IRS Form 712: Like a Box of Chocolates, You Never Know What You’re Going to Get

A primer on IRS Form 712 and the different ways that insurance carriers value policies and report, when and why it matters, and a discussion of other approaches to valuing life insurance policies for wealth transfer strategies.

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A primer on IRS Form 712 and the different ways that insurance carriers value policies and report, when and why it matters, and a discussion of other approaches to valuing life insurance policies for wealth transfer strategies.

I. Introduction. What is the value of a life insurance policy? This question can lead a practitioner down a complex and winding road of options and inquiries, with the only consistency being an answer of “it depends.” Whether a policy is being valued for income, gift, or estate tax purposes, or for other disclosure and non-tax reasons, the preferred and optional valuation strategies will vary based on the particular facts and circumstances involving the insured, the transfer or transaction, and any tax reasons for the valuation.

II. Fair Market Value of a Life Insurance Policy.

A. The value of an asset for tax purposes is generally its "fair market value" as of the valuation date. While the Internal Revenue Code (Code) does not specifically define fair market value, Treas. Reg. Secs. 20.2031-1(b) and 25.2512-1 provide that the fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts.

B. Using the willing buyer standard works well for determining the fair market value of assets that are regularly sold in a retail market or in a strong secondary market as of the valuation date. While there is an active life settlement market for a subset of policies, as described below, for most life insurance policies, there is no willing buyer. For a long time, the only way to “sell” a policy was to surrender it back to the carrier. As a result, the courts and applicable Internal Revenue Service (IRS) Regulations have long provided other, arguably artificial but easily determinable, conventions for valuing policies for tax purposes.

C. The life insurance valuation rules set forth in the Treasury Regulations are over 40 years old and were created at a time when the only types of policies were whole life and renewable term life insurance products. The rules have not kept pace with the constant changes in the insurance market, where we now have universal life, variable universal life, index universal life, universal life with secondary guarantees, level-term contracts and refund option contracts. In addition, the valuation rules are subject to interpretation by insurance carriers and are applied by them in a variety of inconsistent ways to these modern types of policies.

D. The Treasury Regulations value life insurance based in part on the insurance carrier’s reserves set aside for a policy, and in part based on the unapplied portion
of a premium. The methods insurance carriers use to account for reserves has expanded, and each carrier seems to use a different method.

E. The valuation conventions in the Treasury Regulations eliminate the need for an appraisal based on comparable sales to determine fair market value, yet, as this outline will explore, there are circumstances where an appraisal may be preferable.

III. Policy Valuation for Gift Tax and Estate Tax Purposes.

A. Exceptions from Transfer-for-Value Rules. Transactions which require valuation of a life insurance policy for transfer tax purposes generally involve transfers of a policy from the owner to a related third party. With proper planning, such third party will qualify for an exemption from the “transfer for value” rules under Code Section 101(a)(2). Some examples are as follows:

1. A gift to a grantor trust, subject to the “three-year look-back rule” of Code Section 2035;

2. A “full value” sale to a grantor trust, arguably not subject to the Code Section 2035 three year “look back” rule (under its adequate and full consideration exception), nor the transfer for value rule of Code Section 101(a)(2) (under either the exceptions for transfers to the insured or for carry-over basis transactions. See Rev. Rul. 2007-13, 2007-11 IRB, relying on Rev. Rul. 85-13, 1985-1 C.B. 184).

3. A sale by the owner to a partner of the insured or an entity wholly or partially owned by the insured;

4. A sale by a trustee of a trust to the trustee of another grantor trust where the insured is the grantor;

5. As a substitution of assets for a policy held in a grantor trust pursuant to a power retained in the trust;

6. As a transfer at the death of the owner of a policy which insures someone else’s life; or

7. At the insured’s death.

B. Other Transactions Where Value Matters. Other, less obvious circumstances where a valuation is required include:

1. Split-dollar arrangements. The termination of a non-equity collateral assignment under a private split-dollar arrangement technically triggers a
transfer for gift and income tax purposes, even though the legal ownership does not change;

2. Charitable gifts of life insurance policies;

3. To make a late allocation of GST exemption to an insurance trust;

4. Calculating required minimum distributions from a profit-sharing plan that owns life insurance;

5. A private foundation’s determination of the fair market value of its assets for the 5% distribution rule when life insurance is an asset of the foundation;

6. Trustees’ fiduciary duties with respect to asset allocation and risk management, including for decisions whether to hold, exchange, surrender or sell a policy;

7. Business valuations where the business owns life insurance on employees; and

8. Property division in divorce.

IV. Valuation Methods.

A. Supreme Court Cases. The Treasury Regulations discussed next are an extension of case law, which in the 1940s developed a valuation methodology based on ascertaining the values of comparable contracts, valued at replacement cost. See Guggenheim v. Rasquin, 312 U.S. 254 (1941) (dealing with a single premium, traditional whole life policy gifted when the premium was paid) and U.S. v. Ryerson, 312 U.S. 260 (1941) (dealing with a similar policy gifted later).

B. Treasury Reg. Sec. 25.2512-6(a) was originally issued in 1963 and most recently amended in 1974. It states:

“The value of a life insurance contract … issued by a company regularly engaged in the selling of contracts of that character is established through the sale of the particular contract by the company, or through the sale by the company of comparable contracts. As valuation of an insurance policy through sale of comparable contracts is not readily ascertainable when the gift is of a contract which has been in force for some time and on which further premium payments are to be made, the value may be approximated by adding to the interpolated terminal reserve at the date of the gift the proportionate part of the gross premium last paid before the date of the gift which covers the period extending beyond that date. If,
however, because of the unusual nature of the contract such approximation is not reasonably close to the full value, this method may not be used.

A few important points from the Regulations, discussed in more detail below:

1. The Regulations consider the life cycle of an insurance policy and divide the valuation concepts into three stages:
   
   (a) Newly-purchased policies;
   
   (b) Paid up or single premium policies; and
   
   (c) Policies that have been in force “for some time” and on which further premium payments are to be made.

2. The “terminal reserve” is the money the insurance company is putting aside to pay the policy proceeds at the insured’s death. Under normal circumstances, the terminal reserve grows each year until at policy maturity it equals the death benefit.

3. The interpolated terminal reserve (“ITR”) calculation “may” be used to value a life insurance policy, but is not required to be used. A bona fide offer or an appraisal may be used to establish fair market value instead.

4. The ITR calculation “may not be used” where the unusual nature of the contract results in an ITR that is not reasonably close to full value. If today’s sophisticated policy products, which were unanticipated at the time this Regulation was written, qualify as “unusual” contracts, then a different method of determining value may be required.

C. Treas. Reg. Sec. 20.2031-8(a)(2) is the estate tax analog of Reg. Sec. 25.2512-6(a), used to value an unmatured policy on the life of another owned by the decedent, and uses the same concept as the gift tax Regulations.

D. Rev. Proc. 2005-25 provides safe harbor formulas for calculating the fair market value of life insurance policies transferred from a qualified plan by distribution or sale, and can also be used to determine the fair market value of a policy (or policy interests) transferred under a group term plan (Code Section 79) or transferred to an employee as compensation (Code Section 83). It introduces the concept of the “PERC amount” and is discussed in greater detail in Part VIII.A.

V. Applying the Rules to Traditional Policy Types.
A. **New Policy.** For newly issued policies (which practitioners often interpret as up to one year after policy issue), the value of a policy for gift tax purposes is the cost of that policy. In other words, the total premiums paid for the policy at the time of valuation.

1. See, eg, Rev. Rul. 81-198, 1981-2 C.B. 188 (holding that a policy that had been in force for seven years had been “in force for some time”) and Rev. Rul. 79-429, 1979-2 C.B. 321 (reaching a similar conclusion for a policy which had been in force for only three years).

2. If the Service agrees the policy has not been “in force for some time”, it would be valued as a new policy – based on the premium(s) paid, even if the cost value is higher than the ITR.

B. **Paid Up/Single Premium Policies.** For a single premium policy (the Regulations refer to a single premium policy or a paid-up policy), the policy’s gift tax value is its replacement cost.

1. Example 3 of Reg. 25.2512-6 states the replacement cost is an amount that the company would charge for a single premium contract of the same specified amount on the life of a person of the attained age of the insured (also known as the replacement cost).

2. In Rev. Rul. 78-137, 1978-1 C.B. 280, the Service concluded that the economic benefits of a single premium life insurance policy consist of an entire bundle of rights, including the right to surrender the policy, the right to retain it for investment virtues, the right to borrow the cash surrender value of the policy, and the right to the death benefit. Since there was no comparable contract providing the same bundle of rights provided in the original policy, the Service used the ITR approximation of value for a policy held by the decedent on the life of his child. In that case, the replacement cost of a policy was less than the ITR calculation.

C. **In-Force Policy.** For a typical in-force policy on which premiums have been paid and further premiums are due (even if they are to be paid out of policy cash value) and which has been in force for some time (an undefined term), Treasury Regulations provide that the policy’s gift tax value may be approximated by the policy’s interpolated terminal reserve (ITR, as discussed in Part VI), plus any prepaid premiums.
1. The Regulations do not provide for a reduction in the ITR value for policy loans, although line 58(e) of Part II (Living Insured) of Form 712 does, as discussed in Part IX.

2. The ITR valuation approximation is tailored to traditional whole life policies, which were the only kind of permanent policy available when the Regulations were adopted. With whole life policies, premiums are fixed and policy cash values are guaranteed to increase at stated intervals during the life of the policy. Thus, values between anniversary dates can be interpolated on a daily basis.

3. In actuality, the ITR is being used to value universal and variable life policies as well (in which there are no guaranteed increases in the cash surrender values) and for no-lapse guarantee and level term policies (which have no cash value). It is possible that these policies are “unusual” contracts under the Regulations and that the ITR should not be applicable at all.

D. Annual Renewable Term Policy. For an annually renewable term life insurance policy where the premiums increase upon renewal of the insurance contract each year, the value for gift tax purposes should only be the unearned premium for the remainder of the policy year at the time of the gift. Unearned premium is a premium that has been paid to the insurer but on the valuation date has not been earned by the insurance company.

E. Group Term Policy. For assignments of group term policies, Rev. Rul. 76-490, 1976-2 C.C. B. 300, provides another valuation convention – the remainder of the economic benefit for the year of the gift provided to the employee/insured, measured as provided in Rev. Rul. 84-147, 1984-2 C.B. 201, under group term Table 1. Treas. Reg. Sec. 25.2512-6(a) also provides that if, “due to the unusual nature of the contract” (an undefined phrase) the regulation formula doesn’t reasonably approximate its full value (also an undefined phrase), it may not be used (with no indication of what may be used instead). Presumably, a standard policy issued by an insurer would not be subject to this exception.

F. Application of Rules in Published Guidance. There are no Tax Court or other published cases that discuss the applicability of the ITR value approximation as a substitute for fair market value; but in other published guidance, the Service has supported using the ITR to value insurance contracts.

1. In PLR. 9413045, the IRS reviewed the valuation of in-force survivorship life insurance policies that were transferred between irrevocable trusts for consideration, and the potential for inclusion of the full value of the policy proceeds in the estates of the insureds at death. The IRS explained that,
when the value of a policy which has been in existence for some time cannot be ascertained by comparable policy sales, the policy value may be approximated by adding the ITR at the date of the insured's death and the proportionate part of the gross premium last paid before the date of death, which covers the period extending beyond that date. Under the facts presented to the IRS, the insureds were not in danger of imminent death, nor did they have medical problems that would unexpectedly shorten their life expectancy at the time of the transfer of the survivorship policies, thus the consideration paid for the policies was correctly their ITR value plus the value of the unexpired premiums, and the full value of the policy proceeds would not be includable in the insureds' estates at death.

2. Also, in PLR 201235006, another case in which a life insurance policy was sold from one trust to another trust, the IRS sanctioned the use of the policy's ITR value, plus the proportionate amount of premiums last paid before the sale that covers the premium extending beyond the date of sale, for the purpose of determining value of the transferor trust’s interest in the policy under Treas. Reg. Sec. 25.2512-6(a), when calculating the policy purchase price.

G. Exceptions to Normal Valuation Rules. In general, the life insurance policy valuation methods do not consider factors outside of the policy that could affect the policy's value, such as the insured's health at the time of valuation. Nevertheless, the Regulations also provide that "all relevant facts and elements of value as of the time of the gift shall be considered" when determining a policy's value. See Treas. Reg. Sec. 25.2512-1. This language, together with case law, infers that additional factors, such as an insured's impaired health, may necessitate a different valuation method that will likely result in a much higher value.

1. Deathbed Transfers. Code Section 2035 provides that the value of all property interests transferred by a decedent, in trust or otherwise, within 3 years of death, will be included in the decedent’s gross estate, unless the property was transferred in a bona fide sale for adequate and full consideration in money or money's worth. Thus, when using a sale rather than a gift in order to avoid this three year look-back provision, the transaction must have economic significance (money should not be recycled back to the insured) and the purchase price of the policy must equal the current fair market value for gift tax purposes. If the sale truly does occur within 3 years of death, the Service may argue that the fair market value is closer to the face value of the policy than its ITR.

(a) In Pritchard v. CIR, 4 T.C.204 (1944), the insured died within 32 days of the sale of the policy to his daughter, when he knew he was
terminally ill, which was a much shorter time than anticipated by the mortality tables on which the premiums were calculated. The court held that the cost of replacement value at the date of transfer is authoritatively recognized as the value of the policy for gift tax purposes; however, when death is known to be imminent, the value of the policy being transferred must be based on the proceeds that will be received at the insured's death.

(b) TAM 8806004, relying on Allen v. U.S., 293 F. 2nd 916 (10th Cir. 1961), supports the proposition that the fair market value of a policy for purposes of justifying adequate consideration and avoidance of estate inclusion under Code Section 2035, would be an amount which replaces the asset in the insured’s estate – in this case, the full value of the policy proceeds.

(c) When death actually occurs after a transfer but was unexpected, the fair market value of the policy is the gift tax value, and not the death benefit. See, e.g., Wien v CIR, 441 F.2d32 (5th Cir., 1971), where a husband and wife each owned policies on the other’s life and died simultaneously in a plane crash, the value of husband’s policies in wife’s estate was the ITR value established under Treas. Reg. Sec. 20.2031-8(a)(2), and vice versa, and not the death benefits. In Wien, the court stated:

“We think that the principles of estate taxation preclude consideration of such facts as the actual state of the insured's health or peril in valuing the owner's property interest. Indeed it would bring virtual disaster upon the integrity of estate taxation if the value of an ownership interest fluctuated with the probable longevity of the insured. Any valuation method depending upon such an uncertain measure as the day-by-day health of an individual insured would be impossible to enforce accurately.”

(d) See also, PLR 9413045, holding that, in the case of a sale of a survivorship policy when the insureds were not “near death,” the fair market value of the policy was its gift tax value, and PLR 9905010, assuming without comment that a sale of a policy for its gift tax value was full consideration.
(e) When a policy transfer within three years of death of an insured causes estate inclusion under Code Section 2035, the question of the insured’s knowledge of his or her imminent death is irrelevant, and the only question is what portion of the death benefit proceeds will be included in the taxable estate, particularly if the transferee paid premiums on the policy after the date of the transfer. See GCM 38110.

(f) Under the IRS valuation conventions discussed herein, the insured’s health does not matter, because the conventions are, by design, health agnostic – the insurer providing the policy values does not have access to the insured’s current health information. The health of the insured only matters when the policy is being sold or gifted and the transferor has knowledge that the insured’s death is imminent.

2. Transfer of an Undivided Interest. The transfer of an undivided interest in a life insurance policy may be subject to certain valuation discounts and restrictions as, under the terms of every policy, all owners must act together to deal with the policy (i.e., no one owner can surrender it, cancel it, borrow against it, etc.). See Skouras v. CIR, 14 T.C. 523 (1950), holding that gifts of undivided interests in a policy did not qualify for the gift tax annual exclusion, since they were not present interest gifts because no single donee could “presently enjoy” the gift.

VI. Interpolated Terminal Reserve (ITR). An ITR value is a policy value calculated from the reserve value and adjusted to reflect the value on the gift or transfer date of the policy. The terminal reserve value is the money the insurance company sets aside to pay the policy proceeds at the insured’s death. Under normal circumstances, the terminal reserve grows each year until at policy maturity it equals the death benefit. With respect to whole life insurance with guaranteed values, the terminal reserve is set annually on the policy anniversary date and is predictable, based on guaranteed premiums and guaranteed cash value. If the policy is transferred on any date other than the anniversary date, the prior year’s terminal reserve has to be adjusted or “interpolated” to adjust for the growth in the reserve between the past anniversary date and the date of transfer.

A. For example, assume a policy that has been in force “for some time” is given as a gift exactly six months after its anniversary date. The policy’s reserve as of the most recently passed anniversary date is $50,000, and the reserve for the next anniversary date is $60,000. The interpolated terminal reserve would be $55,000.
(i.e., one-half of the $10,000 increase in reserves, or $5,000, is added to the $50,000 last anniversary reserve).\footnote{Credit for this example is given to Keith Buck and Stephan Leimberg, “Life Insurance Valuation – What Practitioners Need to Know”, *Estate Planning Journal* (May 2010).}

B. The computational process is as follows:\footnote{{Id.}}:

1. State the policy’s terminal reserve at the end of the “next policy year”;
2. State the policy’s terminal reserve at the end of the “prior policy year”;
3. The difference between the amounts in steps 1 and 2 is the increase in terminal reserve for a full year, and it is allocated pro rata in arriving at the interpolated terminal reserve. If the valuation date occurs 4 months after the anniversary date of the policy, \(4/12\) (or \(1/3\)) of the increase would be added to the prior year’s terminal reserve from step 2 to estimate the terminal reserve on the date of the taxable event.
4. Any “unearned premium” as of the date of the taxable event is added to this amount. To determine this amount, find the premium that was paid on or around the prior anniversary date and multiply it by the remaining percentage of the policy year. NOTE: It is more cost effective to gift or sell insurance policies right before another annual premium is paid.
5. If there is a loan outstanding on the valuation date, the balance of the loan would be subtracted from the total arrived in steps 1 through 4.

C. The reason the ITR works with whole life policies is that the next policy year’s terminal reserve is always known. In fact, it is usually set forth in a schedule that is given to the owner when the insurance contract is purchased. The next section discusses why the ITR approximation is so difficult for more modern policy types.

VII. Applying the Rules to Modern Insurance Products

A. **Level Term Policy.** Beginning about 25 years ago, annual renewable term contracts, in which premiums increased each year based on mortality tables, have been replaced by “level-term” policies, which are more cost-effective and usually feature a guaranteed, fixed premium for a specified number of years, such as 5, 10, 15, 20 or 30 years. While level-term policies are usually renewable after the term
expires, the premiums usually increase so dramatically that the policy is no longer cost-effective.

1. A level term policy with premiums that are still due, except for a “new” policy, should be valued based on the ITR value, plus unearned premiums. While many people think the ITR of a level-term policy should simply be the unearned premium, actuarial rules put in place to account for the level premium structure can require the carrier to maintain a high level of reserves. As a result, the ITR can be significantly higher than the unearned premiums.

2. On the flip side, using only unearned premiums to determine the gift tax value of a level-term policy may provide a value that is too low. Because of these valuation issues, using the replacement cost approach may be more accurate.

B. **Universal Life.** Universal life policies have flexible premiums and adjustable death benefits, and also accrue cash value. Universal life was developed in the 1970s and 80s, when interest rates were high and the dividend rates in whole life policies lagged behind the interest rates available in the market. The key feature of a universal life policy is the flexible premium. The carrier generally will accept any premium, at any given time, from a very small amount up to the tax limits of the contract. As long as there is enough cash built up inside a universal life policy to support that month’s charges, the policy will continue to provide full coverage for another month. The universal life policy can adapt to its owner’s changing cash flow circumstances over the life of the policy.

C. **Variable Life.** A variable life policy is essentially a whole life policy that allows the owner to select the range of investments inside the policy from a menu of insurer-determined investments similar to stock, bond and money market mutual funds. Variable life provides a guaranteed minimum death benefit and a level premium. The death benefit can grow or shrink (but not below the guaranteed minimum amount) based on the performance of the investments inside the policy. In fact, once the insurer’s charges for expenses and sales costs and mortality costs are accounted for, the balance of each year’s premium is placed in a separate investment account.

D. **Variable Universal Life.** A variable universal life policy combines the flexible premium features of universal life with the owner’s ability to choose the investments inside the policy. If the cash value inside the policy is high enough, the owner may make withdrawals of cash without generating a loan against the
policy and without interest charges, and so VUL policies are often used in retirement planning.

E. **No Lapse Guarantee Universal Life.** A no lapse guarantee universal life policy features permanent death benefit guarantees at the expense of cash value performance. Unlike traditional universal life policies, which will lapse if the cash value dwindles to the point that there are insufficient funds to cover the policy expenses and cost of insurance, the “no lapse” feature guarantees that the policies will stay in force for the insured’s entire life if the premium is paid regularly and on time.

F. **Different Reserve Values.** Unlike whole life policies, for each of the modern policy products discussed above, the value of the next year’s terminal reserve is not known or published ahead of time. It is not known until the end of the policy year. Therefore, it is impossible to “interpolate” the terminal reserve value prior to the end of the year. In addition to more diverse types of insurance products, there are also many different ways to calculate the ITR, including:

1. **Statutory reserve.** State insurance regulators require insurance carriers to file annual financial statements. The statutory reserve is the reserve required to be used for these reports.

2. **Tax reserve.** Reserve value used in the determination of an insurance carrier’s federal income tax. Similar to the statutory reserve, but uses slightly different interest rate assumptions. It is usually lower than the statutory reserve.

3. **AG 38 Reserve.** Actuarial Guideline 38 (“AG 38”) for no lapse guarantee universal life policies (GUL) sets forth a different reserve methodology for these types of policies. It is usually greater than the basic tax or statutory reserve for similar products that do not provide long term death benefit guarantees.

4. **Deficiency Reserve.** For policies with death benefit guarantees (again, such as a GUL), in some cases a calculation of “minimum reserves” is required. Deficiency reserves are the excess of the minimum reserves over the AG 38, tax or statutory basic reserves. Any value that includes deficiency reserves will be greater than the value with no deficiency reserve.

5. There is no guidance on which of these reserves an insurer is supposed to use for the ITR. For a universal life product without a death benefit guarantee, the carrier could use the tax or statutory reserve. If a death
benefit guarantee is added, the carrier could use the tax, statutory or AG 38 reserve, each with or without the deficiency reserve.

G. Alternate Methodologies for ITR Reporting. Due to the ambiguity of the reserve values, a few insurance carriers have chosen to use valuation methodologies that are not even based on any type of policy reserve, as follows.

1. A few insurance companies reportedly list the cash surrender as the ITR of the policy on Form 712.3

2. For universal life contracts, the insurer may list the internal policy value before the surrender charge is subtracted (this can be called the policy value, accumulated value, or cash value, depending on the insurer’s terminology).

3. A few others use the “California Method”, which is the average of the policy value before and after the surrender charge is subtracted.

H. The type of policy and the insured’s health (including whether or not he or she is then insurable) are not relevant considerations in the ITR determination, but, as discussed above, should be taken into consideration by practitioners when determining the policy valuation method.

VIII. Policy Valuation for Income Tax Purposes. Apart from the gift and estate tax regulations and general principles of fair market value, there have been only a few official IRS pronouncements that deal with life insurance policy valuation.

A. Policy Valuation for Transfers Out of Qualified Plans or As Compensation. Purchase or transfer of a policy out of a qualified plan or the purchase by an employer of a policy that will be transferred to an employee (upon retirement or after a period of employment) will require valuation for income tax purposes.

1. A past perceived abuse concerning policy valuation was a technique commonly referred to as "pension rescue." A pension rescue involves the purchase of a life insurance policy inside a qualified plan where policy premiums are funded with the maximum possible pre-tax dollars. When the policy net cash surrender value is lowest, usually early on, the policy would be either distributed or sold to the employee/plan participant at the lowest defensible policy valuation, typically the cash surrender value (which was much lower than the aggregate plan dollars paid into the policy). Income taxes (or consideration paid, in the case of a sale) are then calculated from the low value. Following the sale or distribution, the cash value on that

3 Id.
same policy would increase significantly, providing the owner of the policy with substantial cash value that was not recognized for income tax purposes.

2. The IRS issued Rev. Proc. 2005-25, superseding Rev. Proc. 2004-16, 2004-10 IRD 559, in response to the perceived income tax avoidance surrounding the "springing cash value" policies and valuations based on cash surrender value under pension rescue plans. Rev. Proc. 2005-25 provides safe harbor formulas for calculating the fair market value of life insurance policies transferred from a qualified plan by distribution or sale, which can also be used to determine the fair market value of a policy (or policy interests) transferred under a group term plan (Code Section 79) or transferred to an employee as compensation (Code Section 83).

   (a) The safe harbor formulas provide that the value of a policy for income tax purposes is the greater of:

      i. The sum of the ITR and any unearned premiums plus a pro rata portion of a reasonable estimate of dividends expected to be paid for that policy year based on company experience, and

      ii. the PERC value multiplied by the applicable Average Surrender Factor.

   (b) PERC stands for aggregate Premiums, plus Earnings, minus Reasonable Charges. For this purpose, “aggregate premiums” include premiums that are paid by dividends, and dividends that are applied to purchase paid-up additions. “Earnings” includes any amounts credited (or otherwise made available), including interest and similar income items (whether credited or made available under the contract or to some other account). The term "reasonable charges" is not defined, but explicitly includes mortality charges actually charged on or before the valuation date.

   (c) The applicable “Average Surrender Factor” is the unweighted average of the applicable surrender factors over the 10 years beginning with the policy year of the distribution or sale.

   (d) The safe harbor value is arguably going to be higher than the policy’s actual fair market value.

3. In applying the safe harbor guidelines, the IRS provides that the rules for valuation must be adjusted based on contract provisions that would lead to
changes in fair market value. Also, despite the safe harbor provisions, a taxpayer is not prevented from considering other methods for valuing a policy.

4. For example, in Schwab v. CIR, (9th Cir. 2013), the court rejected the IRS’s position that valuing a policy distributed out of a non-qualified plan should always disregard surrender charges and adopted the Tax Court’s determination of the policy’s “fair market value”, which considered those surrender charges. The court noted that “[t]he variety of insurance policies is too great to adopt as a general rule either the Commissioner's simple proposition that surrender charges should never count, or [taxpayer's] that such charges should always count, in determining a policy's value....We hold instead that surrender charges may be considered under Section 402(b)(2), "but only as part of a more general inquiry into a policy's fair market value.”

5. See, however, Cadwell v. CIR, 136 T.C. 38 (2011), requiring the use of the PERC value to value a policy distributed from a Section 419A plan, where the taxpayer “has not suggested any reason for deviating from the formula it [the safe harbor provision] contains”.

B. Charitable Contribution Value of a Policy. The method for valuing a policy for the purpose of determining a donor’s income tax charitable deduction for gifts of policies to charity has not been specifically addressed by the IRS. If, however, the policy’s perceived value is over $5,000, a qualified appraisal by a qualified appraiser (both defined terms under the Code) will be required for those purposes under Code Section 170(f)(ii)(c).

C. Determination of Gain Upon Policy Surrender or Sale. When a life insurance policy is surrendered or sold, the owner may recognize income in the form of gain in the policy. Rev. Rul. 2009-13 provides guidance on the amount of income and character to be recognized when a policy is surrendered or sold to an unrelated party.

1. For the surrender of a policy, Rev. Rul. 2009-13 provides that Code Section 72(e)(5) governs the amount of gain, which is equal to the amount received by the owner in excess of the “investment in the contract” (or basis). Typically, any income recognized by the policy owner is characterized as ordinary income.

2. In the case of a sale of an existing policy, the amount of gain is equal to the excess of the amount realized over the owner’s adjusted basis in the policy.
In this case, the basis is determined under Code Section 1016, which requires the owner to reduce basis by expenditures, receipts, losses, or other items, properly chargeable to a capital account. For a policy, the IRS takes the position that Code Section 1016 requires the taxpayer to reduce his or her basis by the portion of the premium used to pay for the insurance element of a permanent policy (cost of insurance charges).

3. With respect to the sale of a term policy, the cost of insurance is presumed to be equal to the required premium, thus the basis is reduced to zero, except for any unearned premium.

IX. IRS Form 712 (Life Insurance Statement). Form 712 is the statement required by the IRS for reporting the value of a life insurance policy for gift tax purposes on the Form 709 (U.S. Gift (and Generation-Skipping Transfer) Tax Return) or for estate tax purposes on the Form 706 (U.S. Estate (and Generation-Skipping Transfer) Tax Return). The IRS requires this statement to be made on behalf of the insurance company that issued the policy, by an officer of the company having access to the records of the company.

A. Part I, Decedent-Insured. Part I of Form 712 is applicable when the executor of the insured decedent’s estate requests specific information regarding the policy from the insurance carrier, including (but not limited to) the following:

1. Face amount of the policy;
2. Amount of any indebtedness on the policy;
3. Accumulated dividends;
4. The amount of proceeds payable at death;
5. Whether there was a transfer within three years of death; and
6. Whether the decedent held any incidents of ownership on a policy insuring his/her life that was not owned by the insured at death.

B. Part II, Living Insured. Part II of Form 712 is applicable when a policy has been gifted by a living insured or where a decedent owned a policy on the life of another, and requires the insurance carrier to provide a value for the policy as of the date of the gift (or date of death, if applicable) using either the ITR value (for a policy that is not paid in full) or the replacement value (for a paid-up or single premium policy). The Form 712 does not distinguish between the type of policy being valued (e.g., term contract, whole life policy, universal life, etc.) and the insurance carrier does
not have discretion to select the valuation method to use in each particular circumstance.

1. Line 58(c) – Not previously discussed in this outline, any dividends that have been credited to the policy are to be included in the value.

2. Line 58(e) – As noted previously, even though the Regulations are silent regarding policy loans, Form 712, Part II reduces the gift tax value by the amount of any outstanding loan against the policy.

3. Line 58(f) – This is the net value of the policy that is to be reported on gift and estate tax returns.

C. When Not to Request a Form 712

1. A Form 712 should be requested only if the policy value is needed for estate or gift tax purposes. If requesting the value of a policy for any other purpose, the practitioner should ask the insurance company to provide a letter or other documentation of the policy value, and not a Form 712.

2. The officer of the insurance carrier who completes the Form 712 certifies that the information listed is “true and correct”. Once a Form 712 is issued, the insurance company is unlikely to correct or revise the Form. Therefore, if you can request a letter of value from the insurer before the transaction, you can have a better idea of whether to rely on the Form 712 or an appraised value of the policy for the proposed gift or sale before receiving a Form 712 with a surprising result.

D. Problems with Form 712

1. Inconsistent Reporting Practices. The practice of insurance carriers in reporting values on Form 712 is not consistent, with some reporting only the ITR value, the policy cash value, or the surrender value, and others providing a series of values for a policy, including the “PERC amount”, discussed in Part VIII.A, above. The Form also may include disclaimers regarding a carrier’s inability to accurately calculate certain values. The sample letters attached hereto as Exhibit A, provide series of possible gift tax values for a policy.

2. Inaccurate Value. The ITR value is often not indicative of what a willing buyer would pay a willing seller.
3. **Timing.** Certain insurance carriers are loath to issue a Form 712. It can take weeks or months of cajoling to convince the carrier to send the Form 712 to the owner (who then may or may not deliver the Form 712 to the attorney). Carriers will not issue the Form 712 until a transfer of the policy ownership has occurred, so there may be no way to know the Form 712 value of a policy before the transfer for planning purposes. When a policy is sold, the buyer should pay something to the seller, perhaps the cash surrender value listed on the last annual statement for the policy for universal, variable or whole life policies, or the unapplied portion of the premium for term policies. Then, the purchase agreement should contain “true-up” language to correct the purchase price once the Form 712 is obtained, such as the following:

“In furtherance of the parties' intent that the Purchase Price be equal to the fair market value of the Policy, if the IRS Form 712 value for the policy returned by the Insurer is greater than the Purchase Price, Purchaser agrees to pay to Seller or Seller's beneficiaries an additional amount that would be sufficient to allow the Purchase Price to equal the IRS Form 712 reported value of the Policy as of the date hereof, along with interest at the relevant applicable federal rate. Likewise, if the IRS Form 712 value for the policy is less than the Purchase Price, Seller agrees to refund to Purchaser an amount that would be sufficient to allow the Purchase Price to equal the IRS Form 712 reported value of the Policy as of the date hereof, along with interest at the relevant applicable federal rate.”

4. **Mistakes.** Forms 712 have been known to contain mistakes – wrong owners, wrong anniversary dates, and sometimes even the wrong values. It is worth having the insurance agent ask the actuary who prepared the Form 712 to consider whether a value that seems too high is a mistake or a policy feature. Although not likely, the carrier may be willing to issue a corrected Form 712.

5. **Best Practice.** Given the uncertainty in determining a policy’s gift tax value, practitioners should consider hiring an independent appraiser to value the policy, as the ITR formula is stated to be an approximation of a non-paid up policy’s value, which may (rather than must) be used to determine its value.
X. Planning Tips for Valuing Policies

A. Communicating with Insurance Carrier.

1. When requesting the value of a policy from an insurance company, explain why the value is needed. If it is for income tax purposes, the Rev. Proc. 2005-25 methodology should be used, whereas if it is for gift tax purposes, you may be able to encourage the insurance company to value the policy without deficiency reserves.

2. As mentioned previously, ask for a letter of value before requesting the Form 712, which may make it easier to argue for and obtain a different value before the insurance company formally issues the Form 712.

3. As the insurance company how it calculated the value it has informally provided. Knowing the methodology and type of reserve used can enable the practitioner to better evaluate whether the reported value is reasonable.

4. Ask to speak with the “Advanced Marketing” or “Actuarial” department as opposed to Client Services or Policyholder Services.

B. When to Get an Appraisal

1. Charitable Contribution. Form 8283 requires a qualified appraisal by a qualified appraiser for assets donated to charity with a claimed value of $5,000 or more. Penalties may apply for over-valuation.

   (a) In PLR 8943014, the IRS refused to opine on whether a Form 712 represented fair market value for a life insurance policy donated to charity, stating “Income Tax Regulations Section 1.170A-13(c) … establishes rules for substantiating the value of charitable gifts of property, including rules governing the submission of qualified appraisals with tax returns. The issuance of the requested ruling [that Form 712 value equaled fair market value] would be inconsistent with those rules.”

2. Gifts or Sales of Policies to a Trust. If the amounts at stake are significant, an appraisal is a cost-effective way to prevent controversy on audit or in litigation years after the transfer over the exemption used and/or taxes paid. If a Form 712 value is used instead of an appraisal, the taxpayer may be overpaying taxes, or using up exemption amounts, by multiples over the proper amounts.
3. **Transfers from Old Trusts to New Trusts.** It is in the best interests of the Trustees involved in a sale of a policy from an old trust to a new trust to obtain a defensible appraisal of the policy being sold to avoid claims of breach of fiduciary duty, particularly where the beneficiaries of the selling trust are different from the beneficiaries of the purchasing trust.

4. **Late Allocation of GST Tax.** When a gift tax return has opted out of automatic allocation of GST tax exemption to a GST Trust that owns life insurance, the parties involved may later decide it is in the best interests of the beneficiaries to allocate GST exemption to the trust. It is better to make a late allocation while the insured is living than to wait until the trust receives the insurance proceeds upon the insured’s death.

   (a) The Regulations permit an election to be made on the gift tax return to value to trust assets as of the first day of the month in which the gift tax return making the late allocation is filed. Treas. Reg. Sec. 26.2642-2(a)(2).

   (b) Timing issues with the Form 712 arise here, given that there has been no transfer of the policy, the insurer is unlikely to issue a Form 712. A letter of value from the insurance company or an appraisal of the policy should be requested instead.

C. **Appraiser’s Valuation Methodology.** Like operating businesses, life insurance policies can be valued on the comparable sales approach or the income approach via a discounted cash flow analysis.

1. **Comparable Sales.** In the last decade or two, a secondary market for insurance policies has arisen, called the “life settlement market”, and as a result, policies can be valued based on a comparable sales method. In the life settlement market, the insured’s life expectancy, based on current health information, determines the policy’s value for the prospective buyer.

   (a) The prospective buyer obtains the insured’s current health information, purchases a life expectancy study based on that information, and determines, based on discounted cash flows of the expected policy death benefits, what the policy is worth.

   (b) The shorter the insured’s life expectancy, the fewer the remaining premiums to be paid, and the greater the expected return for the buyer, all result in a higher purchase price.
(c) The same methodology used in the life settlement market would be used by a professional appraiser.

(d) Alternatively, an offer to purchase a policy from a buyer in the secondary market could be used as evidence of fair market value instead of an appraisal.

(e) To date, the IRS has not provided guidance on whether prices in the secondary market can (or must) be considered in the determination of fair market value for tax purposes.

(f) In addition, the secondary market is generally limited to the purchase of policies on older, or unhealthy insureds, and often involve only large policies. Younger, healthier insureds must look elsewhere for valuation methodologies.

2. **Income Approach/Discounted Cash Flow Method.** These valuations use a set of cash flow forecasts based on the life insurance illustrations for the policy being valued, plus mortality tables for the insured life or lives. Then, a discount rate or applicable range of rates is applied to the cash flow forecast, with the discount rates selected based on published and unpublished data from the secondary life settlements market and other markets for similar, but illiquid, cash-flowing assets.⁴

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712 Gift Tax Quote

Insured:

Policy Number: 020130938
Anniversary: 06/28
Effective Date: 01/31/10

(IS Form 712, Part II, Living Insured)

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<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
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<td>Interpolated Terminal Reserve</td>
<td>$2,249,928.31</td>
</tr>
<tr>
<td>58b</td>
<td>Proportionate Premium</td>
<td>$0.00</td>
</tr>
<tr>
<td>58c</td>
<td>Dividends Credited</td>
<td>$0.00</td>
</tr>
<tr>
<td>58d</td>
<td>Subtotal (58a+58b+58c)</td>
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</tr>
<tr>
<td>58e</td>
<td>Loan Outstanding</td>
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</tr>
<tr>
<td>58f</td>
<td>Net Total Gift Value (58d+58e)</td>
<td>$2,249,928.31</td>
</tr>
</tbody>
</table>

Alternate Line 58 value: cash/account value of $124,332.73
Less outstanding indebtedness of $0.00
equals net total policy value of $124,332.73
EXHIBIT A

Life Insurance Operations Center
P.O. Box 2030, Omaha, Nebraska 68103-2030
Tel (800) 347-7787 Fax (949) 462-3066

February 3, 2010

Servicing Producer:

Insured Name: 
Policy Number: VF51746140

Valuations for tax purposes can differ depending on how the policy is used and only you with an independent tax advisor can determine the appropriate fair market value for your situation. As per your request, possible valuations for your life insurance policy are listed below:

Effective Date of Valuation: 02/02/2010

Interpolated Terminal Reserve (ITR) Value: $393,015.45
Accumulated Cash Value: $200,526.45
PERC Value: $249,266.93
 Premiums Paid: $317,258.00

Financial transactions like loans, withdrawals, premium/loan payments, and monthly policy processing will affect these values.

If you would like more information, please contact your servicing producer listed above. If there is no one listed, please use the toll free number to contact a Life Insurance Operations Center service associate.

Life Insurance Operations Center - Client Services Department
May 20, 2009

Policy Number: 
Insured(s): 

Dear Policy Owner:

Enclosed is the requested Form 712. Please note that Line 58(a) in Part II of Form 712 refers to the interpolated terminal reserve (ITR) in reaching the net total value of the policy in Line 58(f). ITR is generally considered to be the amount that is required to be held in reserves to cover the future liabilities of each policy. Currently, we believe there is no general agreement as to whether a universal life insurance policy has an ITR. However, we have included an ITR value in the form which best reflects our analysis of an ITR for such a policy.

The IRS issued guidance on the valuation of life insurance policies in Rev. Proc. 2005-25, issued on April 8, 2005. Under this guidance, the fair market value of a life contract generally is the greater of the Interpolated Terminal Reserve ("ITR") or a formula amount involving Premiums that have been paid plus policy Earnings, minus Reasonable Charges ("PERC"). Please note that the PERC amount is not currently called for on IRS Form 712. Rev. Proc. 2005-25 came out after the creation of Form 712, and the form has not been updated to include PERC.

We understand that the fair market value of a life insurance policy for federal tax purposes is a question of tax law for the individual taxpayer. Transamerica cannot provide legal or tax advice and cannot determine the value of this policy for federal income tax purposes for you. You must seek out and rely on the advice of your own qualified tax and legal advisors.

To assist you in determining the fair market value of the policy, we are providing you certain information:

- The policy's reserve value
- A PERC Amount
- The policy's accumulation value and cash surrender value (accumulation value less surrender charges), as of the date of this letter.

Policy's Reserve Value $496,603.00 as of May 1, 2009
PERC amount $541,106.00 as of May 1, 2009
Policy's Accumulation Value $540,664.54 as of May 20, 2009
Policy's Cash Surrender Value $88,421.29 as of May 20, 2009

We have calculated the PERC amount under our interpretation of the formula set forth in Rev. Proc. 2005-25. Transamerica does not represent or guarantee its interpretation of the manner in which a PERC amount or Average Surrender Factor is determined will be accepted by the Internal Revenue Service.

We appreciate your business and this opportunity to be of service to you. If you have any questions or need additional assistance, please contact the Customer Service Department from 7:00 a.m. to 6:00 p.m. Central Time, Monday through Friday at 1-800-852-4678.

Thank you for choosing Transamerica

Customer Service Department
Fax 1-866-622-5051
til.customerservice@transamerica.com

Enclosure(s): IRS Form 712 - Life Insurance Statement
EXHIBIT A

Attached is the information you requested to help determine the value of your life insurance policy for tax purposes.

There are many ways to value a life insurance policy. This often depends on your own specific situation such as whether the valuation is being done for gift and estate tax purposes or income tax purposes. Additionally, there is little guidance from the IRS. In recent decades, life insurance policies have changed, however, much of the IRS guidance is intended to address types of policies as they existed in the 1980s. As a result, taxpayers such as yourself are left with vague guidelines that may not apply to your specific situation.

Generally, the tax law requires that a life insurance policy be valued at its “fair market value.” The “fair market value” is generally defined as the policy cash value and the value of all rights under the contract, including any supplemental agreements thereto, whether or not guaranteed.

Because this definition is somewhat vague, the IRS Revenue Procedure 2005-25 has provided guidance to determine the fair market value of a life insurance policy for transfers under Section 402 (transfers from qualified plans), Section 79 (permanent benefits under group term) and Section 83 (transfers of property from an employer to an employee). A summary of this guidance is provided as Appendix A. However, the text of the guidance also referred to Treasury Regulation 25.2512-6 to define the new rules that determine the value of a policy for gift tax purposes at the Interpolated Terminal Reserve (ITR) plus unearned premiums unless it should not be used “because of the unusual nature of the contract such approximation is not reasonable close to the full value.” Therefore, although Rev. Proc. 2005-25 only applies to the transfers cited above it is possible that in the future, it may be extended to estate, gift and sale situations as a reasonable fair market value test.

Some professionals have also tried to collect an offer from a life settlement company to determine what an outsider investor would pay for the contract. A value such as that is based on many more assumptions such as future premium payments to keep the policy in force, converting the policy to a permanent product and determining a reasonable rate of return for the transaction. To date, the IRS has not given any guidance that this valuations should be used to determine fair market value.

Appendix B is solely to assist you in your calculation of the fair market value of your life insurance policy for income tax purposes. In addition, you should consider the health of the insured to ensure that there are no known health risks that could increase the value of the contract because of the increased likelihood of death earlier than the mortality assumptions of the product as well as any features or benefits of the contract that may make it more valuable such as guarantees or conversion features. Please remember you must consult your tax advisors to determine the appropriate tax value of your policy. We do not provide legal or tax advice and cannot guarantee that any particular value will be accepted for tax purposes.

Circular 230 Disclosure: Please be advised that this document is not intended as legal or tax advice. In addition, U.S. Treasury Regulations require us to inform you that "any tax information provided in this document is not intended or written to be used, and cannot be used, by any taxpayer for the purpose of avoiding penalties that may be imposed on the taxpayer. The tax information was written to support the promotion or marketing of the transaction(s) or matter(s) addressed and you should seek advice based on your particular circumstances from an independent tax advisor."

THE AXA EQUITABLE LIFE INSURANCE COMPANY
P.O. BOX 1947, CHARLOTTE, NORTH CAROLINA 28201-1947
EXHIBIT A

APPENDIX A

SAFE HARBOR VALUATION UNDER REVENUE PROCEDURE 2005-25

The following summarizes the safe harbor formula provided in Revenue Procedure 2005-25 for valuing a life insurance policy. The safe harbor formula "must be interpreted in a reasonable manner, consistent with the purpose of identifying the fair market value" of a policy.

In addition, the safe harbor formula cannot be interpreted in a manner that would undervalue the fair market value of the policy and associated distributions or transfers. For example, if an insurance policy has not been in force for some time, the value of the contract is best established through the sale of the particular insurance contract by the insurance company (i.e., as the premiums paid for that contract).

Safe Harbor Formula

The fair market value of a life insurance policy can be determined using the greater of:

(a) Adjusted ITR: The sum of the policy’s interpolated terminal reserve (“ITR”)¹ and any unearned premiums plus a pro rata portion of a reasonable estimate of dividends expected to be paid for that policy year based on company experience; and

(b) Adjusted PERC Amount: the product of the "PERC amount" multiplied by the "Average Surrender Factor." The PERC amount is equal to "Premiums" plus "Dividends" plus "Other Earnings" minus "Reasonable Charges" and "Distributions."

Premiums: the premiums paid from the date of issue of the life insurance policy through the valuation date without reduction for dividends that offset those premiums.

Dividends: for non-variable policies, the dividends applied to purchase paid-up insurance prior to the valuation date. For variable policies, the dividends applied to increase the value of the contract (including dividends used to purchase paid-up insurance) prior to the valuation date.

Other Earnings: for non-variable policies, any amounts credited (or otherwise made available) to the policyholder with respect to premiums, including interest and similar income items (whether credited or made available under the contract or to some other account), but not including dividends used to offset premiums and dividends used to purchase paid-up insurance. For variable policies, all adjustments (whether credited or made available under the contract or to some other account) that reflect the investment return and the market value of segregated asset accounts.

Reasonable Charges: explicit or implicit reasonable mortality charges and reasonable charges (other than mortality charges), but only if those charges are actually charged on or before the valuation date and those charges are not expected to be refunded, rebated, or otherwise reversed at a later date.

Distributions: any distributions (including distributions of dividends and dividends held on account), withdrawals, or partial surrenders taken prior to the valuation date.

Average Surrender Factor: for all valuations other than valuations applicable to distributions and surrenders of life insurance policies from qualified plans, the Average Surrender Factor is 1.0. For distributions or surrenders from qualified plans, the Average Surrender Factor is the unweighted average of the "applicable surrender factors" over the ten (10) years beginning with the policy year of the distribution or sale (i.e., a projected value). For this purpose, the applicable surrender factor for a policy year is equal to the greater of (i) 70 and (ii) the following fraction (determined as of the first day of the policy year):

\[ \frac{\text{projected cash surrender value}}{\text{projected (or actual) PERC Amount}} \]

The applicable surrender factor for a year in which there is no surrender charge is 1.0. In addition, a surrender charge can be taken into account only if (a) it is contractually specified at issuance, (b) it is expressed in the form of non-increasing percentages or amounts, (c) it cannot be waived or otherwise avoided and (d) it was not created for purposes of the transfer or distribution.

¹ A policy’s terminal reserve is the amount of money that the life insurance company has set aside by law to guarantee the payment of policy benefits. It is determined once a year. The "interpolated terminal reserve" is a mid-year estimate of the terminal reserve value determined by adding the current year’s increase to the prior year’s reserve. Interpolated terminal reserve is generally understood to be applicable to whole life contracts and, accordingly, has not historically been used for variable universal life or universal life contracts.

² The projected cash surrender value is the projected amount of cash that would be available if the policy were surrendered on the first day of the policy year (or, in the case of the policy year of the distribution or sale of the life insurance policy, the amount of cash that was actually available on the first day of that policy year).
EXHIBIT A

APPENDIX B - LIFE INSURANCE POLICY VALUES

The following schedule is designed to assist the owner of a life insurance policy and the owner’s tax and legal advisors in their calculation of the fair market value of the policy for tax purposes. We do not provide legal or tax advice and can not guarantee that any particular value will be accepted for tax purposes.

Insured: AXA Equitable Life Insurance Company
Policyholder: Athena Survivorship
Issuing Company: Universal Life II
Policy Number: 158 205 864
Policy Name: September 10, 2008
As of: December 31, 2009
Policy Account Value: $229,809.87
Policy Cash Surrender Value: $0.00

ADJUSTED ITR AMOUNT
Interpolated Terminal Reserve1 (including unearned premiums) or Primary: $97,019.28
Benefit Reserve:
No Lapse Guarantee Basic Reserve: $217,249.53
Estimate of Promoted Dividends for Policy Year:
Adjusted ITR Amount: $314,268.81

ADJUSTED PERC AMOUNT2
Perc Amount: $229,809.87

Average Surrender Factor: This calculation applies only to valuations of policies that are distributed or sold by a qualified plan. For all other valuations, the Average Surrender Factor is 1.0.

Applicable Surrender Factors Over Ten-Year Period Beginning with Year of Transfer: 3

<table>
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<tr>
<th>Year</th>
<th>Projected Account Value</th>
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<td>10</td>
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</tbody>
</table>

Average Surrender Factor (average of applicable surrender factors): 1.0
Adjusted PERC Amount (PERC Amount x Average Surrender Factor): $229,809.87

GREATER OF ADJUSTED ITR AMOUNT AND ADJUSTED PERC AMOUNT: $314,268.81

1 Interpolated Terminal Reserve is generally understood to be applicable to whole life contracts and, accordingly, has not historically been used for variable universal life or universal life contracts. Therefore, statutory reserve is listed for contracts other than whole life.
2The PERC value is assumed to be the same as the policy account value because AXA Equitable and MONY policy account values are calculated as premiums paid to date plus earnings credited to the policy, less contract charges, distributions, withdrawals and partial surrenders. The policy charges are assumed to be reasonable for the substandard guidelines (Year 1 values).
3This calculation is only applicable if the policy is owned by a qualified plan, otherwise a surrender factor may not be considered for valuation purposes and the Average Surrender Factor should be entered as 1.0. If the policy is owned by a qualified plan, the values listed are for the beginning of the policy year (e.g. the Year 1 values correspond to the beginning of the current policy year or the end of the last policy year) Then, when comparing this schedule with the in-force policy illustration, please note that the illustration values typically reflect the policy values at the end of the current policy year. Also, please note that the projected account value and projected surrender value are determined based on non-guaranteed values assuming interest charges. The earnings assumptions are based on the policy's current crediting rate for universal life contracts and a 6% gross return rate for variable life policies. Actual results will be different and reflect actual earnings and charges as they occur.

This schedule can be prepared using different assumptions if requested.

4This analysis is designed to calculate the risk borne for the AXA Equitable Universal Life II. These values take into account lapse protection riders, but do not take into account all of the rights, riders or guarantees under the contract. Please consult with your tax and legal advisor to determine the appropriate tax value of your policy.
Dear Trustee:

This letter is in response to your request for information regarding the value of your AIG American General Life Insurance contract for federal tax purposes.

Federal tax laws regarding valuation of life insurance contracts are complex. Application of specific valuation provisions may also depend upon the type of transaction involving your policy. Additional complication exists since federal tax laws provide more than one method of life insurance contract valuation depending upon the type of transaction (e.g., transactions generating potential income tax liability versus transactions generating potential gift or estate tax liability). AIG American General Life Insurance Company does not provide legal, tax, or accounting advice regarding life insurance contract valuation, and we strongly recommend you retain and consult a competent tax, legal or valuation professional in order to determine and apply the life insurance contract valuation rules applicable to your particular situation.

Your chosen tax, legal or valuation professional may find the following references helpful in determining an appropriate valuation method:

Internal Revenue Code Section 2512 addresses the valuation of property generally for tax purposes. This section states the value of property is the price at which such property would change hands between a willing buyer and a willing seller with neither being under any compulsion to buy or to sell.

For federal gift and estate tax purposes, Treasury Regulation 25.2512-6 states the value of a life insurance contract by a company regularly engaged in selling such contracts is established through the sale of a particular contract by the company, or through the sale of comparable contracts by the company. This Treasury Regulation also provides that if the sale of comparable contracts is not readily ascertainable, the value may be approximated by adding to the interpolated terminal reserve at the date of the gift, a proportionate part of the gross premium last paid before the date of the gift which covers the period extended beyond that date.

Revenue Procedure 2005-25 provides guidance regarding life insurance contract valuation primarily for federal income tax purposes. This Rev. Proc. provides two safe harbors setting forth valuation involving life insurance contracts transferred in exchange for services from an employer to an employee or from a qualified plan to a plan participant. The safe harbor methods and computations provided under Revenue Procedure 2005-25, however, are subject to differing interpretations.

While AIG American General Life Insurance Company does not represent, warrant or guarantee the factors provided below are appropriate for use in the valuation of your particular policy given the variety and complexity of prescribed valuation methods under law, they could be useful to your professional advisor when computing the value of your life insurance contract.

The following valuation factors exist for your life insurance contract as of September 11, 2014:

| Tax Reserve             | $101,997.00 |
| Statutory Reserve      | $107,912.00 |
| Accumulation Value     | $108,049.17 |
| Cash Surrender Value   | $101,997.32 |
| Premiums Paid          | $100,012.31 |

AIG American General Life actuary has calculated the fair market value as of September 11, 2014 to be: $106,002.00

Sincerely,

Customer Service Center

0BS904/00B01629D

CC: DAVID M WALThER
Dear Sir or Madam:

I am writing in response to a request for the gift tax form, Form 712 Part 2, for the policies listed above, for each respective insured.

Because the above Universal Life Protector policy contains a Rider to Provide Lapse Protection, we are providing you with two forms, each containing a different value for gift tax reporting. A tax advisor should be consulted to determine which value should be reported.

The value provided on policy number 13362, the first form, $421,062.40, is the net cash value of the contract as of the date of the gift.

The value provided on policy number 13362, the third form, $517,227.00, is the net cash value of the contract as of the date of the gift.

The value provided on the second form for policy 13362, $629,010.60, is the No-Lapse Guarantee Value. The value provided on the fourth form for policy 13362, $683,327.55, is the No-Lapse Guarantee Value. This is the value of the No-Lapse Guarantee, which is part of the Rider to Provide Lapse Protection, as of the date of the gift. This rider provides a guarantee that the policy will not end if the No-Lapse Guarantee Value is equal to or greater than zero. The value developed for the No-Lapse Guarantee is for reference only and is not used in the determination of values and benefits under the contract. It is used only to determine if the contract is in default.

If you have any questions or would like more information, please call our customer service office at (800) 782-5356 and refer to reference number AH/BGZ/315. We are available Monday through Friday between 8:00 a.m. and 7:00 p.m. Eastern time.