



# TaxNewsFlash

## United States

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### **Notice 2016-63: Updated transition guidance on use of mortality tables (life insurance)**

The IRS released an advance version of Notice 2016-63 that provides updated transition guidance for the 2017 Commissioners' Standard Ordinary (CSO) mortality and morbidity tables interpreting the reasonable mortality charge requirement of section 7702(c)(3)(B)(i) and providing safe harbor rules.

[Notice 2016-63](#) [PDF 24 KB] is effective October 19, 2016, and supplements Notice 88-128 and modifies and supersedes Notice 2006-95.

#### **Overview**

Notice 2016-63 keeps all safe harbors allowed in the earlier guidance, and adds an additional provision. Under the new provision, if the only change to an existing contract is a reduction or deletion of benefits provided under the contract, that change won't affect the determination of the issue date of a contract for purposes of the reasonable mortality charge safe harbor. According to the guidance, that change is consistent with the treatment of a decrease in benefits for purposes of section 7702A.

#### **Guidance concerning use of 2017 CSO tables under section 7702**

Notice 2016-63 provides rules interpreting the reasonable mortality charge requirement contained in Code section 7702(c)(3)(B)(i). As originally enacted, section 7702 generally required the use of "the mortality charges specified in the contract" in the actuarial calculations under the cash value accumulation test and the guideline premium requirements.

In 1988, section 7702 was amended to require the use of "reasonable mortality charges" in the determination of the cash value accumulation test and guideline premium requirements. Section 7702(c)(3)(B)(i) provides that the guideline single premium under section 7702(c) is determined on the basis of reasonable mortality

charges that meet the requirements (if any) prescribed in regulations and that (except as provided in regulations) do not exceed the mortality charges specified in the prevailing commissioners' standard tables (as defined in section 807(d)(5)) as of the time the contract is issued.

Section 807(d)(5)(A) provides that the term "prevailing commissioners' standard tables" means, with respect to any contract, the most recent commissioners' standard tables prescribed by the National Association of Insurance Commissioners (NAIC) that are permitted to be used in computing reserves for that type of contract under the insurance laws of at least 26 states when the contract was issued. Section 807(d)(5)(B) provides a three-year transition period during which an insurer may use either the newly prevailing CSO tables or those that were previously prevailing.

The 2017 CSO tables prescribed by the NAIC will become the prevailing commissioners' standard tables within the meaning of section 807(d)(5) on January 1, 2017. The 1980 CSO tables may still be used in all states for contracts issued in calendar years through 2008; and the 2001 CSO tables may still be used in all states for contracts issued in calendar years 2005 through 2019. For contracts issued after 2008, and before January 1, 2017, use of the 2001 CSO tables is mandatory. The 2017 CSO tables may be used for contracts issued on or after January 1, 2017. For contracts issued on or after January 1, 2020, use of the 2017 CSO tables will be mandatory.

## **Modifications to Notice 2006-95**

Notice 2016-63 makes several modifications to Notice 2006-95 that provide for the following:

- Safe harbors regarding the use by taxpayers of the 2017 CSO tables for purposes of section 7702(c)(3)(B)(i). Except as provided in section 5.01 of Notice 2016-63, mortality charges determined with respect to the appropriate CSO mortality table will satisfy the requirements of section 7702(c)(3)(B)(i). Determining the appropriate mortality table depends on the effective date of the contract.
- If the only change to an existing contract is a reduction or deletion of benefits provided under the contract, such a change will not affect the determination of the issue date of a contract for purposes of the reasonable mortality charge safe harbor.
- Changes, modifications or exercises of contractual provisions include reinstatement of a contract as required under applicable state or foreign law.

## **Material change rules**

Generally, contracts received in exchange for existing contracts are to be considered new contracts issued on the date of the exchange. However, a change in an existing contract is not considered to result in an exchange if the terms of the resulting contract (that is, the amount and pattern of death benefit, the premium pattern, the rate or rates

guaranteed on issuance of the contract, and mortality and expense charges) are the same as the terms of the contract prior to the change.

Notice 2016-63 provides limitations on when a change to a contract requires retesting using a different mortality table. If a life insurance contract was tested under section 7702(c)(3)(B)(i) using the appropriate mortality table when originally issued, a change from the previous tables to the 2001 or 2017 CSO tables is not required if: (1) the change, modification, or exercise of a right to modify or add benefits is pursuant to the terms of the contract; (2) the state in which the contract is issued does not require use of the 2001 or 2017 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. Additionally, a change from the previous tables to the 2001 or 2017 CSO table is not required if the only change to an existing contract is a reduction or deletion of benefits provided under the contract.

Notice 2016-63 also lists certain changes, modifications, or exercises of contractual provisions that would require use of the 2017 CSO tables. These include: (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 reinstatement of a policy as required under applicable state or foreign law; and (6) reconsideration of ratings based on rated condition, lifestyle, or activity (such as a change from smoker to nonsmoker status).

### **Rules for gender or smoker-based tables**

Notice 2016-63 allows that mortality charges that do not exceed the applicable charges in gender- or smoker-based variations of the 2001 or 2017 CSO tables will be treated as reasonable mortality charges if a state permits or requires use of unisex or combined smoker/nonsmoker tables.

### **KPMG observation**

In general, Notice 2016-63 provides much anticipated guidance and formal taxpayer transition rules for the new 2017 CSO tables. This will aid taxpayers in assessing the effects on product design, accounting and reporting, business impacts, and the effects on systems and processes.

The notice incorporates a significant change from prior IRS published guidance in that the mere reduction of death benefits—even if the contract does not specifically allow a policyholder to unilaterally request such reduction—will not be a material change. Compare [PLR 201230009](#) [PDF 72 KB]. The industry has advocated that a reduction in death benefits be excluded from material change for purposes of section 7702(c)(3)(B)(i). Notice 2016-63 formalizes the IRS's revised position.

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