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IRS Approves “Longevity” Annuity

In [Private Letter Ruling 200939018](#) (June 18, 2009), the Internal Revenue Service (IRS) ruled favorably on an annuity product providing benefits only in the event the annuitant lives to a specified date.

As has been widely reported, the financial services industries have been designing, in light of changing demographics in the population, decumulation and other products and services to provide retirement income security both inside and outside of formal retirement plans. The life insurance industry has recently introduced, among other products:

- “Longevity” annuities, that is, annuities that pay benefits only if the annuitant is living on a specified date. In purpose and design, these annuities have strong similarities to products issued by the insurance industry during the first half of the 1900s. This new IRS ruling considers the tax treatment of such a product; and
- “Contingent” annuities, which pay benefits only if a specified investment portfolio (held *outside* the insurance product) loses all its value (typically, due to the net effect of longevity, a specified pattern of withdrawals, and investment performance) while the annuitant is still living. These products provide guarantees that are conceptually similar to those provided by “living benefits” on variable annuity values, developed over the last decade. The IRS has not published a ruling on such a product to date.

Facts

While all the features of the longevity product considered by the IRS are not entirely clear, due to substantial redactions in the ruling, its key elements include:

- At the time of contract purchase, the contract owner selects a “Deferral Period,” subject to certain constraints, and an annuitant. The annuitant cannot be changed during the Deferral Period.
- The contract owner remits one or more premiums for the contract, subject to certain restrictions (including a moratorium on premiums for a specified time as the end of the Deferral Period approaches, presumably for anti-selection reasons). Net premiums are credited to, and periodic charges are debited against, a “contingent” cash value to which the contract owner has no access during the Deferral Period. It appears that (1) the contract also provides a form of annual credit on contract anniversaries during the Deferral Period that “rewards” the particular annuitant’s survival and at a minimum reflects the longevity experience of this line of contracts; and (2) the contingent cash value can decrease year over year.

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- During the Deferral Period:
 - The contract provides no cash value, death or annuity benefits; and
 - The contract terminates, without value or any benefit payment, if the annuitant dies or if the contingent cash value is reduced to zero.
- If the annuitant is living and the contract is in force at the end of the Deferral Period, the contingent annuity value becomes a conventional cash value available for surrender, withdrawal or annuitization at guaranteed rates. A death benefit is also provided, and the contract owner can change the annuitant.
- After the Deferral Period, the contract terminates on the date the cash value is reduced to zero, the date of annuitization or surrender, or a specified maturity date.

The contract is treated as an annuity for state insurance filing and other regulatory purposes, and will observe the limitations of Internal Revenue Code (IRC) §§ 72(s) and 72(u).

Ruling

The IRS concluded that this contract is an annuity for purposes of IRC § 72, notwithstanding its lack of an available cash value during the Deferral Period.

- The IRS reasoned that the contract is an annuity within the customary practice of the industry, as specified in Treas. Reg. § 1.72-2(A)(1). In reaching this conclusion, the IRS observed that (1) annuity contracts with deferral features similar to the contract had been issued by the insurance industry in the mid-1990s and earlier; (2) the contract has features in common with traditional deferred variable annuities; and (3) nothing in the authorities indicates that a cash value is a predicate for annuity treatment under IRC § 72.
- Also, because the contract liquidates a fund including principal over a period of years, provides for annuity payments at guaranteed rates, and has an annuity start date as defined in Treas. Reg. § 1.72-4(b), it is an annuity rather than an instrument providing periodic interest payments (which tax authorities distinguish from an annuity).

To the extent there was any question about the tax status of such longevity products—arising from the absence of an accessible cash value and thus of any tax deferral on an explicit “inside buildup,” or otherwise—this ruling helpfully and correctly addresses that question.



If you have questions about this development, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.

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