Part III. Administrative, Procedural, and Miscellaneous

Limitations on Passive Activity Losses and Credits—Treatment of Self-Charged Items of Income and Expense

Notice 2001–47

On April 5, 1991, the Treasury Department and the Internal Revenue Service published in the Federal Register a notice of proposed rulemaking (PS–39–89, 1991–1 C.B. 983 [56 Fed. Reg. 14034]) relating to the treatment of self-charged items of income and expense for purposes of applying the limitations on passive activity losses and passive activity credits under § 469 of the Internal Revenue Code. The comment period for those regulations ended in 1991 and several comments were received.

Treasury and the Service intend to finalize regulations under § 1.469–7. Given the length of time since the regulations were proposed and the number of amendments that have been made to the statutory provisions since that time, Treasury and the Service believe that an additional comment period is appropriate. Consideration will be given to all comments previously submitted in response to the notice of proposed rulemaking published in 1991 as well as to any additional written comments on proposed regulations § 1.469–7 that are submitted timely to the Service in response to this notice.

Written (a signed original and eight (8) copies) or electronic comments must be received by November 5, 2001. Send written comments to: Internal Revenue Service, NT 2001–47, CC:PSI:3, P.O. Box 7604, Ben Franklin Station, Washington, DC. Comments may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to the courier's desk at 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically to *Notice.Comments@m1.irscounsel.treas.gov*. All submissions will be open to public inspection.

The principal author of this notice is Paul B. Myers of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice, contact Paul B. Myers or Danielle Grimm at (202) 622-3080 (not a toll-free call).

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26 CFR § 301.7121–1: Closing agreements.
(Also Part 1, section 7702A)

Rev. Proc. 2001–42

SECTION 1. PURPOSE

This revenue procedure provides the procedures by which an issuer may remedy an inadvertent non-egregious failure to comply with the modified endowment contract rules under § 7702A of the Internal Revenue Code.

SECTION 2. BACKGROUND

.01 *Definition of a modified endowment contract ("MEC").*

(1) Section 7702A(a) provides that a life insurance contract is a MEC if the contract—

(a) is entered into on or after June 21, 1988, and fails to meet the "7-pay test" of § 7702A(b), or

(b) is received in exchange for a contract described in paragraph (a) of this section 2.01(1).

(2) A contract fails to meet the 7-pay test if the accumulated amount paid under the contract at any time during the first 7 contract years exceeds the sum of the net level premiums which would have to be paid on or before such time if the contract were to provide for paid-up "future benefits" (as defined in §§ 7702A(e)(3) and 7702(f)(4)) after the payment of 7 level annual premiums.

(3) Section 72(e)(11) provides that, for purposes of determining amounts includible in gross income, all MECs issued by the same company to the same contract holder during any calendar year are treated as one MEC.

.02 *Tax treatment of amounts received under a MEC.* Section 72(e)(10) provides that a MEC is subject to the rules of § 72(e)(2)(B), which tax non-annuity distributions on an income-out-first basis, and the rules of § 72(e)(4)(A) (as modified by §§ 72(e)(10)(A)(ii) and 72(e)(10)(B)), which generally deem loans and assignments or pledges of any portion of the value of a MEC to be non-annuity distributions. Moreover, under § 72(v), the portion of any annuity or non-annuity distribution received under a MEC that is includible in gross income is subject to a 10% additional tax unless the distribution is made on or after the date on which the taxpayer attains age 59 1/2, is attributable to the taxpayer's becoming disabled (within the meaning of § 72(m)(7)), or is part of a series of substantially equal periodic payments (not less frequently than annually) made for the life (or life expectancy) of the taxpayer or the joint lives (or joint life expectancies) of such taxpayer and the taxpayer's beneficiary.

.03 *Need for a correction mechanism.*

(1) The Internal Revenue Service ("Service") became aware of situations in which, as a result of inadvertent non-egregious failures to comply with the MEC rules, life insurance premiums had been collected which exceed the 7-pay limit provided by § 7702A(b). This could produce significant unforeseen tax consequences for the contract holders. To allow issuers to remedy such situations, Rev. Proc. 99–27, 1999–1 C.B. 1186, set forth the circumstances under which the Service would enter into closing agreements which would provide that contracts identified in the closing agreements would not be treated as MECs. Rev. Proc. 99–27 applied only to requests for relief that were received by the Service on or before May 31, 2001, generally permitted an issuer to make only one request for correction, and excluded certain contracts from the procedure's correction mechanism.

(2) Some issuers were unable to comply with the May 31, 2001, deadline in Rev. Proc. 99–27 or filed a timely submission for some contracts but desire to file supplemental submissions for additional contracts. Also, issuers desire to correct contracts that were not correctable under Rev. Proc. 99–27. To allow issuers to remedy such situations, the Service under the circumstances described below will enter into closing agreements which will provide that contracts identified in the closing agreements will not be treated as MECs.

SECTION 3. DEFINITIONS

The following definitions and rules apply solely for purposes of this revenue procedure.

.01 *Testing period.* The 7-year period described in § 7702A(b) or such additional period as may be required under § 7702A(c)(3) if a contract undergoes a material change.

.02 *Amount paid*. The amount paid under a contract in any "contract year" (as defined in § 7702A(e)(2)) equals the premiums paid for the contract during the year, reduced by amounts to which § 72(e) applies (determined without regard to § 72(e)(4)(A)) but not including amounts includible in gross income. For this purpose, premiums paid do not include—

(1) any portion of any premium paid during the contract year that is returned (with interest) to the contract holder within 60 days after the end of the contract year in order to comply with the 7-pay test, or

(2) the "cash surrender value" (as defined in § 7702(f)(2)(A)) of another life insurance contract (other than a contract that fails the 7-pay test) exchanged for the contract.

.03 *7-pay premium.* (1) *In general*. Except as otherwise provided in section 3.03(2) of this revenue procedure, the 7-pay premium for a contract is the net level premium (computed in accordance with the rules in § 7702A(c)) that would have to be paid for the contract if the contract were to provide for paid up future benefits after the payment of 7 level annual premiums.

(2) *7-pay premium for a contract that undergoes a material change*. If a contract (other than a contract that fails the 7-pay test) is materially changed, the contract is treated as newly issued on the date of the material change and the 7-pay premium for the changed contract is an amount equal to the excess, if any, of—

(a) the net level premium (computed in accordance with the rules in § 7702A(c)) that would have to be paid for the changed contract if the contract were to provide for paid up future benefits after the payment of 7 level annual premiums, over

(b) a "proportionate share of the cash surrender value" (as defined in section 3.04 of this revenue procedure) under the contract.

.04 *Proportionate share of cash surrender value.* The proportionate share of the cash surrender value of a contract is the amount obtained by multiplying—

(1) the "cash surrender value" (as defined in § 7702(f)(2)(A)) of the contract, by

(2) a fraction, the numerator of which is the net level premium (computed in accordance with the rules in § 7702A(c)) that would have to be paid for the changed or new contract if such contract were to provide for paid up future benefits after the payment of 7 level annual premiums, and the denominator of which is the net single premium (determined using the rules in § 7702) for such contract at that time.

.05 *Overage*. A contract's overage is the amount of the excess, if any, of—

(1) the sum of amounts paid under the contract during the testing period for the contract year and all prior contract years, over

(2) the sum of the 7-pay premiums for the contract year and all prior contract years of the testing period.

.06 *Overage earnings.* The overage earnings for a contract year is the amount obtained by multiplying—

(1) the sum of a contract's overage for the contract year and its cumulative overage earnings for all prior contract years, by—

(2) the earnings rate set forth in section 3.07 of this revenue procedure.

.07 *Earnings rates*. (1) *Contracts other than variable contracts.* Except as otherwise provided in sections 3.07(3) and 3.07(8) of this revenue procedure, the earnings rate applicable to a contract year is the "general account total return" (as defined in section 3.07(2) of this revenue procedure) for the calendar year in which the contract year begins.

(2) *General account total return*. The general account total return is the calendar year arithmetic average of the monthly interest rates described as Moody's Corporate Bond Yield Average - Monthly Average Corporates as published by Moody's Investors Service Inc., or any successor thereto.

(3)*Variable contracts described in § 817(d). (a) Pre-2001 contract years*. The earnings rate applicable to a contract year that begins before January 1, 2001, is the rate set forth in the following table for the calendar year in which the contract year begins.

Calendar Year	Earnings Rate
1988	13.5%
1989	17.4%
1990	1.4%
1991	25.4%
1992	5.9%
1993	13.9%
1994	-1.0%
1995	23.0%
1996	14.3%
1997	17.8%
1998	19.7%
1999	12.8%
2000	-5.5%

(b) Post-2000 contract years. Except as otherwise provided in section 3.07(8), the earnings rate applicable to a contract year that begins after December 31, 2000, is equal to the sum of—

(i) 10 percent of the general account total return (as defined in section 3.07(2) of this revenue procedure), and

(ii) 90 percent of the "separate account total return" (as defined in section 3.07(4) of this revenue procedure) for the calendar year in which the contract year begins.

(4) *Separate account total return.* Except as otherwise provided in section 3.07(8), the separate account total return equals—

(a) 75 percent of the "equity fund total return" (as defined in section 3.07(5) of this revenue procedure), plus

(b) 25 percent of the "bond fund total return" (as defined in section 3.07(6) of this revenue procedure), less

(c) 1.1 percentage point.

(5) *Equity fund total return.* The equity fund total return equals—

(a) the "calendar year percentage return" (as defined in section 3.07(7) of this revenue procedure) represented by the end-of-year values of the Standard and Poor's (S&P) 500 Total Return Index, with daily dividend reinvestment, as published by The McGraw-Hill Companies, Inc., or any successor thereto, less

(b) 1.5 percentage point.

(6) *Bond Fund Total Return.* The bond fund total return equals—

(a) the "calendar year percentage return" (as defined in section 3.07(7) of this revenue procedure) represented by the end-of-year values of the Merrill Lynch Corporate Bond Master Bond Index, Total Return, as published by Merrill Lynch & Company, Inc., or any successor thereto, less

(b) 1.0 percentage point.

(7) *Calendar year percentage return.* The calendar year percentage return for an index described in section 3.07(5) or section 3.07(6) of this revenue procedure 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 obtained under paragraph (a) of this section 3.07(7).

(8) 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, then the earnings rate for the contract year (or portion thereof) is determined using the general account total return and, if applicable, the average separate account total return, for the 3 calendar years immediately preceding the calendar year in which the contract year begins.

.08 *Proportionate share of overage earnings allocable to taxable distributions.* The proportionate share of overage earnings allocable to taxable distributions under a contract is the amount obtained by multiplying—

(1) the total amount of the taxable distributions under the contract, by

(2) a fraction, the numerator of which is the contract's cumulative overage earnings and the denominator of which is the total income on the contract.

.09 *Total income on a contract.* The total income on a contract as of any date is an amount equal to the excess, if any, of—

(1) the contract's cash surrender value (as defined in § 7702(f)(2)(A)) on such date, over

(2) the premiums paid under the contract before such date, reduced by amounts to which § 72(e) applies (determined without regard to § 72(e)(4)(A)) but not including amounts includible in the contract holder's gross income.

.10 *Distribution frequency factor.* The distribution frequency factor for a contract is—

(1) .8, if—

(a) the interest rate with respect to any portion of a policy loan that could be made under the contract at any time (including policy loans that could be made after a contractually specified date in the future) is guaranteed not to exceed the sum of:

(i) 1 percentage point, plus

(ii) the rate at which earnings are credited to the portion of the contract's cash surrender value (as defined in § 7702(f)(2)(A)) that is allocable to such portion of the policy loan; or

(b) the contract holder has an option to make a partial withdrawal of the contract's cash surrender value that reduces the "death benefit" (as defined in § 7702(f)(3)) under the contract by less than an amount determined by multiplying—

(i) the death benefit under the contract immediately before the withdrawal, by

(ii) the percentage obtained by dividing the withdrawn amount by the contract's cash surrender value (as defined in § 7702(f)(2)(A)) immediately before the withdrawal; and

(2) .5 for all other contracts.

.11 *Applicable percentage.* (1) *In general.* The applicable percentage for a contract is—

(a) 15%, if the death benefit under the contract is less than $50,000,

(b) 28%, if the death benefit under the contract is equal to or exceeds $50,000 but is less than $180,000, and

(c) 36%, if the death benefit under the contract is equal to or exceeds $180,000.

(2) *Determination of amount of death benefit.* For purposes of determining the applicable percentage, the death benefit under the contract will be the death benefit (as defined in section 7702(f)(3)) as of any date within 120 days of the date of the request for closing agreement, or the last day the contract is in force.

.12 *Reported amount.* The reported amount for a contract is the amount that—

(1) the issuer reports on a timely filed information return as includible in the contract holder's gross income, or

(2) the contract holder includes in gross income on a timely filed income tax return.

.13 *Aggregation of contracts.* All MECs issued by the same issuer to the same contract holder during any calendar year are treated as one MEC.

SECTION 4. SCOPE

.01 *Applicability.* Except as provided in section 4.02 of this revenue procedure, the issuer of a contract can use this revenue procedure to remedy the failure of the contract to comply with the requirements of § 7702A.

.02 *Inapplicability.* The Service may exclude a contract from the correction mechanism provided under this revenue procedure if the contract's status as a MEC resulted from a failure to comply with the requirements of § 7702A that—

(1) are attributable to one or more defective interpretations or positions that the Service determines to be a significant feature of a program to sell investment oriented contracts, or

(2) arises where the controlling statutory provision, as supplemented by any legislative history or guidance published by the Service, is clear on its face and the Service determines that failure to follow the provision results in a significant increase in the investment orientation of a contract.

.03 *Example.* Pursuant to section 4.02, the Service generally will not apply the correction mechanism under this revenue procedure to a MEC if the contract provides for paid-up future benefits after the payment of less than 7 level annual premiums.

SECTION 5. PROCEDURE

.01 *Request for a ruling.* An issuer that seeks relief under this revenue procedure must submit a request for a ruling that meets the requirements of Rev. Proc. 2001–1, 2001–1 I.R.B. 1 (or any successor). Additionally, the submission must contain the following information:

(1) a specimen copy of each contract form;

(2) the policy number and original issue date for each contract;

(3) the taxpayer identification number of each contract holder;

(4) the "death benefit" (as defined in section 7702(f)(3)) under each contract for purposes of determining the 7-pay premium for the contract;

(5) the 7-pay premium assumed by the issuer when the contract was issued;

(6) the cash surrender value (within the meaning of § 7702(f)(2)(A)) of each contract at the end of each contract year;

(7) a description of the defect[s] that caused the contract[s] to fail to comply with the 7-pay test, including an explanation of how and why the defect[s] arose;

(8) a description of the administrative procedures the issuer has implemented to ensure that none of its contracts will inadvertently fail the 7-pay test in the future;

(9) a description of any material change[s] in the benefits under (or in the other terms of) any contract together with the date[s] on which the material change[s] occurred;

(10) for any contract with regard to which a contract holder directly or indirectly received (or was deemed to have received) any distribution to which § 72 applies—

(a) the date and amount of each distribution,

(b) the amount of the distribution includible in the contract holder's gross income,

(c) the amount of gross income reported to the contract holder and to the Service on a timely filed information return as a result of the distribution,

(d) the date on which the contract holder attained [or will attain] age 59 1/2,

(e) whether the distribution is attributable to the contract holder becoming disabled (within the meaning of § 72(m)(7)), and,

(f) whether the distribution is part of a series of substantially equal periodic payments (not less frequently than annually) made for the life (or life expectancy) of the contract holder or the joint lives (or joint life expectancies) of the contract holder and his or her beneficiary;

(11) a template (see, for example, section 5.03(3) of this revenue procedure) setting forth the following information for each contract:

(a) the cumulative amounts paid under the contract within each contract year of the testing period,

(b) the contract's cumulative 7-pay premium,

(c) the overage, if any, for each contract year,

(d) the earnings rate applicable for each contract year;

(e) the overage earnings for each contract year; and,

.02 *Closing agreement.* The issuer also must submit a proposed closing agreement, executed by the issuer, in substantially the same form as the model closing agreement in section 6 of this revenue procedure. The amount shown in section 1(A) of the closing agreement is the sum of the amounts required to be paid (determined under section 5.03 of this revenue procedure) for all of the contracts covered by the agreement.

.03 *Determination of amount required to be paid with regard to a contract.*

(1) *General rule.* Except as provided in section 5.03(2) of this revenue procedure, the amount required to be paid with regard to a contract is the sum of—

(a) the income tax (determined using the applicable percentage for the contract under section 3.11 of this revenue procedure) and the additional tax under section 72(v) with regard to amounts (other than reported amounts (as defined in section 3.12 of this revenue procedure)) received (or deemed received) under the contract during the period commencing with the date 2 years before the date on which the contract first failed to satisfy the MEC rules and ending on the effective date of the closing agreement;

(b) any interest computed under § 6621(a)(2) as if the amounts determined under section 5.03(1)(a) of this revenue procedure are underpayments by the contract holder[s] for the tax year[s] in which the amounts are received (or deemed received); and

(c) an amount, not less than $0, obtained by multiplying—

(i) the excess, if any, of the contract's cumulative overage earnings over the proportionate share of overage earnings allocable to taxable distributions under the contract, by

(ii) the applicable percentage for the contract, and by

(iii) the distribution frequency factor for the contract under section 3.10 of this revenue procedure.

(2) *Special rule for contracts with de minimis overage earnings.* If the overage earnings of a contract at all times during the testing period do not exceed $75, then the amount required to be paid with regard to the contract is determined without regard to paragraphs (a) and (b) of section 5.03(1) of this revenue procedure.

(3) *Examples of the determination of the amount required to be paid with regard to a contract.*

(a) *Example 1.* A, an individual, purchases a life insurance contract other than a contract described in section 3.07(3) or 4.02 of this revenue procedure. The death benefit of the contract exceeds $180,000 on every day within 120 days of the date of the request for closing agreement. The net level premium (assuming paid-up future benefits after seven annual premium payments) for the contract is $10,490. The contract provides that, within 60 days after the end of a contract year, the issuer will return (with interest) the amount of any excess premium that would cause the contract to be a MEC under § 7702A.

The interest rate on all portions of any policy loans will always exceed the rate at which interest is credited to the contract's associated cash value by more than 1 percentage point. A partial withdrawal of the cash surrender value (within the meaning of § 7702(f)(2)(A)) always reduces the death benefit by an amount not less than the amount determined by multiplying the death benefit immediately before the withdrawal by the percentage obtained by dividing the withdrawn amount by the cash surrender value immediately before the withdrawal.

A pays a premium of $10,000 when the contract is issued on January 1, 1991. At the beginning of each of the next 6 contract years, A pays additional premiums of $10,750, $10,800, $10,700, $11,500, $11,000, and $10,000, respectively. Due to an inadvertent error, the issuer fails to return any of the excess premiums.

The issuer desires to enter into a closing agreement to remedy the failure to comply with § 7702A. Pursuant to section 5.01(10) of this revenue procedure, the issuer prepares the following template with regard to the contract.

Contract Year	Cumulative Amounts Paid	Cumulative 7-Pay Premiums	Overage	Earnings Rate	Overage Earnings
1 (1991)	10,000	10,490	0	9.2%	0
2 (1992)	20,750	20,980	0	8.6%	0
3 (1993)	31,550	31,470	80	7.5%	6.00
4 (1994)	42,250	41,960	290	8.3%	24.57
5 (1995)	53,750	52,450	1,300	7.8%	103.78
6 (1996)	64,750	62,940	1,810	7.7%	149.71
7 (1997)	74,750	73,430	1,320	7.6%	121.91

Prior to A's payment of the $10,800 premium at the beginning of contract year 3, the cumulative premiums paid for the contract do not exceed the contract's cumulative 7-pay premiums. Therefore, there are no overage earnings in contract years 1 and 2.

Upon payment of the $10,800 premium at the beginning of contract year 3, however, the cumulative amount paid for the contract ($31,550) exceeds the contract's cumulative 7-pay premiums ($31,470) by $80. As the earnings rate for the calendar year in which contract year 3 begins is 7.5%, the contract's overage earnings for contract year 3 equal $6 ($80 x 7.5%).

For contract year 4, the overage is $290 ($42,250 - $41,960). The cumulative overage earnings for all prior contract years equal $6.00. The earnings rate is 8.3%. The overage earnings for contract year 4 equal $24.57 (($290 + $6) x 8.3%).

For contract year 5, the overage is $1,300 ($53,750 - $52,450). The cumulative overage earnings for all prior contract years equal $30.57 ($6 + $24.57). The earnings rate is 7.8%. The overage earnings for contract year 5 equal $103.78 (($1,300 + $30.57) x 7.8%).

For contract year 6, the overage is $1,810 ($64,750 - $62,940). The cumulative overage earnings for all prior contract years equal $134.35 ($6 + $24.57 + $103.78). The earnings rate is 7.7%. The overage earnings for contract year 6 equal $149.71 ($1,810 + $134.35) x 7.7%).

For contract year 7, the overage is $1,320 ($74,750 - $73,430). The cumulative overage earnings for all prior contract years equal $284.06 ($6 + $24.57 + $103.78 + $149.71). The earnings rate is 7.6%. The overage earnings for contract year 7 equal $121.91 (($1,320 + $284.06) x 7.6%).

The cumulative overage earnings for the contract equal $405.97 ($6 + $24.57 + $103.78 + $149.71 + $121.91). Under sections 3.10 and 3.11 of this revenue procedure, the distribution frequency factor is .5 and the applicable percentage is 36%. Accordingly, the amount required to be paid with regard to the contract under section 5.03 of this revenue procedure is $73.07 ($405.97 x .5 x 36%).

(b) Example 2. The facts are the same as in example 1 except that, at the beginning of contract year 5, A receives $3,000 as a policy loan. The contract's cash value (within the meaning of § 72(e)(3)(A)(i)) immediately prior to the loan is $58,500, which exceeds A's investment in the contract ($53,750) by $4,750. Each year A pays the interest on the policy loan. The issuer does not file a timely information return with regard to the deemed distribution resulting from the policy loan and A does not include the distribution in gross income reported on the income tax return for the taxable years in which the deemed distribution is received. The total income on the contract (as defined in section 3.09 of this revenue procedure) is $14,500.

The amount required to be paid with regard to the contract under section 5.03 of this revenue procedure is the sum of-

(1) an amount equal to the income tax (determined using a 36% tax rate) and the additional tax under section 72(v) with regard to the $3,000 deemed distribution in contract year 5;

(2) interest computed under section 6621(a)(2) as if the amounts determined under (1) were underpayments for the taxable year in which the distributions are deemed to have occurred; and

(3) 36% of $160.99, which is the excess of the contract's cumulative overage earnings over the proportionate share of the overage earnings allocable to taxable distributions ($405.97 - $83.99), multiplied by the distribution frequency factor (.5).

The proportionate share of overage earnings allocable to taxable distributions is obtained by multiplying the total amount of the taxable distribution under the contract ($3,000), by a fraction, the numerator of which is the contract's cumulative overage earnings ($405.97) and the denominator of which is the total income on the contract ($14,500).

.04 *Payment of amount.* The issuer is required to pay the amount determined under section 5.03 of this revenue procedure within thirty (30) days of the date of execution of the closing agreement by the Service. Payment shall be made by check payable to the "United States Treasury" delivered, together with a fully executed copy of the closing agreement, to Internal Revenue Service, Philadelphia Service Center, 11601 Roosevelt Boulevard, Philadelphia, Pennsylvania 19154, Attention: Chief, Receipt and Control Branch, DP3190.

.05 *Correction of contracts*. (1) *General rules.* If, on the date of the execution of the closing agreement by the Service, the testing period (as defined in section 3.01 of this revenue procedure) for a contract has more than ninety (90) days remaining, then the issuer must bring the contract into compliance with § 7702A. The issuer may bring a contract into compliance with § 7702A either by either increasing the contract's death benefit or returning the contract's excess premiums and earnings thereon to the contract holder. The issuer shall take the corrective action required under this section 5.05(1) within ninety (90) days of the date of execution of the closing agreement by the Service.

(2) *No corrective action required if Service executes closing agreement on a date within 90 days of the expiration of testing period.* If the testing period for a contract expires on or before the date within 90 days of the execution of the closing agreement by the Service, then the issuer is not required to take any corrective action under section 5.05(1) of this revenue procedure.

SECTION 6. MODEL CLOSING AGREEMENT

Effective as of the date executed by Internal Revenue Service _________

CLOSING AGREEMENT AS TO FINAL DETERMINATION COVERING SPECIFIC MATTERS

THIS CLOSING AGREEMENT ("Agreement"), made pursuant to section 7121 of the Internal Revenue Code (the "Code") by and between [taxpayer's name, address, and identifying number] ("Taxpayer"), and the Commissioner of Internal Revenue (the "Service").

WHEREAS,

A. Taxpayer is the issuer of one or more modified endowment contracts, as defined in section 7702A of the Code;

B. On __________, Taxpayer pursuant to Rev. Proc. 2001–1, 2001–1 I.R.B. 1, submitted to the Service a request for a ruling that ______ modified endowment contracts (the "Contract[s]"), which are identified on Exhibit A to this Agreement, be treated as contracts that are not modified endowment contracts.

C. Taxpayer represents that the Contract[s] is [are] not described in section 4.02 of Rev. Proc. 2001–42.

D. Taxpayer represents that the cumulative "overage earnings," within the meaning of section 3.06 of Rev. Proc. 2001–42, for the Contract[s] equal $_____.

E. Taxpayer represents that the total of the amounts determined under section 5.03(1)(a), (b), and (c) of Rev. Proc. 2001–42, after taking the special rule in section 5.03(2) of the revenue procedure into account, with regard to the Contract[s] are $________, $________, and $______, respectively.

F. To ensure that the Contracts are not treated as modified endowment contracts, Taxpayer and the Service have entered into this Agreement.

NOW THEREFORE, IT IS HEREBY FURTHER DETERMINED AND AGREED BETWEEN TAXPAYER AND THE SERVICE AS FOLLOWS:

1. In consideration for the agreement of the Service as set forth in Section 2 below, Taxpayer agrees as follows:

(A) To pay to the Service the sum of ______ dollars and ______ cents ($_____) at the time and in the manner described in Section 3 below;

(B) The amount paid pursuant to Section 1(A) above is not deductible by Taxpayer, nor is such amount refundable, subject to credit or offset, or otherwise recoverable by Taxpayer from the Service;

(C) For purposes of its information reporting and withholding obligations under the Code, no holder's investment in any Contract may be increased by any portion of—

(i) the sum set forth in Section 1(A) above, or

(ii) the excess of the cumulative overage earnings over the proportionate share of overage earnings included in gross income reported to the Service on a timely filed information return or income tax return with regard to amounts received under any Contract; and

(D) To bring Contract[s] for which the testing period (as defined in section 3.01 of Revenue Procedure 2001–42) will not have expired on or before the date 90 days after the execution of this Agreement into compliance with § 7702A, either by an increase in death benefit[s] or the return of the excess premiums and earnings thereon to the contract holder[s].

2. In consideration of the agreement of Taxpayer set forth in Section 1 above, the Service and Taxpayer agree as follows:

(A) To treat each Contract as having satisfied the requirements of section 7702A during the period from the date of issuance of the Contract through and including the later of—

(i) date of the execution of this Agreement, and

(ii) the date of the corrective actions described in Section 1(D) above;

(B) To treat the corrective action described in 1(D) above as having no effect on the date the Contract was issued or entered into;

(C) To waive civil penalties for failure of Taxpayer to satisfy the reporting, withholding, and/or deposit requirements for income subject to tax under § 72(e)(10) that was received or deemed received by a contract holder under a Contract in a calendar year ending prior to the date of execution of this Agreement; and

(D) To treat no portion of the sum described in Section 1(A) above as income to the holders of the Contracts.

3. The actions required of Taxpayer in Section 1(D) above shall be taken by Taxpayer within ninety (90) days of the date of execution of this Agreement by the Service. Payment of the amount described in Section 1(A) above shall be made within thirty (30) days of the date of

execution of this Agreement by the Service by check payable to the "United States Treasury," delivered together with a fully executed copy of this Agreement, to Internal Revenue Service, Philadelphia Service Center, 11601 Roosevelt Boulevard, Philadelphia, Pennsylvania 19154, Attention: Chief, Receipt and Control Branch, DP3190.

4. This Agreement is, and shall be construed as being, for the benefit of Taxpayer. The holder[s] of Contract[s] covered by this Agreement are intended beneficiaries of this Agreement. This Agreement shall not be construed as creating any liability of an issuer to the holders of the Contract[s].

5. Neither the Service nor Taxpayer shall endeavor by litigation or other means to attack the validity of this Agreement.

6. This Agreement may not be cited or relied upon as precedent in the disposition of any other matter.

NOW THIS CLOSING AGREEMENT FURTHER WITNESSETH, that Taxpayer and the Service mutually agree that the matters so determined shall be final and conclusive, except as follows:

1. The matter to which this Agreement relates may be reopened in the event of fraud, malfeasance, or misrepresentation of material facts set forth herein.

2. This Agreement is subject to sections of the Code that expressly provide that effect be given to their provisions notwithstanding any other law or rule of law except § 7122 of the Code.

3. This Agreement is subject to any legislation enacted subsequent to the date of execution hereof if the legislation provides that it is effective with respect to closing agreements.

IN WITNESS WHEREOF, the parties have subscribed their names in triplicate.

Taxpayer

Date Signed: ________________ By: ______________________________

____
Title/Office

Commissioner of Internal Revenue

Date Signed: ________________ By: ______________________________

____
Title/Office

SECTION 7. EFFECTIVE DATE

This revenue procedure is effective August 6, 2001, the date this revenue procedure was made available to the public.

SECTION 8. EFFECT ON OTHER DOCUMENTS.

This revenue procedure supersedes Rev. Proc. 99–27.

SECTION 9. PAPERWORK REDUCTION ACT

The collections of information contained in this revenue procedure have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545 –1752.

The collection of information and reporting burden are in section 5 of this revenue procedure. This information will be used to determine whether an issuer may remedy failures to comply with the requirements of § 7702A. The likely respondents are insurance companies.

The estimated total annual reporting burden is 1000 hours.

The estimated annual burden per respondent varies from 50 hours to 150 hours with an average of 100 hours. The estimated number of respondents is 10.

The estimated annual frequency of the responses is one time.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

Books and records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

DRAFTING INFORMATION

For further information regarding this revenue procedure, contact Donald Drees of Financial Institutions and Products at (202) 622-3970 (not a toll-free call).