasonable." The fallback solution in such instances involved resort to a general provision in the Code, section 7121, which permitted the Service to enter into a so-called closing agreement, *i.e.*, "an agreement in writing with any person relating to the liability of such person … in respect of any internal revenue tax for any taxable period." When a section 7121 closing agreement was used to resolve errors under sections 101(f) and 7702, the life insurers that issued the "failed" contracts were required by the Service to pay a toll charge not unlike that described in the section 817(h) regulations, although in this case the toll charge would equate to a tax on all of the income on the contract (including income arising in years prior to the failure) accruing until the closing agreement was completed. In addition, whether a waiver was granted by the Service or a closing agreement was entered into, the contracts involved needed to be corrected in some fashion, such as by increasing death benefits or returning excess premiums to the policyholders who paid them. The problem that arose during this time period was that the Service began construing the waiver provisions quite narrowly, finding a good many errors voluntarily brought to the Service's attention to be unreasonable and thus not waivable. To correct the compliance failures in such cases, the Service required insurers to enter into closing agreements bearing toll charges that often were excessive in proportion to the errors committed.

In 1991, cognizant of the process being used to address section 7702 failures, and after a dialogue with certain life insurance industry representatives, the Service issued Revenue Ruling 91-17.[14] This revenue ruling described the income tax reporting and withholding obligations that the Service believed applicable to life insurers with in-force contracts that failed to comply with section 7702 or that were based on nondiversified separate accounts. It recited the penalties for failing such obligations, and observed that the penalties would not be applied if the failures were waived under section 7702(f)(8). The ruling publicly acknowledged the existence of the closing agreement process correcting fatal errors in contracts and offered a waiver of the reporting and withholding failure penalties for closing agreement submissions that were made prior to June 3, 1991, a date that allowed less than three months to prepare and make submissions. Under such a closing agreement, according to the ruling, the insurer must agree to pay to the Service an amount based on (i) the amount of tax that would have been owed by the policyholders if they were treated as receiving the income on the contracts, and (ii) deficiency interest with regard to such tax. This formula described the toll charge on which the Service insisted to "make the government whole."

After the issuance of Revenue Ruling 91-17, the Service saw an increase in waiver ruling requests and closing agreement offers, although the three-month window for submissions permitted by the ruling was quite short. Even for life insurers that already had identified section 101(f) or 7702 errors, the three-month window was a difficult challenge given the information required for such a submission. At that time, the government may not have understood the full nature of the tasks required to complete a submission. To be sure, however, the ruling and its aftermath—in which the Service applied strict but somewhat case-by-case standards in determining what errors were waivable, and required insurers in nonwaivable cases to enter into expensive closing agreements—did leave a lasting impression on the life insurance industry. From that time forward, insurers tended to pay more attention to administering the Code's definitional requirements while scrutinizing with utmost care, and endeavoring to limit, the circumstances in which a submission to the Service under waiver or closing agreement procedures was considered necessary. The ruling did, however, introduce two concepts that helped pave the road to contract remediation. First, the ruling systematized the use of closing agreements to remedy compliance failures. While that step may not seem significant to insurers striving hard and incurring very substantial costs to achieve compliance, it was a significant step in tax administration, for it allowed insurers to stand in the shoes of their policyholders to resolve what were, in the eyes of the law, the tax liabilities of the latter. (And at times those were expensive shoes to wear.) Second, the ruling made use of the carrot along with the stick: the Service's offer of a blanket (albeit time-limited) waiver of penalties.

Approximately one year later, the Service released more guidance regarding remediation closing agreements, this time relating to section 817(h) failures. Revenue Procedure 92-25[15] laid out the process by which an insurer could request relief for a diversification failure as outlined in the section 817(h) regulations. Repeating the requirements for relief contained in the regulations, the revenue procedure said that the failure must have been inadvertent and the separate account must be (or have been) brought into compliance with the diversification standards within a reasonable time after discovery of the failure. Further, according to the revenue procedure, the insurer requesting relief must pay a toll charge based on the income on the failed contracts (failed, that is, due to the diversification error), the calculation of which generally follows the rules of section 7702(g). Significantly, Revenue Procedure 92-25 exposed to public view the first model closing agreement available for contract remediation proceedings.

E. Round Two: MEC Closing Agreements and Two Special Notices

As noted above, the rules of section 7702A sprang to life rather suddenly, in the summer of 1988, bringing with them substantial challenges to life insurers' contract administration capabilities. These new rules turned out to be dauntingly complex, introducing the net annual (7-pay) premium concept intended to limit gross modal premiums and benefit reduction and material change rules intended to support the 7-pay limit. Material changes were broadly defined, and when they occurred they started new contract years, requiring administration systems to keep track of a new set of annual start and end dates while maintaining the old ones for section 7702 and other purposes. At the same time, the universe of material changes was circumscribed by application of a "necessary premium" concept, which introduced yet another, albeit subtle, form of premium limitation. Not surprisingly, as life insurers came to grips with the new statute, they found that in a significant and growing number of cases a variety of errors—programming errors, administration errors and plain old human errors—inadvertently caused life insurance

contracts to become MECs. Unfortunately, insurers were limited in their recourse, for section 7702A made no provision for waivers of reasonable errors, and while it contained a 60-day rule, the compliance problems were detected by insurers, often long after the 60-day period had expired.

In or about 1995, taking account of the growing population of inadvertent MECs as well as the difficulties insurers were encountering in administering the requirements of sections 101(f), 7702, and 817(h), life insurance industry representatives met with senior Treasury and Service officials to request the establishment of a broad-ranging program for the correction of errors involving life insurance and annuity contracts. The industry's request built on the correction programs announced in Revenue Ruling 91-17 and Revenue Procedure 92-25, analogized to similar programs in place in connection with qualified retirement plans, and drew on the concept at the base of the long-standing 60-day rule, *i.e.*, that the government was sufficiently "made whole" through the payment of tax on the interest associated with excess premiums. In this regard, the industry specifically asked that the toll charge required for the remediation of failures be re-examined, for in many cases it was excessive by all counts and it may not have encouraged compliance. By 1997, the Service had in hand several offers for closing agreements relating to section 7702A, and general agreement had been reached between the government and the industry that the MEC problems should be addressed first, as it was thought that those problems were both compelling—no

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correction procedure existed, unlike the case with section 7702 or section 817(h)—and perhaps more readily capable of being addressed, since administrative precedent was lacking.

If there was a sense that the problem of inadvertent MECs could be dispatched expeditiously and rather easily, that sense was soon dispelled. The Treasury and the Service devoted significant time to the matter, with their work culminating in the issuance of Revenue Procedure 99-27.[16] This revenue procedure enabled insurers, as requested, to correct inadvertent "nonegregious" failures to comply with section 7702A. Further, both the toll charge and the corrective actions that the procedure required for closing agreements were generally thought to be reasonable. The toll charge amounted to the sum of (1) tax at prescribed rates on unreported distributions (whether received or deemed received as in the case of loans) from inadvertent MECs, (2) deficiency interest on such tax amounts, and (3) a tax on the earnings (at imputed rates) on premiums paid in excess of the 7-pay limit. And the required corrective action followed what was by then customary under section 7702 closing agreements, *i.e.*, return of the excess premium payments and earnings thereon to policyholders or increases in the death benefits, as applicable in the 7-pay test context. In this manner, the revenue procedure enabled the remediation of inadvertent MECs with an appropriate level of toll charge.

Unfortunately, and despite the foregoing, Revenue Procedure 99-27 was not received by the life insurance industry with equanimity. This was due to limitations placed on the relief that the revenue procedure would provide and on when that relief would be available, and also to what were perceived as the procedure's unduly burdensome information-gathering requirements. By way of example, the revenue procedure did not apply to corporate owned life insurance ("COLI") contracts, and the procedure was made unavailable, through certain mechanical rules, with respect to contracts that were said to be designed or marketed as heavily investment-oriented contracts. Unfortunately, the mechanical rules often rendered relief unavailable to rather ordinary looking contracts innocently swept into the MEC net, and the anti-COLI rule did not seem to make sense. Additionally, the revenue procedure limited the time that the correction process was available: it applied only to requests received by the Service on or before May 31, 2001, and generally insurers had but one opportunity to submit contracts for correction under the revenue procedure.

Despite the dissatisfaction with the provisions of Revenue Procedure 99-27, life insurers proceeded to make the filings that the procedure permitted—and the Service found itself inundated with closing agreement offers and with the voluminous paper stacks required to accompany them. After the May 2001 due date of the one-time correction offer, the Service issued Revenue Procedure 2001-42.[17] The new revenue procedure formally superceded but largely repeated the provisions of Revenue Procedure 99-27, while also eliminating both the time limit for seeking a closing agreement and the restrictions on the types of life insurance contracts and related categories of error that could be covered by the closing agreement. Thus, the new revenue procedure effectively established a permanent process for the correction of inadvertent MECs, and it enabled the correction of inadvertent MECs that were COLI contracts or that had funding levels above the limits provided in its predecessor. Although the new revenue procedure continued to require voluminous information, many viewed its arrival as a positive step.

Around the same time that Revenue Procedure 99-27 was issued, the Service also released Notice 99-48.[18] This notice announced that the Service would continue to enter into closing agreements to correct errors under section 7702, and that it would continue the practice of waiving penalties that had been observed with closing agreements under Revenue Ruling 91-17. In addition, the notice introduced for section 7702 closing agreements the use of the same tax rate structure that was employed in Revenue Procedure 99-27. This was a three-tiered rate structure based on, for a given contract undergoing the correction process, the amount of the death benefit under that contract as of any date within 120 days of the submission of the closing agreement offer, or as of the last day the contract was in force.

Also in the late 1990s, the Service and the Treasury became aware that certain variable annuity contract fund managers were mistakenly using an alternative diversification standard provided under the section 817(h) regulations. Under that alternative, separate accounts or their underlying funds supporting life insurance contracts—but not annuity contracts—could invest in Treasury securities without regard to the diversification requirements generally imposed under the regulations,[19] and the actions of the fund managers in contravention of those general requirements resulted in diversification failures. While closing agreements under Revenue Procedure 92-25 were available to the affected life insurers in order to correct the failures, the insurers demonstrated to the Service and the Treasury that highly excessive toll charges would be assessed for such closing agreements. Hence, to allow this situation to be rectified in an equitable manner, the Service issued Notice 2000-9,[20] both to remind insurers and fund managers of the scope of the alternative diversification standard and to provide, for a limited time, a process to remedy the diversification failures utilizing Revenue Procedure 92-25 closing agreements with reduced tax rates. In this fashion, by means of special relief provided under the notice, the exaction of penalties disproportionate to the "offense" was avoided.

F. Round Three: Closing Agreements with Special Relief

Beginning in 2001, the Service received requests for waivers of section 7702 failures from life insurers that mistakenly had reflected in their guideline premium calculations charges for QABs using the mortality charge rule of section 7702(c)(3)(B)(i) instead of the expense charge rule of section 7702(c)(3)(B)(ii). The Service, which agreed that the expense charge rule should have been used in the calculations, issued the waivers as requested, but this turned out not to address the full scope of the compliance problem presented by the mistaken (but reasonable) interpretation. That interpretation was imbedded in a number of older, "legacy" computer-based administration systems that tested large blocks of contracts for compliance with section 7702 and 7702A, and it would have been prohibitively expensive for insurers to adapt those systems to what the Service considered the proper interpretation of the statutes. To deal with this conundrum, a group of insurers with legacy systems approached the Service and the Treasury to make a special request: publish guidance on the QAB issue and provide a mechanism for achieving compliance without undue cost. In response, the Service issued Revenue Ruling 2005-6,[21] holding that QAB charges should be taken into account under the expense charge rule of section 7702(c)(3)(B)(ii) for purposes of the sections 7702 and 7702A calculations. In connection with this guidance, the Service provided three alternative courses of action for insurers with tax compliance systems that did not account for QAB charges using the expense charge rule. "Alternative A" stated that if the insurer's compliance system did not properly account for the charges, but no contracts failed to satisfy the statutory requirements, the insurer could correct its system without the need to contact the Service. This may have stated the obvious, but in this complex area of the law, the obvious sometimes bears repeating. "Alternative B" under the ruling gave insurers a limited amount of time—a one-year period ending on February 7, 2006—to request a closing agreement under which the insurer was required to bring neither its contracts nor its administration system into compliance with the holding of the revenue ruling. In the case of the legacy systems, this made particular sense, for without incurring the excessive cost of modifying the systems, the contracts that were out of compliance with section 7702 or 7702A could not even be determined, much less corrected. In return for its agreement with this novel approach, the Service required the payment of a toll charge, but the toll charge rates provided under the ruling proved to be appropriate because they were based on the number of contracts involved in the corrective action rather than the income on the contracts, and the toll charge was capped at $50,000 per insurer seeking relief. The ruling's "Alternative C" was similar to its Alternative B, including the use of the special toll charge rates, but with the important exception that the insurer was required to correct its failed contracts and the flaw in its administration system.

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G. The Final Round: Notice 2007-15 and the New Procedures

If Revenue Ruling 91-17 began the long march toward an improved approach to contract remediation by systematizing the use of closing agreements and waiving insurer-level penalties for reporting and withholding failures, and if Revenue Procedures 99-27 and 2001-42 laid the foundation for a fairer approach to toll charges by applying the tax policy underlying the 60-day rule (*i.e.*, taxing the earnings on the excess premiums), the issuance of Revenue Ruling 2005-6 amounted to the breakthrough event, ushering in a new era for contract corrections. Following the issuance of Revenue Ruling 2005-6, many in the life insurance industry, along with a number of government officials, both recognized the need and perceived the opportunity to undertake fundamental revisions in the contract correction procedures then in place.

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This time, the focus of the reform effort was two-fold—rendering the toll charges for closing agreements more commensurate with the damage to the tax revenues arising from acts of noncompliance (as some said it, "making the punishment fit the crime"), and streamlining the correction process from the government's standpoint as well as that of taxpayers. As to the former, evidence mounted that toll charges based on the section 7702(g) income on the contract at times bordered on the ridiculous, such as when excess premium amounts residing in contracts for only a few days, thereby giving rise to excess inside buildup in relatively small amounts, led to closing agreements costing insurers millions of dollars. Some noted that the government's confiscation of the excess premiums, *i.e.*, exacting a penalty of 100 percent of the excess premiums, would be less punitive than the toll charges sometimes required under the existing closing agreement process. As to the latter, the valuable time of staffs of lawyers in the Service's Office of Chief Counsel was taken up with determining whether simple clerical mistakes constituted "reasonable errors" waivable under section 7702(f)(8). Insurers seeking such waivers were required to engage in the near equivalent of archeological digs for information about decisions made and actions taken long ago (often by former employees). Those in the industry seeking to use the correction mechanism for inadvertent MECs, like those in the government charged with processing the MEC correction requests, were burdened with paperwork mandates that no one could justify. Bringing efficiency to the remediation process, along with greater fairness, was high atop the lists of all involved.

Bringing efficiency to the remediation process, along with greater fairness, was high atop the lists of all involved.

To this end, the government took two actions in 2007. First, the Service issued Revenue Procedure 2007-19.[22] In this procedure, the Service observed that it had become aware of a number of changes that could be made to Revenue Procedure 2001-42 to make it easier for insurers to use that process in correcting inadvertent MECs. The new revenue procedure thus implemented changes to (1) specify new indices on which the imputed earnings rates were based, (2) alter the address to which toll charge payments under Revenue Procedure 2001-42 needed to be sent, and (3) permit insurers to submit exhibits in an electronic format (*e.g.*, on CD-ROM) in connection with their closing agreement offers.

At the same time, the Treasury and the Service released Notice 2007-15. This landmark notice requested public input on a variety of issues that the notice identified, mostly relating to procedures for obtaining closing agreements to correct inadvertent failures of life insurance or annuity contracts to satisfy section 817(h), 7702, or 7702A, as applicable. Also released, in draft form, were four model closing agreements on which the public was invited to comment. In response, the government received several sets of detailed comment letters—from the American Council of Life Insurers (the "ACLI"), from MassMutual, and from Davis & Harman LLP on behalf of the firm, the Committee of Annuity Insurers, and a life insurance company client of the firm—providing information and suggestions that ultimately helped to shape the new correction procedures. Following the receipt and review of the formal comment letters, the Treasury and the Service engaged in intensive discussions with the industry representatives offering comments and internally within the agencies.

On May 6, 2008, draft copies of the five new revenue procedures were posted on the Web site of the Office of Management and Budget ("OMB").[23] Shortly thereafter, following discussions during a meeting of the Section of Taxation of the American Bar Association in which representatives of the Treasury and the Service participated, the ACLI and other industry representatives submitted informal comments intended to refine the draft revenue procedures. A few weeks later, on June 30, 2008, the Service released the five revenue procedures, including the model closing agreements, in final form. In short, under Notice 2007-15, a process was followed that should serve as a model for securing suggestions and vetting changes intended to improve tax compliance and administration. Not surprisingly, this model process produced results of legal excellence, equity, and fairness.

III. A Roadmap to the Ensuing Articles

Inside this issue of *TAXING TIMES* are articles which describe in more detail, and provide useful commentary on, the five new revenue procedures. The subject and author(s) of each of these articles are, in order:

(1) Revenue Procedure 2008-38, providing the procedure for Alternative C closing agreements under Revenue Ruling 2005-6—article authored by Daniela Stoia and Craig R. Springfield.

(2) Revenue Procedure 2008-39, providing a revised procedure to remedy inadvertent MECs—article authored by Daniela Stoia and Craig R. Springfield.

(3) Revenue Procedure 2008-40, providing a closing agreement procedure to correct life insurance contracts that fail to meet the requirements of section 101(f) or 7702, as applicable—article authored by Craig R. Springfield and Daniela Stoia.

(4) Revenue Procedure 2008-41, providing a procedure to correct the inadvertent failure of a variable contract separate account to satisfy the section 817(h) diversification requirements—article authored by Joseph F. McKeever, III and Bryan W. Keene.

(5) Revenue Procedure 2008-42, providing for automatic waivers of clerical-type errors under section 101(f)(3)(H) or 7702(f)(8), as applicable—article authored by Stephen P. Dicke.

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End Notes

[1] All references to "section" are to sections of the Internal Revenue Code of 1986 (the "Code"), as amended.
[2] 2007-1 C.B. 503.
[3] Rev. Proc. 2008-38, 2008-29 I.R.B. 139; Rev. Proc. 2008-39, 2008-29 I.R.B. 143; Rev. Proc. 2008-40, 2008-29 I.R.B. 151; Rev. Proc. 2008-41, 2008-29 I.R.B. 155; Rev. Proc. 2008-42, 2008-29 I.R.B. 160.
[4] Pub. L. No. 97-248.
[5] Pub. L. No. 98-369.
[6] *See, e.g.*, PLR 8403081 (October 20, 1983). A private letter ruling is issued to a particular taxpayer and can be relied upon only by that taxpayer. *See* section 6110(k)(3).
[7] Rev. Rul. 81-225, 1981-2 C.B. 12; Rev. Rul. 80-274, 1980-2 C.B. 27; Rev. Rul. 77-85, 1977-1 C.B. 12.
[8] T.D. 8242, 1989-1 C.B. 215.
[9] Treas. Reg. section 1.817-5(a)(2).
[10] Pub. L. No. 100-647.
[11] Section 7702A(b).
[12] Section 72(e)(10).
[13] Section 72(v).
[14] 1991-1 C.B. 190.
[15] 1992-1 C.B. 741.
[16] 1999-1 C.B. 1186.
[17] 2001-2 C.B. 212.
[18] 1999-2 C.B. 429.
[19] Treas. Reg. section 1.817-5(b)(3).
[20] 2000-1 C.B. 449.
[21] 2005-1 C.B. 471.
[22] 2007-1 C.B. 515.
[23] Pursuant to the Paperwork Reduction Act, guidance released by the Service generally undergoes an approval process at OMB. In some cases, draft copies of guidance can be obtained through the Web site managed by OMB.