Modified Endowment Contracts (MECs)

In 1988 Congress passed TAMRA to discourage folks from using life insurance as a tax shelter or for investment purposes. Life insurance has certain qualities that make it attractive for investment purposes.

- The interest the cash value earns is not taxable each year
- Loans against cash values are not taxed, even if the amount is more than one's "cost basis"

All of this is true if the life insurance policy IS a life insurance policy and not something called a MEC. If it is a MEC and NOT a life insurance policy, then loans WOULD be subject to tax (but only the the extent of the gain.)

How does a life insurance policy become a MEC? It must meet something called a 7 pay test. If it passes the test it is a life insurance policy, if it fails the test, it is a MEC. A bad thing.

7 Pay test: Take the total premiums necessary to pay the policy up. Divide this by 7. One can not pay any more than this each year. If you do, it's a MEC. Wow!!!

This is the responsibility of the insurance company to make sure it doesn't become a MEC