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End Notes

1 In the case of the GPT, there is a limited ability to return premiums that exceed the guideline premium limitation with interest within 60 days of the end of a contract year, so that such excess premiums are disregarded. Also, if a contract is intended to comply with the CVAT but does not, it may inadvertently comply with the GPT; the converse generally would not be the case because the CVAT must be satisfied at all times by the terms of the contract.

2 *See* Rev. Rul. 91-17, 1991-1 C.B. 190, wherein the Service discussed various obligations that arise with respect to failed life insurance contracts.

3 *See* sections 101(f)(3)(H) and 7702(f)(8).

4 As noted above, the section 7702(g) income on the contract for all years prior to the year of failure is deemed received by a contract holder in the year of failure. *See* section 7702(g)(1)(C). The Service's closing agreement procedures for correcting failures under sections 101(f) and 7702, both past and present, do not permit reflection of statute of limitations defenses.

5 *See also* Rev. Proc. 2008-38, 2008-29 I.R.B. 139, addressing contracts that fail to comply with section 7702 due to failures to account properly for charges for qualified additional benefits.

6 Rev. Proc. 2008-40 section 3.

7 Section 4.03(5)(c) of Rev. Proc. 2008-40 sets forth a definition of "excess premiums" that looks to the highest amount by which premiums paid exceeded the guideline premium limitation at any time under a contract. This definition, however, appears to be applicable only for purposes of the 100 percent of the Error Toll Charge calculation (which is discussed on page 29 of this issue) and not for purposes of the calculation of excess earnings.

8 *See* Brian G. King, *Earnings Rates under Rev. Procs. 2008-39 and 2008-40, TAXING TIMES SUPPLEMENT*, February 2009, p. 32.

9 *See* Brian G. King, *History of the Use of Tax Rates in Sections 7702 and 7702A Closing Agreements, TAXING TIMES SUPPLEMENT*, February 2009, p. 24.

10 If all rights under a contract have vested with the beneficiary of the death benefit, it would seem appropriate to treat such person as the contract holder for this purpose.

Earnings Rates Under Rev. Procs. 2008-39 and 2008-40

by Brian G. King

Rev. Procs. 2008-39 and 2008-40 both provide for alternative toll charge calculations that are based in whole or in part on the "earnings" that accrue on amounts in excess of the respective premium limitation. As was the case under Rev. Procs. 99-27[1] and 2001-42,[2] Rev. Proc. 2008-39 continues to provide a toll charge calculation based on "overage earnings" (*i.e.*, the earnings that accrue on a contract's "overage") while Rev. Proc. 2008-40 provides a new toll charge alternative based on "excess earnings" (*i.e.*, the earnings that accrue on "excess premiums").

While both revenue procedures define "earnings" using different terminology (overage earnings vs. excess earnings), both are determined based on the same set of earnings rates. In defining the earnings that underlie the development of the toll charge, the revenue procedures do not look to the actual earnings accruing inside the life insurance contract, but instead base the earnings calculation on proxy earnings rates. These earnings rates are defined in section 3.07 of Rev. Proc. 2008-39 and vary based on whether the contract qualifies as a variable contract under section 817(d) and apply on a contract year basis according to the calendar year in which the contract year begins.

Methodology for Computing Earnings Rates: For contract years beginning in calendar years 1988 through 2007, the earnings rates are specified in section 3.07(2)(a) and (3)(a) of Rev. Proc. 2008-39. Section 3.07(2)(b) and (3)(b) of Rev. Proc. 2008-39 provides the formulas to be used to determine the earnings rates for contract years after 2007.[3] The **general account total return** rate defines the earnings rate applicable to contracts other than variable life insurance contracts, while the **variable contract earnings rate** defines the rates applicable to variable life insurance contracts.

The general account total return equals:

(i) 50 percent of the Moody's Seasoned Corporate Aaa Bond Yield,[4] frequency annual, or any successor thereto; plus

TABLE 1: EARNINGS RATES TO BE USED TO CALCULATE EITHER "EXCESS EARNINGS" OR "OVERAGE EARNINGS"			
YEAR	CONTRACTS OTHER THAN VARIABLE CONTRACTS	VARIABLE CONTRACTS	SOURCE
1982	15.0%	21.8%	Application of Rev. Proc. 2008-39 Section 3.07 Formulas
1983	12.8%	16.4%	Application of Rev. Proc. 2008-39 Section 3.07 Formulas
1984	13.5%	7.0%	Application of Rev. Proc. 2008-39 Section 3.07 Formulas
1985	12.0%	26.1%	Application of Rev. Proc. 2008-39 Section 3.07 Formulas
1986	9.7%	15.0%	Application of Rev. Proc. 2008-39 Section 3.07 Formulas
1987	10.0%	2.7%	Application of Rev. Proc. 2008-39 Section 3.07 Formulas
1988	10.2%	13.5%	Rev. Proc. 2008-39
1989	9.7%	17.4%	Rev. Proc. 2008-39
1990	9.8%	1.4%	Rev. Proc. 2008-39
1991	9.2%	25.4%	Rev. Proc. 2008-39
1992	8.6%	5.9%	Rev. Proc. 2008-39
1993	7.5%	13.9%	Rev. Proc. 2008-39
1994	8.3%	-1.0%	Rev. Proc. 2008-39
1995	7.8%	23.0%	Rev. Proc. 2008-39
1996	7.7%	14.3%	Rev. Proc. 2008-39
1997	7.6%	17.8%	Rev. Proc. 2008-39
1998	6.9%	19.7%	Rev. Proc. 2008-39
1999	7.4%	12.8%	Rev. Proc. 2008-39
2000	8.0%	-5.5%	Rev. Proc. 2008-39
2001	7.5%	-7.1%	Rev. Proc. 2008-39
2002	7.2%	-14.1%	Rev. Proc. 2008-39
2003	6.2%	19.6%	Rev. Proc. 2008-39
2004	6.1%	6.9%	Rev. Proc. 2008-39
2005	5.6%	2.1%	Rev. Proc. 2008-39
2006	6.0%	10.0%	Rev. Proc. 2008-39
2007	6.0%	3.6%	Rev. Proc. 2008-39
2008	5.9%	5.2%	Average of Prior Three Years

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(ii) 50 percent of the Moody's Seasoned Corporate Baa Bond Yield, frequency annual, or any successor thereto.

The **variable contract earnings rate** is equal to the sum of:

(i) 10 percent of the **general account total return**, and

(ii) 90 percent of the **separate account total return** for the calendar year in which the contract year begins.

Separate account total return. The separate account total return equals:

(a) 75 percent of the **equity fund total return**, plus

(b) 25 percent of the **bond fund total return**, less

(c) 1.1 percentage point.

Equity fund total return. The equity fund total return equals:

(a) the calendar year percentage return[5] represented by the end-of-year values of the Standard and Poor's (S&P) 500 Total Return Index, with daily dividend reinvestment, or any successor thereto, less

(b) 1.5 percentage point.

Bond fund total return. The bond fund total return equals:

(a) the calendar year percentage return represented by the end-of-year values of the Merrill Lynch U.S. Corporate Master Index (C0A0)[6], or any successor thereto, less

(b) 1.0 percentage point.

Incomplete calendar year: In order to compute the earnings rate for calendar year 2008 and later, the calendar year-end values for the various indices must be available. If the general account total return or the separate account total return for a calendar year cannot be determined because the calendar year in which the contract year begins has not ended, the earnings rate for the contract year (or portion thereof) is determined by taking the average of the rates (general account total return or variable contract earnings rates) for the prior three years. For example, the general account total return for 2008 (assuming the year-end indices are not available) would be based on the average of the general account total return rates for 2005, 2006, and 2007 ((5.6% + 6.0% + 6.0%) / 3 = 5.8666% or 5.9%).

Table 1 on page 33 contains the earnings rates for years 1982 to 2008. The earnings rates for years 1982 through 1987 are based on the application of the formulas contained in section 3.07(2)(b) and (3)(b) of Rev. Proc. 2008-39. The rates for 1988 through 2007 are provided in Rev. Proc. 2008-39, while the earnings rates for 2008 are based on the arithmetic average of the earnings rates for 2005, 2006 and 2007.

It is important to note that the 2008 rates will change once the published indices are available. At that point, the 2009 rates will be based on the arithmetic average of the 2006, 2007 and 2008 rates until the 2009 indices are available.

End Notes

1 1999-1 C.B. 1186, *superseded by* Rev. Proc. 2001-42.

2 2001-2 C.B. 212, *modified and amplified by* Rev. Proc. 2007-19, 2007-7 I.R.B. 515.

3 Section 3.07(2)(a) and (3)(a) of Rev. Proc. 2008-39 only provides earnings rates back to 1988 because section 7702A was enacted in that year. However, sections 101(f) and 7702 were enacted earlier, and, as a result, earnings rates prior to 1988 will be needed to calculate excess earnings for contracts failing to comply with those sections prior to 1988. In this regard, section 4.03(5)(b)(ii) of Rev. Proc. 2008-40 provides that the applicable earnings rate for contract years beginning prior to 1988 is determined using the formulas set forth in section 3.07 of Rev. Proc. 2008-39 for contract years after 2007.

4 Moody's Seasoned Corporate Aaa and Baa Bond Yields are publicly available at *www.federalreserve.gov*.

5 The calendar year percentage return is calculated by:

(a) dividing the end-of-year value of the index for the calendar year by the end-of-year value of the index for the immediately preceding calendar year, and

(b) subtracting 1 from the result.

6 The Merrill Lynch U.S. Corporate Master Index (C0A0) is publicly available at *www.mlindex.ml.com*.

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