

Dec. 31, 1963, in taxable years ending after such date, see section 204(d) of Pub. L. 88-272, set out as an Effective Date note under section 79 of this title.

Amendment by section 234(b)(3) of Pub. L. 88-272 applicable to taxable years beginning after Dec. 31, 1963, see section 234(c) of Pub. L. 88-272, set out as a note under section 1503 of this title.

EFFECTIVE DATE OF 1962 AMENDMENTS

Section 5(b) of Pub. L. 87-870 provided that: “The amendment made by subsection (a) of this section [amending this section] shall apply with respect to taxable years beginning after the date of the enactment of the Revenue Act of 1962 [Oct. 16, 1962].”

Section 6(g)(3) of Pub. L. 87-834 provided that: “The amendment made by subsection (c) [amending this section] shall apply to taxable years beginning after the date of the enactment of this Act [Oct. 16, 1962].”

EFFECTIVE DATE OF 1960 AMENDMENTS

Amendment by Pub. L. 86-778 effective Sept. 13, 1960, see section 103(v)(1) of Pub. L. 86-778, set out as an Effective Date of 1960 Amendment note under section 402 of Title 42, The Public Health and Welfare.

Amendment by Pub. L. 86-624 effective August 21, 1959, see section 18(k) of Pub. L. 86-624, set out as a note under section 3121 of this title.

EFFECTIVE DATE OF 1959 AMENDMENT

Amendment by Pub. L. 86-70 effective Jan. 3, 1959, see section 22(i) of Pub. L. 86-70, set out as a note under section 3121 of this title.

SAVINGS PROVISION

For provisions that nothing in amendment by section 11812(b)(13) of Pub. L. 101-508 be construed to affect treatment of certain transactions occurring, property acquired, or items of income, loss, deduction, or credit taken into account prior to Nov. 5, 1990, for purposes of determining liability for tax for periods ending after Nov. 5, 1990, see section 11821(b) of Pub. L. 101-508, set out as a note under section 45K of this title.

TRANSFER OF FUNCTIONS

For transfer of authorities, functions, personnel, and assets of the Coast Guard, including the authorities and functions of the Secretary of Transportation relating thereto, to the Department of Homeland Security, and for treatment of related references, see sections 468(b), 551(d), 552(d), and 557 of Title 6, Domestic Security, and the Department of Homeland Security Reorganization Plan of November 25, 2002, as modified, set out as a note under section 542 of Title 6.

Coast Guard transferred to Department of Transportation and all functions, powers, and duties, relating to Coast Guard, of Secretary of the Treasury and of other offices and officers of Department of the Treasury transferred to Secretary of Transportation by Pub. L. 89-670, § 6(b)(1), Oct. 15, 1966, 80 Stat. 938. Section 6(b)(2) of Pub. L. 89-670, however, provided that notwithstanding such transfer of functions, Coast Guard shall operate as part of Navy in time of war or when President directs as provided in section 3 of Title 14, Coast Guard. See section 108 of Title 49, Transportation.

PLAN AMENDMENTS NOT REQUIRED UNTIL JANUARY 1, 1998

For provisions directing that if any amendments made by subtitle D [§§1401-1465] of title I of Pub. L. 104-188 require an amendment to any plan or annuity contract, such amendment shall not be required to be made before the first day of the first plan year beginning on or after Jan. 1, 1998, see section 1465 of Pub. L. 104-188, set out as a note under section 401 of this title.

PLAN AMENDMENTS NOT REQUIRED UNTIL JANUARY 1, 1994

For provisions directing that if any amendments made by subtitle B [§§521-523] of title V of Pub. L.

102-318 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1994, see section 523 of Pub. L. 102-318, set out as a note under section 401 of this title.

PLAN AMENDMENTS NOT REQUIRED UNTIL JANUARY 1, 1989

For provisions directing that if any amendments made by subtitle A or subtitle C of title XI [§§1101-1147 and 1171-1177] or title XVIII [§§1800-1899A] of Pub. L. 99-514 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see section 1140 of Pub. L. 99-514, as amended, set out as a note under section 401 of this title.

AUTHORS OR ARTISTS PERFORMING SERVICES UNDER CONTRACT WITH CORPORATION

Pub. L. 96-605, title IV, §402, Dec. 28, 1980, 94 Stat. 3532, as amended by Pub. L. 99-514, §2, Oct. 22, 1986, 100 Stat. 2095, provided that:

“(a) IN GENERAL.—An author or artist performing services under contract with a corporation shall be considered as an employee of the corporation for the purpose of applying the provisions specified in section 7701(a)(20) of the Internal Revenue Code of 1986 [formerly I.R.C. 1954], if, on December 31, 1977, such author or artist was a participant in one or more of the pension, profit-sharing or annuity plans of such corporation which are described in subsection (b)(2).

“(b) DEFINITIONS.—For purposes of this section—

“(1) CONTRACT.—The term ‘contract’ means a contract which during its term—

“(A) requires such author or artist to give the corporation first reading or first refusal on writings or drawings of specified types, and prohibits him from offering any such writing or drawing to any other publication unless it has been offered to and rejected by the corporation; or

“(B) requires such author or artist to use his best efforts to produce work of specified types for the corporation.

“(2) CORPORATION.—The term ‘corporation’ means a corporation which for at least 15 years prior to January 1, 1978, had in effect one or more pension, profit-sharing and annuity plans, each of which—

“(A) had contained from its inception a definition of the term ‘employee’ that included the category of ‘authors and artists under contract’, and

“(B) had been determined by the Secretary of the Treasury (taking into account the definition described in subparagraph (A)) to be a qualified plan within part I of subchapter D of chapter 1 of subtitle A of the Internal Revenue Code of 1986 [section 401 et seq. of this title] for all of such years.

“(c) EFFECTIVE DATE.—The provisions of this section shall apply to taxable years ending after December 31, 1980.”

§ 7702. Life insurance contract defined

(a) General rule

For purposes of this title, the term “life insurance contract” means any contract which is a life insurance contract under the applicable law, but only if such contract—

(1) meets the cash value accumulation test of subsection (b), or

(2)(A) meets the guideline premium requirements of subsection (c), and

(B) falls within the cash value corridor of subsection (d).

(b) Cash value accumulation test for subsection (a)(1)

(1) In general

A contract meets the cash value accumulation test of this subsection if, by the terms of

the contract, the cash surrender value of such contract may not at any time exceed the net single premium which would have to be paid at such time to fund future benefits under the contract.

(2) Rules for applying paragraph (1)

Determinations under paragraph (1) shall be made—

(A) on the basis of interest at the greater of an annual effective rate of 4 percent or the rate or rates guaranteed on issuance of the contract,

(B) on the basis of the rules of subparagraph (B)(i) (and, in the case of qualified additional benefits, subparagraph (B)(ii)) of subsection (c)(3), and

(C) by taking into account under subparagraphs (A) and (D) of subsection (e)(1) only current and future death benefits and qualified additional benefits.

(c) Guideline premium requirements

For purposes of this section—

(1) In general

A contract meets the guideline premium requirements of this subsection if the sum of the premiums paid under such contract does not at any time exceed the guideline premium limitation as of such time.

(2) Guideline premium limitation

The term “guideline premium limitation” means, as of any date, the greater of—

(A) the guideline single premium, or
(B) the sum of the guideline level premiums to such date.

(3) Guideline single premium

(A) In general

The term “guideline single premium” means the premium at issue with respect to future benefits under the contract.

(B) Basis on which determination is made

The determination under subparagraph (A) shall be based on—

- (i) reasonable mortality charges which meet the requirements (if any) prescribed in regulations and which (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,
- (ii) any reasonable charges (other than mortality charges) which (on the basis of the company’s experience, if any, with respect to similar contracts) are reasonably expected to be actually paid, and
- (iii) interest at the greater of an annual effective rate of 6 percent or the rate or rates guaranteed on issuance of the contract.

(C) When determination made

Except as provided in subsection (f)(7), the determination under subparagraph (A) shall be made as of the time the contract is issued.

(D) Special rules for subparagraph (B)(ii)

(i) Charges not specified in the contract

If any charge is not specified in the contract, the amount taken into account

under subparagraph (B)(ii) for such charge shall be zero.

(ii) New companies, etc.

If any company does not have adequate experience for purposes of the determination under subparagraph (B)(ii), to the extent provided in regulations, such determination shall be made on the basis of the industry-wide experience.

(4) Guideline level premium

The term “guideline level premium” means the level annual amount, payable over a period not ending before the insured attains age 95, computed on the same basis as the guideline single premium, except that paragraph (3)(B)(iii) shall be applied by substituting “4 percent” for “6 percent”.

(d) Cash value corridor for purposes of subsection (a)(2)(B)

For purposes of this section—

(1) In general

A contract falls within the cash value corridor of this subsection if the death benefit under the contract at any time is not less than the applicable percentage of the cash surrender value.

(2) Applicable percentage

In the case of an insured with an attained age as of the beginning of the contract year of:	The applicable percentage shall decrease by a ratable portion for each full year:
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More than:	But not more than:	From:	To:
0	40	250	250
40	45	250	215
45	50	215	185
50	55	185	150
55	60	150	130
60	65	130	120
65	70	120	115
70	75	115	105
75	90	105	105
90	95	105	100.

(e) Computational rules

(1) In general

For purposes of this section (other than subsection (d))—

(A) the death benefit (and any qualified additional benefit) shall be deemed not to increase,

(B) the maturity date, including the date on which any benefit described in subparagraph (C) is payable, shall be deemed to be no earlier than the day on which the insured attains age 95, and no later than the day on which the insured attains age 100,

(C) the death benefits shall be deemed to be provided until the maturity date determined by taking into account subparagraph (B), and

(D) the amount of any endowment benefit (or sum of endowment benefits, including any cash surrender value on the maturity date determined by taking into account subparagraph (B)) shall be deemed not to exceed the least amount payable as a death benefit at any time under the contract.

(2) Limited increases in death benefit permitted

Notwithstanding paragraph (1)(A)—

(A) for purposes of computing the guideline level premium, an increase in the death benefit which is provided in the contract may be taken into account but only to the extent necessary to prevent a decrease in the excess of the death benefit over the cash surrender value of the contract,

(B) for purposes of the cash value accumulation test, the increase described in subparagraph (A) may be taken into account if the contract will meet such test at all times assuming that the net level reserve (determined as if level annual premiums were paid for the contract over a period not ending before the insured attains age 95) is substituted for the net single premium, and

(C) for purposes of the cash value accumulation test, the death benefit increases may be taken into account if the contract—

(i) has an initial death benefit of \$5,000 or less and a maximum death benefit of \$25,000 or less,

(ii) provides for a fixed predetermined annual increase not to exceed 10 percent of the initial death benefit or 8 percent of the death benefit at the end of the preceding year, and

(iii) was purchased to cover payment of burial expenses or in connection with pre-arranged funeral expenses.

For purposes of subparagraph (C), the initial death benefit of a contract shall be determined by treating all contracts issued to the same contract owner as 1 contract.

(f) Other definitions and special rules

For purposes of this section—

(1) Premiums paid**(A) In general**

The term “premiums paid” means the premiums paid under the contract less amounts (other than amounts includible in gross income) to which section 72(e) applies and less any excess premiums with respect to which there is a distribution described in subparagraph (B) or (E) of paragraph (7) and any other amounts received with respect to the contract which are specified in regulations.

(B) Treatment of certain premiums returned to policyholder

If, in order to comply with the requirements of subsection (a)(2)(A), 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.

(C) Interest returned includible in gross income

Notwithstanding the provisions of section 72(e), the amount of any interest returned as provided in subparagraph (B) shall be includible in the gross income of the recipient.

(2) Cash values**(A) Cash surrender value**

The cash surrender value of any contract shall be its cash value determined without regard to any surrender charge, policy loan, or reasonable termination dividends.

(B) Net surrender value

The net surrender value of any contract shall be determined with regard to surrender charges but without regard to any policy loan.

(3) Death benefit

The term “death benefit” means the amount payable by reason of the death of the insured (determined without regard to any qualified additional benefits).

(4) Future benefits

The term “future benefits” means death benefits and endowment benefits.

(5) Qualified additional benefits**(A) In general**

The term “qualified additional benefits” means any—

(i) guaranteed insurability,

(ii) accidental death or disability benefit,

(iii) family term coverage,

(iv) disability waiver benefit, or

(v) other benefit prescribed under regulations.

(B) Treatment of qualified additional benefits

For purposes of this section, qualified additional benefits shall not be treated as future benefits under the contract, but the charges for such benefits shall be treated as future benefits.

(C) Treatment of other additional benefits

In the case of any additional benefit which is not a qualified additional benefit—

(i) such benefit shall not be treated as a future benefit, and

(ii) any charge for such benefit which is not prefunded shall not be treated as a premium.

(6) Premium payments not disqualifying contract

The payment of a premium which would result in the sum of the premiums paid exceeding the guideline premium limitation shall be disregarded for purposes of subsection (a)(2) if the amount of such premium does not exceed the amount necessary to prevent the termination of the contract on or before the end of the contract year (but only if the contract will have no cash surrender value at the end of such extension period).

(7) Adjustments**(A) In general**

If there is a change in the benefits under (or in other terms of) the contract which was not reflected in any previous determination or adjustment made under this section, there shall be proper adjustments in future determinations made under this section.

(B) Rule for certain changes during first 15 years

If—

- (i) a change described in subparagraph (A) reduces benefits under the contract,
- (ii) the change occurs during the 15-year period beginning on the issue date of the contract, and
- (iii) a cash distribution is made to the policyholder as a result of such change,

section 72 (other than subsection (e)(5) thereof) shall apply to such cash distribution to the extent it does not exceed the recapture ceiling determined under subparagraph (C) or (D) (whichever applies).

(C) Recapture ceiling where change occurs during first 5 years

If the change referred to in subparagraph (B)(ii) occurs during the 5-year period beginning on the issue date of the contract, the recapture ceiling is—

- (i) in the case of a contract to which subsection (a)(1) applies, the excess of—

(I) the cash surrender value of the contract, immediately before the reduction, over

(II) the net single premium (determined under subsection (b)), immediately after the reduction, or

- (ii) in the case of a contract to which subsection (a)(2) applies, the greater of—

(I) the excess of the aggregate premiums paid under the contract, immediately before the reduction, over the guideline premium limitation for the contract (determined under subsection (c)(2), taking into account the adjustment described in subparagraph (A)), or

(II) the excess of the cash surrender value of the contract, immediately before the reduction, over the cash value corridor of subsection (d) (determined immediately after the reduction).

(D) Recapture ceiling where change occurs after 5th year and before 16th year

If the change referred to in subparagraph (B) occurs after the 5-year period referred to under subparagraph (C), the recapture ceiling is the excess of the cash surrender value of the contract, immediately before the reduction, over the cash value corridor of subsection (d) (determined immediately after the reduction and whether or not subsection (d) applies to the contract).

(E) Treatment of certain distributions made in anticipation of benefit reductions

Under regulations prescribed by the Secretary, subparagraph (B) shall apply also to any distribution made in anticipation of a reduction in benefits under the contract. For purposes of the preceding sentence, appropriate adjustments shall be made in the provisions of subparagraphs (C) and (D); and any distribution which reduces the cash surrender value of a contract and which is made within 2 years before a reduction in benefits under the contract shall be treated as made in anticipation of such reduction.

(8) Correction of errors

If the taxpayer establishes to the satisfaction of the Secretary that—

(A) the requirements described in subsection (a) for any contract year were not satisfied due to reasonable error, and

(B) reasonable steps are being taken to remedy the error,

the Secretary may waive the failure to satisfy such requirements.

(9) Special rule for variable life insurance contracts

In the case of any contract which is a variable contract (as defined in section 817), the determination of whether such contract meets the requirements of subsection (a) shall be made whenever the death benefits under such contract change but not less frequently than once during each 12-month period.

(g) Treatment of contracts which do not meet subsection (a) test**(1) Income inclusion****(A) In general**

If at any time any contract which is a life insurance contract under the applicable law does not meet the definition of life insurance contract under subsection (a), the income on the contract for any taxable year of the policyholder shall be treated as ordinary income received or accrued by the policyholder during such year.

(B) Income on the contract

For purposes of this paragraph, the term "income on the contract" means, with respect to any taxable year of the policyholder, the excess of—

- (i) the sum of—

(I) the increase in the net surrender value of the contract during the taxable year, and

(II) the cost of life insurance protection provided under the contract during the taxable year, over

- (ii) the premiums paid (as defined in subsection (f)(1)) under the contract during the taxable year.

(C) Contracts which cease to meet definition

If, during any taxable year of the policyholder, a contract which is a life insurance contract under the applicable law ceases to meet the definition of life insurance contract under subsection (a), the income on the contract for all prior taxable years shall be treated as received or accrued during the taxable year in which such cessation occurs.

(D) Cost of life insurance protection

For purposes of this paragraph, the cost of life insurance protection provided under the contract shall be the lesser of—

- (i) the cost of individual insurance on the life of the insured as determined on the basis of uniform premiums (computed on the basis of 5-year age brackets) prescribed by the Secretary by regulations, or
- (ii) the mortality charge (if any) stated in the contract.

(2) Treatment of amount paid on death of insured

If any contract which is a life insurance contract under the applicable law does not meet the definition of life insurance contract under subsection (a), the excess of the amount paid by the reason of the death of the insured over the net surrender value of the contract shall be deemed to be paid under a life insurance contract for purposes of section 101 and subtitle B.

(3) Contract continues to be treated as insurance contract

If any contract which is a life insurance contract under the applicable law does not meet the definition of life insurance contract under subsection (a), such contract shall, notwithstanding such failure, be treated as an insurance contract for purposes of this title.

(h) Endowment contracts receive same treatment**(1) In general**

References in subsections (a) and (g) to a life insurance contract shall be treated as including references to a contract which is an endowment contract under the applicable law.

(2) Definition of endowment contract

For purposes of this title (other than paragraph (1)), the term “endowment contract” means a contract which is an endowment contract under the applicable law and which meets the requirements of subsection (a).

(i) Transitional rule for certain 20-pay contracts**(1) In general**

In the case of a qualified 20-pay contract, this section shall be applied by substituting “3 percent” for “4 percent” in subsection (b)(2).

(2) Qualified 20-pay contract

For purposes of paragraph (1), the term “qualified 20-pay contract” means any contract which—

- (A) requires at least 20 nondecreasing annual premium payments, and
- (B) is issued pursuant to an existing plan of insurance.

(3) Existing plan of insurance

For purposes of this subsection, the term “existing plan of insurance” means, with respect to any contract, any plan of insurance which was filed by the company issuing such contract in 1 or more States before September 28, 1983, and is on file in the appropriate State for such contract.

(j) Certain church self-funded death benefit plans treated as life insurance**(1) In general**

In determining whether any plan or arrangement described in paragraph (2) is a life insurance contract, the requirement of subsection (a) that the contract be a life insurance contract under applicable law shall not apply.

(2) Description

For purposes of this subsection, a plan or arrangement is described in this paragraph if—

(A) such plan or arrangement provides for the payment of benefits by reason of the death of the individuals covered under such plan or arrangement, and

(B) such plan or arrangement is provided by a church for the benefit of its employees and their beneficiaries, directly or through an organization described in section 414(e)(3)(A) or an organization described in section 414(e)(3)(B)(ii).

(3) Definitions

For purposes of this subsection—

(A) Church

The term “church” means a church or a convention or association of churches.

(B) Employee

The term “employee” includes an employee described in section 414(e)(3)(B).

(k) Regulations

The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section.

(Added Pub. L. 98-369, div. A, title II, § 221(a), July 18, 1984, 98 Stat. 767; amended Pub. L. 99-514, title XVIII, § 1825(a)-(c), Oct. 22, 1986, 100 Stat. 2846-2848; Pub. L. 100-647, title V, § 5011(a), (b), title VI, § 6078(a), Nov. 10, 1988, 102 Stat. 3660, 3661, 3709.)

AMENDMENTS

1988—Subsec. (c)(3)(B)(i), (ii). Pub. L. 100-647, § 5011(a), added cls. (i) and (ii) and struck out former cls. (i) and (ii) which read as follows:

“(i) the mortality charges specified in the contract (or, if none is specified, the mortality charges used in determining the statutory reserves for such contract),

“(ii) any charges (not taken into account under clause (i)) specified in the contract (the amount of any charge not so specified shall be treated as zero), and”.

Subsec. (c)(3)(D). Pub. L. 100-647, § 5011(b), added subpar. (D).

Subsecs. (j), (k). Pub. L. 100-647, § 6078(a), added subsec. (j) and redesignated former subsec. (j) as (k).

1986—Subsec. (b)(2)(C). Pub. L. 99-514, § 1825(a)(2), substituted “subparagraphs (A) and (D)” for “subparagraphs (A) and (C)”.

Subsec. (e)(1). Pub. L. 99-514, § 1825(a)(3), inserted “(other than subsection (d))” after “section”.

Subsec. (e)(1)(B). Pub. L. 99-514, § 1825(a)(1)(A), substituted “shall be deemed to be no earlier than” for “shall be no earlier than”.

Subsec. (e)(1)(C). Pub. L. 99-514, § 1821(a)(1)(C), added subpar. (C). Former subpar. (C) redesignated (D).

Subsec. (e)(1)(D). Pub. L. 99-514, § 1821(a)(1)(C), (D), redesignated subpar. (C) as (D) and substituted “the maturity date determined by taking into account subparagraph (B)” for “the maturity date described in subparagraph (B)”.

Subsec. (e)(2)(C). Pub. L. 99-514, § 1825(a)(4), added subpar. (C).

Subsec. (f)(1)(A). Pub. L. 99-514, § 1825(b)(2), substituted “less any excess premiums with respect to which there is a distribution described in subparagraph (B) or (E) of paragraph (7) and any other amounts received” for “less any other amounts received”.

Subsec. (f)(7). Pub. L. 99-514, § 1825(b)(1), amended par. (7) generally. Prior to amendment, par. (7)(A), in general, read as follows: “In the event of a change in the future benefits or any qualified additional benefit (or in any other terms) under the contract which was not reflected in any previous determination made under this section, under regulations prescribed by the Secretary, there shall be proper adjustments in future determina-

tions made under this section.”, and par. (7)(B), certain changes treated as exchange, read as follows: “In the case of any change which reduces the future benefits under the contract, such change shall be treated as an exchange of the contract for another contract.”

Subsec. (g)(1)(B)(ii). Pub. L. 99-514, §1825(c), amended cl. (ii) generally. Prior to amendment, cl. (ii) read as follows: “the amount of premiums paid under the contract during the taxable year reduced by any policyholder dividends received during such taxable year.”

EFFECTIVE DATE OF 1988 AMENDMENT

Section 5011(d) of Pub. L. 100-647 provided that: “The amendments made by this section [amending this section] shall apply to contracts entered into on or after October 21, 1988.”

Section 6078(b) of Pub. L. 100-647 provided that: “The amendment made by subsection (a) [amending this section] shall take effect as if included in the amendment made by section 221(a) of the Tax Reform Act of 1984 [Pub. L. 98-369, which enacted this section].”

EFFECTIVE DATE OF 1986 AMENDMENT

Section 1825(a)(4) of Pub. L. 99-514, as amended by Pub. L. 100-647, title I, §1018(j), Nov. 10, 1988, 102 Stat. 3583, provided that the amendment made by that section is effective with respect to contracts entered into after Oct. 22, 1986.

Amendment by section 1825(a)(1)-(3), (b), (c) of Pub. L. 99-514 effective, except as otherwise provided, as if included in the provisions of the Tax Reform Act of 1984, Pub. L. 98-369, div. A, to which such amendment relates, see section 1881 of Pub. L. 99-514, set out as a note under section 48 of this title.

EFFECTIVE DATE

Section 221(d) of Pub. L. 98-369, as amended by Pub. L. 99-514, §2, title XVIII, §§1825(e), 1899A(69), Oct. 22, 1986, 100 Stat. 2095, 2848, 2962, provided that:

“(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section [enacting this section and amending section 101 of this title and provisions set out as a note under section 101 of this title] shall apply to contracts issued after December 31, 1984, in taxable years ending after such date.

“(2) SPECIAL RULE FOR CERTAIN CONTRACTS ISSUED AFTER JUNE 30, 1984.—

“(A) GENERAL RULE.—Except as otherwise provided in this paragraph, the amendments made by this section shall apply also to any contract issued after June 30, 1984, which provides an increasing death benefit and has premium funding more rapid than 10-year level premium payments.

“(B) EXCEPTION FOR CERTAIN CONTRACTS.—Subparagraph (A) shall not apply to any contract if—

“(i) such contract (whether or not a flexible premium contract) would meet the requirements of section 101(f) of the Internal Revenue Code of 1986 [formerly I.R.C. 1954],

“(ii) such contract is not a flexible premium life insurance contract (within the meaning of section 101(f) of such Code) and would meet the requirements of section 7702 of such Code determined by—

“(I) substituting ‘3 percent’ for ‘4 percent’ in section 7702(b)(2) of such Code, and

“(II) treating subparagraph (B) of section 7702(e)(1) of such Code as if it read as follows: ‘the maturity date shall be the latest maturity date permitted under the contract, but not less than 20 years after the date of issue or (if earlier) age 95’, or

“(iii) under such contract—

“(I) the premiums (including any policy fees) will be adjusted from time-to-time to reflect the level amount necessary (but not less than zero) at the time of such adjustment to provide a level death benefit assuming interest crediting and an annual effective interest rate of not less than 3 percent, or

“(II) at the option of the insured, in lieu of an adjustment under subclause (I) there will be a comparable adjustment in the amount of the death benefit.

“(C) CERTAIN CONTRACTS ISSUED BEFORE OCTOBER 1, 1984.—

“(i) IN GENERAL.—Subparagraph (A) shall be applied by substituting ‘September 30, 1984’ for ‘June 30, 1984’ in the case of a contract—

“(I) which would meet the requirements of section 7702 of such Code if ‘3 percent’ were substituted for ‘4 percent’ in section 7702(b)(2) of such Code, and the rate or rates guaranteed on issuance of the contract were determined without regard to any mortality charges and any initial excess interest guarantees, and

“(II) the cash surrender value of which does not at any time exceed the net single premium which would have to be paid at such time to fund future benefits under the contract.

“(ii) DEFINITIONS.—For purposes of clause (i)—

“(I) IN GENERAL.—Except as provided in subclause (II), terms used in clause (i) shall have the same meanings as when used in section 7702 of such Code.

“(II) NET SINGLE PREMIUM.—The term ‘net single premium’ shall be determined by substituting ‘3 percent’ for ‘4 percent’ in section 7702(b)(2) of such Code, by using the 1958 standard ordinary mortality and morbidity tables of the National Association of Insurance Commissioners, and by assuming a level death benefit.

“(3) TRANSITIONAL RULE FOR CERTAIN EXISTING PLANS OF INSURANCE.—A plan of insurance on file in 1 or more States before September 28, 1983, shall be treated for purposes of section 7702(i)(3) of such Code as a plan of insurance on file in 1 or more States before September 28, 1983, without regard to whether such plan of insurance is modified after September 28, 1983, to permit the crediting of excess interest or similar amounts annually and not monthly under contracts issued pursuant to such plan of insurance.

“(4) EXTENSION OF FLEXIBLE PREMIUM CONTRACT PROVISIONS.—The amendments made by subsection (b) [amending section 101 of this title and provisions set out as a note under section 101 of this title] shall take effect on January 1, 1984.

“(5) SPECIAL RULE FOR MASTER CONTRACT.—For purposes of this subsection, in the case of a master contract, the date taken into account with respect to any insured shall be the first date on which such insured is covered under such contract.”

INTERIM RULES; REGULATIONS; STANDARDS BEFORE REGULATIONS TAKE EFFECT

Section 5011(c) of Pub. L. 100-647 provided that:

“(1) REGULATIONS.—Not later than January 1, 1990, the Secretary of the Treasury (or his delegate) shall issue regulations under section 7702(c)(3)(B)(i) of the 1986 Code (as amended by subsection (a)).

“(2) STANDARDS BEFORE REGULATIONS TAKE EFFECT.—In the case of any contract to which the amendments made by this section [amending this section] apply and which is issued before the effective date of the regulations required under paragraph (1), mortality charges which do not differ materially from the charges actually expected to be imposed by the company (taking into account any relevant characteristic of the insured of which the company is aware) shall be treated as meeting the requirements of clause (i) of section 7702(c)(3)(B) of the 1986 Code (as amended by subsection (a)).”

PLAN AMENDMENTS NOT REQUIRED UNTIL JANUARY 1, 1989

For provisions directing that if any amendments made by subtitle A or subtitle C of title XI [§§1101-1147 and 1171-1177] or title XVIII [§§1800-1899A] of Pub. L. 99-514 require an amendment to any plan, such plan

amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see section 1140 of Pub. L. 99-514, as amended, set out as a note under section 401 of this title.

TREATMENT OF FLEXIBLE PREMIUM CONTRACTS ISSUED DURING 1984 WHICH MEET NEW REQUIREMENTS

Section 221(b)(3) of Pub. L. 98-369, as added by Pub. L. 99-514, title XVIII, §1825(d), Oct. 22, 1986, 100 Stat. 2848, provided that: "Any flexible premium contract issued during 1984 which meets the requirements of section 7702 of the Internal Revenue Code of 1954 [now 1986] (as added by this section) shall be treated as meeting the requirements of section 101(f) of such Code."

§ 7702A. Modified endowment contract defined

(a) General rule

For purposes of section 72, the term "modified endowment contract" means any contract meeting the requirements of section 7702—

(1) which—

(A) is entered into on or after June 21, 1988, and

(B) fails to meet the 7-pay test of subsection (b), or

(2) which is received in exchange for a contract described in paragraph (1) or this paragraph.

(b) 7-pay test

For purposes of subsection (a), a contract fails to meet the 7-pay test of this subsection if the accumulated amount paid under the contract at any time during the 1st 7 contract years exceeds the sum of the net level premiums which would have been paid on or before such time if the contract provided for paid-up future benefits after the payment of 7 level annual premiums.

(c) Computational rules

(1) In general

Except as provided in this subsection, the determination under subsection (b) of the 7 level annual premiums shall be made—

(A) as of the time the contract is issued, and

(B) by applying the rules of section 7702(b)(2) and of section 7702(e) (other than paragraph (2)(C) thereof), except that the death benefit provided for the 1st contract year shall be deemed to be provided until the maturity date without regard to any scheduled reduction after the 1st 7 contract years.

(2) Reduction in benefits during 1st 7 years

(A) In general

If there is a reduction in benefits under the contract within the 1st 7 contract years, this section shall be applied as if the contract had originally been issued at the reduced benefit level.

(B) Reductions attributable to nonpayment of premiums

Any reduction in benefits attributable to the nonpayment of premiums due under the contract shall not be taken into account under subparagraph (A) if the benefits are reinstated within 90 days after the reduction in such benefits.

(3) Treatment of material changes

(A) In general

If there is a material change in the benefits under (or in other terms of) the contract

which was not reflected in any previous determination under this section, for purposes of this section—

(i) such contract shall be treated as a new contract entered into on the day on which such material change takes effect, and

(ii) appropriate adjustments shall be made in determining whether such contract meets the 7-pay test of subsection (b) to take into account the cash surrender value under the contract.

(B) Treatment of certain benefit increases

For purposes of subparagraph (A), the term "material change" includes any increase in the death benefit under the contract or any increase in, or addition of, a qualified additional benefit under the contract. Such term shall not include—

(i) any increase which is attributable to the payment of premiums necessary to fund the lowest level of the death benefit and qualified additional benefits payable in the 1st 7 contract years (determined after taking into account death benefit increases described in subparagraph (A) or (B) of section 7702(e)(2)) or to crediting of interest or other earnings (including policyholder dividends) in respect of such premiums, and

(ii) to the extent provided in regulations, any cost-of-living increase based on an established broad-based index if such increase is funded ratably over the remaining period during which premiums are required to be paid under the contract.

(4) Special rule for contracts with death benefits of \$10,000 or less

In the case of a contract—

(A) which provides an initial death benefit of \$10,000 or less, and

(B) which requires at least 7 nondecreasing annual premium payments,

each of the 7 level annual premiums determined under subsection (b) (without regard to this paragraph) shall be increased by \$75. For purposes of this paragraph, the contract involved and all contracts previously issued to the same policyholder by the same company shall be treated as one contract.

(5) Regulatory authority for certain collection expenses

The Secretary may by regulations prescribe rules for taking into account expenses solely attributable to the collection of premiums paid more frequently than annually.

(6) Treatment of certain contracts with more than one insured

If—

(A) a contract provides a death benefit which is payable only upon the death of 1 insured following (or occurring simultaneously with) the death of another insured, and

(B) there is a reduction in such death benefit below the lowest level of such death benefit provided under the contract during the 1st 7 contract years,

this section shall be applied as if the contract had originally been issued at the reduced benefit level.