Deficiency reserves included in statutory reserve cap that applies to life insurance reserves

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In brief

The IRS issued Notice 2013-19, which clarifies that deficiency reserves are taken into consideration in computing the statutory reserve cap under Section 807(d)(1). This guidance is important to note, as it clarifies an issue raised by some IRS agents in the past.

In detail

To determine the decrease or increase in life insurance reserves for a contractunder Section 807, Section 807(d)(1) provides that the life insurance reserve for any such contract is the greater of (i) the contract's net surrender value, or (ii) the federally prescribed reserve for the contract under Section 807(d)(2). The amount taken into account may not, however, exceed the amount that would be taken into account with regard to the contract in computing statutory reserves.

Section 807(d)(2) provides that the tax method applicable to the contract is used to determine the federally prescribed reserve. Section 807(d)(3) sets forth the applicable tax reserve method and provides a rule that disallows any additional reserve deduction for deficiency reserves. In general, deficiency reserves arise because the net premium taken into account in computing reserves eceeds the actual premiums or othe consideration charged for the benefits under the contract.

The Notice explains that the term 'statutory reserve' under Section 807(d)(6) means the aggregate amount set forth in the annual statement with respect to items described in Section 807(c), which includes life insurance reserves.

The Notice cites the legislative history as well as the Joint Committee on Taxation's general explanation of the revenue provisions of the Tax Reform Act of 1984. The Notice concludes that Congress intended that deficiency reserves would be taken into consideration when applying the statutory reserve cap under Section 807(d)(1) with respect to a life insurance. Some IRS agents had asserted that the statutory reserve cap does not include deficiency reserves despite contrary guidance in the Internal Revenue Manual.

The takeaway

This guidance is welcomed by taxpayers, as it clarifies an issue raised by some IRS agents. This notice fulfils one of the IRS's 2012-2013 Priority Guidance Plan items in the insurance area.

Let's talk

For a deeper discussion, please contact:

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