Life

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Field Bulletin

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Impact of Changes to Section 7702 on life insurance policies

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On December 21, 2020, Congress passed the Consolidated Appropriations Act of 2021, which included several updates to Section 7702. These updates will positively impact the life insurance industry through illustrated performance and policy funding.

What is Section 7702?
Internal Revenue Code Section 7702 requires a life insurance policy to meet one of two tests (Cash Value Accumulation Test or Guideline Premium Test) to be considered life insurance for federal income tax purposes.

What changes are being made?
The biggest change was to the rates that determine whether a policy qualifies as life insurance for federal income tax purposes and if it will be treated as a Modified Endowment Contract (MEC). These changes are intended to bring the rates used in these key calculations in-line with the current interest rate environment. Both indexed universal life and universal life policies will be impacted by this change.

How will these changes impact you and your clients?

1. **More premium can be paid into a policy due to increasing limits.** These reduced rates allow more premium to be paid into a policy before it becomes a MEC, allowing for more cash value growth potential.
2. **The same amount of premium can be put in a policy with a *lower* specified amount,** offering more potential cash value and less net amount at risk for your clients. A lower net amount of risk reduces the cost of insurance which makes the cost of carrying the policy lower when compared to the prior rules.

When will changes be made?
North American is actively reviewing the regulations to determine when we will be able to apply the updated rates and allow changes to be made to our currently marketed products. Updates will be shared as they become available. The new regulations will only apply to policies issued January 1, 2021 and later.

In the meantime, please review the Frequently Asked Questions or contact your MGA for more information on these changes.

For most policies, withdrawals are free from federal income tax to the extent of the investment in the contract, and policy loans are also tax-free so long as the policy does not terminate before the death of the insured. However, if the policy is a Modified Endowment Contract (MEC), a withdrawal or policy loan may be taxable upon receipt. Further, unpaid loan interest on a MEC may be taxable. A MEC is a contract received in exchange for a MEC or for which premiums paid during a seven-year testing period exceed prescribed premium limits (7-pay premiums).

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