DEPARTMENT OF THE TREASURY
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OFFICE OF THE CHIEF COUNSEL

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UIL: 7702.00-00, 7702A.00-00

The Honorable Bradley Schneider
Member, U. S. House of Representatives
111 Barclay Boulevard, Suite 200
Lincolnshire, IL 60069

Attention:

Dear Representative Schneider:

I'm responding to your January 15, 2025 inquiry on behalf of your constituent, . She asked about the qualification rules for life insurance contracts and modified endowment contracts (MECs) under the Internal Revenue Code (IRC) Section 7702 and 7702A.

I cannot comment on and contracts with . However, I can provide the following helpful general information about life insurance policies and MECs.

<u>Section 7702</u>
Under Section 7702(a), any contract entered into after December 31, 1984 qualifies as a life insurance contract under the IRC if the contract is a life insurance contract under applicable law and passes either test listed below:

- The cash value accumulation test or
- The guideline premium and cash value corridor tests

Congress passed Section 7702(a) in 1984, which included the cash value accumulation test and the guideline premium and cash value corridor tests.

Section 7702(a) has not changed since 1984. Generally, once a contract satisfies the requirements of Section 7702(a) through one of the tests mentioned above, it must continue to satisfy that test in order to qualify as a life insurance contract for federal income tax purposes.

Cash Value Accumulation Test (CVAT)
The CVAT limits the cash value of a contract intended to qualify as a life insurance

contract. Under the CVAT, the cash surrender value of such a contract may not exceed the net single premium which the insured must pay to fund future benefits under the contract.

Guideline Premium Test (GPT) and Cash Value Corridor Test
The GPT limits the amount of premiums the insured may pay on a contract that is intended to qualify as a life insurance contract.

If the insured pays the premiums above this limit it will cause a contract to fail to qualify as a life insurance contract under Section 7702. However, a contract can qualify if the insurance company returns the premiums paid over the limit at year's end as described in Section 7702(f)(1)(B).

As described in Section 7702(d), a contract falls within the cash value corridor if the contract's death benefit is not less than the applicable percentage of the cash surrender value. Section 7702(d) shows a table with the applicable percentage, which varies with the insured's age.

<u>Section 7702A</u>
Under 7702A, a contract that began on or after June 21, 1988 is a MEC if it meets the requirements of Section 7702 but fails to meet the seven-pay premium test set forward in Section 7702A(b). A contract fails to meet the seven-pay premium test if the accumulated amount of premiums paid for the contract at any time during the first seven years exceeds the amount of premiums that would have been paid at that time if the contract provided for seven equal annual premiums sufficient to fund the future benefits.

asked about making exceptions for certain life insurance contracts from Section 7702. She also asked about modifying that provision's requirements more generally. However, her suggestions require Congress to make changes to applicable law.

I hope this information is helpful. If you have any questions, please contact me at , or or at .

Sincerely,

Office of the Associate Chief Counsel
(Financial Institutions & Products)