

Part III - Administrative, Procedural, and Miscellaneous

Guidance Concerning Use of 2001 CSO Tables Under Section 7702

Notice 2006-95

SECTION 1. PURPOSE

This notice provides rules interpreting the reasonable mortality charge requirement contained in § 7702(c)(3)(B)(i) of the Internal Revenue Code. Specifically, this notice supplements Notice 88-128, 1988-2 C.B. 540, and modifies and supersedes Notice 2004-61, 2004-2 C.B. 596, by providing safe harbors regarding the use by taxpayers of either the 1980 Commissioners' Standard Ordinary mortality and morbidity tables (1980 CSO tables) or the 2001 Commissioners' Standard Ordinary mortality and morbidity tables (2001 CSO tables) to determine whether mortality charges are reasonable. These safe harbors are designed to assist taxpayers in complying with the requirements of § 7702(c)(3)(B)(i).

SECTION 2. BACKGROUND

Section 7702 of the Code defines the term "life insurance contract" for purposes of the Code. Section 7702(a) provides that a "life insurance contract" is any contract that is a life insurance contract under the applicable law, but only if such contract either (1) meets the cash value accumulation test of § 7702(b), or (2) both meets the guideline premium requirements of § 7702(c) and falls within the cash value corridor of § 7702(d).

Section 7702(c)(3)(B)(i) provides that the guideline single premium under § 7702(c) is determined on the basis of reasonable mortality charges that meet the requirements (if any) prescribed in regulations and that (except as provided in regulations) do not exceed the mortality charges specified in the prevailing commissioners' standard tables (as defined in § 807(d)(5)) as of the time the contract is issued. The mortality charges specified in § 7702(c)(3)(B)(i) are also used for determining the "net single premium" (see § 7702(b)(2)(B)), and the "guideline level premium" (see § 7702(c)(4)). The same reasonable mortality charge standard applies for purposes of determining whether a life insurance contract is a modified endowment contract under § 7702A (see § 7702A(c)(1)(B)).

Section 807(d)(5)(A) provides that the term "prevailing commissioners' standard tables" means, with respect to any contract, the most recent commissioners' standard tables prescribed by the National Association of Insurance Commissioners (NAIC) that are permitted to be used in computing reserves for that type of contract under the insurance laws of at least 26 states when the contract was issued. Section 807(d)(5)(B) provides a 3-year transition period during which an insurer may use either the newly prevailing CSO tables or those that were previously prevailing.

The 2001 CSO tables prescribed by the NAIC became the prevailing commissioners' standard tables within the meaning of § 807(d)(5) during calendar year 2004, and have now been adopted by all 50 states. The 1980 CSO tables may still be

used in all states for contracts issued in calendar years through 2008. For contracts issued after 2008, use of the 2001 CSO tables will be mandatory.

Notice 88-128 was issued after § 7702 was amended to require that only “reasonable” mortality charges be taken into account for purposes of testing life insurance contract qualification under § 7702. Under Notice 88-128, interim safe harbors provided that the 1980 CSO tables (and, for certain previously issued contracts, the 1958 CSO tables) would satisfy the requirement that mortality charges be “reasonable” under § 7702(c)(3)(B)(i). Notice 2004-61 supplemented Notice 88-128 by providing additional safe harbors to account for the promulgation of the 2001 CSO tables. Neither Notice 88-128, Notice 2004-61, nor this Notice addresses the reasonable mortality charge requirement in the case of substandard risk underwriting. See the Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647 (1988 Act), § 5011(c)(2).

SECTION 3. PUBLIC COMMENTS AND MODIFICATIONS TO NOTICE 2004-61

Notice 2004-61 requested comments on the need for additional guidance on the adoption of the 2001 CSO tables. This notice modifies Notice 2004-61 in response to the comments that were received. First, the safe harbor for contracts issued based on the 1980 CSO tables (1980 CSO contracts) is modified to remove the requirement in Notice 2004-61 that mortality charges used to determine whether a contract qualifies as a life insurance contract under § 7702 not exceed the mortality charge specified in the contract at issuance. Second, the new rules for gender- or smoker-based tables are modified to apply only to contracts issued based upon the 2001 CSO tables (2001 CSO contracts). These two changes help to ensure that the Notice does not subject 1980 CSO contracts to more stringent standards, retroactively, than applied under Notice 88-128. Third, the rule for determining the issue date of a contract that undergoes an increase or decrease in death benefit is simplified by eliminating the concept of “underwriting.” This change broadens the grandfather rule of Notice 2004-61 to encompass many routine transactions, but does not wholly defer to an issuer’s administrative practices and procedures. Fourth, additional examples are provided of changes, modifications, or exercises of contractual provisions that will not require a change from previous tables to the 2001 CSO tables. Except as described above, this notice does not modify the definition of “issue date” that was provided in Notice 2004-61.

SECTION 4. SAFE HARBORS UNDER SECTION 7702

The following safe harbors apply for purposes of determining reasonable mortality charges under § 7702:

.01 Notice 88-128. The interim rules described in Notice 88-128 remain in effect, except as otherwise modified by this notice.

.02 1980 CSO tables. A mortality charge with respect to a life insurance contract will satisfy the requirements of § 7702(c)(3)(B)(i) so long as (1) the mortality charge does not exceed 100 percent of the applicable mortality charge set forth in the 1980 CSO tables; (2) the contract is issued in a state that permits or requires the use of the 1980 CSO tables at the time the contract is issued; and (3) the contract is issued before January 1, 2009.

.03 2001 CSO tables. A mortality charge with respect to a life insurance contract will satisfy the requirements of § 7702(c)(3)(B)(i) so long as (1) the mortality charge does not exceed 100 percent of the applicable mortality charge set forth in the 2001 CSO tables; (2) the mortality charge does not exceed the mortality charge specified in the contract at issuance; and (3) either (a) the contract is issued after December 31, 2008, or (b) the contract is issued before January 1, 2009, in a state that permits or requires the use of the 2001 CSO tables at the time the contract is issued.

SECTION 5. ISSUE DATE OF CONTRACTS

.01 For purposes of this Notice, the date on which a contract was issued generally is to be determined according to the standards that applied for purposes of the original effective date of § 7702. See H.R. Conf. Rep. No. 861, 98th Cong., 2d Sess. 1076 (1984), 1984-3 (Vol. 2) C.B. 330; see also 1 Staff of Senate Comm. on Finance, 98th Cong., 2d Sess., Deficit Reduction Act of 1984, Explanation of Provisions Approved by the Committee on March 21, 1984, at 579 (Comm. Print 1984). Thus, contracts received in exchange for existing contracts are to be considered new contracts issued on the date of the exchange. For these purposes, a change in an existing contract is not considered to result in an exchange if the terms of the resulting contract (that is, the amount and pattern of death benefit, the premium pattern, the rate or rates guaranteed on issuance of the contract, and mortality and expense charges) are the same as the terms of the contract prior to the change.

.02 Notwithstanding section 5.01, if a life insurance contract satisfied section 4.01 or 4.02 when originally issued, a change from previous tables to the 2001 CSO tables is not required if (1) the change, modification, or exercise of a right to modify, add or delete benefits is pursuant to the terms of the contract; (2) the state in which the contract is issued does not require use of the 2001 CSO tables for that contract under its standard valuation and minimum nonforfeiture laws; and (3) the contract continues upon the same policy form or blank.

.03 The changes, modifications, or exercises of contractual provisions referred to in section 5.02 include (1) the addition or removal of a rider; (2) the addition or removal of a qualified additional benefit (QAB); (3) an increase or decrease in death benefit (whether or not the change is underwritten); (4) a change in death benefit option (such as a change from an option 1 to option 2 contract or vice versa); (5) reinstatement of a policy within 90 days after its lapse; and (6) reconsideration of ratings based on rated condition, lifestyle or activity (such as a change from smoker to nonsmoker status).

SECTION 6. RULES FOR GENDER- OR SMOKER-BASED TABLES

For purposes of section 4.03 (the 2001 CSO safe harbor), mortality charges that do not exceed the applicable charges in gender- or smoker-based variations of the 2001 CSO tables will be treated as reasonable mortality charges, provided the following requirements are satisfied:

.01 Unisex tables. If a state permits minimum nonforfeiture values for all contracts issued under a plan of insurance to be determined using the 2001 CSO Gender-Blended Mortality tables ("unisex tables"), then the applicable mortality charges in those tables are treated as reasonable mortality charges for female insureds provided

the same tables are used to determine mortality charges for male insureds.

.02 Smoker/nonsmoker tables. If a state permits minimum nonforfeiture values for all contracts issued under a plan of insurance to be determined using the 2001 CSO Smoker and Nonsmoker Mortality tables ("smoker/nonsmoker tables"), then the applicable mortality charges in those tables for smoker insureds are treated as reasonable mortality charges provided nonsmoker tables are used to determine nonsmoker mortality charges.

SECTION 7. EFFECT UPON OTHER PUBLICATIONS

This notice supplements Notice 88-128 and modifies and supersedes Notice 2004-61.

SECTION 8. EFFECTIVE DATE

This notice is effective October 12, 2006, except that the provisions of this Notice will not be applied adversely to taxpayers who issued, changed or modified contracts in compliance with Notice 2004-61 (without regard to the modifications made by this Notice).

SECTION 9. PROCEDURAL INFORMATION

This notice serves as an "administrative pronouncement" as that term is described in § 1.6661-3(b)(2) of the regulations and may be relied upon to the same extent as a revenue ruling or a revenue procedure.

DRAFTING INFORMATION

The principal author of this notice is Ann H. Logan of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this notice, contact Ann H. Logan on (202) 622-3970 (not a toll-free call).