

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

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Taxpayer =

Parent =

Date 1 =

Date 2 =

State A =

State B =

Rider =

Dear :

This is in reply to the Date 1 letter and subsequent letters submitted by your authorized representatives, requesting two rulings regarding the federal income tax treatment under section 7702(f) and under section 104(a)(3) of the Internal Revenue Code (Code) of certain life insurance policies (Contracts). By Date 2 letter, you representative informed us that you were withdrawing your request for a ruling under section 7702(f).

## FACTS

Taxpayer makes the following representations. Taxpayer is an insurance company subject to taxation under Part I of Subchapter L of the Code. Taxpayer is a stock life insurance company organized and operated under the laws of State A. Taxpayer is licensed to engage in the life insurance business in State B. Taxpayer joins in the filing of a consolidated federal income tax return with Parent on a calendar year basis, using an accrual method of accounting.

The Contracts are individual, non-participating, flexible premium adjustable life insurance policies issued by the Taxpayer. The Contracts are designed to qualify as life insurance contracts under section 7702 by meeting the guideline premium requirements of section 7702(a)(2)(A) and 7702(c) and the cash value corridor requirements of section 7702(d) (GP test). In addition, certain of the Contracts will be issued with an endorsement that the Taxpayer is currently developing that is designed to ensure their compliance under section 7702 by meeting the cash value accumulation test of section 7702(a)(1) and 7702(b) (CVA test).

The Rider allows the owner to make an election to accelerate the receipt of all or a portion of the death benefit under the Contract to which the Rider is attached if the person insured thereunder becomes critically ill. The Rider pays a benefit to the policy owner during the insured's life time if the insured is diagnosed by a physician as having a qualifying covered condition. The covered conditions are defined in the Rider. Payment of the benefit reduces the death benefit payable under the Contract. The Contract terminates if the death benefit payable is reduced to zero upon payment of the covered condition benefit.

The Rider states that it does not provide any cash value or loan value. Taxpayer represents that the Contract and Rider are purchased with after-tax monies, i.e., no premiums are deductible by the owner or attributable to contributions by an employer of an owner which were not includible in the gross income of the owner. Thus, the Contract and Rider are purchased solely with the owner's after-tax funds.

Taxpayer represents that the Rider is not a "qualified additional benefit" within the meaning of section 7702(f)(5).

## REQUESTED RULING

With respect to the Rider Benefit paid under the Rider, whether the Rider Benefit will be fully excludable from the recipient's gross income under section 104(a)(3).

## LAW AND ANALYSIS

Section 7702(a) of the 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 satisfy either (1) satisfy the CVA test of section 7702(b), or (2) the GP test. A contract meets the CVA test if, by the terms of the contract, the cash surrender value of the contract will 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.

To meet the CVA test, the "cash surrender value" (as defined in section 7702(f)(2)) of a contract at any time cannot, by the contract's own terms, be capable of exceeding the "net single premium" that would have to be paid at that time for the "future benefits" under the contract. Section 7702(b) requires that the "net single premium" be computed using: (1) an interest rate, which is the greater of an annual effective rate of 4% or the rate or rates "guaranteed" on issuance of the contract; (2) reasonable mortality charges 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)); and (3) in the case of "qualified additional benefits", any reasonable charges (other than mortality charges) for "qualified additional benefits" to the extent that those charges are reasonably expected to be actually paid. "Cash surrender value" is defined as the "cash value" (i. e., the amount to which a policyholder is entitled upon surrender of the contract or against which the policyholder can borrow) of a contract without regard to any surrender charge, policy loan, or reasonable termination dividend.

Section 7702(e) provides computational rules applicable to the determination of the amount of "future benefits" taken into account in calculating the "net single premium". Specifically, section 7702(e)(1) provides, for purposes other than the cash value/minimum risk corridor test under section 7702(d), that --

(A) the death benefit (and any qualified additional benefit) shall be deemed not to increase,

(B) the maturity date, including the date on which any benefit described in subparagraph (C) is payable, shall be 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,

(C) the death benefits shall be deemed to be provided until the maturity date determined taking into account subparagraph (B), and

(D) the amount of any endowment benefit (or sum of endowment benefits), including any cash surrender value on the maturity date determined by taking into account subparagraph (B), shall be deemed not to exceed the least amount payable as a death benefit at any time under the contract.

Section 104(a)(3) provides that, except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 (relating to medical expenses) for any prior taxable year, gross income does not include amounts received through accident or health insurance (or through an arrangement having the effect of accident or health insurance) for personal injuries or sickness (other than amounts received by an employee, to the extent such amounts (1) are attributable to contributions by the employer which were not included in the gross income of the employee, or (2) are paid by the employer).

Based on the representations and the authority cited above, we conclude that the Rider will be treated as accident or health insurance and benefits received under the Rider will be excludable from the recipient's gross income under section 104(a)(3) of the Code, as long as the benefits are attributable to the recipient's after-tax contributions.

Except as set forth above, no opinion is expressed or implied concerning the tax consequences of section 7702(f) to this transaction or any aspect of any transaction or item discussed or referenced in this letter. This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

The ruling contained in this letter is based upon information and representations submitted by the Taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for ruling, it is subject to verification on examination.

Sincerely,

/S/

SHERYL FLUM  
Branch Chief, Branch 4  
Office of the Associate Chief Counsel  
(Financial Institutions & Products)