I. BACKGROUND

A. TAM 9604001

Dealt with equity arrangements wherein the IRS ruled under Sec. 83 that, if the cash value exceeds the employer premiums paid at the crossover point, the insured is taxable on the economic benefit of the life insurance protection and the annual increase in cash value in excess of the amount repayable to the employer. Under the TAM, the insured is also deemed to make an annual gift to the owner (an ILIT) equal to the amount includable in income.

B. Notice 2001-10

1. Clarifies prior rulings regarding the taxation of split dollar arrangements;

2. Provides taxpayers with interim guidance pending publication of future guidance;

3. Primary focus is on split dollar arrangements between employers and employees, but applies to other arrangements, including arrangements that provide compensation to non-employees and economic benefits to corporate shareholders and arrangements involving gifts;

4. Special attention is paid to equity split dollar. Equity split dollar results in the employee deriving an economic benefit beyond the value of the current life insurance protection addressed in Rev. Rul. 64-328, 1964-2 C.B. 11 and Rev. Rul. 66-110, 1966-1 C.B. 12. Except for private rulings, the Notice is the first public announcement by the IRS concerning equity arrangements (unless Rev. Rul. 64-328 deals with equity arrangements as some commentators suggest);

5. Applicable to endorsement and collateral assignment arrangements alike; and


- P.S. 58 rates are based on 1946 mortality tables and no longer bear an appropriate RELATIONSHIP to the fair market value of current life insurance protection.
Table 2001 published to provide a modern uniform rate table to determine value of current life insurance protection under split dollar arrangements and qualified plans for taxable years ending or before December 31, 2001.

Table 2001 provides no guidance for second to die policies.

C. Notice 2002-8 - Further Guidance.

1. Impact of the Notice.

- Revokes Notice 2001-10 except for Table 2001;
- Announces that the Treasury and IRS intend to publish proposed regulations providing comprehensive guidance;
- Outlines rules expected to be included in the final regulations and suggests that two mutually exclusive regimes (economic benefit regime and loan regime) may be the direction taken;
- Provides guidance regarding the valuation of current life insurance protection under split dollar arrangements, qualified retirement plans and under employee annuity contracts; and
- Continues application of Table 2001.

2. Transition Rules and Safe Harbors.

Transition rules and safe harbors are provided for arrangements entered into before finalization of the regulations.

3. No Mention of Reverse Split Dollar.

Unlike Notice 2001-10, the 2002-8 Notice makes no specific mention of reverse split dollar arrangements. Nor is there any comment on shared ownership or similar arrangements. Likely, this is not an oversight, but rather a thought by the IRS that its general admonition that its principles “are expected to govern the Federal tax treatment of split dollar insurance arrangement in other contexts ...”.


1. Prop Reg Sec. 1.61-2(d)(2)(ii)(A); Prop Reg Sec. 1.61-22; Prop Reg Sec. 1.83-6(a)(5); Prop Reg Sec. 1.301-1(q); Prop Reg Sec. 1.7872-15; Prop Reg Sec. 31.3121(a)-1(k); Prop Reg Sec. 31.3231(e)-1(a)(6); Prop Reg Sec. 31.3306(b)-1(L)

2. Effective Date.
The regulations are proposed to apply to any split dollar arrangement (a defined term) entered into after the final regulations are published.

An arrangement entered into on or before final publication which is “materially modified” after that date is treated as a new arrangement.

NOTE: The IRS requested comments regarding whether certain modifications should be disregarded as a “material modification”, such as the exchange of policies in an IRC Sec. 1035 transaction.

The Preamble reminds taxpayers that Notice 2002-8 provides guidance with respect to arrangements entered into before the effective date of the final regulations.

Taxpayers may rely on the proposed regulations for the treatment of any split dollar arrangement entered into on or before the date final regulations are published provided that all parties to the arrangement treat the arrangement consistently.

EXAMPLE: According to the Preamble, an owner and a non-owner of a life insurance contract that is part of a split dollar arrangement may not rely on the proposed regulations if one party treats the arrangement as subject to the economic benefit rules of Sec. 1.61-22 and the other party treats the arrangement as subject to the Sec. 1.7872-15.

NOTE: Parties to an equity split dollar arrangement subject to the economic benefit regime may rely on the proposed regulations only if the value of all economic benefits taken into account by the parties exceeds the value of the economic benefits the parties would have taken into account if the arrangement were a non-equity split dollar arrangement (determined using Table 2001), thereby reflecting the fact that such an arrangement provides the non-owner with economic benefits that are more valuable than current life insurance protection.

The IRS reserved guidance on a number of important aspects of split dollar arrangements.


Following the publication of the proposed regulations, it came to the IRS’ attention that certain reverse split-dollar life insurance arrangements were being structured using inappropriately high current term insurance rates, prepayment of premiums,
or other techniques to confer policy benefits other than current life insurance protection on another party and to understate the value of those benefits.

In the view of the IRS, the use of these techniques by any party to understate the value of those other policy benefits distorts the income, employment or gift tax consequences of the arrangement and does not conform to, and are not permitted by, any published guidance.

Thus, Notice 2002-59 reminds that Notice 2002-8 provides that PS 58 rates cannot be used after 2001 outside of the compensatory context. Neither the premium rates in Table 2001 nor the insurer’s lower one-year term rates may be relied upon to value one party’s current life insurance protection for the purpose of establishing the value of any policy benefits to which another party may be entitled.

Media reports and internet discussions indicate that the particular structure which precipitated the IRS action was a private split dollar arrangement based on PLR 9636033 and involved the execution of a confidentiality agreement. Although there was no prior guidance from the IRS on reverse split dollar, practitioners logically assumed that a reverse structure would produce simply the reverse of the normal tax results of a traditional split structure, not an unreasonable assumption. Some practitioners pushed the envelope with very aggressive planning which no doubt finally got the IRS’ attention.

NOTE: It should not go unnoticed that there is an Illinois Bar ethics opinion ruling that the execution of a confidentiality agreement under these or comparable circumstances is unethical because it limits the lawyer’s ability to represent other clients. Ill State Bar Association - Op. No. 00 - 01 deals with the conflict of interest created between a lawyer’s representation of one client and other similar clients if the lawyer signs a confidentiality agreement required as an incident to the client’s tax planning.

The Notice contains no effective date However, it speaks in current terms and it can reasonably be assumed that the Notice will have immediate application to existing reverse or comparable arrangements.


These regulations proposed in May 2003 provided for the valuation of economic benefits under an equity split dollar life insurance structure governed by the economic benefit regime. These proposals have been carried forward and included in the final regulations.

These proposed regulations provided that, in the case of equity split dollar structures, the value of the economic benefit provided to the non-owner under the arrangement for a taxable year equals the cost of any current life insurance protection provided to the non-owner, the amount of policy cash value to which the non-owner has current access (to the extent that such amount was not actually taken into account for a prior taxable year) and the value of any other economic benefits
provided to the non-owner (to the extent not actually taken into account for a prior taxable year).

NOTE: The policy value relating to cash value is computed without surrender charges. This calculation is also carried forward in the final regulations.

II. FINAL REGULATIONS - SCOPE

The final regulations follow the proposed regulations, including the economic benefit valuation proposals, in very substantial part with most of the significant changes relating to the economic benefit regime and with only a few significant changes to the loan regime. Reference is made to the proposed regulations at VI below.

26 CFR 1.61-22: Taxation of split-dollar life insurance arrangements. (Also: §§ 83; 301; 316; 2503; 2511; 2512; 7805; 7872; 1.83-3; 1.83-6; 1.301-1; 1.316-1; 25.2503-1; 25.2511-1; 25.2512-6; 301.7805-1; 1.7872-15.).

A. T.D. 9092.

1. Provides comprehensive final regulations regarding the federal income, gift and employment taxation of split dollar arrangements.

2. Exceptions.

   • The gift tax consequences of a transfer of an interest in a life insurance contract to a third party will continue to be determined under established gift tax principles notwithstanding who has treated the owner of the life insurance contract under the final regulations. See, for example, Rev. Rul. 81-198, 1981-2 C.B. 188.

   • For estate tax purposes, regardless of who is treated as the owner of a life insurance contract under the final regulations, the inclusion of the policy proceeds in a decedent’s gross estate will continue to be determined under Sec. 2042.


C. Structures Impacted.

The regulations apply to all varieties of split dollar arrangements, including the following: