7. *Front-End Sales Load Charge.* a. The front-end sales load is based on the amount of the premium paid in relation to the ''Target Premium,'' [2] the Contract Year in which the premium is paid, and the pro-rated amount of the premium payment attributable to the basic face amount and to the supplemental face amount.[3]

b. Current and maximum front-end sales load for premium payments attributable to: (1) the basic face amount up to Target Premium, (2) the basic face amount in excess of the Target Premium, and (3) supplemental face amount, are as follows:

FRONT-END SALES LOADS

Contract years	Basic face amount		Supplemental face amount
	Up to target premium	Excess of target premium	
	Current/max (percent)	Current/max (percent)	Current/max (percent)
1	50.0/50.0	9.0/9.0	4.0/4.0
2–5	15.0/15.0	4.0/4.0	4.0/4.0
6–10	10.0/10.0	4.0/4.0	4.0/4.0
11–20	2.0/2.0	2.0/2.0	2.0/2.0
After 20	0.0/0.0	0.0/2.0	0.0/2.0

8. *Section 848 ''DAC Tax'' Charge.* a. Applicants state that the 1.25% charge deducted from each Premium Payment is designed to reimburse the Companies for their increased federal tax burden resulting from the application of Section 848 of the Code to the receipt of those premiums. Section 848, as amended, requires life insurance companies to capitalize and amortize over ten years certain general expenses for the current year rather than deduct these expenses in full from the current year's gross income, as allowed under prior law. Section 848 effectively accelerates the realization of income from specified contracts and, consequently, the payment of taxes on that income. Taking into account the time value of money, Section 848 increases the insurance company's tax burden because the amount of general deductions that must be capitalized and amortized is measured by the premiums received under the Contracts.

b. Deductions subject to Section 848 equal a percentage of the current year's net premiums received (*i.e.*, gross premiums minus return premiums and reinsurance premiums) under life insurance or other contracts categorized under this Section. The Contracts will be categorized as ''specific contracts'' under Section 848 requiring 7.7% of the net premiums received to be capitalized and amortized under the schedule set forth in Section 848(c)(1).

c. The increased tax burden on every $10,000 of net premiums received under the Contracts is quantified by Applicants as follows. For each $10,000 of net premiums received in a given year, the Companies' general deductions are reduced by $731.50, or (a) $770 (*i.e.*, 7.7% of $10,000), minus (b) $38.50 (one-half year's portion of the ten year amortization which may be deducted in the current year). The remaining $731.50 ($770 less $38.50) is subject to taxation at the corporate tax rate of 34% and results in $248.71 (.34% × $731.50) more in taxes for the current year than the Companies otherwise would have owed prior to OBRA 1990. However, the current tax increase will be offset partially by deductions allowed during the next ten years, which result from amortizing the remainder $770 ($77 in each of the following nine years and $38.50 in year ten).

d. In calculating the present value of these increased future deductions, the Companies determined that, in their business judgment, it is appropriate to use a discount rate of 10% for the following reasons. To the extent that capital must be used by the Companies to pay the increased federal tax burden under Section 848, such surplus will be unavailable for investment. Thus, the cost of capital used to satisfy this increased tax burden under Section 848 is the Companies' targeted rate of return (*i.e.*, return sought on invested capital), which is in excess of 10%. Accordingly, Applicants submit that the targeted rate of return is appropriate for use in this present value calculation.

e. Applicants also submit that, to the extent that the 10% discount rate is lower than the Companies' actual targeted rate of return, the calculation of this increased tax burden will continue to be reasonable over time, even if the applicable corporate tax rate is reduced, or their targeted rate of return is lowered.

f. In determining the targeted rate of return used in arriving at the discount rate, the Companies first identified a reasonable risk-free rate of return that can be expected to be earned over the long term. The Companies then determined the premium needed to earn more than that risk-free rate of return because of the inherently risky nature of the insurance products it sells. Applicants represent that these are appropriate factors to consider in determining the Companies' targeted rate of return.

g. Using a federal corporate tax rate of 34%, and applying a discount rate of 10%, the present value of the tax effect of the increased deductions allowable in the following ten years, which partially offsets the increased tax burden, equals $155.82. The effect of Section 848 on the Contract, therefore, is an increased tax burden with a present value of $92.89 for each $10,000 of net premiums (*i.e.*, $248.71 less $155.82).

h. Applicants state that the Companies do not incur incremental federal income tax when they pass on state premium taxes to Contract Owners because state premium taxes are deductible in computing the Companies' federal income taxes. Conversely, federal income taxes are not deductible in computing the Companies' federal income taxes. To compensate the Companies fully for the impact of Section 848, an additional charge must be imposed to make them whole for the $92.89 additional tax

[2] The ''Target Premium'' is a percentage of the level annual premium payment, or the ''Guideline Annual Premium,'' necessary to provide future benefits under the Policy through maturity.

[3] Premium payments are allocated to the basic face amount and to the supplemental face amount in the same ratio that the initial amounts each bear, respectively, to the initial face amount.