Current Internal Revenue Code, SEC. 7702. LIFE INSURANCE CONTRACT DEFINED.

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7702(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—

7702(a)(1) meets the cash value accumulation test of subsection (b), or

7702(a)(2)

7702(a)(2)(A) meets the guideline premium requirements of subsection (c), and

7702(a)(2)(B) falls within the cash value corridor of subsection (d).

7702(b) Cash Value Accumulation Test for Subsection (a)(1).—

7702(b)(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.

7702(b)(2) Rules for applying paragraph (1).— Determinations under paragraph (1) shall be made —

7702(b)(2)(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,

7702(b)(2)(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

7702(b)(2)(C) by taking into account under subparagraphs (A) and (D) of subsection (e)(1) only current and future death benefits and qualified additional benefits.

7702(c) Guideline Premium Requirements.— For purposes of this section—

7702(c)(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.

7702(c)(2) Guideline premium limitation.— The term “guideline premium limitation” means, as of any date, the greater of—

7702(c)(2)(A) the guideline single premium, or

7702(c)(2)(B) the sum of the guideline level premiums to such date.

7702(c)(3) Guideline single premium.—

7702(c)(3)(A) In general.— The term “guideline single premium” means the premium at issue with respect to future benefits under the contract.

7702(c)(3)(B) Basis on which determination is made.— The determination under subparagraph (A) shall be based on—

7702(c)(3)(B)(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,

7702(c)(3)(B)(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

7702(c)(3)(B)(iii) interest at the greater of an annual effective rate of 6 percent or the rate or rates guaranteed on issuance of the contract.

7702(c)(3)(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.

7702(c)(3)(D) SPECIAL RULES FOR SUBPARAGRAPH (B)(ii).—

7702(c)(3)(D)(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.

7702(c)(3)(D)(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.

7702(c)(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”.

7702(d) CASH VALUE CORRIDOR FOR PURPOSES OF SUBSECTION (a)(2)(B).— For purposes of this section—

7702(d)(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.

7702(d)(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:	
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

7702(e) COMPUTATIONAL RULES.—

7702(e)(1) IN GENERAL.— For purposes of this section (other than subsection (d))—

7702(e)(1)(A) the death benefit (and any qualified additional benefit) shall be deemed not to increase,

7702(e)(1)(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,

7702(e)(1)(C) the death benefits shall be deemed to be provided until the maturity date determined by taking into account subparagraph (B), and

7702(e)(1)(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.

7702(e)(2) LIMITED INCREASES IN DEATH BENEFIT PERMITTED.— Notwithstanding paragraph (1)(A)—

7702(e)(2)(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,

7702(e)(2)(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,

7702(e)(2)(C) for purposes of the cash value accumulation test, the death benefit increases may be taken into account if the contract—

7702(e)(2)(C)(i) has an initial death benefit of $5,000 or less and a maximum death benefit of $25,000 or less,

7702(e)(2)(C)(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

7702(e)(2)(C)(iii) was purchased to cover payment of burial expenses or in connection with prearranged 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.

7702(f) OTHER DEFINITIONS AND SPECIAL RULES.— For purposes of this section—

7702(f)(1) PREMIUMS PAID.—

7702(f)(1)(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.

7702(f)(1)(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.

7702(f)(1)(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.

7702(f)(2) Cash values.—

7702(f)(2)(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.

7702(f)(2)(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.

7702(f)(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).

7702(f)(4) Future benefits.— The term "future benefits" means death benefits and endowment benefits.

7702(f)(5) Qualified additional benefits.—

7702(f)(5)(A) In general.— The term "qualified additional benefits" means any—

7702(f)(5)(A)(i) guaranteed insurability,

7702(f)(5)(A)(ii) accidental death or disability benefit,

7702(f)(5)(A)(iii) family term coverage,

7702(f)(5)(A)(iv) disability waiver benefit, or

7702(f)(5)(A)(v) other benefit prescribed under regulations.

7702(f)(5)(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.

7702(f)(5)(C) Treatment of other additional benefits.— In the case of any additional benefit which is not a qualified additional benefit—

7702(f)(5)(C)(i) such benefit shall not be treated as a future benefit, and

7702(f)(5)(C)(ii) any charge for such benefit which is not prefunded shall not be treated as a premium.

7702(f)(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).

7702(f)(7) Adjustments.—

7702(f)(7)(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.

7702(f)(7)(B) Rule for certain changes during first 15 years.— If—

7702(f)(7)(B)(i) a change described in subparagraph (A) reduces benefits under the contract,

7702(f)(7)(B)(ii) the change occurs during the 15-year period beginning on the issue date of the contract, and

7702(f)(7)(B)(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).

7702(f)(7)(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—

7702(f)(7)(C)(i) in the case of a contract to which subsection (a)(1) applies, the excess of—

7702(f)(7)(C)(i)(I) the cash surrender value of the contract, immediately before the reduction, over

7702(f)(7)(C)(i)(II) the net single premium (determined under subsection (b)), immediately after the reduction, or

7702(f)(7)(C)(ii) in the case of a contract to which subsection (a)(2) applies, the greater of—

7702(f)(7)(C)(ii)(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

7702(f)(7)(C)(ii)(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).

7702(f)(7)(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).

7702(f)(7)(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.

7702(f)(8) CORRECTION OF ERRORS.— If the taxpayer establishes to the satisfaction of the Secretary that—

7702(f)(8)(A) the requirements described in subsection (a) for any contract year were not satisfied due to reasonable error, and

7702(f)(8)(B) reasonable steps are being taken to remedy the error,

the Secretary may waive the failure to satisfy such requirements.

7702(f)(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.

7702(g) TREATMENT OF CONTRACTS WHICH DO NOT MEET SUBSECTION (a) TEST.—

7702(g)(1) INCOME INCLUSION.—

7702(g)(1)(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.

7702(g)(1)(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—

7702(g)(1)(B)(i) the sum of—

7702(g)(1)(B)(i)(I) the increase in the net surrender value of the contract during the taxable year, and

7702(g)(1)(B)(i)(II) the cost of life insurance protection provided under the contract during the taxable year, over

7702(g)(1)(B)(ii) the premiums paid (as defined in subsection (f)(1)) under the contract during the taxable year.

7702(g)(1)(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.

7702(g)(1)(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—

7702(g)(1)(D)(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

7702(g)(1)(D)(ii) the mortality charge (if any) stated in the contract.

7702(g)(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.

7702(g)(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.

7702(h) ENDOWMENT CONTRACTS RECEIVE SAME TREATMENT.—

7702(h)(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.

7702(h)(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).

7702(i) TRANSITIONAL RULE FOR CERTAIN 20-PAY CONTRACTS.—

7702(i)(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).

7702(i)(2) QUALIFIED 20-PAY CONTRACT.— For purposes of paragraph (1), the term "qualified 20-pay contract" means any contract which—

7702(i)(2)(A) requires at least 20 nondecreasing annual premium payments, and

7702(i)(2)(B) is issued pursuant to an existing plan of insurance.

7702(i)(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.

7702(j) CERTAIN CHURCH SELF FUNDED DEATH BENEFIT PLANS TREATED AS LIFE INSURANCE.—

7702(j)(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.

7702(j)(2) DESCRIPTION.— For purposes of this subsection, a plan or arrangement is described in this paragraph if—

7702(j)(2)(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

7702(j)(2)(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).

7702(j)(3) DEFINITIONS.— For purposes of this subsection—

7702(j)(3)(A) CHURCH.— The term "church" means a church or a convention or association of churches.

7702(j)(3)(B) EMPLOYEE.— The term "employee" includes an employee described in section 414(e)(3)(B).

7702(k) REGULATIONS.— The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section.