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IRS Updates Post-Age-100 Guidance

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Eight years ago, in Revenue Procedure 2010-28, 2010-34 I.R.B. 270, the Internal Revenue Service established "safe harbor" rules for calculations of net single premiums and guideline premiums under section 7702[1] and 7-pay premiums and necessary premiums under section 7702A in the case of life insurance contracts that (1) have mortality guarantees based on the 2001 Commissioners' Standard Ordinary Mortality Tables (2001 CSO tables) and (2) may continue in force after the day on which the insured attains age 100. Last February, the Internal Revenue Service issued Revenue Procedure 2018-20, 2018-11 I.R.B. 427, extending these safe harbor rules to "life insurance contracts that have mortality guarantees based upon not only the 2001 CSO tables, but also upon the 2017 CSO tables and any other prevailing commissioners' standard tables that extend beyond age 100."

By way of background, in order for a contract that is a life insurance contract under applicable law to be treated as a life insurance contract for federal tax purposes, section 7702 requires that the contract's cash surrender value must not (by the contract's terms) exceed the net single premium for its death benefit at any time. If that is not the case, then at minimum the gross premiums paid for the contract cannot exceed the guideline premium limitation as defined in section 7702. Also, assuming the contract meets one of these rules, the premiums paid for it as of any time cannot exceed the cumulation of the 7-pay premiums as defined for the contract under section 7702A if the contract is not to be classified as a "modified endowment contract," which would result in a more adverse tax treatment of distributions from the contract while the insured is living. And to avoid treating a benefit increase under the contract as a "material change" within the meaning of section 7702A, re-subjecting the contract to the 7-pay premiums' limit, the premiums paid cannot exceed the "necessary premium" referenced in the statute's material change rule. All of these calculated limits—the net single premiums, guideline premiums, 7-pay premiums and necessary premiums—have in common the "maturity date" requirement of section 7702(e)(1)(B). Pursuant to that requirement, these premiums must be computed assuming that the contract matures no earlier than when the insured attains age 95 and no later than the insured's 100th birthday. When section 7702 was enacted (in 1984), the assumption that the contract would be at an end by the time the insured reached age 100 aligned with the assumption in the official mortality tables then in use, *i.e.*, the 1958 and 1980 CSO tables.

But along came the 2001 CSO tables in the first decade of the 21st century, with all lives no longer assumed to end by age 100. Those tables contained a limiting age, but a much higher one—age 121. As a result of this change, companies that issue life insurance contracts with maturity dates now typically use age 121 as their terminal dates (and, as was previously the case, other contracts do not specify a maturity date). These changes in contract design prompted questions regarding how contracts with age 121 maturity dates should be administered under sections 7702 and 7702A in light of the maturity date requirement of section 7702(e)(1)(B). Some wondered whether it was permissible to use a contract's actual maturity date in the statutes' calculations, even though that date exceeded the maximum deemed maturity date specified in section 7702(e)(1)(B), while others were concerned with how the tests should be applied technically assuming the maximum age of 100 controlled. How, it was asked, should a 7-pay premium be calculated in circumstances where a contract was materially changed less than 7 years before the insured reached age 100?

In 2005, the Taxation Section of the Society of Actuaries formed the 2001 CSO Maturity Age Task Force (SOA Task Force) to study the effect section 7702's requirement of a deemed maturity date not later than the insured's age 100 would have on a contract providing coverage through the end of the 2001 CSO tables. The SOA Task Force proposed methodologies, published in the May 2006 issue of *Taxing Times*, that would be actuarially acceptable under sections 7702 and 7702A for calculations under contracts that do not provide for actual maturity by or before age 100. Others in the life insurance industry requested such guidance from the government, and there followed the issuance of Notice 2009-47[2] by the Treasury Department and the IRS, setting forth safe harbor rules—denominated the "Age 100 Safe Harbor Testing Methodologies"—modeled on the SOA Task Force recommendations. The Notice also requested comments on certain tax issues that could arise where a life insurance contract continues beyond the insured's age 100. The virtues of, and problems in, this Notice were explored in an article published in *Taxing Times* in September 2009.[3]

Following considerable back and forth between life insurance industry representatives and the government, the IRS published Revenue Procedure 2010-28 in August 2010,[4] in most key respects adopting the safe harbor rules described in Notice 2009-47. In doing so, Revenue Procedure 2010-28 specifically referenced the role of the SOA Task Force and the publication of its recommendations in *Taxing Times*. By its terms, the revenue procedure applied—and provided a safe harbor—only with respect to sections 7702 and 7702A and only for contracts based on the 2001 CSO tables that may continue in force after the insured attains age 100. More specifically, Revenue Procedure 2010-28 stated that the IRS "will not challenge the qualification of a contract as a life insurance contract under section 7702, or assert that a contract is a [modified endowment contract] under section 7702A, if the contract satisfies the requirements of those provisions using all of the 'Age 100 Safe Harbor Testing Methodologies.'" In this connection, the 2010 revenue procedure made it clear that to take advantage of its safe harbor, all calculations under sections 7702 and 7702A (other than the cash value corridor) must assume the contract's maturity by the insured's age 100, notwithstanding a later contractual maturity date; the remainder of the safe harbor methodologies were keyed to this assumption. Thus, pursuant to the revenue procedure, the date the insured attains age 100 must be used as the maturity date for calculating net single and guideline premiums as well as necessary premiums; to determine the guideline level premiums, premium payments must be assumed to be made through the day the insured attains age 99; and under section 7702A, in the case of a contract issued or materially changed within fewer than seven years of the day the insured attains age 100, the 7-pay premiums must be computed assuming level annual premium payments over the number of years between the date the contract is issued or materially changed and the date the insured attains age 100. In addition, the cumulation of the guideline level premiums and the 7-pay premiums must stop by the time the insured reaches age 100, although premiums may continue to be paid and, if so, must be tested against those "frozen" limits.

Revenue Procedure 2010-28 thus clarified many section 7702 and 7702A computational issues presented by contracts based on the 2001 CSO tables. It also provided guidance for administering the statutes' rules for contracts that undergo changes in their benefits. And while the 2010 revenue procedure provided its safe harbor only if all of its age 100 testing methodologies were followed, it made crystal clear, as the life insurance industry urged, that it was indeed a safe harbor. In the revenue procedure's own words, "[n]o adverse inference should be drawn with respect to the qualification of a contract as a life insurance contract under § 7702, or its status as not a MEC under § 7702A, merely by reason of a failure to satisfy all of the requirements" of the testing methodologies. Additional detail on Revenue Procedure 2010-28, including illustrations of the effects of its rules, may be found in an article published in *Taxing Times* in 2011.[5]

The issuance of Revenue Procedure 2010-28 seemingly settled the questions regarding section 7702's age 100 maturity date

requirement for a number of years, but then the 2017 CSO tables arrived when new VM-20 became effective on Jan. 1, 2017. Since the 2010 revenue procedure by its terms addressed only contracts based on the 2001 CSO tables, the prior questions theoretically became pertinent once again.

And this development brings us to Revenue Procedure 2018-20. The new revenue procedure recites the history of and rationale for the issuance of the 2010 revenue procedure, acknowledging (as did its predecessor) the role played by the SOA Task Force in formulating the Age 100 Safe Harbor Testing Methodologies. Revenue Procedure 2018-20 also sets out all of those methodologies in full, as it now (effective Feb. 23, 2018) replaces its predecessor as the official statement of the age 100 testing methodologies; it "modifies and supersedes" Revenue Procedure 2010-28. Additionally, mirroring its predecessor, the new revenue procedure repeats *verbatim* the "no inference" language quoted above.

Most importantly, as noted at the outset, Revenue Procedure 2018-20 extends all of this to the 2017 CSO tables and to all future CSO tables that provide mortality rates beyond age 100. To quote from the operative wording of the new procedure, the safe harbor provided under its predecessor is made available "to life insurance contracts that (1) have mortality guarantees based upon prevailing commissioners' standard tables that extend beyond age 100, such as the 2001 CSO tables and the 2017 CSO tables, and (2) may continue in force after the day on which the insured individual attains age 100." In so stating, Revenue Procedure 2018-20 cites to the meaning of "prevailing commissioners' standard tables" as defined in section 7702(f)(10) as added by section 13517 of Public Law 115-97, becoming the first official IRS pronouncement to reference section 7702 as amended by the 2017 tax legislation.

The IRS is to be commended for issuing Revenue Procedure 2018-20, which represents a good step forward. The new revenue procedure is helpful to life insurers and others charged with assuring the section 7702 and 7702A compliance of life insurance contracts, who otherwise would be concerned with the same questions that spawned the drafting of the age 100 testing methodologies in the first place. It also represents a sound approach to tax administration by looking beyond the newest CSO tables and making the safe harbor available to all contracts based on prevailing commissioners' standard tables that extend beyond age 100. Insofar as mortality tables are anticipated to change in the future and perhaps to do so more frequently, the approach taken by the IRS in Revenue Procedure 2018-20 provides greater certainty going forward while reducing the need for further official guidance on this topic. ■

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ENDNOTES

1 Unless otherwise noted, all references to "section" are to provisions of the Internal Revenue Code of 1986, as amended (the "Code").

2 2009-24 I.R.B. 1083.

3 John T. Adney, Craig R. Springfield, Brian G. King and Alison R. Peak, "IRS Issues Proposed Safe Harbor Prescribing 'Age 100 Methodologies,'" *Taxing Times*, , Vol. 5, No. 3, at p. 19 (September 2009).

4 2010-34 I.R.B. 270.

5 John T. Adney, Craig R. Springfield, Brian G. King and Alison R. Peak, "Life Beyond 100: Rev. Proc. 2010-28 Finalizes the 'Age 100 Methodologies' Safe Harbor," *Taxing Times*, Vol. 7, No. 1 (February 2011).