

Part III - Administrative, Procedural, and Miscellaneous

Guidance Concerning Use of 2001 CSO Tables Under Section 7702

Notice 2004-61

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. Specifically, this notice supplements Notice 88-128, 1988-2 C.B. 540, by providing safe harbors regarding the use of either the 1980 Commissioners' Standard Ordinary mortality and morbidity tables (1980 CSO tables) or the 2001 Commissioners' Standard Ordinary mortality and morbidity tables (2001 CSO tables) by taxpayers 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 of the Code 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).

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 2001 CSO tables prescribed by the NAIC became the prevailing commissioners' standard tables within the meaning of section 807(d)(5) during calendar year 2004. In each of the states that have adopted the 2001 CSO tables, the 1980 CSO tables may be used for contracts issued in calendar years through 2008. After 2008, use of the 2001 CSO tables will be mandatory in these states. In states that have not yet adopted the 2001 CSO tables, use of the 1980 CSO tables is still required.

SECTION 3. SAFE HARBORS UNDER SECTION 7702

Pending publication of additional guidance, the following safe harbors will apply for purposes of § 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 mortality charge does not exceed the mortality charge specified in the contract at issuance; (3) 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 (4) 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; and (3) either the contract is issued after December 31, 2008, or 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.

SECTION 4. RULES FOR GENDER- OR SMOKER-BASED TABLES

Mortality charges that do not exceed the applicable charges in gender- or smoker-based variations of the 1980 CSO tables or 2001 CSO tables (as applicable) will be treated as reasonable mortality charges, provided the following requirements are satisfied:

.01 Unisex tables. If a state permits minimum nonforfeiture values for all contracts issued under a plan of insurance to be determined using the 1980 or 2001 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 1980 or

2001 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 5. ISSUE DATE OF CONTRACTS

.01 For purposes of this notice, the date on which a contract was issued generally is to be determined according to the standards that applied for purposes of the original effective date of section 7702. See H.R. Conf. Rep. No. 861, 98th Cong., 2d Sess. 1076 (1984), 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, if a life insurance contract satisfied Section 3.01 or Section 3.02 when originally issued, a change from previous tables to the 2001 CSO tables is not required if:

- (a) The change, modification, or exercise of a right to modify, add or delete benefits is pursuant to the terms of the contract;
- (b) The state in which the contract is issued does not require use of the 2001 CSO tables for that contract under its standard valuation and minimum nonforfeiture laws; and
- (c) The contract continues upon the same policy form or blank.

The changes, modifications, or exercises of contractual provisions referred to in this subsection include addition or removal of a rider, an increase or decrease in death benefit (if the change is not underwritten), and a change from an option 1 to option 2 contract or vice versa.

SECTION 6. EFFECT UPON OTHER PUBLICATIONS

This notice supplements Notice 88-128.

SECTION 7. REQUEST FOR COMMENTS

The Internal Revenue Service and the Treasury Department recognize that additional guidance may be needed regarding the application of § 7702(c)(3)(B)(i). Therefore, the Treasury Department and the IRS request comments from taxpayers regarding guidance needed to address issues not specifically addressed by this notice or by Notice 88-128, including issues addressed by § 1.7702-1 of the proposed Income Tax Regulations, published in the Federal Register on July 5, 1991 (56 Fed. Reg.

30718).

Comments should be submitted by January 10, 2005. Comments may be submitted to CC:PA:RU (Notice 2004-61), room 5203, Internal Revenue Service, PO Box 7604 Ben Franklin Station, Washington, DC. 20044. Comments may be hand delivered between the hours of 8:00 a.m. and 4 p.m. Monday to Friday to CC:PA:RU (Notice 2004-61), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC 20224. Alternatively, comments may be submitted via the internet at Notice.Comments@irs.counsel.treas.gov. All comments will be available for public inspection and copying.

SECTION 8. PROCEDURAL INFORMATION

This notice serves as an "administrative pronouncement" as that term is described in § 1.6661-3(b)(2) of the regulations and may be relied upon to the same extent as a revenue ruling or a revenue procedure.

DRAFTING INFORMATION

The principal author of this notice is Ann H. Logan of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this notice, contact Ann H. Logan on (202) 622-3970 (not a toll-free call).