INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

August 30, 2004

Third Party Communication: None
Date of Communication: Not Applicable

Number: **200448046**
Release Date: 11/26/2004
Index (UIL) No.: 807.03-00, 807.03-02, 807.04-00
CASE-MIS No.: TAM-132334-04

Taxpayer's Name:
Taxpayer's Address:

Taxpayer's Identification No
Years Involved:
Date of Conference:

LEGEND:

Taxpayer: =

Y =

State Z

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Date 8 =

Date 9 =

Amount 10 =

Amount 11 =

Date 12 =

Date 13 =

Amount 14 =

Amount 15 =

Date 16 =

Date 17 =

ISSUE:

Whether the Taxpayer may use the very conservative reserve method required only by Connecticut that it used to compute its statutory reserves in the annual statements filed in all states to compute federal tax reserves for Minimum Guaranteed Death Benefits associated with deferred variable annuity contracts issued prior to the effective date of Actuarial Guideline XXXIV.

CONCLUSION:

Taxpayer may not use the very conservative reserve method required only by Connecticut that it used to compute its statutory reserves in the annual statements filed in all states to compute federal tax reserves for Minimum Guaranteed Death Benefits associated with deferred variable annuity contracts issued prior to the effective date of Actuarial Guideline XXXIV. Section 807 requires that Taxpayer calculate its tax reserves using the CARVM prescribed by the NAIC which is in effect on the date of the issuance of the contract. Where the NAIC is silent, the Taxpayer is required to calculate its tax reserves using the prevailing state practice.

FACTS:

The Taxpayer is a life insurance company within the meaning of section 816(a) of the Internal Revenue Code. Taxpayer is a member of an affiliated group that files a consolidated life/nonlife return and is principally engaged in the sale of annuities. The company does business in Y states. Taxpayer was incorporated in State Z which is the company's "state of domicile" for statutory accounting purposes. Taxpayer issued deferred variable annuities to policyholders throughout Date 1, and continues to do so today. "The variable annuity contract provides benefits that vary directly with the investment experience of the assets that back the contract. Assets backing variable annuities … are maintained in a separate account and the investment results of this account are reflected directly in the variable annuity values."[1]

Statutory reserves for the variable accumulation portion, and the fixed portion that is subject to market value adjustments, of these annuities are customarily reported on Taxpayer's Separate Account Annual Statement, or "green book." Reserves for any fixed accumulation portion of these annuities not subject to market value adjustments are customarily reported on Taxpayer's General Account Annual Statement, or "blue book." Many of its issued policies contained a Minimum Guaranteed Death Benefit (MGDB) for the variable accumulation portion of the policy. These contract provisions provide that Taxpayer would be liable if the policy value actually dropped below a certain amount, and the policyholder died before the policy annuitized. In such instances, Taxpayer would be required to pay a death benefit to the beneficiary equal to the higher minimum guaranteed amount. Statutory reserves for the Minimum Guaranteed Death Benefit were reported on Taxpayer's Annual Statement for its General Account or "blue book."

For taxable years prior to Date 2, the taxpayer established MGDB reserves when the account value for a deferred variable annuity subject to CARVM actually dropped below the MGDB. For example, if the MGDB for such a policy was 100, and the actual account value was 75, an MGDB reserve would be established in the blue book to account for the risk measured by the difference, computed using mortality and interest rate assumptions.

Standard valuation law requires that reserves be established for minimum guaranteed death benefits provided under variable annuity contracts. Prior to 1998 (the year in which AG 34 became effective), the methods of calculation of reserves for these variable annuity benefits were not uniform throughout the industry. However, Connecticut was the only state to require that such reserves be computed using a deemed drop in asset value, rather than the actual asset value.

By letter of Date 3, Connecticut's Insurance Department had advised CFO's and appointed actuaries of life and health insurance companies licensed to do business in

---

[1] Kenneth Black, Jr. and Harold D. Skipper, Jr., Life Insurance 107 (11th ed. 1987).

the state, of a new requirement for non-incidental[2] death benefit statutory reserves offered with variable annuities. The new requirement involved an assumption that, in computing these reserves, the account value of the annuity be reduced by a deemed one third drop in asset value, regardless of the type of assets that supported the policy's account value. So, MGDB reserves for a deferred variable annuity with a value that was supported by money market investments, as well as MGDB reserves for a deferred variable annuity with a value that was supported by investments in stock, would both be computed by first making an assumption that the asset value at the end of the year had dropped by one third.

Except for Connecticut, this method was not a specifically stated requirement of any other state for variable annuities sold by life and health insurance companies doing business in them and filing Annual Statements with their Insurance Departments.

Beginning in Date 4 for statutory reserves, and in Date 2 for tax reserves, in computing its end of the year reserves for MGDBs provided with deferred variable annuities (issued prior to and during those years), Taxpayer used the statutory accounting method required only by Connecticut. When employed for tax or statutory purposes, this deemed one third drop in asset value increased both the number of instances in which a MGDB reserve was required, as well as the size of those reserves. Taxpayer continued using this method for tax purposes until Date 5. For statutory purposes, it changed to the method required by AG 34 in Date 6. Audits of tax years Date 2 and Date 7 are now closed.

At Date 8 and Date 9, Taxpayer applied the Connecticut requirement to all deferred variable annuity policies offering this benefit, and computed its reported tax reserves for MGDBs as shown in the table below.

MGDB RESERVES COMPUTED WITH THE CONNECTICUT REQUIREMENT

Reserves reported on…		At Date 8	At Date 9
Annual Statement, Exhibit 8	General Acct	Amount 10	
Tax Return, Form 1120L	Schedule F	Amount 10	Amount 11

The National Association of Insurance Commissioners adopted Actuarial Guideline 34, Variable Annuity Minimum Guaranteed Death Benefit Reserves, in September of 1997. Beginning in 1998, for statutory accounting purposes, life insurance companies were instructed to use this Guideline to compute Minimum Guaranteed Death Benefit reserves for all contracts issued on or after January 1, 1981, if the application of AG 34

[2] The Connecticut letter explains non-incidental death benefits as follows: "…death benefits which, at any time, may exceed the greater of the sum of the premiums paid (guarantee of principal) and the account value (forgiveness of surrender charge), shall be deemed to be a 'non-incidental' death benefit. Examples of non-incidental benefits are death benefits reset every 5 years and death benefits increasing by 5% a year, whether or not the current death benefit exceeds that payable under an incidental death benefit provision."

produced “higher [MGDB] reserves than the company had otherwise established by their previously used interpretation.” In other words, the minimum amount of MGDB reserves reportable on life and health insurance company annual statements had to equal the amount computed using the requirements of AG 34.

The method of computing MGDB reserves under AG 34 involved different deemed asset value drops than Connecticut required. Instead of a one third drop in value for all assets regardless of the type of investment supporting the account, AG 34 required drop in value assumptions which varied from 2.5% to 14%, depending on the type of assets supporting the account. In addition to these new deemed drops in asset values, AG 34 required the use of assumptions that there were subsequent recoveries based on net assumed returns, at rates that varied from 6.5% to 14%, again depending on the type of assets supporting the account.

MGDB reserves computed using these assumptions required by AG 34 would generally be lower than MGDB reserves computed using the one third drop assumption required by the State of Connecticut, and required in fewer instances.

The Background section of AG 34 states that its purpose is to “interpret the standards for the valuation of reserves for Minimum Guaranteed Death Benefits (MGDBs) included in variable annuity contracts. This Guideline codifies the basic interpretation of the Commissioners Annuity Reserve Valuation Method (CARVM) by clarifying the assumptions and methodologies which will comply with the intent of the Standard Valuation Law.” In addition to requirements for assumptions for immediate value drops and subsequent recoveries at net assumed returns, AG 34 also interpreted the “mortality standards to be applied to projected MGDBs in the reserve calculation.”

The Scope section of the guideline states that AG 34 applies to “variable annuity contracts which provide a Minimum Guaranteed Death Benefit that has the potential to exceed the account value, whether or not the MGDB exceeds the account value on the valuation date.” By contrast, the Connecticut requirement was applicable only to non-incidental MGDBs as defined in the Date 3 letter.

Taxpayer computed its beginning and end of year Date 5 reported tax reserves using the requirements and assumptions of AG 34, for all policies, regardless of date of issue. This table summarizes the amounts thus reported:

MGDB RESERVES COMPUTED UNDER AG 34

Reserves reported on…		At Date 12	At Date 13
Tax Return, Form 1120L	Schedule F	Amount 14	Amount 15

To summarize reported tax reserves for all MGDBs associated with deferred variable annuities, the following table shows the amounts reported on Taxpayer’s tax returns for Date 17, with amounts computed using the Connecticut method shown in bold print, and amounts computed using AG 34 shown in normal print.

Summary Table: MGDB TAX RESERVES REPORTED ON FORM 1120L, Schedule F

@ Date 8	@ Date 16	@ Date 9	Date 12	Date 13
Amount 10	**Amount 10**	**Amount 11**	Amount 14	Amount 15

The taxpayer has also begun to spread the difference between the end of year Date 6 MGDB reserves and beginning of year Date 5 MGDB reserves into income beginning in tax year Date 5, and planned to continue this spread over ten years in accordance with IRC 807(f).

LAW AND ANALYSIS:

The computation of reserve deductions with respect to life insurance, annuity, and noncancellable and guaranteed renewable accident and health insurance contracts is subject to the rules set out in section 807 of the Internal Revenue Code.

Section 805(a)(2) allows an insurance company to take a deduction against taxable income for increases in certain life insurance reserves. More specifically, section 807(b) provides that if, for any taxable year, the closing balance of "the items described in subsection (c)" (which includes life insurance reserves) exceeds the opening balance, the excess is taken into account as a deduction under section 805(a)(2). By contrast, if the opening balance exceeds the closing balance, the excess is included in gross income under section 803(a)(2).

The methods of determining life insurance reserves for use in computing an insurance company's taxable income are prescribed in section 807(d). For this purpose, the reserve for any contract generally is equal to the greater of (a) the "net surrender value" of such contract or (b) the amount of reserves otherwise determined under section 807(d)(2). In no event may the reserve for any contract exceed the amount taken into account with respect to that contract as of that time in determining the statutory reserves (reduced by any deferred and uncollected premiums taken into account in determining the statutory reserves). Section 807(d)(1) (flush language); see also sections 809(b)(4)(B) and 811(c).

Section 807(d)(2) provides that the reserve for any contract must be determined by using:
(A) the tax reserve method applicable to such contract,
(B) the greater of--
(i) the applicable Federal interest rate, or
(ii) the prevailing state assumed interest rate, and
(C) the prevailing commissioners' standard tables for mortality and morbidity adjusted as appropriate to reflect the risks (such as substandard risks) incurred under the contract which are not otherwise taken into account.

In general, the life insurance reserve rules of section 807(d)(2) are intended to limit the amount of an insurance company's reserves for purposes of computing increases and decreases to the minimum reserve which most states would require to be set aside with respect to a contract, unless the net surrender value of the contract is greater. *See* H.R.Rep. No. 432, 98th Cong., 2d Sess., Pt. 2, at 1414 (1984); Senate Committee on Finance, 98th Cong., 2d Sess., *Deficit Reduction Act of 1984*, *Explanation of Provisions Approved by the Committee on March 21,* 1984, Vol. 1, 540 (Comm. Print 1984).

Section 807(d)(3) of the Code prescribes specific reserve methods for particular types of contracts.

1. <u>Where the NAIC did not provide specific guidance for the calculation of reserves for MGDBs, Taxpayer must use the prevailing state practice.</u>

For annuity contracts, the prescribed reserve method is the Commissioners' Annuities Reserve Valuation Method (CARVM) as recommended by the National Association of Insurance Commissioners (NAIC) that is in effect when the contract is issued. See section 807(d)(3)(B)(ii). The calculation of insurance reserves for state regulatory purposes is dictated by the Standard Valuation Law (SVL). The NAIC promulgates actuarial guidelines that supplement the SVL for purposes of the insurer's annual statement, which is filed with the state in which the insurer is subject to state regulation. By relying on the reserving methods recommended by the NAIC, the life insurance reserve rules seek to minimize state by state variations in the methods used by insurance companies to calculate deductible reserve additions. *See Supplemental Report of the Committee on Ways and Means*, H.R. Rep. No. 432, 98th Cong., 2d Sess., Part 2, 1414; Senate Committee on Finance, 98th Cong., 2d Sess., *Deficit Reduction Act of 1984*, *Explanation of Provisions Approved by the Committee on March 21,* 1984, Vol. 1, 540-41 (Comm. Print 1984).

Thus, as a general rule, a life insurance company calculates its life insurance reserves under section 807(d)(2) taking into account any factors specifically recommended by the NAIC. If specific factors are not prescribed by the NAIC recommended method, however, the prevailing state practice or interpretation of that method should be considered for purposes of determining what factors can be taken into account in applying the computation method for tax purposes. *See* Senate Committee on Finance, 98th Cong., 2d Sess., *Deficit Reduction Act of 1984*, *Explanation of Provisions Approved by the Committee on March 21, 1984*, Vol. 1, 541 (Comm. Print 1984).

The Conference Report for the Tax Reform Act of 1984 (1984 Act) indicates that, in 1984, divergent practices existed among the states with respect to whether surrender charges should be taken into account in the computation of annuity reserves under CARVM and that the matter was being considered by the NAIC for a recommendation. The Conference report stated that if the NAIC in 1984 clarified what surrender charge factors are to be disregarded (and not to reduce the amount of the reserve) under CARVM, then that clarification would be considered to have been effective on the issue date of the annuity contracts. This was an exception to the general rule that the prevailing state interpretation of the NAIC recommended method as of the issue date of the contract should be considered when determining how specific factors not prescribed by that method are applied for tax purposes. *See* H.R.Conf.Rep. No. 861, 98th Cong., 2d Sess. 1052 (1984), 1984-2 C.B. (Vol. 2) 1052.

The legislative committee reports accompanying the technical corrections title of the Tax Reform Act of 1986 indicate that the NAIC did not take action in 1984 to resolve the state differences as to how CARVM should apply. Therefore, the 1986 legislative committee reports state that annuity reserves should be revalued as of January 1, 1984, based on the prevailing state interpretation of CARVM at that time. The 1986 legislative committee reports state that, through 1983, the prevailing interpretation of CARVM was that annuity reserves could be reduced by surrender charges (whether or not contingent). *See* S.Rep. No. 313, 99th Cong., 2d Sess. 964 (1986), 1986-3 (Vol. 3) C.B. 964.

In September 1997, the NAIC adopted Actuarial Guideline XXXIV, Variable Annuity Minimum Guaranteed Death Benefit Reserves (AG 34), interpreting the standards for the valuation of reserves for “minimum guaranteed death benefits” provided in variable annuity contracts. AG 34 was effective on December 31, 1998, for all contracts issued on or after January 1, 1981. Taxpayer acknowledges that section 807(d) prohibits it from using this guideline for the contracts in question that were issued prior to the effective date of AG 34. Taxpayer also acknowledges that it must calculate its reserves for these contracts in accordance with the rules of section 807 and that it must use the CARVM as dictated by the NAIC in effect on the date of issuance of the contracts. Taxpayer argues, however, that, prior to the issuance of AG34, CARVM was silent as to the calculation of MGDB reserves for these contracts and that it thus was permitted to use Connecticut's reserve method to calculate its tax reserves under section 807(d). The practical effect of using Connecticut's reserve method was to increase reserves dramatically because of the greatly increased conservatism of the required one third drop in asset values.

CARVM promulgated by the NAIC consists of the SVL and the actuarial guidelines issued by the NAIC. CARVM was adopted as the minimum reserve standard for annuity contracts as part of the 1976 amendments to the Standard Valuation Law. The development of CARVM was spurred by the growing sales by the life insurance industry of deferred annuity contracts that had been designed to serve as cash accumulation vehicles through the crediting of current interest rates, rather than to guarantee a stream of retirement income.

CARVM as set forth in the Standard Valuation Law provides as follows:

> Reserves according to the commissioners’ annuity reserve method for benefits under annuity or pure endowment contracts, excluding any disability and accidental death benefits in such contracts, shall be the

> greatest of the respective excesses of the present values, at the date of valuation, of the future guaranteed benefits, including guaranteed nonforfeiture benefits, provided for by such contract at the end of each respective contract year, over the present value, at the date of valuation, of any future valuation considerations derived from future gross consideration, required by the terms of such contract, that become payable prior to the end of such respective contract year.

National Association of Insurance Commissioners, Model Insurance Laws, Regulations, and Guidelines, Vol. IV, 820-10 (1984).

Even if the CARVM prescribed by the NAIC did not address benefits such as MGDBs, the legislative history requires that the Taxpayer utilize the prevailing state practice or interpretation of CARVM. The term prevailing state practice with respect to any particular annuity contract's specific reserve methodology means the interpretation of reserve computation methodology that is accepted by a majority of states and which produces the minimum reserve for that particular annuity contract. *See* Supplemental Report of the Committee on Ways and Means, H.R. Rep. No. 432, 98th Cong., 2d Sess., Part 2, 1414.

Taxpayer admits that the accepted methodology for calculating MGDB reserves in 49 states was by valuing the assets at their current value, without any drop in asset value. Connecticut was the only state that deviated from this practice. The Taxpayer argues because the other states accepted its higher Connecticut reserve calculation on the annual statements filed with those states, Connecticut's one third "asset [value] drop assumption meets the definition of a prevailing interpretation of CARVM." However, because the primary interest of states is to prevent insolvency of insurance companies, all states would accept the higher reserves that resulted from using Connecticut's method if the company's surplus would support them. Thus, merely because the states accepted Taxpayer's higher reserve calculations is of no consequence in deciding what the proper tax reserves should be.

Taxpayer was required to use the prevailing state practice of valuing the MGDB reserves using no drop in asset value.

2. <u>Taxpayer's usage of Connecticut's reserve method is contrary to the express legislative intent.</u>

The Connecticut methodology of calculating MGDB reserves was the most conservative methodology used in any of the 50 states. This methodology cannot be used for tax reserve calculations because that would be contrary to the congressional intent when it adopted the tax reserve calculation in the Tax Reform Act of 1984. The Legislative History regarding the life insurance reserve rules of section 807(d)(2) are intended to permit insurance companies to utilize the <u>minimum reserve</u> which most states would require to be set aside (unless the net surrender value is greater). *See* H.R. Rep.

No. 432, pt. 2, 98th Cong. 2d Sess. 1414 (1984); *See* Senate Committee on Finance, 98th Cong., 2d Sess., *Deficit Reduction Act of 1984*, *Explanation of Provisions Approved by the Committee on March 21,* 1984, Vol. 1, 540 (Comm. Print 1984).

Connecticut's reserve calculation resulted in the highest reserve, not the minimum state reserve required by most states and its usage was contrary to express congressional intent. Taxpayer may not use the extremely conservative method of one state to calculate its tax reserves.

Taxpayer argues that this decision should be determined by TAM 200108002, a prior Technical Advice Memorandum issued to a different taxpayer. Section 6110(k)(3) states that " [u]nless the Secretary otherwise establishes by regulations, a written determination may not be used or cited as precedent." Section 6110(k)(3) thus prohibits the reliance upon a TAM issued to a different taxpayer.

Moreover, TAM 200108002 differed factually from the present case. In TAM 200108002, the graded interest rate method that the taxpayer sought to use resulted in a minimum reserve and was determined to be consistent with CARVM and NAIC Guideline IX-B. That is diametrically opposite to the present case where Taxpayer's usage of the extremely conservative reserving method of Connecticut is neither the CARVM prescribed by the NAIC nor the prevailing state practice or interpretation of CARVM. In fact, the NAIC expressly rejected Connecticut's method when AG 34 was being developed because it was deemed to be too "arbitrary" and "overly conservative." See 1995 Valuation Actuary Symposium Proceedings, Session 2, Life and annuity Valuation Issues, pp. 53-57. Contrary to the graded interest rate method, Connecticut's reserve method resulted in the maximum rather than the minimum reserve.

3. <u>The NAIC rejected Connecticut's extreme reserving method of reserving when it adopted AG 34.</u>

Connecticut borrowed the assumed drop in asset value methodology from its required method of reserving for MGDBs in variable life insurance policies. Connecticut's methodology reflected the NAIC's Variable Life Insurance Model Regulations that addressed reserve requirements for variable life policies. “Prior to 1983, the model required that a variable life insurance policy provide a ‘minimum death benefit… in an amount at least equal to the initial face amount of the policy so long as premiums are duly paid.’”[3] A 1983 revision to the Variable Life Insurance Model Regulation required that MGDB reserves for scheduled premium variable life policies be computed using a deemed one third drop (or “depreciation”) in the underlying separate account asset values.

Connecticut was one of a minority of states that had adopted regulations calling for a one third drop in asset values for MGDB reserves on both flexible premium and

[3] NAIC, <u>Model Regulation Service</u>-April 1997, at 270-38.

scheduled premium variable life policies, followed by a net investment return equal to the valuation interest rate. In Date 3, a letter from the Director of the Connecticut Insurance Department's Examination Division notified insurance companies licensed to do business in Connecticut that they were to begin using its variable life minimum death benefit reserve requirements in computing statutory reserves for non-incidental variable annuity death benefits.

Life insurance policies (including variable life insurance policies) are purchased for their death benefits. They protect against the risk of loss of income due to premature death. Annuities (including variable annuities), on the other hand, are purchased to protect against the possibility of outliving one's income.[4] To insurance companies, different risk factors are associated with each, and different probability (i.e., mortality) tables are therefore used for life insurance and annuities.[5]

The risk profiles associated with variable life MGDBs and variable annuity MGDBs are also different. The one third drop in asset value utilized in the Connecticut method was deemed to be "a very arbitrary and overly conservative number" for MGDB reserves. The NAIC expressly rejected Connecticut's method when AG 34 was being developed because it was deemed to be too conservative. *See* 1995 Valuation Actuary Symposium Proceedings, Session 2, Life and Annuity Valuation Issues, pp. 55-56.

4. Taxpayer's interpretation of Section 811(a) is incorrect and renders the provision a nullity.

Taxpayer argues that Section 811(a) permits it to use its annual statement reserve amounts for its federal tax reserves. Taxpayer's interpretation of section 811(a) is incorrect and ignores the express language of the statute.

Section 811(a) requires generally that all computations entering into the determination of a life insurance company's taxable income be made under an accrual method of accounting, unless a combination of an accrual method and another method (other than a cash method) is permitted under regulations. Section 811(a) also states:

> To the extent not inconsistent with the preceding sentence or any other provision of this part, all such computations shall be made in a manner consistent with the manner required for purposes of the annual statement approved by the National Association of Insurance Commissioners.

[4] Black and Skipper, pp. 100-01.
[5] Floyd S. Harper and Lewis C. Workman, Fundamental Mathematics of Life Insurance 122 (1970). "Experience has shown that the rates of mortality for persons buying annuity contracts are lower, age by age, than for those buying life insurance contracts. This apparently results from the fact that some persons base their selection of one or the other type of contract upon the knowledge that their own probabilities of dying are better or worse than average."

Section 811(a) thus requires first and foremost that the rules of tax reserving under section 807 be followed. Only to the extent not inconsistent with the federal income tax accounting rules and other federal tax rules applicable to life insurance companies may computations be made in a manner consistent with the manner required for purposes of the annual statement approved by the NAIC.

Although the 1984 Act carries over the historical definition of “life insurance reserves” as set forth in former § 801(b), it substantially changed the impact of this definition on the amounts taken into account in computing life insurance company taxable income. Prior to the 1984 Act, the amount of life insurance reserves for which increases and decreases were recognized in computing taxable income was based on the amount of the reserve liabilities reported on the insurance company's annual statement for state regulatory reporting purposes.

While section 807(c)(1) still includes “life insurance reserves” as defined in section 816(b)" among the deductible reserve items, the legislative committee reports indicate that this cross-reference was intended merely to identify the type of reserve for which increases and decreases were taken into account, and was not intended to superimpose the requirement of proper computation of state law reserves for allowing increases in these reserves to be recognized. *See* Senate Committee on Finance, 98th Cong., 2d Sess., *Deficit Reduction Act of 1984*, *Explanation of Provisions Approved by the Committee on March 21,* 1984, Vol. 1, 541 (Comm. Print 1984); *See also* Joint Committee on Taxation Staff, *General Explanation of the Tax Reform Act of 1984* , 98th Cong., 2d Sess. 598 (1984).

Rather, under the 1984 Act, the amount of the life insurance reserves for which increases and decreases are recognized for tax purposes is prescribed regardless of the method employed by the insurance company in its computation of statutory reserves for purposes of the NAIC annual statement. According to the legislative committee reports, the prescribed rules for computing life insurance reserves were intended to allow insurance companies to recognize at least the minimum reserve that most states would require to be set aside for the contract, but no more unless the net surrender value for the contract was a greater amount. See H.R. Rep. No. 432, at 1414 (1984); S. Rep. No. 169, at 540 (1984).

The legislative history to the 1984 Act also states:

> The bill, however, takes a new approach by prescribing specific rules for computing life insurance reserves for tax purposes, and as a consequence, the amount of the deduction allowable or income includible in any taxable year is prescribed <u>regardless of the manner employed in computing state statutory reserves</u>.

See Senate Committee on Finance, 98th Cong., 2d Sess., *Deficit Reduction Act of 1984*, *Explanation of Provisions Approved by the Committee on March 21,* 1984, Vol. 1, 539-40 (Comm. Print 1984). (Emphasis added.)

Thus, under prior law, a company's reserves were based on its statutory reserves, which were computed using assumptions under state law. The result was a significant overstatement of liabilities in comparison to those measured under realistic economic assumptions. Congress concluded that a more accurate measure of liabilities for tax purposes can be achieved by imposing specific rules for the computation of tax reserves that result in a reserve that approximates the least conservative (smallest) reserve which would be required under the prevailing law of the States. *See* S. Print. No 169, Vol. 1, at 521 (1984).

Congress was afraid that "[r]eliance on state law reserves to determine deductions or exclusions from income could create the potential for companies with greater available assets to establish larger reserves and thus obtain a tax advantage vis-à-vis companies with smaller amounts of surplus assets**.**" Joint Committee on Taxation Staff and Senate Finance Committee,, Major Issues in the Taxation of Life Insurance Products, Policyholders, and Companies 33 (J. Comm. Print JCS-48-83, Oct. 3, 1983).

Statutory accounting for reserves is the "abuse" Congress sought to avoid by dictating the use of a federally prescribed reserve method. Rather than being an "anti-abuse" measure, section 811(a) is a default provision which allows statutory accounting to be considered only where there is no federally prescribed method to follow.

Taxpayer was required by the tax reserve computation rules of section 807(d) to determine its tax reserves for MGDBs for the Contracts issued in Date 17.

CAVEAT(S):
A copy of this technical advice memorandum is to be given to the taxpayer. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.