

Attained Age of the Insured Under Section 7702

REG-168892-03

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations explaining how to determine the attained age of an insured for purposes of testing whether a contract qualifies as a life insurance contract for Federal income tax purposes. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by August 24, 2005. Requests to speak and outlines of topics to be discussed at the public hearing scheduled for Wednesday, September 14, 2005, must be received by August 24, 2005.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-168892-03), room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Comments may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-168892-03), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or submitted to the IRS web site at www.irs.gov/regs or via the Federal eRulemaking Portal at www.regulations.gov (IRS-REG-168892-03). All comments will be available for public inspection and copying. Requests to speak, with outlines of topics to be discussed, at the hearing scheduled for September 14, 2005, at 10 a.m., must be received by August 24,

2005. The public hearing will be held in the IRS Auditorium (7th Floor), Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Ann H. Logan, 202-622-3970. Concerning submission of comments, the hearing, or to be placed on the building access list to attend the hearing, LaNita Van Dyke of the Publication and Regulations Branch, 202-622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

Section 7702(a) of the Internal Revenue Code (Code) provides that, for a contract to qualify as a life insurance contract for Federal income tax purposes, the contract must be a life insurance contract under the applicable law and must either (1) satisfy the cash value accumulation test of section 7702(b), or (2) both meet the guideline premium requirements of section 7702(c) and fall within the cash value corridor of section 7702(d). To determine whether a contract satisfies the cash value accumulation test, or meets the guideline premium requirements and falls within the cash value corridor, it is necessary to determine the attained age of the insured.

A contract meets the cash value accumulation test of section 7702(b) if, by the terms of the contract, the cash surrender value of the contract may not at any time exceed the net single premium that would have to be paid at that time to fund future benefits under the contract. Under section 7702(e)(1)(B), the maturity date of the contract is deemed to be no earlier than the day on which the insured attains age 95, and no later than the day on which the insured attains age 100, for purposes of applying the cash value accumulation test.

A contract meets the guideline premium requirements of section 7702(c) if the sum of the premiums paid under the contract does not at any time exceed the greater of

the guideline single premium or the sum of the guideline level premiums as of such time. The guideline single premium is the premium that is needed at the time the policy is issued to fund the future benefits under the contract based on the following three elements enumerated in section 7702(c)(3)(B):

(i) 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 section 807(d)(5)) as of the time the contract is issued;

(ii) Any reasonable charges (other than mortality charges) that (on the basis of the company's experience, if any, with respect to similar contracts) are reasonably expected to be actually paid; and

(iii) Interest at the greater of an annual effective rate of six percent or the rate or rates guaranteed on issuance of the contract.

The guideline level premium is the level annual amount, payable over a period not ending before the insured attains age 95, computed on the same basis but using a minimum interest rate of four percent, rather than six percent. Like the cash value accumulation test, the guideline premium requirements are applied by deeming the maturity date of the contract to be no earlier than the day on which the insured attains age 95, and no later than the day on which the insured attains age 100. The deemed maturity date generally is the determination date set forth in the contract or the end of the mortality table (which, when section 7702 was enacted in 1984, was age 100).

A contract falls within the cash value corridor if the death benefit of the contract at any time is not less than the applicable percentage of the cash surrender value. The applicable percentage is determined based on the attained age of the insured as of the beginning of the contract year, as follows:

APPLICABLE PERCENTAGE

In the case of an insured with an attained age as of the beginning of the contract year of:		The applicable percentage shall decrease by a ratable portion for each full year:	
More than:	But not more than:	From:	To:
0	40	250	250
40	45	250	215
45	50	215	185
50	55	185	150
55	60	150	130
60	65	130	120
65	70	120	115
70	75	115	105
75	90	105	105
90	95	105	100

The Code does not define the attained age of the insured for purposes of applying the cash value corridor, the guideline premium limitations, and the computational rules of section 7702(e). The Senate Finance Committee explanation of the Deficit Reduction Act of 1984, Public Law 98-369 (98 Stat. 494), however, states that the attained age of the insured means the insured's age determined by reference to contract anniversaries (rather than the individual's actual birthdays), so long as the age assumed under the contract is within 12 months of the actual age. See S. Prt. No. 98-169, Vol. 1, at 576 (1984).

Section 7702A defines a modified endowment contract as a contract that meets the requirements of section 7702 (that is, a contract that is a life insurance contract), but that fails to meet the 7-pay test set forth in section 7702A(b). 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 that would have been paid on or before that time if the contract provided for paid-up future benefits after the payment of 7 level annual premiums. Section 7702A(c)(1)(B) provides that, for purposes of this test, the computational rules of section 7702(e) generally apply, including the contract's deemed maturity no earlier than the day on which the insured attains age 95, and no later than the day on which the insured attains age 100.

In sum, the attained age of an insured under a contract that is a life insurance contract under the applicable law must be determined to test whether the contract com-

plies with the guideline premium requirements of section 7702(c), the cash value corridor of section 7702(d), and (by reason of the computational rules of section 7702(e)) the cash value accumulation test of section 7702(b) and the 7-pay test of section 7702A(b), as applicable.

Discussion

Although most life insurance contracts insure the life of one person, some life insurance contracts insure multiple lives. For example, a last-to-die life insurance contract (sometimes referred to as a survivorship or second-to-die life insurance contract) insures two or more lives and pays death benefits when the last insured dies. Such contracts are sometimes used in connection with business continuation or estate tax planning; the contracts typically involve lower premiums than do contracts insuring a single life.

A first-to-die life insurance contract (sometimes referred to as a joint life insurance contract) also insures two or more lives, but pays death benefits and terminates upon the death of the first insured. These contracts typically involve higher risks and thus higher premiums than do contracts insuring a single life. First-to-die life insurance contracts represent a small percentage of the multiple-life insurance contracts that are issued.

Section 7702A, which defines the term *modified endowment contract* (MEC), incorporates the computational rules of section 7702, both in its initial determination of whether a contract is a life insurance contract, and in its 7-pay test calcu-

lations. Further, section 7702A(c)(6) provides a specific computational rule that applies to multiple life insurance contracts if the death benefit under the contract is reduced.

Neither section 7702, section 7702A, nor the legislative history of either provision, addresses how an insured's attained age is determined for purposes of testing a life insurance contract insuring multiple lives under the cash value accumulation test of section 7702(b), the guideline premium requirements of section 7702(c), or the computational rules of section 7702(e).

Explanation of Provision

This document contains proposed amendments to 26 CFR part 1 under section 7702. The proposed regulations provide guidance on how to determine the attained age of an insured individual under a contract that is a life insurance contract under the applicable law, for purposes of testing whether the contract qualifies as a life insurance contract under section 7702 and is a MEC under section 7702A. Under the proposed regulations, the attained age of the insured under a contract insuring the life of a single individual is either (i) the insured's age determined by reference to the individual's actual birthday as of the date of determination (actual age) or (ii) the insured's age determined by reference to contract anniversary (rather than the individual's actual birthday), so long as the age assumed under the contract (contract age) is within 12 months of the actual age. The attained age of the insured under a contract insuring multiple lives on

a last-to-die basis is the attained age of the youngest insured. The attained age of the insured under a contract insuring multiple lives on a first-to-die basis is the attained age of the oldest insured. The Treasury Department and the IRS understand that the approach of the proposed regulations is consistent with the existing practice of many (but not all) issuers of both contracts insuring a single life and contracts insuring multiple lives. In addition, by mandating the use of a single, predictable age, the proposed regulations provide rules that are straightforward for both issuers and the IRS to administer.

The proposed regulations generally would be applicable for contracts issued on or after the date that is one year after the regulations are published as final regulations in the **Federal Register**. This applicability date recognizes that some issuers will need time to conform their compliance system to the proposed standard for the issuance of new contracts, to file policy forms with State authorities, or both. Taxpayers also would be permitted to apply the regulations retroactively for contracts issued before the date that is one year after the regulations are published as final regulations, provided they do not later determine qualification of those contracts under section 7702 in a manner inconsistent with the regulations.

The proposed regulations defining the attained age for purposes of these provisions are not intended to specify which multiple-life actuarial methodologies are appropriate to determine reasonable mortality charges under sections 7702 and 7702A, or how any such methodology should be applied.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking will be submitted

to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are timely submitted to the IRS. In addition to comments on the proposed regulations more generally, the IRS and Treasury Department specifically request comments on (i) the clarity of the proposed regulations and how they can be made easier to understand, (ii) the industry's existing practice for determining the attained age to use under both last-to-die and first-to-die life insurance contracts, (iii) the need for special rules for determining the attained age of one or more insureds to calculate mortality charges under section 7702(c)(3)(B)(i), and (iv) the effective date of the proposed regulations. All comments will be available for public inspection and copying.

A public hearing has been scheduled for September 14, 2005, at 10 a.m., in the IRS Auditorium (7th Floor), Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. All visitors must present a photo identification to enter the building. Because of access restrictions, visitors must use the Constitution Avenue entrance and will not be admitted beyond the Internal Revenue Building lobby more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing.

Persons who wish to present oral comments at the hearing must submit written comments by August 24, 2005, and submit an outline of the topics to be discussed and the time to be devoted to each topic (a signed original and eight (8) copies) by that same date.

A period of 10 minutes will be allotted to each person(s) for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed.

Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these proposed regulations is Ann H. Logan, Office of the Associate Chief Counsel (Financial Institutions and Products), Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the IRS and the Treasury Department participated in their development.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding entries in numerical order to read as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.7702-3 also issued under 26 U.S.C. 7702(k). * * *

Par. 2. Section 1.7702-0, proposed to be added at 56 FR 30720 and published on July 15, 1991, and further proposed to be amended at 57 FR 59321 and published on December 15, 1992, is further proposed to be revised to read as follows:

§1.7702-0 Table of contents.

This section lists the captions that appear in §§1.7702-1, 1.7702-2, and 1.7702-3:

§1.7702-1 Mortality charges.

- (a) General rule.
- (b) Reasonable mortality charges.
 - (1) Actually expected to be imposed.
 - (2) Limit on charges.
- (c) Safe harbors.
 - (1) 1980 C.S.O. Basic Mortality Tables.
 - (2) Unisex tables and smoker/non-smoker tables.
 - (3) Certain contracts based on 1958 C.S.O. table.
- (d) Definitions.
 - (1) Prevailing commissioners' standard tables.
 - (2) Substandard risk.
 - (3) Nonparticipating contract.
 - (4) Charge reduction mechanism.
 - (5) Plan of insurance.

(e) Effective date.

§1.7702-2 Definitions.

- (a) In general.
- (b) Cash value.
 - (1) In general.
 - (2) Amounts excluded from cash value.
- (c) Death benefit.
 - (1) In general.
 - (2) Qualified accelerated death benefit treated as death benefit.
- (d) Qualified accelerated death benefit.
 - (1) In general.
 - (2) Determination of present value of the reduction in death benefit.
- (3) Examples.
- (e) Terminally ill defined.
- (f) Certain other additional benefits.
 - (1) In general.
 - (2) Examples.
- (g) Adjustments under section 7702(f)(7)
 - (h) Cash surrender value.
 - (1) In general.
 - (2) For purposes of section 7702(f)(7).
 - (i) Net surrender value.
 - (j) Effective date and special rules.
 - (1) In general.
 - (2) Provision of certain benefits before July 1, 1993.
 - (i) Not treated as cash value.
 - (ii) No effect on date of issuance.
 - (iii) Special rule for addition of benefit or loan provision after December 15, 1992.
 - (3) Addition of qualified accelerated death benefit.
 - (4) Addition of other additional benefits.

§1.7702-3 Attained age of the insured under a life insurance contract.

- (a) In general.
- (b) Contract insuring a single life.
- (c) Contract insuring multiple lives on a last-to-die basis.
- (d) Contract insuring multiple lives on a first-to-die basis.
- (e) Examples.
- (f) Effective dates.
 - (1) In general.
 - (2) Contracts issued before the general effective date.

Par. 3. Section 1.7702-3 is added to read as follows:

§1.7702-3 Attained age of the insured under a life insurance contract.

(a) *In general.* This section provides guidance on determining the attained age of an insured under a contract that is a life insurance contract under the applicable law, for purposes of testing whether the contract complies with the guideline premium requirements of section 7702(c), the cash value corridor of section 7702(d), and the computational rules of section 7702(e), as applicable.

(b) *Contract insuring a single life.* (1) If a contract insures the life of a single individual, either of the following two ages may be treated as the attained age of the insured with respect to that contract—

(i) The insured's age determined by reference to the individual's actual birthday as of the date of determination (actual age); or

(ii) The insured's age determined by reference to contract anniversary (rather than the individual's actual birthday), so long as the age assumed under the contract (contract age) is within 12 months of the actual age.

(2) Whichever attained age is used with respect to a contract must be used consistently from year to year and consistently for purposes of sections 7702(c), 7702(d), and 7702(e), as applicable.

(c) *Contract insuring multiple lives on a last-to-die basis.* If a contract insures the lives of more than one individual on a last-to-die basis, the attained age of the insured is determined by applying paragraph (b) of this section as if the youngest individual were the only insured under the contract.

(d) *Contract insuring multiple lives on a first-to-die basis.* If a contract insures the lives of more than one individual on a first-to-die basis, the attained age of the insured is determined by applying paragraph (b) of this section as if the oldest individual were the only insured under the contract.

(e) *Examples.* The following examples illustrate the determination of the attained age of the insured for purposes of testing whether the contract complies with the guideline premium requirements of section 7702(c), the cash value corridor of section 7702(d), and the computational rules of section 7702(e), as applicable. The examples are as follows:

Example 1. (i) X was born on May 1, 1947. On January 1, 2008, X purchases from IC a contract in-

sureing X's life. January 1 is the contract anniversary date for all future years. Under the contract, X's premiums are determined on an age-last-birthday basis. X became 60 years old on May 1, 2007. Based on the method used under the contract to determine age, X has an attained age of 60 for the first contract year, 61 for the second contract year, and so on.

(ii) Section 1.7702-3(b) provides that, if a contract insures the life of a single individual, the insured's age may be determined by reference to contract anniversary (rather than the individual's actual birthday), so long as the contract age is within 12 months of the actual age. For each contract year, X's contract age, determined on an age-last-birthday basis, is within 12 months of X's actual age. Accordingly, provided it does so consistently from year to year, IC may compute X's attained age on an age-last-birthday basis for purposes of testing whether a contract complies with the guideline premium requirements of section 7702(c), the cash value corridor of section 7702(d), and the computational rules of section 7702(e), as applicable.

Example 2. (i) The facts are the same as in *Example 1* except that, under the contract, X's premiums are determined on an age-nearest-birthday basis. X's nearest birthday to January 1, 2008, is May 1, 2008, when X will become 61 years old. Based on the method used under the contract to determine age, X has an attained age of 61 for the first contract year, 62 for the second contract year, and so on.

(ii) Section 1.7702-3(b) provides that, if a life insurance contract insures the life of a single individual, the insured's age may be determined by reference to contract anniversary (rather than the individual's actual birthday), so long as the contract age is within 12 months of the actual age. For each contract year, X's contract age, determined on an age-nearest-birthday basis, is within 12 months of X's actual age. Accordingly, provided it does so consistently from year to year, IC may compute X's attained age on an age-nearest-birthday basis for purposes of testing whether the contract complies with the guideline premium requirements of section 7702(c), the cash value corridor of section 7702(d), and the computational rules of section 7702(e), as applicable.

Example 3. (i) The facts are the same as in *Example 1* except that in addition to X, the insurance contract also insures the life of Y. Y was born on September 1, 1942. The death benefit will be paid when the last of the two insureds dies.

(ii) Section 1.7702-3(c) provides that if a life insurance contract insures the lives of more than one individual on a last-to-die basis, the attained age of the insured is determined by applying §1.7702-3(b) as if the youngest individual were the only insured under the contract. Because X is younger than Y, the attained age of X must be used for purposes of testing whether the contract complies with the guideline premium requirements of section 7702(c), the cash value corridor of section 7702(d), and the computational rules of section 7702(e), as applicable. The attained ages of X and Y are determined as set forth in *Example 1*.

Example 4. (i) The facts are the same as *Example 1* except that in addition to X, the insurance contract also insures the life of Y. Y was born on September 1, 1952. The death benefit will be paid when the first of the two insureds dies.

(ii) Section 1.7702-3(d) provides that if a life insurance contract insures the lives of more than one individual on a first-to-die basis, the attained age of the insured is determined by applying §1.7702-3(b) as if the oldest individual were the only insured under the contract. Because X is older than Y, the attained age of X must be used for purposes of testing whether the contract complies with the guideline premium requirements of section 7702(c), the cash value corridor of section 7702(d), and the computational rules of section 7702(e), as applicable. The attained ages of X and Y are determined as set forth in *Example 1*.

(f) *Effective dates*—(1) *In general*. Except as provided in paragraph (f)(2), these regulations are effective for contracts issued on or after the date that is one year after the regulations are published as final regulations in the **Federal Register**.

(2) *Retroactive application*. Pursuant to section 7805(b)(7), a taxpayer may elect to apply these regulations retroactively for contracts issued before the date that is one year after the regulations are published as final regulations in the **Federal Register**, provided that the taxpayer does not later determine qualification of those contracts in a manner that is inconsistent with these regulations.

Mark E. Matthews,
*Deputy Commissioner for
Services and Enforcement.*