Significant Index No. 401.00-00

201043048

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

AUG 0 3 2010

SE:T:EP:RA:T3

Company =

WL Policy =

QP Rider =

AP Rider =

APP Rider =

CO Rider =

EO Rider =

Contract =

X =

Y =

Z =

J =

K =

L =

M =

N =

Dear

This letter is in response to your request for rulings regarding the application of the "incidental death benefit" rule in situations in which Contracts are issued on the lives of participants in retirement plans qualified under section 401(a) of the Code ("Qualified Plans"). Specifically, you have requested rulings that:

(1) Each WL Policy with the QP Rider and any or all of the Other Four Riders (Contract) that is acquired on the life of a Qualified Plan participant qualifies as an "ordinary" life insurance contract within the meaning of Revenue Ruling 54-51, 1954-1 C.B. 147.

(2) Death benefits provided to participants in a Qualified Plan through such Contracts will be considered "incidental" within the meaning of section 1.401-1(b)(1) of the regulations provided that, with respect to each participant, less than 50% of the total contributions allocated to the participant are applied to pay premiums on the Contract (or any other life insurance contract) insuring the life of the participant.

Included in your submission were policy specification pages for the WL Policy for sample participants, ages , , , and , on a male, female, and unisex gender basis, for face amounts $ $1 million, and $, on a preferred/non-nicotine, standard/non-nicotine, and nicotine underwriting basis. Accordingly, you submitted sets of policy specification pages. Hereinafter, each one of these age/gender/face amount/underwriting class combinations will be known as a

Also included in your submission were tables of current cost of insurance (COI) charges and tables of current and maximum surrender charges covering all ages and all durations.

Facts

The WL Policy is a level premium level face amount whole life insurance policy. As long as premiums are paid in the amount and at the times specified in the WL Policy (the "Scheduled Premiums"), the death benefit may only differ from the face amount listed in the policy specification pages under two circumstances: (1) decreases in accordance with the Decreases in Face Amount provision of the policy and (2) increases necessary to ensure that the policy qualifies as a life insurance contract for federal tax purposes under section 7702 of the Code. In the event of a face amount decrease, the Scheduled Premium and Guaranteed Cash Values will be reduced in the same proportion that the face amount is reduced.

Cash Values under the WL Policy are determined as the greater of (1) the Guaranteed Cash Value and (2) the Account Value less any applicable Surrender Charges. The WL Policy states that the Cash Values provided by the WL Policy are not less than the minimum values and benefits required by the insurance laws of the State in which the WL Policy is issued and delivered.

The basis for computations for the Guaranteed Cash Value is interest at an annual rate of X percent and the 2001 Commissioners Standard Ordinary mortality table.

The Account Value is generally determined as cumulative premiums received plus interest credits less COI charges and less other charges ("Other than COI Charges"). Other than COI Charges include a percent of premium charge ("Percent of Premium Charge"), a monthly per $ of face amount charge ("Monthly per 1000 Charge"), and a monthly administrative charge. The monthly administrative charge is $Y per month. The WL Policy lists maximum Percent of Premium Charges and maximum Monthly per $ Charges. The Company states that it always charges the maximum Percent of Premium Charge and the maximum Monthly per $1000 Charge.

There are no provisions in the WL Policy for the payment of premiums other than Scheduled Premiums. With respect to the Submitted Cells, Guaranteed Cash Values at ages and (age in the case of contracts issued to year olds), with the exception of a de minimus number of cells[1], exceed fifty percent of the applicable Scheduled Premium accumulated (at a rate of X percent) to the comparable age (e.g., a Guaranteed Cash Value at age would be compared to the Scheduled Premium accumulated to age).

For example, the Scheduled Premium for a 35 year old Male issued a WL policy with a face amount of $100,000 on a standard non-nicotine basis is $J. The Guaranteed Cash Values of such a policy at ages 55 and 65 are $K and $L respectively. The Scheduled Premiums, accumulated at a rate of X percent to ages 55 and 65 are $M and $N respectively. Accordingly, with respect to this Submitted Cell, the Guaranteed Cash Value represents 66 percent of the accumulated Scheduled Premium at age 55, and 60 percent of the accumulated Scheduled Premiums at age 65.

The QP Rider is a generic agreement between the Insurer and the Qualified Plan fiduciary which owns the policy to which the rider is attached. The stated purpose of the QP Rider is to help maintain the qualification of any Qualified Plan that holds the policy and the QP Rider. The QP Rider generally

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[1] There were Z cells in which the ratios of the accumulated premiums to the guaranteed cash values were between 45 and 49 percent. It does not appear that any of these Z cells will comprise a significant portion of total Contract sales.

precludes any assignment or transfer of policy benefits, and in addition, specifically precludes policy loans, including automatic premium loans, and specifically precludes face amount reductions, while the policy is owned by a Qualified Plan fiduciary.

The AP Rider is a generic rider that adds an additional premiums provision to the policy to which it is attached. The AP Rider generally permits the payment of premiums toward the policy above and beyond any Scheduled Premiums. Such premiums have no effect on the Guaranteed Cash Value of the policy but will serve to increase the Account Value of the policy. The payment of additional premiums under the provisions of the AP Rider will not increase the death benefit of the policy except as necessary to comply with the limits of section 7702 of the Code.

The APP Rider is a generic rider that adds an automatic premium payment provision to the policy to which it is attached. The APP Rider provides that in the event a Scheduled Premium is due and unpaid at the end of the policy grace period, the Scheduled Premium will be paid by an automatic deduction from the Account Value of the policy. However, this deduction will be made only if the Account Value exceeds the Guaranteed Cash Value by more than the amount of the Scheduled Premium[2].

The CO Rider is a generic rider that adds a conversion option to the policy to which it is attached (the "Pre-Conversion Policy"). The conversion option described in the CO Rider is not available while the Pre-Conversion Policy is owned by a tax-qualified retirement plan fiduciary.

The EIO Rider is a generic rider that adds an extended insurance option to the policy to which it is attached. The EIO Rider's benefits are not available while the policy is owned by a tax-qualified retirement plan fiduciary.

Law

Section 401(a)(1) of the Code provides that a trust created or organized in the United States and forming part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries shall constitute a qualified trust under that section if contributions are made to the trust by such employer, or employees, or both, ... for the purpose of distributing to such

[2] The automatic premium provision provided under the APP Rider differs substantively from a loan provision, including an automatic premium loan provision, which are not permitted under the QP Rider. Under the former, excess cash value (i.e., cash value in excess of the guaranteed cash value) is withdrawn and used to pay a premium. Once the premium is paid, and the excess cash value is reduced, the slate is, in effect, drawn clean. In contrast, under a loan provision, amounts are borrowed to pay a required premium and interest accrues on the loaned amounts. Thus, should the policy owner fail to repay the loan, the policy may lapse even if all future premiums are paid.

employees or their beneficiaries the corpus and income of the fund accumulated by the trust in accordance with such plan.

Section 1.401-1(b)(1) of the regulations provides that a pension plan may provide for the payment of a pension due to a disability and may also provide for the payment of incidental death benefits through insurance or otherwise.

Revenue Ruling 54-51 states that an investment by a profit-sharing trust in an ordinary life insurance contract for each insurable participant under the trust will be considered incidental and subordinate to the primary purpose of a qualified profit-sharing plan where (1) the aggregate premiums for life insurance in the case of each participant is less than one-half of the aggregate of the contributions allocated to him at any particular time; and (2) the plan shall require the trustee to convert the entire value of the life insurance contract at or before retirement to provide periodic income so that no portion of such value may be used to continue life insurance beyond retirement.

Revenue Ruling 61-164 states that the following interpretation of 'incidental' will be applied with respect to qualified plans providing one or more life or accident or health insurance benefits for participants with funds that have not been accumulated for the period prescribed by the plan for the deferment of distributions:

(1) If only ordinary life insurance contracts are purchased, the amount expended for premiums may not exceed the percentage permitted in Revenue Ruling 54-51.

(2) If only accident and/or health insurance contracts (including hospitalization, major medical, or similar types of insurance) are purchased, the amount expended for premiums may not exceed 25 percent of the funds allocated to an employee's account that have not been accumulated for the period prescribed by the plan for the deferment of distributions.

(3) If both ordinary life and accident and/or health insurance contracts are purchased, the amount expended for accident and/or health premiums plus one-half of the amount expended for ordinary life insurance premiums may not, in the aggregate, exceed 25 percent of the funds allocated to an employee's account that have not been accumulated for the period prescribed by the plan for deferment of distributions. At no time may this percentage be exceeded.

Revenue Ruling 66-143 states that in essence, a 25-percent limitation on pure insurance protection is applicable under a profit-sharing plan or a pension plan of the money purchase type since the 50-percent limitation on amounts credited to a participant's account, which may be expended for premiums on ordinary life insurance contracts under such plans takes into account the fact, as stated in Revenue Ruling 61-164, that only approximately one-half of the premiums paid for such contract are for pure insurance protection, the remainder being applied to the building up of a reserve.

Analysis

The WL Policy is similar to an ordinary whole life insurance policy[3] in that it provides death benefit coverage for life in a stipulated level amount as long as scheduled level premiums are paid as they fall due. It differs from an ordinary whole life policy in that cash values will exceed the Guaranteed Cash Value whenever the Account Value less the Surrender Charges is greater than the Guaranteed Cash Value. Thus, at all times cash values under the WL Policy will equal or exceed the minimum cash values under an ordinary whole life insurance policy. Moreover, as Guaranteed Cash Values under the WL generally exceed 50 percent of the accumulated Scheduled Premiums, it is clear, for the block of business as a whole, that less than 50 percent of the Scheduled Premiums will be used for pure insurance protection. Accordingly, the WL Policy, when looked at without the addition of any riders, may be treated as an "ordinary" life insurance contract for purposes of applying the rules set forth in Rev. Rul. 54-51, 1954-1 C.B. 147.

The addition of the Qualified Plan Rider and any or all of the Other Four Riders to the WL Policy does not alter this analysis. This is so because the addition of the Qualified Plan Rider and any of these riders, either individually, or in combination, can not result in an increase in pure insurance protection beyond that found in a comparable ordinary whole life insurance policy. In particular, while the policy is owned by a Qualified Plan fiduciary, not one of the Other Four Riders allow for, or permits, any reduction in the Guaranteed Cash Value or any increase in the face amount of the WL Policy, except as necessary to comply with the limits of section 7702 of the Code. Note that any increase in the face amount of the WL Policy required in order to maintain compliance with section 7702 can only occur in a situation in which the amount of pure insurance protection is so small that, if not for the increase, the policy would be deemed not to be life insurance for purposes of Title 26, and subsequent to the increase, the amount of pure insurance protection is at the minimum amount permissible under section 7702 of the Code.

Conclusion

(1) Each Contract acquired on the life of a participant in a Qualified Plan will be treated as an "ordinary" life insurance contract for purposes of applying the rules set forth in Rev. Rul. 54-51, 1954-1 C.B. 147.

(2) Death Benefits provided to Qualified Plan participants through such Contracts will be considered "incidental" within the meaning of section 1.401-1(b)(1) of the regulations provided that, with respect to

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[3] The term "ordinary life insurance" is used herein to describe policies that provide life insurance for the whole of life, with premiums that are payable for the whole of life. Under such policies, cash values are guaranteed and determined in accordance with State non-forfeiture laws, and generally listed in the policy.

each participant in the Qualified Plan, less than 50% of the total contributions allocated to the participant are applied to pay premiums on the Contract (or any other life insurance contract) insuring the life of the participant.

If you have any questions on this ruling letter, please contact

Sincerely,

David M. Ziegler, Manager
Employee Plans Actuarial Group 2