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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

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Attained Age of the Insured Under Section 7702

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulation.

SUMMARY: This document contains final 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.

DATES: Effective Date: These regulations are effective September 13, 2006.

Applicability Dates: For dates of applicability, see §1.7702-2(f).

FOR FURTHER INFORMATION CONTACT: Ann H. Logan, 202-622-3970 (not a toll-free number).

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 as the guideline single premium 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, or 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 (MEC) 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 complies 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.

On May 24, 2005, the IRS and Treasury Department published a notice of proposed rulemaking (REG-168892-03), (2005-25 I.R.B. 1293, June 20, 2005) in the **Federal Register** (70 FR 29671) (the proposed regulations). The proposed regulations provide guidance on how to determine the attained age of an individual insured 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 modified endowment contract under section 7702A. Under

the proposed regulations, the attained age of the insured 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 proposed regulations provide that 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, and 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 sole party requesting a public hearing timely withdrew its request. One written comment regarding the notice of proposed rulemaking was received.

### **Explanation of Provisions**

After consideration of the written comment received, this Treasury decision adopts the regulations as proposed, with the modifications noted below.

#### **A. Identity of the Insured Individual**

The proposed regulations provide that, in the case of a last-to-die contract, the attained age of the insured means the age of the youngest individual insured under the contract. The comment letter pointed out that, in the case of such a contract, the death of the youngest insured raises a question whether the attained age under the contract should continue to be determined based on the attained age of the deceased insured, or should instead be based on the attained age of the

youngest surviving insured. Some last-to-die life insurance contracts undergo a change in both cash value and future mortality charges as a result of the death of an insured. These changes take into account the identity of the surviving insured or insureds. Other last-to-die life insurance contracts treat the death of an insured as a non-event for purposes of measuring cash value and future mortality charges under the contract. The comment letter suggested a rule for last-to-die contracts that would take into account the age of the youngest surviving insured if the contract undergoes modifications to both the cash value and future mortality charges under the contract, so that the attained age assumptions used for Federal income tax purposes are consistent with those used under the terms of the contract. The final regulations include such a rule in §1.7702-2(c)(2).

#### B. Changes in Benefits Between Policy Anniversaries

The proposed regulations provide that the age of an individual insured under a life insurance contract 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 proposed regulations do not, however, define the attained age to be used if there is an increase in death benefits between policy anniversary dates. Specifically, should the attained age as of the beginning of the contract year continue to be used at the time of the benefit

increase, even if the date of change is closer to the next contract anniversary? The comment letter requests flexibility to use the attained age as of either the previous or subsequent policy anniversary, or any age between those two ages. The final regulations address this issue by clarifying that the attained age of the insured under a contract, once determined, changes annually. This rule is set forth in §1.7702-2(b)(2).

### C. Use of Derived Ages for Multiple Life Contracts

Under the proposed regulations, the attained age of the insured under a contract insuring multiple lives is either the attained age of the youngest insured (in the case of a last-to-die contract) or the attained age of the oldest insured (in the case of a first-to-die contract). Some issuers, however, determine mortality charges under such contracts using a single, derived age that does not correspond to the attained age of any single insured under the contract. In addition, in some cases issuers currently account for substandard risks by determining mortality charges based on an age that is older than the actual attained age of the insured under the contract. The comment letter requested a rule that would permit the use of the same derived age as the attained age of the insured in these circumstances, to avoid whatever administrative complexities could result from the use of different ages for different purposes in the course of testing compliance of the contracts with sections 7702 and 7702A.

The final regulations do not make this change. The manner in which age is

used to determine reasonable mortality charges under section 7702(c)(3)(B)(i) is independent of the age that is treated as the attained age of the insured for purposes of determining the guideline level premium under section 7702(c)(4), or applying the cash value corridor of section 7702(d) or the computational rules of section 7702(e). The final regulations do not, nor are they intended to, endorse or prohibit any methodology for determining reasonable mortality charges under section 7702(c). Reasonable mortality charges were the subject of regulations proposed July 5, 1991, (FI-069-89) (1991-2 C.B. 963) in the **Federal Register** (56 FR 30718), and also were addressed in Notice 88-128, 1988-2 C.B. 540, and Notice 2004-61, 2004-2 C.B. 596. See §601.601(d)(2)(ii). This prior guidance is not modified, clarified, or in any other way affected by these final regulations.

#### D. Contract Anniversary

The comment letter requested that the regulations include a definition of contract anniversary other than the issue date of the contract and subsequent anniversaries of that date. The final regulations do not include such a definition because the terms issue date and contract year have broad application, and it would be inappropriate to address the matter for the first time in these final regulations.

#### E. Effective Date

The proposed regulations were proposed to apply to contracts issued on or after the date that is one year after the regulations are published as final regulations

in the **Federal Register**. A taxpayer would be permitted, however, to apply these final regulations retroactively for contracts issued before that date provided the taxpayer does not later determine qualification of those contracts in a manner that is inconsistent with these regulations.

The comment letter requested that the final regulations conform more closely to the adoption dates for the 2001 Commissioners' Standard Ordinary mortality and morbidity tables (2001 CSO tables). These tables are now prevailing within the meaning of section 807(d)(5) and have a mandatory effective date of January 1, 2009. In some States, insurers have the option to use either the 1980 CSO tables or the 2001 CSO tables for contracts issued before January 1, 2009. Either changing from the 1980 CSO mortality tables to the 2001 CSO tables or adopting changes to the determination of the insured's attained age under this regulation (or both) may require filing new contract forms with the relevant state insurance commissioners and may require changes to existing compliance systems. Accordingly, the effective date of this final regulation has been adjusted to take into account the transition period for adoption of the new mortality tables. Specifically, the final regulations apply to life insurance contracts that are either (1) issued after December 31, 2008, or (2) issued on or after October 1, 2007, and based upon the 2001 CSO tables. This modification will enable issuers to make any changes required by this final regulation concurrently with the changes required by the adoption of the 2001 CSO mortality tables. In addition, taxpayers may apply the

regulations for contracts issued before October 1, 2007, provided they do not later determine qualification of those contracts under section 7702 in a manner inconsistent with the regulations.

### **Special Analyses**

It has been determined that this Treasury decision 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) and (d) 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 preceding this Treasury decision was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

### **Drafting Information**

The principal author of these final 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 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 1.7702-2 also issued under 26 U.S.C. 7702(k). \* \* \*

Par. 2. Section 1.7702-0 is added 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/nonsmoker 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 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.
  - (1) In general.
  - (2) Modifications to cash value and future mortality charges upon the death of insured.
- (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.

§1.7702-3 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.

Par. 3. Section 1.7702-2 is added to read as follows:

§1.7702-2 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 determining the guideline level premium of the

contract under section 7702(c)(4), applying the cash value corridor of section 7702(d) or applying 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 as of that date.

(2) Once determined under paragraph (b)(1) of this section, the attained age with respect to an individual insured under a contract changes annually. Moreover, the same attained age must be used for purposes of applying sections 7702(c)(4), 7702(d), and 7702(e), as applicable.

(c) Contract insuring multiple lives on a last-to-die basis--(1) In general. Except as provided in paragraph (c)(2) of this section, 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 for purposes of sections 7702(c)(4), 7702(d), and 7702(e), as applicable.

(2) Modifications to cash value and future mortality charges upon the death of

insured. If both the cash value and future mortality charges under a contract change by reason of the death of one or more insureds to no longer take into account the attained age of the deceased insured or insureds, the youngest surviving insured shall thereafter be treated as 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 for purposes of sections 7702(c)(4), 7702(d), and 7702(e), as applicable.

(e) Examples. The following examples illustrate the determination of the attained age of the insured for purposes of sections 7702(c)(4), 7702(d), and 7702(e), as applicable. The examples are as follows:

Example 1. (i) X was born on May 1, 1947. X became 60 years old on May 1, 2007. On January 1, 2008, X purchases from IC a contract insuring X's life. January 1 is the contract anniversary date for all future years. IC determines X's annual premiums on an age-last-birthday basis. Based on the method used by IC 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 1.7702-2(b)(1) permits the determination of attained age under either of two alternative approaches. Section 1.7702-2(b)(1)(i) provides that, if a contract insures the life of a single insured individual, the attained age may be determined by reference to the individual's actual birthday as of the date of determination. Under this provision, X has an attained age of 60 for the first contract year, 61 for the second contract year, and so on. Alternatively, §1.7702-2(b)(1)(ii) provides that the insured's age may be determined by reference to contract anniversary (rather than the individual's actual birthday), so long as the age assumed under the contract is within 12 months of the actual age as of that date. If IC determines X's attained age under §1.7702-2(b)(1)(ii), X likewise has an attained age of 60 for the first contract year, 61 for the second contract year, and so

on. Whichever provision IC uses to determine X's attained age must be used consistently from year to year for purposes of sections 7702(c)(4), 7702(d), and 7702(e), as applicable.

Example 2. (i) The facts are the same as in Example 1 except that, under the contract, X's annual 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 by IC 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 1.7702-2(b)(1) permits the determination of attained age under either of two alternative approaches. Section 1.7702-2(b)(1)(i) provides that, if a contract insures the life of a single insured individual, the attained age may be determined by reference to the individual's actual birthday as of the date of determination. Under this provision, X has an attained age of 60 for the first contract year, 61 for the second contract year, and so on. Alternatively, §1.7702-2(b)(1)(ii) provides that the insured's age may be determined by reference to contract anniversary (rather than the individual's actual birthday), so long as the age assumed under the contract is within 12 months of the actual age as of that date. If IC determines X's attained age under §1.7702-2(b)(1)(ii), X has an attained age of 61 for the first contract year, 62 for the second contract year, and so on. Whichever provision IC uses to determine X's attained age must be used consistently from year to year for purposes of sections 7702(c)(4), 7702(d), and 7702(e), as applicable.

Example 3. (i) The facts are the same as in Example 1 except that the face amount of the contract is increased on May 15, 2011. During the contract year beginning January 1, 2011, the age assumed under the contract on an age-last-birthday basis is 63 years. However, X has an actual age of 64 as of the date the face amount of the contract is increased.

(ii) Section 1.7702-2(b)(1)(ii) provides that the insured's age may be determined by reference to contract anniversary (rather than the individual's actual birthday), so long as the age assumed under the contract is within 12 months of the actual age. Section 1.7702-2(b)(2) provides that, once determined under paragraph (b)(1) of this section, the attained age with respect to an individual insured under a contract changes annually. Accordingly, X continues to be 63 years old throughout the contract year beginning January 1, 2011, for purposes of sections 7702(c)(4), 7702(d), and 7702(e), as applicable.

Example 4. (i) The facts are the same as in Example 1 except that in addition to X (born in 1947), the insurance contract also insures the life of Y, born on

September 1, 1942. The death benefit will be paid when the second of the two insureds dies.

(ii) Section 1.7702-2(c)(1) 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 §1.7702-2(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 sections 7702(c)(4), 7702(d), and 7702(e), as applicable.

Example 5. (i) The facts are the same as Example 4 except that X (the younger of the two insureds) dies in 2012. After X's death, both the cash value and mortality charges of the life insurance contract are adjusted to take into account only the life of Y.

(ii) Section 1.7702-2(c)(1) 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 §1.7702-2(b) as if the youngest individual were the only insured under the contract. Paragraph (c)(2) of this section provides that if both the cash value and future mortality charges under a contract change by reason of the death of an insured to no longer take into account the attained age of the deceased insured, the youngest surviving insured is thereafter treated as the only insured under the contract. Because both the cash value and mortality charges are adjusted after X's death to take into account only the life of Y, only the attained age of Y is taken into account after X's death for purposes of sections 7702(c)(4), 7702(d), and 7702(e), as applicable.

Example 6. (i) The facts are the same as Example 1 except that in addition to X (born in 1947), the insurance contract also insures the life of Z, born on September 1, 1952. The death benefit will be paid when the first of the two insureds dies.

(ii) Section 1.7702-2(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 §1.7702-2(b) as if the oldest individual were the only insured under the contract. Because X is older than Z, the attained age of X must be used for purposes of sections 7702(c)(4), 7702(d), and 7702(e), as applicable.

(f) Effective dates--(1) In general. Except as provided in paragraph (f)(2) of this section, these regulations apply to all life insurance contracts that are either--

(i) Issued after December 31, 2008; or

(ii) Issued on or after October 1, 2007, and based upon the 2001 CSO

tables.

(2) Contracts issued before the general effective date. Pursuant to section 7805(b)(7), a taxpayer may apply these regulations retroactively for contracts issued before October 1, 2007, provided that the taxpayer does not later determine

qualification of those contracts in a manner that is inconsistent with these regulations.

Deborah M. Nolan

Acting Deputy Commissioner for Services and Enforcement

Approved: September 6, 2006

Eric Solomon

Acting Deputy Assistant Secretary of the Treasury (Tax Policy)