

Guidance Concerning Use of 2017 CSO Tables Under Section 7702

Notice 2016-63

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 (Code). Specifically, this notice supplements Notice 88-128, 1988-2 C.B. 540, and modifies and supersedes Notice 2006-95, 2006-2 C.B. 848, by providing safe harbors regarding the use by taxpayers of the 1980 Commissioners' Standard Ordinary mortality and morbidity tables (1980 CSO tables), the 2001 Commissioners' Standard Ordinary mortality and morbidity tables (2001 CSO tables), or the 2017 Commissioners' Standard Ordinary mortality and morbidity tables (2017 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 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). As originally enacted, § 7702 generally required the use of "the mortality charges specified in the contract" in the actuarial calculations under the cash value accumulation test and the guideline premium requirements. In 1988, § 7702 was amended to require the use of "reasonable mortality charges" in the determination of the cash

value accumulation test and guideline premium requirements. Technical and Miscellaneous Revenue Act of 1988 (1988 Act), Pub. L. No. 100-647, § 5011(a).

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 2017 CSO tables prescribed by the NAIC will become the prevailing commissioners' standard tables within the meaning of § 807(d)(5) on January 1, 2017. The 1980 CSO tables may still be used in all states for contracts issued in calendar years through 2008; and the 2001 CSO tables may still be used in all states for contracts issued in calendar years 2005 through 2019. For contracts issued after 2008, and before January 1, 2017, use of the 2001 CSO tables is

mandatory. The 2017 CSO tables may be used for contracts issued on or after January 1, 2017. For contracts issued on or after January 1, 2020, use of the 2017 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 2006-95 supplemented Notice 88-128 by providing additional safe harbors to account for the promulgation of the 2001 CSO tables. Neither Notice 88-128, Notice 2006-95, nor this notice addresses the reasonable mortality charge requirement in the case of substandard risk underwriting. *See* 1988 Act § 5011(c)(2).

SECTION 3. MODIFICATIONS TO NOTICE 2006-95

This notice makes several modifications to Notice 2006-95. First, it provides safe harbors regarding the use by taxpayers of the 2017 CSO tables for purposes of § 7702(c)(3)(B)(i). Second, it provides that if the only change to an existing contract is a reduction or deletion of benefits provided under the contract, such a change will not affect the determination of the issue date of a contract for purposes of the reasonable mortality charge safe harbor. This modification is consistent with the treatment of a decrease in benefits for purposes of § 7702A. The legislative history of § 7702A states that a decrease in future benefits under a contract is not considered a material change, which would result in the contract being treated as a new contract subject to new testing as of the date of the material change. H.R. Rep. No. 100-1104, at 101 (1988) (Conf. Rep.), 1988-3 C.B. 591; *cf.* § 7702(f)(7) (reduction in future benefits is an event requiring appropriate adjustments of determinations under § 7702). Third, it provides that

changes, modifications, or exercises of contractual provisions referred to in section 5.02 of this notice include reinstatement of a contract as required under applicable state or foreign law.

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; (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; and (4) the contract is issued before January 1, 2020.

.04 *2017 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 2017 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, 2019, or (b) the contract is issued before January 1, 2020, in a state that permits or requires the use of the 2017 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 is issued generally is determined according to the standards that applied for purposes of the original effective date of § 7702. *See* H.R. Rep. No. 98-861, at 1076 (1984) (Conf. Rep.), 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 of this notice, if a life insurance contract satisfied section 4.01, 4.02, or 4.03 of this notice when originally issued, a change from the previous tables to the 2001 or 2017 CSO tables is not required if: (1) the change, modification, or exercise of a right to modify or add 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 or 2017 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. Additionally, a change from the previous tables to the 2001 or 2017 CSO table is

not required if the only change to an existing contract is a reduction or deletion of benefits provided under the contract.

.03 The changes, modifications, or exercises of contractual provisions referred to in section 5.02 of this notice 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 or reinstatement of a policy as required under applicable state or foreign law; 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 sections 4.03 and 4.04 of this notice (the 2001 and 2017 CSO safe harbors), mortality charges that do not exceed the applicable charges in gender- or smoker- based variations of the 2001 or 2017 CSO tables will be treated as reasonable mortality charges, provided the following requirements are satisfied:

.01 *Unisex tables.* If a state permits or requires minimum nonforfeiture values for all contracts issued under a plan of insurance to be determined using the 2001 or the 2017 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 or the 2017 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 2006-95.

SECTION 8. EFFECTIVE DATE

This notice is effective October 19, 2016.

DRAFTING INFORMATION

The principal author of this notice is Alexis A. MacIvor of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this notice, contact Ms. MacIvor at (202) 317-6995 (not a toll-free call).