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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
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Person To Contact:
, ID No.
Telephone Number:

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PLR-135274-11
Date:
January 30, 2012

Taxpayer =

Parent =

State =
X =
Y =

Dear :

This is in reply to your request for a ruling with respect to the "reasonable mortality charge" requirements under § 7702(c)(3)(B)(i) of the Internal Revenue Code for certain life insurance contracts issued on or after October 21, 1988 and before January 1, 2009 ("Contract(s)").

FACTS

Taxpayer represents as follows:

Taxpayer was incorporated in State and is an indirect wholly-owned subsidiary of Parent with whom it files a consolidated Federal income tax return. Taxpayer is licensed to engage in the life insurance business in X and Y and represents that it is a life insurance company as defined by § 816. Further, the Contracts are life insurance contracts under § 7702 by satisfying the cash value accumulation test ("CVAT") of § 7702(b). In making the computations required by § 7702 for the Contracts, Taxpayer utilizes the 1980 CSO mortality tables.

Under certain circumstances, owners of the Contracts want to decrease the death benefit.[1] For example, (1) the contract owner may not need the full amount of coverage originally purchased; (2) market downturns increase the net amount at risk on a variable contract and the contract owner may not want, or cannot afford, to pay higher premiums; (3) the contract owner can no longer afford the premium; and (4) if the contract owner cannot, or does not want, to pay the full premium, coverage could lapse and terminate without value. The Contracts do not include a provision that explicitly contemplates the owner's ability to request a decrease in coverage under the contract. The Contracts contain provisions allowing the owner to request a modification, and requiring Taxpayer's consent to the modification. When owners have used these provisions to request a reduction of the death benefit, Taxpayer's historical practice has been to grant the request.

REPRESENTATIONS

Additionally, Taxpayer represents that:

(1) Taxpayer issued each contract before January 1, 2009, and the state in which each contract was issued permitted or required the use of the 1980 CSO mortality tables at the time of issuance.
(2) Each contract qualifies for, and relies upon the safe harbors in Notice 88-128 and Notice 2006-95 that deems mortality charges based on the 1980 CSO mortality tables to be "reasonable" mortality charges for purposes of § 7702(c)(3)(B)(i).
(3) Taxpayer will grant a request by a contract owner for a decrease in face amount under the contract, and will not treat the decrease as causing a loss of the 1980 CSO safe harbor under Notice 2006-95, only if:
    (i) the contract will continue on the same policy form or blank; and
    (ii) the state in which the contract was issued will continue to permit the use of the 1980 CSO mortality tables under the state's standard valuation and minimum nonforfeiture laws as applied to the contract.

REQUESTED RULING

Taxpayer requests a ruling that a reduction in the face amount under a Contract pursuant to the owner's request and with Taxpayer's consent, will not cause the Contract to be treated as 'newly issued' for purposes of § 5 of Notice 2006-95.

[1] The death benefit may change if there is a withdrawal of the Contract's cash value. At issue here is a contractual modification of the death benefit, not a modification resulting from the application of formula to the Contract's cash value.

LAW

A “life insurance contract” is any contract that is a life insurance contract under applicable law but only if the contract (1) meets the CVAT or (2) meets the “guideline premium requirements” and falls within the “cash value corridor”. § 7702(a).[2]

A contract meets the CVAT if, by the terms of the contract, the cash surrender value does not at any time exceed the net single premium which would have to be paid to fund future benefits under the contract. § 7702(b).

Under § 7702(b)(2), the CVAT determination is made:

(1) On the basis of interest at the greater of an annual effective rate of 4 percent or the rate(s) guaranteed in the contract;
(2) Based on a reasonable mortality charge; and
(3) Certain computation rules.

For contracts issued on or after October 21, 1988, the reasonable mortality charge must meet the requirements prescribed in regulations[3] and may not exceed the mortality charges specified in the prevailing commissioners’ standard tables at the time the contract is issued. § 7702(3)(B)(i).[4]

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. When the tables change, 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 Commissioners’ Standard Ordinary mortality and morbidity tables (2001 CSO tables) prescribed by the NAIC became the prevailing commissioners’ standard tables during calendar year 2004. Accordingly, the 2001 CSO mortality tables generally must be used for purposes of applying the reasonable mortality charge requirements of § 7702(c)(3)(B)(i) with regard to contracts issued after December 31, 2008. *See* Notice 2006–95.

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[2] Section 221 of the Deficit Reduction Act of 1984 ("DEFRA"), Pub. L. No. 98-369, 98 Stat. 767, 1984-3 (Vol. 1) C.B. 274, added § 7702 to the Code providing a statutory definition of the term "life insurance contract". Section 7702 applies to contracts issued after December 31, 1984 in taxable years ending after that date.

[3] In 1991, the IRS issued proposed regulations defining "reasonable mortality charges" for computations under §§ 7702 and 7702A (*see*, Prop. Treas. Reg. § 1.7702-1(b)) but has not published them in final form.

[4] *See*, § 5011(a) of the Technical and Miscellaneous Revenue Act of 1988 ("TAMRA"), Pub. L. 100-647 (1988), 102 Stat. 3660, 1988-3 C.B. 320.

Notice 2006-95 provides guidance on the applicable issue date for purposes of the reasonable mortality charge requirements. Section 5.01 provides that

> [t]he 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 [§] 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.

For contracts that satisfied the Notice's "safe harbors" when issued, § 5.02 of Notice 2006-95 provides an exception from the "exchange rule". For these contracts, a change in an existing contract does not result in an exchange of the existing contract for a new contract to which the 2001 CSO tables apply 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.

Section 5.03 of Notice 2006-95 explains that that:

> [t]he changes, modifications, or exercises of contractual provisions referred to in [§] 5.02 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; and (6) reconsideration of ratings based on rated condition, lifestyle

or activity (such as a change from smoker to nonsmoker status).

ANALYSIS

Under § 5.02 of Notice 2006-95, certain alterations of a life insurance contract are not considered to result in an exchange that would cause the contract to be considered "newly issued" on the date of the alteration. The excepted alterations are those made "if the change, modification, or exercise of a right to modify, add or delete benefits is *pursuant to the terms of the contract*." (*Emphasis added*) Here, the requested decrease is not pursuant to the terms of the Contract(s). In contrast to some contracts, the Contracts do not contain any terms that operate to alter of the amount of coverage. The alteration neither occurs automatically upon the satisfaction of a condition set forth in the Contracts nor as a result of the exercise of any contractual right provided to a party to the contract. Accordingly, a reduction in the face amount under a Contract, pursuant to the owner's request and with Taxpayer's consent, is not an alteration "pursuant to the terms of the contract" under § 5.02 of Notice 2006-95.

RULING

A reduction in the face amount under a Contract, pursuant to the owner's request and with Taxpayer's consent, results in an exchange that causes the Contract to be treated as newly issued for purposes of reasonable mortality charge requirements of § 7702(c)(3)(B)(i).

CAVEATS

The rulings contained in this letter are based upon information and representations submitted by Taxpayer and accompanied by a penalties of perjury statement executed by the appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination. Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter, including but not limited to the treatment under §§ 7702, 7702A, 72, or 807.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Temporary or final regulations pertaining to one or more issues addressed in this ruling have not yet been adopted. Therefore, this ruling will be modified or revoked by adoption of temporary or final regulations to the extent the regulations are inconsistent with any conclusion in the ruling. See § 11.04 Rev. Proc. 2012-1, 2012-1 C.B. 1, when the criteria in § 11.04 of Rev. Proc. 2012-1 are satisfied, a ruling is not revoked or modified retroactively except in rare or unusual circumstances.

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

Sincerely,

/s/

JOHN E. GLOVER
Senior Counsel, Branch 4
Office of Associate Chief Counsel
(Financial Institutions & Products)

cc: