Definition of Life Insurance – Oxford

“Insurance that pays out a sum of money either on the death benefit of the insured person or after a set period.”

“The creation of cash where there were none before. When needed the most and tax free.”

Ben Feldman

A 7702 plan refers to a cash value life insurance policy where some of the premium goes to the death benefit and some goes to the policy’s cash value.

Bankrate

7702 Tax Advantaged Life Insurance Policy -

IRC section 7702 defines the criteria that Cash Value Life Insurance Must Meet to retain their tax advantaged status.

Guideline for premiums paid and defines the corridor and cash value accumulation tests that must be satisfied in order for the cash value inside the policy to grow on a tax deffered basis.

7702 was created in response to the large number of life insurance policyholders who were using cash value life insurance as a tax shelter.

Investopedia – Proceeds from life insurance contracts are tax advantaged and/or provide favorable tax treatment.

IF IT DOES NOT MEET THE DEFINITION OF THE IRC OF LIFE INSURANCE – TAXED AS ORDINARY INCOME.

Prior to 7702, federal government took a “hands off” approach when it came to taxation of life insurance.

Requirements:

Pass one of two tests-

CVAT – Cash Value Accumulation Test or

GPT – Guideline Premium and Corridor Test

CVAT – Cash Value

GPT- Premiums Paid

CVAT – surrender of the contract “may not exceed, at any time” the net single premium which would have to be paid at such time to fund future benefits under the contract.

MEANING – Amount of money a policyholder could get out of the policy if they were to cancel CAN’T BE GREATER THAN THE AMOUNT THAT THE POLICYHOLDER WOULD HAVE PAID TO PURCHASE THE POLICY WITH A SINGLE LUMP SUM.

GPT – Requires the sum of the premiums paid under such contract does not at any time exceed the guideline premium limitation as of such time

MEANING – Policyholder can’t have paid more into a policy than would be necessary to fun its insurance benefits

IF it fails either of those tests, it’s a MEC

YOU MAY NOT FLIP-FLOP the two tests!

REVISION OF THE 7702 Regulation

Passed on December 27, 2020 found deep in the 5,593 page Consolidated Approriations Act of 2021 (CARE ACT)

Life Insurance Companies had been pushing for this change so they could continue operating a sustainable business. Protect policyholders amid declining rates. The bill back in 1988 used 4-6 percent interest and was seen as a conservative figure. The new bill reflects economic realities.

FOR DEATH BENEFIT (WHOLE LIFE)

The new act lowers the actuarial interest rate assumption for premiums to create a future death benefit down to 2%.

Consumers must now put in more premiums for same amount of death benefit.

FOR ACCUMULATION

Optimized by paying the most amount of premium for the least amount of death benefit (to lower the underlying cost) Could really be a good play for 2nd to Die Cases.

Must have repriced their internal IUL or Whole Life fees to cope with low interest rate they expect on their investment portfolio

THE BLACK BOX (Whole Life)

Guarantees of future whole life will be significantly watered down

THE TRANSPARENT BOX (IUL)

IUL’s largely tied to the amount of death benefit, this now makes today’s IUL more cost efficent.