

Part I

Section 807.--Rules for Certain Reserves

Rev. Rul. 2002-6

ISSUE

Whether, under the circumstances described below, a change in the computation of existing life insurance reserves for annuity contracts is a change in basis subject to 807(f) of the Code?

FACTS

The National Association of Insurance Commissioners (NAIC) adopted Actuarial Guideline XXXIII, Determining Minimum Commissioners' Annuities Reserve Valuation Method (CARVM) Reserves for Individual Annuity Contracts (AG 33), effective on December 31, 1995, for all contracts issued on or after January 1, 1981.

IC, a life insurance company within the meaning of 816(a), issued Annuity Contracts in 1999. In computing its end of the year (EOY) life insurance reserves for Annuity Contracts under 807(d)(2) for taxable years 1999 and 2000, IC did not take into account several specific factors set forth by the NAIC in AG 33. In 2001, IC modified its reserve computation to take those factors into account in computing its EOY 2001 reserves for Annuity Contracts. IC's EOY 2001 reserves for Annuity Contracts equaled \$ 8x. If IC had continued using its former method, its EOY 2001 life insurance reserves for Annuity Contracts would have been \$ 6x.

For taxable years 1999 through 2001, the EOY reserve computed under 807(d)(2) for Annuity Contracts exceeded the net surrender value of the contracts. The 1999 and 2000 tax years for IC remain open.

APPLICABLE LAW AND ANALYSIS

Section 807(c) lists various items, including life insurance reserves, that are taken into account in determining life insurance company taxable income.

Section 807(d)(1) provides that, other than for purposes of 816 (relating to qualification as a life insurance company), the amount of the life insurance reserve for any contract is the greater of (i) the net surrender value of the contract, or (ii) the reserve determined under 807(d)(2). At no time may the reserve for a contract exceed the amount taken into account with respect to that contract as of that time in determining the statutory reserves set forth in the company's annual statement.

Sections 807(d)(2) and 807(d)(3)(B)(ii) provide that the reserve for any contract must be determined using the tax reserve method applicable to that type of contract. The tax reserve method applicable to annuity contracts is the CARVM prescribed by the NAIC and in effect on the date of the issuance of the contract.

Section 807(f) provides that if the basis for determining any item referred to in 807(c) as of the close of any taxable year differs from the basis for determining that item as of the close of the preceding taxable year, then 1/10 of the difference between (i) the amount of the item at the close of the taxable year, computed on the new basis, and (ii) the amount of the item at the close of the taxable year, computed on the old basis, that is attributable to contracts issued before the taxable year, is taken into account (as either a deduction or an item of gross income), for each of the succeeding 10 taxable years.

AG 33 contains the statement that the guideline "does not constitute a change of method or basis from any previously used method." This statement could lead one to conclude that taking this guideline into account in a company's CARVM computation does not result in a change in basis. However, for purposes of determining life insurance company taxable income, any change in a company's tax reserve method is a change in basis subject to the change in basis rules under 807(f). See Rev. Rul. 94-74, 1994-2 C.B. 157.

Under 807(d), IC is required to calculate the life insurance reserves for Annuity Contracts using CARVM. For taxable years 1999 and 2000, IC did not take into account several specific factors set forth in AG 33. For tax year 2001, IC modified its reserve computation to take those factors into account in computing its EOY 2001 reserves for Annuity Contracts. IC's change of reserving method is a change in basis under 807(f).

IC's EOY 2001 life insurance reserves for Annuity Contracts, computed on the new basis, exceed the EOY 2001 reserves for those contracts, computed on the old basis, by \$2x. Pursuant to the adjustment rules of 807(f), IC can take 1/10 of the \$2x into account as a deduction under 805(a)(2) in each of succeeding 10 taxable years, beginning with the 2002 tax year. In the alternative, in accordance with Rev. Rul. 94-74, IC may file amended returns for 1999 and 2000 and recalculate its tax reserves for Annuity Contracts for those years in accordance with AG 33.

HOLDING:

A change in the computation of existing life insurance reserves by IC for Annuity Contracts to take into account specific factors set forth in AG 33 is a change in basis subject to 807(f) of the Code.

DRAFTING INFORMATION:

The principal author of this revenue ruling is Linda Boyd of the Office of Associate Chief Counsel (Financial Institutions and Products). For further information regarding this revenue ruling contact Ms. Boyd at (202) 622-3970 (not a toll-free call).