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ADMINISTRATION OF THE "MATERIAL CHANGE" RULES: MEETING THE CHALLENGE

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Are you troubled by strange noises in the middle of the night?
Do you experience feelings of dread in your basement or attic?
If the answer is "yes," then don't wait another minute. Pick up the phone and call the professionals …

Ghostbusters, 1984

Life insurers have the sometimes daunting responsibility of maintaining life insurance contracts in compliance with the requirements imposed by the Internal Revenue Code (the "Code"). Administration of these tax provisions is no simple task—they are complex tax rules applied to increasingly complex life insurance contracts. With the coming of modern life insurance products, including universal life and variable life, policy administration systems were called on to manage often highly flexible and transaction-driven coverage. Further complicating the task, the tax rules become particularly intricate when applied to insurance contracts undergoing provision or benefit changes. In this article, we focus on the day-to-day implications of the material change rules as they apply to the ongoing administration of life insurance policies. This article is a companion to "They Go Bump in the Night: Life Insurance Policies and the Law of Material Change," an article written by John T. Adney and Craig R. Springfield that describes the various material change rules found in the Code, highlighting the complexities insurers face in navigating through these rules when a life insurance contract is materially changed. The Adney and Springfield article also addresses the difficulties in interpreting the tax law requirements under the various effective date rules contained in the Code sections affecting life insurance contracts.

While the Code may contain an inherent level of uncertainty regarding the tax treatment of material changes, by their very nature life insurance administration systems cannot deal with uncertainty. Administration systems are rules-based. They must be programmed with specific interpretations of the tax requirements for each and every transaction affecting a life insurance contract—interpretations made and specified for programming during the development and implementation of a system with respect to compliance. Failure to interpret or properly implement the rules correctly can lead to errors, which in turn may result in a contract becoming an inadvertent failure under section 7702 or an inadvertent modified endowment contract ("MEC") under section 7702A. Additionally, since these "rules" can, do, and have changed over time, administration systems are required to decipher whether a particular contract should apply an "at issue" rule set in processing a policy change request, or whether a new set of tax rules may govern based on the effective date of the material change.

The development of the section 101(f), 7702 and 7702A rules can be thought of as creating "categories" of life insurance contracts classified according to the statutory requirements in effect when a contract is issued. These categories generally correspond with the enabling legislation that created the Code sections that govern the taxation of the contracts, defining the rules underlying the tax qualification of life insurance ("rule eras"). The various rule eras establish the broad framework for tax compliance by establishing actuarial limitations on the permissible funding of life insurance contracts. Each rule era has its own effective date provisions that provide administrators with guidance as to when a life insurance contract would become subject to its requirements. These rules create a dual aspect to compliance. The first is at-issue compliance, which generally falls to the product development staff to ensure that the section 7702 and 7702A actuarial requirements are met for newly developed and issued products. The second aspect relates to in-force management, for which policy administration systems and business procedures are the gatekeeper to tax compliance. The responsibility for administration of the material change rules falls primarily to the in-force management functions.

Once programmed and developed, administration systems are called on to interpret policy changes, calculate actuarial funding limits, and apply the various actuarial tests according to how they are programmed. Policy changes on life insurance contracts can create significant complexity in determining the appropriate tax treatment of life insurance contracts. There are competing and sometimes conflicting requirements for determining the date on which a contract is "issued" or "en-

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tered into." For example, a contract may be issued on one date for purposes of section 7702 and entered into on another date for purposes of section 7702A. Additionally, when a material change occurs, a life insurance contract issued in one rule era could become subject to the requirements of a subsequent rule era, yielding potential administrative consequences. With respect to applying appropriate tax compliance and withholding and reporting requirements, these complications present challenges for an insurer on a day-to-day basis during the administration of life insurance contracts. In the remaining sections of this article, we describe the various rules and assumptions, and describe the calculation requirements for adjustments.

RULE AND ASSUMPTION ERAS

There are four distinct rule eras: Pre-DEFRA, Section 101(f), Section 7702 and Section 7702A.

1. Pre-DEFRA policies include other than flexible premium contracts issued on or before Dec. 31, 1984. Other than the familiar "risk shifting and risk distribution" common law rules defining life insurance, there are no actuarial limitations on a contract for it to be treated as "life insurance" under the Code.

2. Section 101(f) provided for the first time a statutory definition of life insurance for federal income tax purposes, albeit for only a limited time and for a limited class of contracts referred to as flexible premium life insurance contracts. A flexible premium contract was defined as a contract under which one or more premium payments were not fixed by the insurer as to both timing and amount. Section 101(f), which applied to contracts issued before Jan. 1, 1984 (later extended to Jan. 1, 1985), was expressly made temporary and limited in its application pending a more permanent and comprehensive solution, which emerged under section 7702.

3. Section 7702 generally applies to contracts issued after Dec. 31, 1984, and to certain increasing benefit contracts issued during 1984. Section 7702 replaced section 101(f) and, like section 101(f), provided a statutory definition of life insurance. However, unlike section 101(f), which applied to a specific class of contracts, section 7702 applied to all life insurance contracts, resulting in the elimination of some forms of contracts, including short-term endowments, from the market.

4. Section 7702A created a new class of life insurance contracts called a modified endowment contract (or MEC). Section 7702A applies to all life insurance contracts that are subject to the section 7702 requirements that are "entered into" on or after June 21, 1988. A MEC is a qualifying life insurance contract under section 7702, but pre-death distributions (*e.g.*, withdrawals and policy loans) are taxed under rules that generally apply to annuity contracts (*i.e.*, income is distributed before premiums are returned).

The rule eras follow the legislative enactment of the Code sections that govern the taxation of life insurance contracts. Further complicating matters, however, the Technical and Miscellaneous Revenue Act of 1988 (TAMRA) legislation introduced modifications to section 7702 that altered the permissible actuarial assumptions used in computing definitional limits for contracts entered into after Oct. 20, 1988, creating a new "assumption era" within the existing rule era. More specifically, the Section 7702 era is bifurcated into two distinct assumption eras:

1. Pre-TAMRA Era—Section 7702 did not explicitly impose a statutory limit on the mortality or expense assumptions to be used in the determination of guideline or net single premiums apart from requiring that the assumption be based on contractual guarantees.

2. Post-TAMRA Era—Pursuant to the changes enacted by TAMRA, for contracts entered into on or after Oct. 21, 1988, the net single, guideline and 7-pay premiums are to be determined using *reasonable* mortality charges as defined in section 7702(c)(3)(B)(i) and *reasonable* expense (and other) charges as defined in section 7702(c)(3)(B)(ii).[1]

The reasonable mortality charge requirements of section 7702(c)(3)(B)(i) are based in part on the prevailing commissioners' standard mortality table in effect at the time a contract is issued. Thus, the Post-TAMRA Era can further be subdivided according to the prevailing commissioners' standard mortality table in effect at the date of issue. The Internal Revenue Service ("IRS") has issued guidance in the form of Notices (Notice 88-128 and Notice 2006-95) that provide "safe harbors" insurers can rely on for meeting the reasonable mortality requirements of section 7702(c)(3)(B)(i), with each safe harbor providing its own effective date rules. The above table summarizes the various rule and assumption eras.

MATERIAL CHANGES, EFFECTIVE DATE RULES AND POLICY ADJUSTMENTS

As the section 101(f), 7702 and 7702A limitations are in the form of actuarial standards, some procedures are necessary to adjust the actuarial standards for contract changes. Contract

Life Insurance Contract Rule and Assumption Eras				
	Statute	Application	Rule Era	Assumption Era
Other than Flexible Premium Life Insurance	N/A	All contracts issued before 1/1/1985; 10-pay and shorter premium contracts increasing benefit contracts issued 6/30/84.	Pre-DEFRA	N/A
Flexible Premium Life Insurance	IRC 101(f)	All contracts issued before 1/1/1985.	Guideline Premium and Cash Value Test	Contract Guarantees Guideline; "Most Recent Table Cash Value Test
All Life Insurance Contracts	IRC 7702	Contracts issued on or after 12/31/1984 and entered into before 6/21/1988.	Guideline Premium and Cash Value Accumulation Test	Pre-TAMRA: Contract Guarantees
All Life Insurance Contracts	IRC 7702 & 7702A	Contracts issued on or after 6/21/1988 and entered into before 10/21/1988.	Guideline Premium and Cash Value Accumulation Test; 7-Pay Test	Pre-TAMRA: Contract Guarantees
All Life Insurance Contracts	IRC 7702 & 7702A	Contracts issued on or after 10/21/88 and entered into before 12/31/1988.	Guideline Premium and Cash Value Accumulation Test; 7-Pay Test	Reasonable Mortality and Expense (1958 CSO)
All Life Insurance Contracts	IRC 7702 & 7702A	Contracts issued on or after 10/21/88 and entered into before 1/1/2009.	Guideline Premium and Cash Value Accumulation Test; 7-Pay Test	Reasonable Mortality and Expense (1980 CSO)
All Life Insurance Contracts	IRC 7702 & 7702A	Contracts issued on or after 1/1/2009.	Guideline Premium and Cash Value Accumulation Test; 7-Pay Test	Reasonable Mortality and Expense (2001 CSO)

changes can have any number of potential impacts to a policy depending on both the rule era governing the contract, the type of contract change, and the provisions of the underlying contract. Each Code section has both effective date rules and adjustment provisions for dealing with contract changes. In many instances, however, as explained in the companion article, tax laws and available published guidance are not always clear as to whether a particular contract change results in the contract being treated as "newly issued" under the effective date rules or whether the existing adjustment methodology applies. Because different rules apply to a contract based on the date of issue, preservation of the "at issue" treatment is an important element in administering the limitations.

Regardless of the uncertainty in the tax law requirements, administration systems need to be able to identify contract changes and determine when the change will result in either an adjustment to actuarial limitations based on the existing rule era or a contract newly "entered into" in a new rule or assumption era:

Adjustments to Actuarial Limitations: Beginning with section 101(f) and continuing with section 7702, statutory adjustment rules have permitted a degree of flexibility—to allow for increases and decreases in death benefits—while still maintaining definitional limitations. Section 7702A provides additional rules for establishing the tax treatment of pre-death distributions, under which events defined as "material changes" result in the contract being treated as newly issued. In addition, reductions in benefits under section 7702A within the first seven years (or at any time, in the case of a second-to-die contract) also can cause the 7-pay premium to be recomputed.

A Newly "Entered Into" Contract: It is possible that a change can result in the loss of "grandfathered" status, thus causing it to be viewed as a newly issued contract for purposes of determining the applicable rule or assumption era. This may in turn result in a contract being newly subject to the section 7702 and 7702A limitations, to new mortality and expense assumptions, or both.

ADMINISTRATION OF POLICY CHANGES

Administrators of life insurance systems need to determine both the "rules" and the "assumptions" necessary for deter-

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mining definitional limits not only when the contract is originally issued, but also on subsequent dates of policy changes. Whether by default or design, administration systems will react to every financial transaction (*e.g.*, premium payment or withdrawal) and every contract change (*e.g.*, death benefit increase, change to a death benefit option, change in an underwriting status, etc.) according to how they are programmed.

An effective tax compliance system needs to be able to identify the appropriate treatment of all types of contract changes that can apply to a life insurance contract. Put differently, rules need to be defined within an administration system for ALL contract changes that can: (1) identify the contract change; (2) determine the appropriate set of rules to apply to the transaction; (3) apply the rules to determine the appropriate actuarial limitations; and (4) determine the consequences of the actuarial limitation as applied to the contract.

Rules or procedures can generally be incorporated into an administration system in one of two ways: (1) they can be explicitly put there by the administrator; or (2) they can be implicitly put there by the developer of the administration system. In some cases, the administration system or procedures may not have a particular rule set for dealing with a particular transaction. This may be a conscious decision, or it may be an oversight on the part of the administrator. Regardless of the reasoning, it should be recognized that even the lack of a particular rule or procedure for a transaction does in fact create an applicable rule set— that is, the rule is that the transaction has no effect and is therefore ignored.

Step 1: Identify the Contract Change

It is important to recognize that contract changes can arise at the behest of the insurance company, the policyholder, or through the normal operation of the contract (*e.g.*, death benefit increases resulting from the application of the section 7702(d) corridor). The first step in dealing with a policy change is to identify the type of change to determine the impact, if any, of the then-current rule and assumption era, and the applicability of adjustment rules under the existing rule era.

Company-Initiated Changes: Adney and Springfield highlight a number of the considerations affecting whether a change initiated by an insurance company is "material," suggesting that certain types of company-initiated changes are in fact immaterial. The IRS has ruled on certain types of administrative changes, such as a change to a policy loan provision[2] or the addition of an investment option to a variable life insurance contract,[3] concluding in the rulings that these types of changes do not require adjustment to the actuarial limitations or subject a contract to a new rule or assumption era. In most instances, reinsurance, rehabilitations and corporate reorganizations that result in contract changes generally do not require adjustments. However, in a 1993 private letter ruling, the IRS held that an increase in a life insurance contract's mortality charges or other charges in connection with a restructuring of a contract issued by an insurer in rehabilitation is an adjustment event under section 7702(f)(7)(A) and would require an adjustment to the section 7702 funding limitation.[4] Given the broad spectrum of company-initiated changes that can occur, and the potential impact on policy administration, administrative processes and procedures need to be in place for identifying them. Once the change has been identified, the proper analysis of the change can take place to determine the appropriate set of rules to apply to the transaction.

Further complications can exist with administering company-initiated changes beyond simply identifying the change, particularly when the change does not generate a "transaction" within the administration system. If the company-initiated change requires modifications to existing tax law funding limitations, it may necessitate procedures outside of the administration system to properly give effect to the change. However, where a company-initiated change is applied to a particular class of contracts, there is an opportunity to address tax compliance as part of the planning for the transaction.

Policyholder-Initiated Changes: In addition to company-initiated changes, policyholder- initiated changes are commonplace with life insurance contracts. Cash value life insurance contracts provide the policyholders with the ability to borrow, alter the investment elections in the case of variable contracts, increase or decrease coverage, request a change in underwriting status, etc. Administration systems need to be able to identify these types of changes as well and apply the appropriate rules for administering the changes.

Another classification related to policyholder-initiated changes is whether the change is explicitly provided for in the contract or only permitted through administrative practice (*e.g.*, permitting a change in smoking status based upon a showing of cessation of smoking, even if there is not an expressly stated right in the written terms of policies regarding the change). In a rule-based structure typically found within most administration systems, administrative procedures would need to be developed to account for potentially differing treatment of policy changes that may be expressly permitted under some policy forms and permitted only through administrative practice under other policy forms.

In Notice 2006-95, the IRS provided guidance on types of policy changes that would not cause a contract issued under a policy form with mortality guarantees based on either the 1958 or 1980 CSO mortality tables to become subject to reasonable mortality requirements based on 2001 CSO mortality. The original reasonable mortality requirement could be retained, allowing the continued use of either 1958 or 1980 CSO mortality, if the policy change consisted of one of the following:

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; or
6. Reconsideration of ratings based on rated condition, lifestyle or activity (such as a change from smoker to non-smoker status).

However, in order to continue with the use of either 1958 or 1980 CSO mortality, Notice 2006-95 also requires that (1) the change is pursuant to the terms of the contract; (2) 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 (3) the contract continues upon the same policy form or blank.

This guidance caused some concern with administrators as not all life insurance contracts expressly provide for the changes listed above, yet most of these changes are routinely performed in the course of normal business. In response to the published guidance, some insurance companies altered their administrative practice with regard to changes not explicitly provided for by the terms of the contract. More specifically, some companies no longer allow policy changes that are not explicitly provided for by the terms of the contract, or endorse existing products to explicitly provide for these types of policy changes. (An endorsement usually cannot be added after the effective date of a rule change since the addition of the endorsement itself may cause a material change.)

Changes Occurring under the Normal Operation of the Contract: Some contract changes are not initiated by the policyholder or the company, and are instead the result of the normal operation of the contract. Examples include:

1. Death benefit increases required by the section 7702(d) corridor test or the section 7702(b) cash value accumulation test ("CVAT") (or under similar provisions in prior law section 101(f)) that do not require the insurer's consent at the time of increase.

2. Death benefit increases resulting from the application of policyholder dividends that are used to purchase paid-up additions.

3. For variable contracts and universal life contracts with an option 2 death benefit pattern (*i.e.*, death benefit is defined to be face amount plus the cash surrender value), death benefit increases resulting from an increase in the cash surrender value of the contract.

These types of changes result in modifications to the death benefit but generally do not require the consent of the insurer. As a result, these types of contract changes generally would <u>not</u> cause a contract to be treated as a new contract.

Step 2: Determine the Appropriate Set of "Rules" to Apply to the Transaction

As discussed above, contract changes can take on many different forms and can arise in a number of different ways. Properly identifying and categorizing contract changes are critical for the tax administration of contracts. Policy issue dates and effective dates of policy changes become important elements in determining how to administer contract changes. Tax compliance issues can arise when existing products are sold after the effective date of new rules or assumptions (*e.g.*, issuing a 1958 CSO contract after Dec. 31, 1988). Procedures for dealing with the transition from one set of rules or assumptions to another are both important and necessary, and need to address the following:

- Section 101(f): Sunset date of Dec. 31, 1984;

- Reasonable Mortality Era for 1958 CSO Contracts: Sunset date of Dec. 31, 1988;

- Reasonable Mortality Era for 1980 CSO Contracts: Sunset date of Dec. 31, 2008.[5]

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Many administration systems, however, are not designed to look to issue dates or transaction dates for determining the applicability of tax law requirements. Therefore, administrative procedures external to the administration system may be necessary to limit both contract issuance and policy changes to ensure proper rule and assumption eras are applied. One way insurance companies have historically dealt with this issue is to develop new products or issue existing products under a new “plan code” as rules change.

The IRS has from time to time expressed its views on the effect of certain changes to life insurance contracts. In Chief Counsel Advice 200805022 (Aug. 17, 2007) (the “CCA”), the IRS essentially concluded that the addition of a QAB rider that was not pursuant to the exercise of an option or right granted under the contract will cause a loss of grandfathering under the DEFRA effective date provisions governing the applicability of section 7702 to a pre-1985 contract and under the TAMRA effective date provisions relating to reasonable mortality and expenses. The CCA came to the same conclusion where a death benefit pattern was changed in the absence of a right granted under the contract. As originally issued, the contracts provided only for an increasing death benefit pattern, with no ability for the policyholders to obtain a level death benefit. In addition, the express terms of the contracts did not address QAB riders, although the taxpayer had a practice of allowing policyholders to add such riders with evidence of insurability.

The positions taken by the IRS in the CCA highlight the view that policy changes can cause contracts to lose grandfathering and change rule or assumption eras, potentially subjecting contracts to the tax law requirements in effect on dates of policy changes. While not all policy changes will have this result, understanding and properly administering the implications of all policy changes become necessary elements to an effective tax compliance system.

Step 3: Apply the Rules to Determine the Appropriate Actuarial Limitations

Identifying the rule era and assumption era applicable to a policy change will identify the appropriate action needed for determining the funding limitation for purposes of sections 7702 and 7702A. In some cases, the change may require the contract be viewed as newly issued; while, in other cases, the statutory adjustment rules would apply. While a detailed discussion of the adjustment rules is beyond the scope of this article, the form of the rules is important in any discussion of the impact of contract changes.

In administering the change to a guideline premium product, the attained age decrement method is employed. Under that method, attained age layers of guideline premium values are added to the existing guideline single and guideline level premiums:

Incremental Guideline Single Premium$_{x+t}$ = *GSP(AFTER)*$_{x+t}$ - *GSP(BEFORE)*$_{x+t}$ *and*

Incremental Guideline Level Premium$_{x+t}$ = *GLP(AFTER)*$_{x+t}$ - *GLP(BEFORE)*$_{x+t}$

The “after” and “before” values are typically derived independently, with the “after” values based on the policy characteristics in effect after the change and the “before” values based on the policy characteristics in effect immediately before the change.[6] Policy administration systems are generally designed to retain the policy characteristics (death benefits, insured characteristics, rider characteristics, etc.) for both the “before” and “after” calculations. However, when the adjustment results in a need to change rules or assumptions, functionality needs to exist to properly account for this change, particularly when the change results in a need to reflect different requirements for mortality in the calculation of the “before” and “after” values.

For CVAT policies, the test is prospective, based on the net single premium (“NSP”) for the future policy benefits provided after the change. Some administration systems contain “stored NSP factors,” while others calculate NSPs “on-the-fly” or when needed. Stored factors are typically maintained at the plan or product level, and are generally not stored at the policy level. If a transaction causes a contract to change eras, it may require the need to develop additional NSP factors based on the requirements of that era and apply those to particular contracts, resulting in the need to use different NSP factors for otherwise similar policies issued under the same plan code. Using different NSP factors may be problematic since the CVAT requires a policy to satisfy this test by the terms of the contract, and some states require a table of NSP factors to be provided in the policy form. A switch to a new table might require the administration system to send out a new set of policy pages to the policyholders.

A similar challenge is presented by the 7-pay test under section 7702A. Two adjustment rules, which are different from those under section 7702, apply to the calculations under section 7702A—one for reductions in benefits that occur within the first seven years, and another for material changes. A special reduction in benefits rule applies to survivorship products (*i.e.*, second-to-die). In that case, section 7702A(c)(6) requires that the reduction in benefits rule apply over the life of the contract. Finally, the “necessary premium” rule of section

7702A(c)(3)(B)(i) adds a further complication to compliance by making the recalculation optional for some changes.

Step 4: Determine the Consequences of the Actuarial Limitation as Applied to the Contract

Once the appropriate adjustment has been made to the actuarial funding limitations, an additional assessment may be necessary to ensure ongoing compliance with the tax law requirements. In many instances, an adjustment will simply modify the applicable limitations. In other circumstances, it may result in a "failed" life insurance contract or an inadvertent MEC. It may also require a refund of excess premiums (and interest) to maintain the policy's compliance with the limitations. Both sections 7702 and 7702A contain provisions that allow for the removal of excess premium, provided the excess premium (and earnings associated with the excess premium) is removed within 60 days after the end of the contract year. For contracts designed to meet the guideline premium test requirements, section 7702(f)(1)(B) provides that if, in order to comply with guideline premium test requirements, any portion of any premium paid during any contract year is returned by the insurance company (with interest) within 60 days after the end of a contract year, the amount so returned (excluding interest) shall be deemed to reduce the sum of the premiums paid under the contract during such year. While only applicable to contracts designed to comply with the guideline premium test requirements, this provision recognizes that certain transactions may result in a negative adjustment large enough to reduce the guideline premium limitation below premiums paid. In such circumstances, failure to return the excess premium (and interest) within the 60-day window provided by section 7702(f)(1)(B) would cause a violation of the section 7702 requirements, resulting in a failed life insurance contract.

A companion provision also exists in section 7702A(e)(1)(B) that applies to contracts subject to the requirements of the 7-pay test. However, unlike section 7702(f)(1)(B), where the failure to return the excess premium results in a failed life insurance contract, the consequences under section 7702A(e)(1)(B) are not as severe. Instead, the failure to return excess premium under the requirements of section 7702A(e)(1)(B) will result in the contract becoming a "modified endowment."

It is worth noting that a similar provision does not exist for contracts subject to the requirements of the CVAT. The CVAT is not a premium-based test, which renders a "window" for the return of excess premium (and interest) inapplicable. In fact, the CVAT is a test that must be satisfied at all times by the terms of the contract. Any excess funding in a CVAT contract resulting from a policy adjustment (*i.e.*, cash surrender value in excess of the net single premium for future benefits) must be remedied immediately at the time of the adjustment, consistent with contract terms, or the policy would risk being out of compliance with the "terms of the contract" requirement of section 7702(b)(1).

CONCLUSION

The complexity of the material change rules creates challenges in the development of an effective overall tax compliance monitoring process for life insurance products. Any administration system will need continual assessment over the entire product life cycle. The administrator will constantly need to assess existing administrative processes and procedures to address: (1) new advancements in product features and designs and how they interact with existing tax law requirements; (2) emerging guidance on existing rule and assumption eras; and (3) potential changes in the rules. Policy changes are a particular challenge for policy administration, since administration systems must react to a set of rules established by the administrator. As discussed in the Adney and Springfield article, the rules are not always clear, forcing insurers to take positions with potentially uncertain outcomes. An effective system will need to have assigned to it accountability and ownership for compliance, often in spite of tax administration being overlooked for in-force policy administration. And, finally, an effective compliance system must safeguard and ensure that existing processes and procedures are being followed, since the consequences of getting it "wrong" can be substantial.

The views expressed are those of the authors and not of Ernst & Young LLP.

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END NOTES

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1 TAMRA, Pub. L. No. 100 647, §5011(a) (1988).

2 *See, e.g.*, PLR 9737007 (June 11, 1997).

3 PLR 8648018 (Aug. 27, 1986).

4 PLR 9338023 (June 24, 1993).

5 Note that to use Dec. 31, 2008 as the sunset date, it would appear that a contract would need to comply with the safe harbor set forth in Notice 2006-95. Otherwise, the sunset date is Dec. 31, 2007.

6 See Christian J. DesRochers, John T. Adney, Douglas N. Hertz & Brian G. King, LIFE INSURANCE & MODIFIED ENDOWMENTS: UNDER INTERNAL REVENUE CODE SECTIONS 7702 AND 7702A, 91-102 (1st ed. 2004).