

Summary of Issues Identified in Notice 2008-18

	Issue	Potential Government Action
1.	<p><u>Life Insurance Qualification</u></p> <p>Whether reserves determined under VACRVM or PBR would qualify as "life insurance reserves" under section 816 (b)</p> <p>The notice indicates that the government does not believe that life qualification should be adversely effected due solely to changes in statutory reserving methodology.</p>	<p>In order to prevent this concern, the government may publish guidance that would:</p> <ul style="list-style-type: none"> (i) require the continued use of statutory reserves for purposes of the reserve ratio test, even if those reserves are determined under VACARVM or PBR; (ii) require the continued use of CARVM or CRVM, as applicable, under such terms as applied before the adoption of VACARVM or PBR; (iii) apply principles similar to those of Prop. Reg. §1.801-4(g) to ensure that reserves with respect to life insurance and annuity contracts are appropriately accounted for in the reserve ratio test of section 816(a); or (iv) require the use of only the standard scenario amount (in the case of VACARVM) or deterministic reserve (in the case of PBR) for purposes of the reserve ratio test.
2.	<p><u>Life Contract Qualification under 7702</u></p> <p>Whether the adoption of PBR would render it impossible for issuers of life insurance contracts to satisfy the requirement of section 7702(c)(3)(B) that reasonable mortality charges not exceed the mortality charges specified in "the commissioners' standard mortality tables" as defined in section 807(d)(5).</p> <p>The notice indicates that the government believes it is inappropriate for a change in statutory accounting under section 807(d) to effect a wholesale change in the standards for qualification of contracts as "life insurance contracts" under section 7702.</p>	<p>To prevent this result, if PBR is adopted, the government may:</p> <ul style="list-style-type: none"> (i) exercise the authority under section 7702(c)(3)(B) either to prescribe mortality tables or to permit the continued use of the 1980 Commissioners' Standard Ordinary mortality and morbidity tables (1980 CSO tables) or the 2001 Commissioners' Standard Ordinary mortality and morbidity tables (2001 CSO tables), as appropriate, to satisfy the reasonable mortality charge requirement of that section; or (ii) provide a reasonable interpretation of the prevailing commissioners' standard mortality tables under section 807 that would not render the cross reference in section 7702(c)(3)(B) meaningless.
3.	<p><u>Contract-by-contract versus aggregate reserves.</u></p> <p>The government believes that the standard scenario or deterministic reserve determined under VACARVM or PBR would more closely resemble the methodology in effect when Congress enacted section 807 in 1984 than would the CTE amount or stochastic reserve.</p> <p>The government is concerned more fundamentally that because the CTE amount (under VACARVM) or stochastic reserve (under PBR) would not represent an expected value of a company's obligations with respect to the underlying contracts, some or all of these amounts are nondeductible "solvency" or "contingency" reserves.</p>	<p>If this concern is not satisfied, the government may:</p> <ul style="list-style-type: none"> (i) permit a contract-by-contract apportionment of a stochastically-determined reserve, but with appropriate adjustments so that reserve reflects an expected value of the company's obligations (for example, by adjusting the CTE from 65 to 0, assuming that the chosen scenarios have a uniform probability distribution and the scenarios not chosen have a zero probability); (ii) conclude that the methodology of VACARVM or PBR is so different from that which was in effect when Congress enacted section 807 in 1984 that taxpayers must continue to apply section 807 as if VACARVM or PBR had not been adopted; or (iii) interpret the statutory cap under section 807(d)(1) and CARVM/CRVM under section 807(d)(2) to encompass only the standard scenario amount (in the case VACARVM)

		or the deterministic reserve (in the case of PBR).
4.	<p><u>Prevailing state assumed interest rate.</u></p> <p>It has been suggested that in the case of PBR, the absence of a single, prescribed interest rate means that taxpayers should be allowed to determine tax reserves simply using the AFR.</p> <p>The government is concerned that this approach would nullify an important safeguard against situations where the AFR is an inappropriately low rate for determining a fair valuation of the tax reserve with respect to a contract.</p>	<p>Rather than interpret the term "prevailing State assumed interest rate" to refer to a null set, the government may require the use of a rate that is the greater of the AFR and some other objective rate or rates, such as (i) the rate implicit in the aggregate reserves that are determined stochastically; (ii) the rate used by the company in pricing the contract; or (iii) the rate used to determine the deterministic reserve.</p>
5.	<p><u>Prevailing mortality tables.</u></p> <p>The government is concerned that determining an aggregate reserve stochastically and, after the fact, using the reserve so determined to "map" to one of a large number of NAIC-approved mortality tables would not satisfy the requirement that the prevailing commissioners' standard tables be used for purposes of determining the tax reserve for a contract.</p>	<p>If this concern is not satisfied, the government may interpret the prevailing commissioners' standard mortality tables under section 807(d)(5) to mean either:</p> <ul style="list-style-type: none"> (i) the 2001 CSO mortality tables; (ii) the mortality tables, if any, which served as the basis for pricing the particular contract; (iii) if more than one standard mortality table or option could apply to a particular contract, whichever table generally would yield the lowest reserve for the contract (see section 807(d)(5)(E)); or (iv) in the case of VACARVM, the mortality tables used for purposes of determining the standard scenario amount with respect to a contract.
6.	<p><u>Transition rules: application to in-force contracts.</u></p> <p>If VACARVM or PBR is adopted, it is anticipated the new rules would apply for federal income tax purposes only to contracts that are issued after the date of adoption and not to previously issued contracts that are in force on that date, regardless of the applicability of the new rules to previously issued contracts for regulatory purposes.</p>	