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# ACLI UPDATE COLUMN

By Walter Welsh and Mandana Parsazad

**Walter Welsh**  
is executive vice president, Taxes & Retirement Security at the ACLI in Washington, D.C. and may be reached at [walterwelsh@acli.com](mailto:walterwelsh@acli.com).

**Mandana Parsazad**  
is senior counsel, Taxes & Retirement Security at the ACLI in Washington, D.C. and may be reached at [MandanaParsazad@acli.com](mailto:MandanaParsazad@acli.com).

## NOTICE 2009-47: SECTION 7702 AND AGE 100 INSURED

In May 2009, Treasury and the Internal Revenue Service (IRS) issued Notice 2009-47 (“Notice”) with proposed safe harbors regarding the application of the computational rules of sections 7702 and 7702A to a contract with mortality guarantees based on the 2001 CSO Mortality Tables. In October 2009, ACLI submitted a letter in response to the request for comments in the Notice. ACLI and its members appreciate that the notice provided proposed rules and an opportunity for comment. The intersection of the rules of section 7702 and a new mortality table is an area where actuaries and tax professionals must come together and the issuance of rules in proposed form provides an opportunity to develop the most workable rules.

ACLI endorsed the use of the recommendations of the 2001 CSO Maturity Age Task Force of the Society of Actuaries’ Taxation Section in the Proposed Safe Harbor. In particular ACLI urged Treasury and IRS to finalize and publish the list of age 100 testing methodologies in section 3.02(a)-(h) of the Proposed Safe Harbor, subject to some technical suggestions offered. In this connection, ACLI recommended that the Proposed Safe Harbor be limited to life insurance contracts that a) contain mortality rate guarantees which are based on the 2001 CSO Tables (or any successor prevailing mortality tables) and b) may continue in force beyond the insured’s age 100.

ACLI’s letter contrasted these useful computational rules with the proposed rule in section 3.02 (i) of the Notice, that a contract be required to provide at all times a death benefit equal to or greater than 105 percent of the cash value. ACLI’s letter questioned whether basing the 105 percent corridor requirement on case law requiring an insurance contract to exhibit risk shifting and risk distribution was correct. The *Helvering v. Le Gierse*<sup>1</sup> case should not apply to a contract that complies with section 7702, provides material insurance

coverage during an insured’s life, and ceases to have a net amount at risk in the rare circumstance in which the insured survives to a very late age. The letter also pointed out that the rules of section 7702 and section 72 should govern the taxation of distributions from life insurance contracts rather than the general constructive receipt doctrine (*see* Treas. Reg. § 1.451-2(a)).

## NEED FOR GUIDANCE ON COMBINED ANNUITY AND LONG-TERM CARE CONTRACTS

Even though Congress permitted life insurance companies to issue annuity contracts that include qualified long-term care insurance coverage as part of the Pension Protection Act of 2006,<sup>2</sup> companies, Treasury and IRS are just now getting around to discussing the fine points of how the federal tax rules should apply to premiums, application of insurance charges, payment of benefits and surrender of the contract. Although the legislative history provides assistance with a number of questions regarding the tax consequences to policyholders who purchase combination annuity/long-term care insurance contracts, there are other issues for which there is currently no guidance available.

ACLI and its member companies have been identifying a number of issues in need for guidance on the federal tax treatment for annuity/long-term care combination contracts. ACLI plans to ask for guidance to confirm that:

- All premiums paid into an annuity/long-term care insurance contract will be included in the investment in the contract consistent with §72(e)(11).
- The investment in the contract will be reduced by the long-term care insurance charges that are imposed.
- Amounts received as qualified long-term care benefits will be excluded from gross income under §104(a)(3).
- The payment of long-term care benefits under a combina-

tion contract does not cause a reduction in the investment in the contract, without regard to whether the payment causes a reduction in the contract's cash value.

- Taxpayers may engage in a partial exchange of an annuity contract for qualified LTC insurance.

ACLI has met with Treasury and IRS to begin the discussion, and believes that Treasury and IRS will issue guidance on a number of these questions. ACLI also believes that guidance on some of the more novel issues may be published in proposed form. ◀

END NOTES

<sup>1</sup> 312 U.S. 531 (1941).

<sup>2</sup> P.L. 109-280, §844 (c) and (f).

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