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2012–2013 PRIORITY GUIDANCE PLAN—WHAT'S IN IT FOR LIFE INSURANCE COMPANIES?

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In mid-November 2012, the Internal Revenue Service (IRS) and Department of Treasury released the 2012–2013 Priority Guidance Plan, which sets forth some 317 projects as priorities for allocation of their resources during the 12-month period from July 2012 through June 2013. The section for Insurance Companies and Products contains 10 projects, nine of which would address life insurance issues (as opposed to property/casualty issues), seven of which are substantially the same as what was listed in last year's plan. The two new projects addressing life insurance issues are:

• Guidance to clarify which table to use for I.R.C. § 807(d)(2) purposes when there is more than one applicable table in the 2001 CSO mortality table; and

• Guidance clarifying whether the Conditional Tail Expectation (CTE) Amount computed under Actuarial Guideline (AG) 43 should be taken into account for purposes of the Reserve Ratio Test under I.R.C. § 816(a) and the Statutory Reserve Cap under I.R.C. § 807(d)(6).

The CTE Amount project was expected because these issues were specifically left open by Notice 2010-29[1] in providing guidance on how to implement AG 43 for tax purposes when it became effective at the end of 2009. However, the 2001 CSO mortality table project came as a surprise to the industry. Because it had not been something discussed at insurance tax conferences and had not been among the projects recommended by the industry through the American Council of Life Insurers (ACLI), it is difficult to infer what specific problem or issue the project will address. Informal feedback from the IRS Insurance Branch indicates that the 2001 CSO mortality table project was added to the Guidance Plan at the request of the IRS Field offices but, if the project is supposed to address some issue that is being identified in exams, it is not an issue about which companies generally are aware. Could what seems like a simple company tax issue have unintended consequences for life insurance products? For example, I.R.C. § 7702(c)(3)(B)(i) cross references the prevailing commissioners' standard tables defined in I.R.C. § 807(d)(5), which determines the applicable mortality table to be used for the I.R.C. § 807(d)(2) computation.[2] Thus, the 2001 CSO mortality table project could be somewhat of a wild card from the industry perspective. Hopefully the IRS Chief Counsel's office will bring the industry into the picture to discuss the issue being addressed and any tentative conclusions before reaching any final decision in order to avoid unforeseen and unintended adverse consequences the final guidance might have.

Specifically, the projects listed for Insurance Companies and Products are:

1. Final regulations under I.R.C. § 72 on the exchange of property for an annuity contract. Proposed regulations were published on Oct. 18, 2006. (This has been the same for the last several years.)

2. Guidance on annuity contracts with a long-term care insurance rider under I.R.C. §§ 72 and 7702B. (This was on the 2011–2012 Plan and the IRS published Notice 2011-68,[3] so there must be more coming.)

3. Revenue Ruling under I.R.C. § 801 addressing the application of Revenue Ruling 2005-40 or Revenue Ruling 92-93 to health insurance arrangements that are sponsored by a single employer. (This was on the 2011-2012 Plan.)

4. Guidance to clarify which table to use for I.R.C. § 807(d)(2) purposes when there is more than one applicable table in the 2001 CSO mortality table. (This is a new project; see discussion above.)

5. Notice clarifying whether deficiency reserves should be taken into account in computing statutory reserves under I.R.C. § 807(d)(6). (This project had been in past Guidance Plans, with the language changing from "Guidance" to a "Revenue Ruling" to a "Notice"; presumably this project was completed with the recent publication of Notice 2013-19.[4])

6. Revenue Ruling on the determination of the company's share and policyholder's share of the net investment income of a life insurance company under I.R.C. § 812. (This has been the same for the last several years, except a "Revenue Ruling" has been substituted for the more general term "Guidance" used earlier.)

7. Guidance clarifying whether the CTE Amount computed under AG 43 should be taken into account for purposes of the Reserve Ratio Test under I.R.C. § 816(a) and the Statutory Reserve Cap under I.R.C. § 807(d)(6). (This is a new project; see discussion above.)

8. Regulations under I.R.C. § 833 to establish the method to be used by Blue Cross Blue Shield entities in determining the medical loss ratio required by that section. (This is a new project and addresses an issue for health insurance companies from the Affordable Care Act of 2010.)

9. Guidance on exchanges under I.R.C. § 1035 of annuities for long-term care insurance contracts. (This was on the 2011–2012 Plan.)

10. Regulations under I.R.C. § 7702 defining cash surrender value. (This has been the same for the last several years.)

While the 2012–2013 Priority Guidance Plan includes the CTE Amount project, there is no project on principle-based reserves (PBR) for life insurance contracts as requested by the ACLI. However, even if the ACLI's request for a life PBR project may have been declined (*e.g.*, because the rules are not yet required for tax purposes), IRS Insurance Branch representatives have indicated that life PBR issues are still being actively considered.

Other projects included in the 2012–2013 Priority Guidance Plan that are not directed to, but may be of interest to, life insurance companies are:

- Financial Institutions and Products—Guidance addressing the character and timing of hedge gains and losses for purposes of I.R.C. § 1221 and Treas. Reg. § 1.446-4 for hedges of guaranteed living benefits and death benefits provided with regard to variable annuities. (This was on the 2011–2012 Plan.)

- General Tax Issues—Final regulations under I.R.C. § 7701 regarding Series LLCs and cell companies. Proposed regulations were published on Sept. 14, 2010. (This is a new project.)

- International Issues (Inbound Transactions)—Regulations under I.R.C. § 882 regarding insurance companies. (This is a new project.)

- Tax Accounting—Regulations under I.R.C. § 453 addressing certain annuity contracts received in exchange for property. (This has been on the Guidance Plans for the last several years.).

END NOTES

1 2010-15 I.R.B. 547.

2 Apparently the 2001 CSO mortality table project is not intended to include a reconsideration of the analysis in PLR 201230009 (Jan. 30, 2012), which surprised the industry by concluding that a reduction in death benefit would cause a life insurance contract to be "newly issued" for purposes of the safe harbors provided in § 5 of Notice 2006-95, 2006-2 C.B. 848, for satisfying the reasonable mortality charge requirements of I.R.C. § 7702(c)(3)(B)(i).

3 2011-36 I.R.B. 205.

4 2013-14 I.R.B. 743.

APPLYING SECTION 72(S) TO JOINT-LIFE GLWBS COVERING NON-SPOUSES

By Alison R. Peak, Bryan W. Keene and Joseph F. McKeever

In January, the Internal Revenue Service ("IRS") released PLRs 201302015 and 201302016, which address how section 72(s) applies to a deferred annuity that has a guaranteed lifetime withdrawal benefit ("GLWB") rider covering the joint lives of the owner and a non-spouse beneficiary.[1] Section 72(s) requires certain distributions to be made from a non-qualified annuity after the owner dies.[2] If the beneficiary is the owner's surviving spouse, however, the contract can continue without section 72(s) requiring any distributions until the spouse dies.[3] In the two recent rulings, the contract issuer proposed a "New Distribution Option" that would allow a *non-spouse* beneficiary to continue the contract—and thus the GLWB coverage—after the owner's death, without requiring any distributions from the contract. The rulings conclude that this will comply with section 72(s). The key to the conclusion was that the New Distribution Option caused the contract's death benefit to be immediately taxable to the non-spouse beneficiary as if he had received it, even though

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