JOURNAL
OF THE AMERICAN SOCIETY OF CLU & ChFC

Section 1035 Exchanges and Modified Endowment Contracts

by
Douglas I. Friedman, JD, CLU

Opinions expressed in the Journal by the editors and contributors are not necessarily endorsed by the American Society of CLU & ChFC. Articles are chosen for their general interest, but conclusions are those of the individual authors.

Section 1035 Exchanges and Modified Endowment Contracts

DOUGLAS I. FRIEDMAN, JD, CLU

Many life insurance sales depend upon the replacement of less competitive policies with new policies. By exchanging an existing policy for a new policy in accordance with Section 1035 of the Internal Revenue Code[1] (Code), the policyowner can defer income taxes that would otherwise be payable on the exchange. The Technical and Miscellaneous Revenue Act of 1988 (TAMRA) upset this so-called "roll-over market" due to fears that the new policy would be classified under TAMRA as a modified endowment contract (MEC), from which distributions are taxed less favorably than distributions from other life insurance policies. Consequently, avoiding MEC treatment is desirable in many cases.

This article first discusses the rules under Section 1035 of the Code for deferring taxable gain on the exchange of a life insurance policy for another life insurance policy. The article next discusses and evaluates the MEC rules. Finally, the article examines the interrelationships between Section 1035 and the MEC rules, and explores possible solutions to problems posed by TAMRA.

Section 1035 Exchanges

Operation of Section 1035

Section 1035 sets forth a method for exchanging a life insurance policy for another life insurance policy, while deferring the recognition of income that may otherwise result if an existing policy is surrendered outright and replaced later with a new policy.[2] Other exchanges are also permitted.[3] No gain or loss is recognized on the exchange.[4] The policyowner's basis in the new contract is the same as the basis in the old contract.[5] The owner of the new contract must be the same as the owner of the previous contract.[6] There is no requirement that the contracts have the same face amount, although caution suggests retaining the same face amount.[7]

Treatment of Policy Loans

This tax deferral rule works simply and cleanly when the existing policy does not have a policy loan. A policy loan, however, complicates the operation of the rule. If the new insurer assumes a loan under the existing policy, or accepts the existing policy subject to a loan, the policyowner is treated as receiving cash upon the exchange. The amount of cash treated as received by the policyowner is the amount of loan assumed or accepted. In such a case, if the policyowner would have had a gain on the existing policy if it had been surrendered, the policyowner will have taxable income on the exchange. The taxable income equals the amount of the loan assumed or accepted, but the taxable income may not exceed the amount of the gain that would have resulted upon surrender of the existing policy.[8]

Before invoking Section 1035 the policyowner should determine whether there would be any gain if the existing policy was surrendered. Generally, there would be a gain if the sum of the premiums, minus dividends, is less than the sum of the cash surrender value plus outstanding loans. In other words, if upon surrender the policyowner would receive more in cash from the policy than the owner paid in premiums on the policy, there would be gain to the extent that the cash received exceeds the cost of the policy. If there would not be a gain, then the existence of a loan will not result in any taxes, and the client need not elect Section 1035 treatment. In such cases, a policy can be surrendered, and the cash used to buy a new policy, without any taxable income to the policyowner. In some cases, however, the client may still want to elect Section 1035 treatment so that he or she can carry over the loss basis to the new policy.

If there would be a taxable gain because of a loan, one way to avoid recognizing a gain is to have the new insurer issue the new policy with a loan outstanding for the same amount as on the old policy. In such a case, the policyowner should not be

"The only cases permitting the surrender of a policy and then the purchase of a new one involve annuity policies under pension plans . . ."

---

treated as receiving any cash on the exchange.[9] Unfortunately, few, if any, companies will issue a new policy with a loan already on it.

There are several other possible solutions that may avoid income taxes. First, the client can use other cash assets to pay off the loan, so that upon exchange there will not be a loan outstanding. The payment will increase the cash surrender value of the existing policy, and after the exchange is completed, the client can borrow the same amount as the old loan, but this time from the new policy. The second loan will not be taxable unless the new contract is treated as a modified endowment contract, as discussed below.

The client may borrow the needed funds from a bank, or if the client has other life insurance policies, the client may consider borrowing from the other policies. Often clients have several policies that they surrender for a new policy.[10] In doing so the client should examine each policy individually, rather than lump them all together, because the client may find that by borrowing on policies that upon surrender would be loss situations, the client can repay loans on a policy that would otherwise cause the recognition of income.

Clients, therefore, must carefully analyze the tax consequences before proceeding with the exchange of one life insurance policy for another, and they should seek tax and legal counsel about the effects of the exchange. If a client does not do so, he or she may receive a "surprise," such as when the client receives a 1099 at the end of the year from the original insurer.

Electing Section 1035 Treatment

Since Section 1035 permits the deferral of income that would otherwise be taxable, the Section's technical requirements should be strictly followed. The existing policy should be assigned by the owner to the new insurer, and the new insurer should then surrender it, and issue a new policy to the owner.[11] If the owner surrenders the existing policy, receives the cash surrender value, and then pays the cash surrender value to the new company, the transaction probably will not qualify under Section 1035, as the existing policy would not have been "exchanged" for the new one.[12] The only cases permitting the surrender of a policy and then the purchase of a new one involve annuity policies under pension plans, not life insurance policies. In those cases the annuity policies were nonassignable by their terms, and additional restrictions existed on the transaction.[13]

Due to the paperwork involved in a Section 1035 exchange, the agent and client should evaluate whether it is worth the effort. The original insurer may not readily[14] provide the necessary information for the client to make an informed decision, and questions aside of the propriety of such failure, the practical result is that someone, usually the agent, will spend many unexpected hours ("surprise") trying to gather and piece together information. Even if the necessary information is available, the agent usually completes the paperwork, and guides the transaction through underwriting at the new insurer. These are services in addition to placing the insurance policy, and the agent usually does not receive any additional compensation for these additional services.

Even if the proper formalities are observed, clients sometimes receive a 1099 from the original insurer. The client should rightfully not be concerned, but anyone who has ever received a 1099 by mistake can commiserate with the client about the extra time needed to convince the IRS that an error has been made. However, it may take more time than the client anticipates. To lessen the possibility that clients will be anxious if they receive a 1099, the client should be forewarned of this possibility.

Modified Endowment Contracts

Distributions from a MEC

If a contract is classified as a modified endowment contract (MEC), any distribution from that contract is included in the recipient's income to the extent of the gain under the contract at the time of distribution. The term "distribution" includes all loans and partial surrenders, as well as all dividends,[15] except dividends retained by the insurer to pay premiums or to buy paid-up additions.[16] In addition to including the distribution in income, a ten percent penalty tax is charged on the amount of the distribution. The penalty tax does not apply if the distribution is due to death or disability, or if it is made after age 59½, or if it is made over the life expectancy of the policyowner, or over the joint life expectancies of the policyowner and the beneficiary.[17] In other words, the taxation of a MEC is now similar to that of an annuity. Instead of "first-in first-out" (FIFO) treatment usually accorded life insurance contracts, a MEC is taxed under "last-in first-out" (LIFO).

Definition of Modified Endowment Contract (MEC)

A MEC is a life insurance contract entered into after June 20, 1988 that does not meet the 7-pay test described below. A MEC is also a life insurance contract that is exchanged for a contract described in the previous sentence.[18] Note that this is a two step process—the first step is to determine whether the contract is a life insurance policy, which requires satisfying the cash value accumulation test, or the guideline premium and corridor test.[19] The second step is to determine if the life insurance policy is a MEC. To avoid MEC

treatment, then, a policy must simultaneously satisfy the cash value or guideline premium/corridor test, as well as the 7-pay test.

Insurers simplify the calculation of the 7-pay limit by providing computer proposals and rate cards. Consequently, to determine the 7-pay limit it is not necessary to understand the test intimately. The 7-pay test is as follows: A life insurance contract fails the 7-pay test if the accumulated premium paid under the contract at any time during the first seven contract years exceeds the sum of the net level premiums that would have been paid on or before such time if the contract provided for paid-up future benefits after the payment of seven level annual premiums.[20]

There are several computational rules to assist in applying the 7-pay test. First, the 7-pay computation is made as of the issue date. Secondly, the death benefit provided for the first seven years is deemed as provided until maturity date without regard to any scheduled reduction after the first seven contract years.[21] A reduction after the first seven years, therefore, should not trigger retesting. Third, if there is a reduction in benefits within the first seven years, the test is applied as if the contract had originally been issued at the reduced benefit level. If the reduction is due to the nonpayment of premiums, and the benefits are reinstated within ninety days of the reduction, the reduction is not taken into account.[22]

Material Change Rules

If there is a material change in the benefits (or in other terms of the contract), and the change was not reflected in any previous determination under these rules, then the contract is treated as entered into on the date of the material change, and adjustments will be made to take into account the cash value under the contract.[23] Thus, policies must be retested under the 7-pay test if there is a material change.

The term "material change" means any increase in future benefits under the contract, with several exceptions as follows: (1) increases resulting from funding the lowest level of future benefits payable in the first seven contract years (after considering increases necessary to prevent a decrease in the excess of the death benefit over the cash surrender value), and (2) increases due to the crediting of interest or other earnings (including dividends).[24] Consequently, a material change generally occurs whenever the policyowner, as opposed to the terms of the contract, acts to increase the benefits under a policy.

Distributions Affected If Contract Fails 7-Pay Test

If a contract fails the 7-pay test, any distributions made during the contract year of the failure are subject to the rules for MECs. All distributions in all subsequent years are also subject to the rules. Furthermore, distributions made in anticipation of failing the test are subject to the rules, and the statute defines such distributions as those made within the two years before the failure to meet the 7-pay rules.[25]

Definitions

The amount paid under the contract does not include any premium returned by the insurer within 60 days after the end of a contract year. Any interest returned within the sixty day period is included in income. A contract year is the 12 month period beginning with the first month for which the contract is in effect, and subsequent twelve month periods.[26] Since the statute requires the return of the premium within the sixty day period, the client should have received and deposited the refund check within the sixty day period. A mere request for a return of premium probably will not be enough. If the refund is mailed within the sixty day period, perhaps that will be sufficient. This sixty day grace period provides the best opportunity under TAMRA to correct an unintentional MEC.

Antiabuse Rules

All MECs issued by an insurer to the same policyholder during any twelve month period shall be treated as one MEC.[27] This rule is designed to prevent abuse of the MEC requirements by multiple purchases.

Effective Dates

The MEC rules apply to contracts entered into after June 20, 1988, but there are additional rules that bring pre-June 21, 1988 contracts under the new statute.[28] If the death benefit on a pre-June 21 policy increases by more than $150,000 over the death benefit in effect on October 20, 1988, the material change rules apply to the policy, and the policy will be subject to the 7-pay test. This $150,000 rule does not apply to a contract that requires at least seven level annual premium payments and under which the owner continues to make level annual premium payments over the life of the contract. This exception apparently grandfathers traditional whole life policies, as opposed to flexible premium policies. Another additional rule is that a contract entered into before June 21, 1988 is treated as entered into on or after that date if, after June 20, 1988, the death benefit is increased, and, before June 21, 1988, the owner did not have a unilateral right to obtain the increase without providing evidence of insurability. The $150,000 rule and the unilateral right rule, when read together, apparently mean that the $150,000 exception applies only if the policyowner also meets the unilateral right exception. Still another rule is that a contract entered into before June 21, 1988 is treated as entered into on or after that date if, after June 20, 1988, the contract is converted from a term

Before trying to avoid the MEC rules, clients should consider whether the result of MEC treatment warrants taking evasive action.

contract to something else, in spite of the owner's unilateral right to do so. The result of these rules is that just about any policy that has an increase in benefits becomes subject to the 7-pay requirements.

The effective date provisions also affect changing from Option A (i.e., level death benefit) to Option B (increasing death benefit) under a universal life contract. For post-June 20 contracts, if the change results in an increase in death benefits, the material change rules should apply in any case. On pre-June 21 contracts, if, prior to that date, the policyholder had the unilateral right to make the change without submitting evidence of insurability, and the death benefit does not increase by more than $150,000, the contract would not be subject to the 7-pay rules. If the policyholder did not have the unilateral right to make the change without evidence, the contract would be treated like a new contract and the 7-pay rules would be applied. Since contracts usually do not provide for such a unilateral right,[29] the 7-pay rules should usually be applied when changing from Option A to Option B.

Certain Exchanges Permitted

If a MEC that (1) required at least seven annual level premiums, (2) was entered into after June 20, 1988 and before November 10, 1988 (the date of the TAMRA's enactment), and (3) was exchanged within three months after November 10, 1988 for a contract that is not a MEC, the new contract will not be treated as a MEC if the policyowner elects to recognize gain on the transaction, and not to defer tax under Section 1035. This exchange rule is virtually useless because universal life contracts do not require the payment of at least seven annual level premiums. Furthermore, since the policyowner cannot elect Section 1035 treatment, the rule doesn't help clients if, under Section 1035, they exchanged a pre-June 21 contract for a new contract that is a MEC. In view of the limitations on the exchange rule, clients may find that taking a distribution of the excess premium in the sixty days after the end of the policy year is more useful than the exchange rule. Hopefully, Congress will remedy this problem in a technical corrections act.

Avoiding the MEC rules

Before trying to avoid the MEC rules, clients should consider whether the result of MEC treatment warrants taking evasive action. If the client intends to keep the policy until death, the MEC rules, which apply only to lifetime withdrawals, will be of no consequence. Secondly, even if a policy is taxed under the MEC rules, at least the accumulations credited to a MEC are not taxed unless and until they are withdrawn, unlike other common investments that are taxed as soon as the earnings are credited, such as CDs. Third, since the ten percent penalty tax does not apply to policyholders above the age of 59½, the effect of MEC treatment on older clients is still more favorable than the tax treatment of a CD.

Even if a policy is a MEC, if the owner annuitizes, the usual exclusion ratio rules will apply. The Internal Revenue Code expressly excludes payments received as annuities from the income-first treatment of a MEC.[30]

The adverse effects of the 7-pay limits may also be lessened by adding a term rider on the insured. The 7-pay premium on the base policy will be increased by the amount needed to fund the term rider. The additional amount is determined on a net premium basis assuming the rider is in effect until the maturity date of the base policy. The calculation is similar to determining the present value of the future stream of total term premiums, and then allocating that present value over seven level annual premiums.

The client might add a term rider so that the 7-pay limit would be raised, and then drop the rider in the eighth year. Such a plan should avoid a recalculation of the 7-pay limit, although it may trigger a "force-out" of cash value that may be taxable.[31]

The 7-pay rules probably cannot be avoided by a change from smoker to nonsmoker. Since the resulting change in rates would not have been reflected in any previous determination under the 7-pay rules, such a change should cause the policy to be retested. To allow such a change and not require retesting would result in a higher 7-pay limit for the new nonsmoker than if the insured had been a nonsmoker originally. Although the terms of the printed contract may not change when the rate is changed to the nonsmoker rate, the 7-pay rule is founded upon a calculation using the rates as a vital term of the contract; therefore, a change in the rates would be a change of a very important factor used in determining the 7-pay limit, and such a change should constitute a material change. The same analysis should apply to the removal of a rating.

The conversion of a term rider to permanent insurance also probably does not afford an opportunity to avoid the 7-pay rules. The 7-pay rules apply to term policies that are converted, so the conversion of a term rider should be treated the same as the conversion of a term policy. For post-June 20, 1988 contracts, a policy with a term rider would have been tested at issue and the 7-pay premium would have been established according to the face amount of the base policy, plus the amount of the rider as term insurance. The policyholder would probably want the policy retested in such a case, otherwise the 7-pay premium might be too low in view of the increased cost due to the increase in permanent benefits.

Section 1035 Exchanges and Modified Endowment Contracts

Meshing Section 1035 with the MEC Rules

Many clients bought policies after June 20, 1988 by rolling over the cash value of pre-June 21 policies. Such transactions were commonplace prior to TAMRA. At first blush, TAMRA appears to have ended the rollover market because, if the "amount paid" for purposes of the 7-pay rule is the amount of the cash value transferred, a rollover will often exceed the 7-pay limit.

Perhaps the material change rules themselves provide a solution for the rollover sale. TAMRA includes a formula for taking into consideration the cash value of a non-MEC contract that, due to a material change, must be retested. Generally speaking, the allowable 7-pay premium is reduced by an amount that considers the existing cash value of the policy.[32]

The formula works as follows: consider a male, age 41, nonsmoker, who has an existing policy with a $7,000 cash surrender value, and who wants to increase the face amount of the policy from $75,000 to $100,000. The seven pay premium for this particular contract is $46 per thousand, for a total of $4,600. Under the material change rules the $7,000 is multiplied by a fraction. The numerator of the fraction is the 7-pay premium, and the denominator is the net single premium for the policy. In this example, the fraction equals .172. When the fraction is multiplied by the cash value, the result is $1,204. ($7,000 x .172 = $1,204.) The $1,204 is then subtracted from the 7-pay premium, and the difference, $3,396, is the permissible 7-pay premium for the $100,000 policy ($4,600 - 1,204 = $3,396). In other words, the owner can pay an annual premium of $3,396 and not violate the 7-pay test.

A possible loophole exists for Section 1035 exchanges[33] in connection with this formula in that the House Committee report says that "a material change includes the exchange of a life insurance contract for another life insurance contract."[34] If the exchange of one contract for another is a material change, then the above formula would be applied to a Section 1035 exchange in exactly the same fashion as set forth above. The only difference would be that instead of adding to an existing policy, the existing policy would be exchanged for a new policy. The formula presumably would allow all rollovers to escape MEC treatment, even though additional premiums might not be permitted.

Consider the application of the formula to old policies that are exchanged under Section 1035. If the cash value of the existing policy is $26,453, after the rollover the policyowner would still be able to make a $50.09 premium payment without violating the 7-pay limit. $4,600 minus (26,453 x .172) = $50.09. Presumably, to take this example one step further, a rollover of an even larger amount, such as $100,000, would not result in MEC treatment. The formula would indicate only that no additional premium could be paid. $4,600 minus (100,000 x .172) = zero.

Although the House Committee report says that the exchange of one policy for another is a material change, the House bill was just the first step in the legislative process. After being passed by the House, the bill went to the Senate, which adopted the House bill with certain amendments. Neither the Senate Amendment to the House bill, nor the accompanying Committee Report, mention policy exchanges. In the final step of the legislative process, members of the House and Senate conferred to work out the differences between the House and Senate versions of the bill. The Conference Agreement adopts the Senate Amendment with certain changes, but, again, neither the bill in its final form, nor the accompanying Committee Reports, mention policy exchanges. Consequently, the status of policy exchanges is unclear.

Conceptually, treating a policy exchange as a material change makes sense. There does not appear to be any reason that the cash value of an existing contract should be treated differently upon exchange than the cash value of a non-MEC contract that undergoes a material change. Perhaps the actuaries will determine that the existing policy is not adequately taken into consideration under the 7-pay rules by the formula. In that case, if an abuse of the statute would result, the IRS would probably move quickly to close this possible loophole.

Unfortunately, since this question is one of statutory construction, what makes sense may not be important. Unless the statute expressly permits the use of the material change formula for policy exchanges, the statute may be construed to prohibit it. To reach the desired result, the statute would have to be construed to exclude an item from a taxpayer's income. In such cases, courts may narrowly construe the provision at issue, and deny the desired result by reasoning that if Congress intended an item to be excluded from income, Congress would have made its intention clear. Of course, in any case, Congress could make its intention clear in a technical corrections act.

Until TAMRA is clarified, clients should avoid relying upon the formula approach unless there is no alternative. This approach may be most appealing to those clients who bought a policy after June 20, 1988, and before November 10, 1988, the date TAMRA was enacted. Such purchasers could not have anticipated the content of TAMRA, and the formula approach may provide

the only feasible solution for them. Hopefully, the IRS will resolve the uncertainty in this area by issuing a favorable ruling. (I/R Code No. 4400.09/7400.023)J

Douglas I. Friedman, JD, CLU, practices law in Birmingham, Alabama, and counsels life insurance companies and businesses about estate planning, business planning, qualified and nonqualified deferred compensation, and other advanced sales matters. A member of the Bars of Alabama and New York, Friedman has written articles and conducted seminars about the legal and tax aspects of life insurance marketing.

(1) Unless otherwise stated, all references will be to the Internal Revenue Code of 1986.
(2) Section 1035 provides as follows: "No gain or loss shall be recognized on the exchange of: (1) a contract of life insurance for another contract of life insurance or for an endowment or annuity contract; or (2) a contract of endowment insurance (A) for another contract of endowment insurance which provides for regular payments beginning at a date not later than the date payments would have begun under the contract exchanged, or (B) for an annuity contract; or an annuity contract for an annuity contract . . . "
(3) *Id.* Although this article discusses only the exchange of life insurance policies, the statute permits other exchanges, such as a life insurance policy for an annuity, or an annuity for an annuity.
(4) *Id.*
(5) I.R.C. Regulation Section 1.1035-1(c); I.R.C. Section 1031(d).
(6) Code Regulation Section 1.1035-1(c).
(7) If the new policy is as similar to the old policy as possible, the transaction should not be vulnerable to a claim by the Internal Revenue Service that the new policy is more valuable than the old policy, in which case the difference would be taxable to the policyowner. Code Sections 1035(c)(1), 1031(b), and the Regulations for those sections.
(8) The policyowner's basis is increased by the amount of cash treated as received, but gain is recognized to the extent of the cash treated as received.
(9) Private Letter Ruling 8806058.
(10) The exchange of several policies for one new policy is apparently permissible, if for no other reason than that the client could combine one policy at a time until the desired result is obtained.
(11) Revenue Rulings 68-235, 72-358.
(12) *See, e.g.* P.L.R. 8810010 (where taxpayer owned Policy A and Policy B, the subsequent surrender of Policy A and the contribution of its cash surrender value to Policy B, was not an exchange under Section 1035 because Policy B already existed when Policy A was surrendered, and therefore Policy B was not received in exchange for Policy A).
(13) *See, e.g.*, Revenue Ruling 73-124. "Apparently there are three prerequisites to receiving Section 1035 treatment on transfers of otherwise nonassignable annuities: (1) the existence of a binding agreement controlling or directing the use of the surrender proceeds, (2) a quick time sequence in applying the proceeds to the second contract, and (3) no personal use of the proceeds." Dropick, Dorothy K., *Life Insurance Exchanges Under Section 1035: Think Twice Before You Surrender*, 17 Conn. L. Rev. 525 (1985).
(14) Insurers on existing policies usually do not make any profit by cooperating with a Section 1035 exchange; moreover, they are losing business. Consequently, one can understand why the process may be very slow. Furthermore, the insurer often will not correspond with anyone other than the policyowner, even when requested by the policyowner to do so.
(15) The statute and committee reports require that dividends be treated as distributions except for those described in the text accompanying this note. Since accumulations are not mentioned as an exception, they should be included as a distribution.
(16) Code Sections 72(e)(4)(A), 72(e)(10). The reader should refer to the various Committee Reports under Section 5012 of TAMRA, H.R. 4333, for explanations not included specifically in the Code.
(17) Code Section 72(v).
(18) Code Section 7702A(a).
(19) Code Section 7702(a).
(20) Code Section 7702A(b).
(21) Code Section 7702A(c)(1).
(22) Code Section 7702A(c)(2).
(23) Code Section 7702A(c)(3)(A).
(24) Code Section 7702A(c)(3)(B).
(25) Code Section 7702A(d).
(26) Code Section 7702A(e).
(27) Code Section 7702A(e)(11).
(28) TAMRA Section 5012(e).
(29) Generally, the insurer retains the right to request medical information whenever the policyholder takes action to increase the death benefit under the policy.
(30) Code Section 72(e)(1).
(31) Code Section 7702(f)(7).
(32) TAMRA Section 5012(c)(1); Code Section 7702A(c)(3)(A)(ii). "In the case of a contract that is materially changed due to an increase in future benefits that is attributable to a premium that is not necessary to fund the lowest death benefit payable in the first seven contract years, the amount of the premium that is not necessary to fund such death benefit is to be subject to the 7-pay test without regard to the timing of the premium payment. In applying the 7-pay test to any premiums paid under a contract that has been materially changed, the 7-pay premium for each of the first seven contract years after the change is to be reduced by the product of (1) the cash surrender value of the contract as of the date that the material change takes effect (determined without regard to any increase in the cash surrender value that is attributable to the amount of the premium payment that is not necessary), and (2) a fraction the numerator of which equals the 7-pay premium for the future benefits under the contract, and the denominator of which equals the net single premium for such benefits computed using the same assumptions used in determining the 7-pay premium." Conference Committee Report to TAMRA Section 5012.
(33) Although this article discusses the exchange formula in terms of Section 1035 exchanges, it appears that the formula approach would apply to any exchange, whether or not the client elected treatment under Section 1035. From a practical standpoint, of course, a client usually makes an exchange only under Section 1035.
(34) House Committee Report to TAMRA Section 5012.