

Split-Dollar Life Insurance
Arrangements
Treasury Regulation §1.61-22
Indexed and Annotated

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#

Treasury Regulation §1.61-22

Taxation of Split-Dollar Life Insurance Arrangements

(a) Scope.

(1) In general. This section provides rules for the taxation of a split-dollar life insurance arrangement for purposes of the income tax, the gift tax, the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA), the Railroad Retirement Tax Act (RRTA), and the Self-Employment Contributions Act of 1954 (SECA). For the Collection of Income Tax at Source on Wages, this section also provides rules for the taxation of a split-dollar life insurance arrangement, other than a payment under a split-dollar life insurance arrangement that is a split-dollar loan under §1.7872-15(b)(1). A split-dollar life insurance arrangement (as defined in paragraph (b) of this section) is subject to the rules of paragraphs (d) through (g) of this section, §1.7872-15, or general tax rules. For rules to determine which rules apply to a split-dollar life insurance arrangement, see paragraph (b)(3) of this section.

(2) Overview. Paragraph (b) of this section defines a split-dollar life insurance arrangement and provides rules to determine whether an arrangement is subject to the rules of paragraphs (d) through (g) of this section, §1.7872-15 [**#which governs split dollar loans**], or general tax rules. Paragraph (c) of this section defines certain other terms. Paragraph (d) of this section sets forth rules for the taxation of economic benefits provided under a split-dollar life insurance arrangement. [**#the economic benefit regime is the alternative approach under the 2003 Regulations to the loan regime provided under the 7872 Regulations**] Paragraph (e) of this section sets forth rules for the taxation of amounts received under a life insurance contract that is part of a split-dollar life insurance arrangement. Paragraph (f) of this section provides rules for additional tax consequences of a split-dollar life insurance arrangement, including the treatment of death benefit proceeds. Paragraph (g) of this section provides rules for the transfer of a life insurance contract (or an undivided interest in the contract) that is part of a split-dollar life insurance arrangement. Paragraph (h) of this section provides examples illustrating the application of this section. Paragraph (j) of this section provides the effective date of this section. [**#Note, these regulations cover only split-dollar subject to the economic benefit regime. To identify split-dollar arrangements that are instead subject to the loan regime under Treasury Regulation Section 1.7872-15 the following requirements must be met: (1) Payment must be made by the non-owner to the owner; (2) The payment is**

a loan for federal income tax purposes, or a reasonable person would expect the amounts loaned to be repaid; and (3) Repayment is made from, or secured by, the life insurance policy's death benefit, cash value, or both.]

(b) Split-dollar life insurance arrangement.

(1) In general. A split-dollar life insurance arrangement is any arrangement *[#the Regulations use the term "arrangement" not the term "contract" so that it appears that if the parties arrangement is reflected in their treating the transaction in the manner described below, that arrangement will be a split-dollar arrangement even if it is not formally memorialized in a written split-dollar agreement between the parties. The Regulations do not require a signed contract. So, if the transaction or arrangement looks like split-dollar, is handled like split-dollar and quacks like split-dollar, then it is a split-dollar duck regardless as to whether it is ever formally memorialized as split-dollar.]* between an owner and a non-owner of a life insurance contract that satisfies the following criteria— *[#the following provides a definition of "split-dollar"]*

(i) Either party to the arrangement pays, directly or indirectly, all or any portion of the premiums on the life insurance contract *[#If, for example, an ILIT is Owner and a family member is the Payor Party, although the ILIT is the Owner and would generally pay the premiums directly to the insurance company, the family member as the Payor Party appears authorized to pay a portion or all of the premiums directly to the insurance company],* including a payment by means of a loan to the other party that is secured by the life insurance contract *[#a key to qualifying for split-dollar treatment is that the payments by the Premium Payor have to be secured by an interest in the life insurance policy/contract.*

(ii) At least one of the parties to the arrangement paying premiums under paragraph (b)(1)(i) of this section is entitled to recover (either conditionally or unconditionally *[#"unconditionally" would mean a recourse arrangement. For example, if an ILIT was Owner of the policy, if the trustees guaranteed repayment then the repayment would be "unconditional" or recourse. "Conditionally" would mean that the Premium Payor's rights to reimbursement are limited to the policy, so that if the cash surrender value of the policy were less than the aggregate premiums advanced by the Premium Payor, the Premium Payor would not recoup the entire amount advanced.]*) all or any portion of those premiums and such recovery is to be made from, or is secured by, the proceeds of the life insurance contract *[#This is*

typically done by the Payor Party having its interests in the life insurance policy secured by a collateral assignment of the policy so that it is repaid the premiums advanced, or if greater in a non-equity arrangement, the cash surrender value]; and

(iii) The arrangement is not part of a group-term life insurance plan described in section 79 unless the group-term life insurance plan provides permanent benefits to employees (as defined in §1.79-0).

(2) Special rule.

(i) In general. Any arrangement between an owner and a non-owner of a life insurance contract is treated as a split-dollar life insurance arrangement (regardless of whether the criteria of paragraph (b)(1) of this section are satisfied) if the arrangement is described in paragraph (b)(2)(ii) or (iii) of this section.

(ii) Compensatory arrangements. An arrangement is described in this paragraph (b)(2)(ii) if the following criteria are satisfied—

(A) The arrangement is entered into in connection with the performance of services **[#an example might be an employer corporation provides an insurance benefit to a key employee by purchasing and paying for life insurance on the executive, letting the executive designate a beneficiary for the death benefit under the policy in excess of the reimbursement amount due to the corporation to repay the premiums advanced.]** and is not part of a group-term life insurance plan described in section 79;

(B) The employer or service recipient pays **[#It does not only have to be a formal employer/employee relationship, anyone benefiting from the services provided would be subject to this rule.,** directly or indirectly, all or any portion of the premiums; and

(C) Either—

(1) The beneficiary of all or any portion of the death benefit is designated by the employee or service provider **[#For example, the executive might have a family trust designated to receive the portion of the death benefit not required to repay the employer/service**

recipient's advance of premiums.] or is any person whom the employee or service provider would reasonably be expected to designate as the beneficiary [**#Presumably this would include a family member of the executive, etc.];** or

(2) The employee or service provider has any interest in the policy cash value of the life insurance contract. [**#This provision is not clear but would appear to be an "equity" type arrangement wherein the employee could receive, for example, the excess of the cash surrender value of the policy over the aggregate premiums advanced by the employer/Premium Payor. It does give some credence to being able to do reverse split-dollar, although without the comfort of a definable term rate as per Notice 2002-59.]**

(iii) Shareholder arrangements. An arrangement is described in this paragraph (b)(2)(iii) if the following criteria are satisfied—

(A) The arrangement is entered into between a corporation and another person in that person's capacity as a shareholder in the corporation [**#If the individual/insured is both a shareholder and an employee of the corporation it may be difficult to determine the capacity in which the split-dollar insurance arrangement is received. There is little law helping to make this determination. Thus, the governing legal documentation, and corroboration of facts supporting the position taken, may be key. If a benefit inures to a shareholder, it may be treated as a distribution and hence taxed as a dividend depending on the corporation's earnings and profits, and so forth. If the corporation is an S corporation care must be taken to avoid a second class of stock if a benefit inures to one shareholder and there are other shareholders with different rights.];**

(B) The corporation pays, directly or indirectly, all or any portion of the premiums; and

(C) Either—

(1) The beneficiary of all or any portion of the death benefit is designated by the shareholder or is

any person whom the shareholder would reasonably be expected to designate as the beneficiary ***[#Similar to the discussion above for a service provider, this presumably means that a spouse or child or other heir of the shareholder is the beneficiary. Presumably, insurance used in a buy out arrangement would benefit the partner and not meet this criteria.];*** or

(2) The shareholder has any interest in the policy cash value of the life insurance contract. ***[#This provision is not clear but would appear to be an "equity" type arrangement wherein the employee could receive, for example, the excess of the cash surrender value of the policy over the aggregate premiums advanced by the employer/Premium Payor. It does give some credence to being able to do reverse split-dollar, although without the comfort of a definable term rate as per Notice 2002-59.]***

(3) Determination of whether this section or §1.7872-15 applies to a split-dollar life insurance arrangement. [#See comments in initial paragraphs of these regulations as to which transactions are subject to the loan regime.]

(i) Split-dollar life insurance arrangements involving split-dollar loans under §1.7872-15. Except as provided in paragraph (b)(3)(ii) of this section, paragraphs (d) through (g) of this section do not apply to any split-dollar loan as defined in §1.7872-15(b)(1). Section 1.7872-15 applies to any such loan. ***[#The loan regime under 7872 is independent and mutually exclusive of the economic benefit regime under the 61 Regulations.]*** See paragraph (b)(5) of this section for the treatment of a payment made by a non-owner under a split-dollar life insurance arrangement if the payment is not a split-dollar loan. ***[#If a non-Owner person, referred to in these comments as the Premium Payor, advances a premium for a policy and that advance is not subject to the loan regime, then that advance is subject to the economic benefit regime under these 61 Regulations.]***

(ii) Exceptions. Paragraphs (d) through (g) of this section apply (and §1.7872-15 does not apply) ***[#These 61 Regulations and***

the economic benefit regime apply to the transactions listed below.] to any split-dollar life insurance arrangement if—

(A) The arrangement is entered into in connection with the performance of services, and the employer or service recipient is the owner of the life insurance contract (or is treated as the owner of the contract under paragraph (c)(1)(ii)(A)(1) of this section); or

(B) The arrangement is entered into between a donor and a donee (for example, a life insurance trust) and the donor is the owner of the life insurance contract (or is treated as the owner of the contract under paragraph (c)(1)(ii)(A)(2) of this section). ***[#In this scenario the regulations allow for someone to be treated as the owner, whether in fact the actual owner – the case in which the legal owner is the donee and the policy is collaterally assigned to the donor. The importance is that they are caught up with their own terms – “owner” and “non-owner”.***

(4) Consistency requirement. A split-dollar life insurance arrangement described in paragraph (b)(1) or (2) of this section must be treated in the same manner by the owner and the non-owner of the life insurance contract under either the rules of this section or §1.7872-15. In addition, the owner and non-owner must fully account for all amounts under the arrangement under paragraph (b)(5) of this section, paragraphs (d) through (g) of this section, or §1.7872-15. ***[#Consideration could be given to mandating the consistent treatment in the split-dollar agreement between the parties.]***

(5) Non-owner payments that are not split-dollar loans. If a non-owner of a life insurance contract makes premium payments (directly or indirectly) under a split-dollar life insurance arrangement, and the payments are neither split-dollar loans nor consideration for economic benefits described in paragraph (d) of this section, then neither the rules of paragraphs (d) through (g) of this section nor the rules in §1.7872-15 apply to such payments. Instead, general income tax, employment tax, self-employment tax, and gift tax principles apply to the premium payments. See, for example, §1.61-2(d)(2)(ii)(A). ***[#This covers scenarios in which the arrangement does not meet the requirements of the regulation such as an agreement to pay less than 80% of a loan as in 1.7872-15.]***

(6) Waiver, cancellation, or forgiveness. If a repayment obligation described in §1.7872-15(a)(2) is waived, cancelled, or forgiven at any time, then the parties must take the amount waived, cancelled, or

forgiven into account in accordance with the relationships between the parties (for example, as compensation in the case of an employee-employer relationship). ***[#In the case of a donee/donor for private split-dollar, the characterization could be a gift for gift tax purposes. In the case of a corporation and its shareholder, the characterization could be a distribution, which depending on the earnings and profits of the corporation could be taxed as a dividend, return of capital, etc. If the corporation is an S corporation the issue of the waiver, cancellation or forgiveness might trigger the risk of IRS characterizing the amount involved as a second class of stock, thereby jeopardizing the one-class of stock requirement for an S corporation.]***

(7) Change in the owner. If payments made by a non-owner to an owner ***[#e.g., from an employee to an employer when the employer owns the policy and the employees interest is evidenced by an endorsement of the death benefit in excess of the premiums advanced to a beneficiary designated by the employee.]*** were treated as split-dollar loans under §1.7872-15 and the split-dollar life insurance arrangement is modified such that, after the modification, the non-owner is the owner (within the meaning of paragraph (c)(1) of this section) of the life insurance contract under the arrangement, paragraphs (d) through (g) of this section apply to the split-dollar life insurance arrangement from the date of the modification. ***[#The employee who was the non-owner becomes the "owner" as defined in these regulations.]*** The payments made (both before and after the modification) are not treated as split-dollar loans under §1.7872-15 on or after the date of the modification. ***[#Again, this section seems to allow for reverse split dollar arrangements.]*** The non-owner of the life insurance contract under the modified split-dollar life insurance arrangement must fully take into account all economic benefits provided under the arrangement under paragraph (d) of this section on or after the date of the modification. For the treatment of a transfer of the contract when the unmodified arrangement is governed by paragraphs (d) through (g) of this section, see paragraph (g) of this section.

(c) Definitions. The following definitions apply for purposes of this section:

(1) Owner.

(i) In general. With respect to a life insurance contract, the person named as the policy owner of such contract generally is the owner of such contract. ***[#This is a simple bright line test, but does not govern many private split-dollar arrangements for purposes of the application of the economic benefit regulations because the provisions of (c)(1)(ii)(A)(1) override this general rule. Under this latter provision, if an***

ILIT is the owner named in the insurance contract and enters into a split-dollar agreement with the insured/grantor/Premium Payor, the insured/grantor/Premium Payor is treated as the owner under (c)(1)(ii)(A)(1) and that is the mechanism that causes the arrangement to be subject to the economic benefit regime. If two or more persons are named as policy owners of a life insurance contract and each person has, at all times, all the incidents of ownership with respect to an undivided interest in the contract, each person is treated as the owner of a separate contract to the extent of such person's undivided interest. ***[#This could occur if for example, two siblings owned a life insurance policy on a parent and both were named as co-owners]***. If two or more persons are named as policy owners of a life insurance contract but each person does not have, at all times, all the incidents of ownership with respect to an undivided interest in the contract, the person who is the first-named policy owner is treated as the owner of the entire contract. (ii) Special rule for certain arrangements.

(A) ***[#This section covers situations in which the arrangement is done by collateral assignment but is treated as economic benefit – since the term “owner” as previously defined refers to endorsement split-dollar – a cause for confusion without a close reading.]*** In general. Notwithstanding paragraph (c)(1)(i) of this section—

(1) An employer or service recipient is treated as the owner of a life insurance contract under a split-dollar life insurance arrangement that is entered into in connection with the performance of services if, at all times, the only economic benefit that will be provided under the arrangement is current life insurance protection as described in paragraph (d)(3) of this section; and

(2) A donor is treated as the owner of a life insurance contract under a split-dollar life insurance arrangement that is entered into between a donor and a donee (for example, a life insurance trust) if, at all times, the only economic benefit that will be provided under the arrangement is current life insurance protection as described in paragraph (d)(3) of this section.

(B) Modifications. If an arrangement described in paragraph (c)(1)(ii)(A) of this section ***[#i.e., the employer/donor is treated as the owner of the policy]*** is modified such that the arrangement is no longer described in paragraph (c)(1)(ii)(A) of this section, the following rules apply:

(1) If, immediately after such modification, the employer, service recipient, or donor is the owner of the life insurance contract under the split-dollar life insurance arrangement (determined without regard to paragraph (c)(1)(ii)(A) of this section), the employer, service recipient, or donor continues to be treated as the owner of the life insurance contract. ***[#Is still treated by the parties as an economic benefit arrangement.]***

(2) If, immediately after such modification, the employer, service recipient, or donor is not the owner of the life insurance contract under the split-dollar life insurance arrangement (determined without regard to paragraph (c)(1)(ii)(A) of this section), the employer, service recipient, or donor is treated as having made a transfer of the entire life insurance contract to the employee, service provider, or donee under the rules of paragraph (g) of this section as of the date of such modification. ***[#The modification changes the legal ownership of the policy – all the rights that inured to party who was the owner before the modification now inure to the new owner.]***

(3) For purposes of this paragraph (c)(1)(ii)(B), entering into a successor split-dollar life insurance arrangement that has the effect of providing any economic benefit in addition to that described in paragraph (d)(3) of this section is treated as a modification of the prior split-dollar life insurance arrangement.

(iii) Attribution rules for compensatory arrangements. For purposes of this section, if a split-dollar life insurance arrangement is entered into in connection with the performance of services, the employer or service recipient is treated as the owner of the life insurance contract if the owner (within the meaning of paragraph (c)(1)(i) of this section ***[#the person named as the policy***

owner...]) of the life insurance contract under the split-dollar life insurance arrangement is—

(A) A trust described in section 402(b);

(B) A trust that is treated as owned (within the meaning of sections 671 through 677) [**#Grantor trust**] by the employer or the service recipient;

(C) A welfare benefit fund within the meaning of section 419(e)(1); or

(D) A member of the employer or service recipient's controlled group (within the meaning of section 414(b)) or a trade or business that is under common control with the employer or service recipient (within the meaning of section 414(c)).

(iv) Life insurance contracts owned by partnerships. [Reserved]

(2) Non-owner.

(i) Definition. With respect to a life insurance contract, a non-owner is any person (other than the owner of such contract under paragraph (c)(1) of this section [**#the person named as the policy owner...**]) that has any direct or indirect interest in such contract [**#This issue is important because the non-owner is the taxpayer who may have to recognize income under the economics benefit regime, etc.**](but not including a life insurance company acting only in its capacity as the issuer of a life insurance contract).

(ii) Example. The following example illustrates the provisions of this paragraph (c)(2):

Example. (i) On January 1, 2009, Employer R and Trust T, an irrevocable life insurance trust that is not treated under sections 671 through 677 as owned by a grantor or other person, enter into a split-dollar life insurance arrangement in connection with the performance of services under which R will pay all the premiums on the life insurance contract until the termination of the arrangement or the death of E, an employee of R. C, the beneficiary of T, is E's child. R is the owner of the contract under paragraph (c)(1)(i) of this section. E is the insured under the life insurance contract. Upon termination of the arrangement or E's death, R is entitled to receive the lesser of the aggregate premiums or the policy cash value of the contract [**#This is an**

“equity” arrangement]and T will be entitled to receive any remaining amounts. Under the terms of the arrangement and applicable state law, the policy cash value is fully accessible by R and R’s creditors but T has the right to borrow or withdraw at any time the portion of the policy cash value exceeding the amount payable to R.

(ii) Because E and T each have an indirect interest in the life insurance contract that is part of the split-dollar life insurance arrangement, each is a non-owner under paragraph (c)(2)(i) of this section. E and T each are provided economic benefits described in paragraph (d)(2) of this section pursuant to the split-dollar life insurance arrangement. Economic benefits are provided by owner R to E as a payment of compensation, and separately provided by E [**#indirectly**] to T as a gift.

(3) Transfer of entire contract or undivided interest therein.

A transfer of the ownership of a life insurance contract (or an undivided interest in such contract) that is part of a split-dollar life insurance arrangement occurs on the date that a non-owner becomes the owner (within the meaning of paragraph (c)(1) of this section) of the entire contract or of an undivided interest in the contract.

(4) Undivided interest. An undivided interest in a life insurance contract consists of an identical fractional or percentage interest or share in each right, benefit, and obligation with respect to the contract [**#See comments above as to each owner with an identical interest being treated as an owner of a separate policy. See C. 1.i.**]. In the case of any arrangement purporting to create undivided interests where, in substance, the rights, benefits or obligations are shared to any extent among the holders of such interests, the arrangement will be treated as a split-dollar life insurance arrangement.

(5) Employment tax. The term employment tax means any tax imposed by, or collected under, the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA), the Railroad Retirement Tax Act (RRTA), and the Collection of Income Tax at Source on Wages.

(6) Self-employment tax. The term self-employment tax means the tax imposed by the Self-Employment Contributions Act of 1954 (SECA).

(d) Economic benefits provided under a split-dollar life insurance arrangement. [#If you treat a split-dollar arrangement under the economic benefit split-dollar paradigm, e.g. with a collateral assignment agreement securing the non-owner’s interests in the policy, the Regulations treat this as such, but getting there is a bit confusing. See****

comment above to the effect that if the arrangement quacks like a split-dollar duck then it is a split-dollar duck. The terminology used by Treasury in the following paragraph can be confusing. From an estate planning perspective, the application of the concept below (namely that the donor/Premium Payor/Insured in the context of a private or family non-equity split-dollar arrangement is deemed the "owner" rather than the ILIT, results in the applicability of the economic benefit regime since the deemed "owner" not the deemed non-owner (ILIT) is the Premium Payor. So it might quack like a duck, but it's a pretty odd duck! The terminology below seemingly fits the paradigm of an employer as owner and an employee as the non-owner, under an endorsement arrangement. Using that construct the employer owns the policy and lets the provision below employee assign a the excess of the death benefit over the amount due the employer (e.g., refund of premiums paid) to a beneficiary. The employee will receive an "economic benefit". When reading the following provision in the context of a private-split dollar arrangement between the insured/grantor and an ILIT, the terminology below of "owner" and "non-owner" is incongruous. Consider substitution in the following the term "owner" with "Premium Payor", for the person who pays the premiums, and for the term the "non-owner" with "Benefit Recipient", for the person who receives the economic benefit flowing from the split-dollar arrangement.]

(1) In general. In the case of a split-dollar life insurance arrangement subject to the rules of paragraphs (d) through (g) of this section, economic benefits are treated as being provided to the non-owner [*#i.e., "Benefit Recipient"*] of the life insurance contract [*#e.g., an ILIT is listed as the owner on the life insurance contract, and therefore owns the life insurance policy on the donor/insured. The ILIT would be the owner. The donor/insured who enters into a split-dollar arrangement and pays for a portion of the premiums, the donor/insured is the non-owner.*]. The non-owner [*#i.e. "Benefit Recipient"*] (and the owner for gift and employment tax purposes) must take into account the full value of all economic benefits described in paragraph (d)(2) of this section, [*#e.g. the value of term insurance coverage on an annual basis, even if the policy held by the ILIT as owner and paid in part for by the donor as non-owner was permanent coverage.*] reduced by the consideration paid directly or indirectly by the non-owner to the owner [*# i.e., "Premium Payor"*] for those economic benefits [*e.g. the ILIT could pay the Table 2001 term insurance costs for the coverage, in which case the economic benefit would equal the consideration paid by the owner and no net economic benefit, gift, would occur from the non-owner donor/insured to the owner ILIT*]. Depending on the relationship between the owner and the non-owner, the economic benefits may constitute a payment of compensation, a distribution under section 301 [*e.g. a dividend to the extent of earnings and profits*], a contribution

to capital, a gift [**#e.g., in the context of private split-dollar arrangements**], or a transfer having a different tax character. Further, depending on the relationship between or among a non-owner [**#i.e., “Benefit Recipient”**] and one or more other persons (including a non-owner or non-owners), the economic benefits may be treated as provided from the owner to the non-owner and as separately provided from the non-owner to such other person or persons (for example, as a payment of compensation from an employer to an employee and as a gift from the employee to the employee's child) [**#e.g., in the private-split dollar estate planning context if an employer pays for all of the premiums on life insurance owned by an ILIT for the employee and for which employee was grantor, then the payment would constitute income from employer to employee and then a gift from the employee to the ILIT.**] (2) **Value of economic benefits.** The value of the economic benefits provided to a non-owner for a taxable year [**#The measurement period is each taxable year**] under the arrangement equals—

(i) The cost of current life insurance protection provided to the non-owner [**#i.e., “Benefit Recipient”**] as determined under paragraph (d)(3) of this section;

(ii) The amount of policy cash value to which the non-owner has current access within the meaning of paragraph (d)(4)(ii) of this section (to the extent that such amount was not actually taken into account for a prior taxable year) [**#This was an issue that concerned the IRS in the employment context. An employer would establish a split-dollar arrangement with an employee. The employee could pay the current term cost of the insurance benefit received and avoid any current income taxation as compensation. Under prior law, the employee could then borrow the cash surrender value inside the policy and thus access this value without a current tax consequence. This is changed by requiring the employee to recognize income, typically compensation income, as soon as the employee can access the cash value. This issue can also arise in the context of what is known as the “fifth dividend option” in which the dividends are reinvested in additional term insurance coverage. This too can be characterized as an economic benefit to the employee that triggers current income taxation.**]; and

(iii) The value of any economic benefits not described in paragraph (d)(2)(i) or (ii) of this section provided to the non-owner (to the extent not actually taken into account for a prior taxable year). [**#This is the old kitchen sink provision.**]

(3) Current life insurance protection. [#The basic concept that is the foundation of the economic benefit paradigm in these regulations is that if the Benefit Recipient pays the cost of one year of term life insurance, then for the particular taxable year in question the Benefit Recipient will not generally receive any Economic Benefit even though the actual insurance cost is much higher and advanced by the Premium Payor. Thus, there will generally not be any current tax consequence of the split-dollar arrangement. The determination of what that term insurance cost is, depends on when the split-dollar arrangement, became effective, whether it was materially modified, and other factors. For most current arrangements the Table 2001 term rates promulgated by the IRS are used to determine the value of the current term protection. Since the touchstone is a hypothetical benchmark the actual real benefit to the Benefit Recipient can be substantially greater. For example, if the insured has health issues and is rated the actual real term cost would be substantially greater, but nevertheless under the Economic Benefit paradigm of these Regulations the Benefit Recipient will not have an incremental tax consequence because of this.]

(i) Amount of current life insurance protection. In the case of a split-dollar life insurance arrangement described in paragraph (d)(1) of this section, the amount of the current life insurance protection provided to the non-owner ***[#read "Benefit Recipient"]*** for a taxable year (or any portion thereof in the case of the first year or the last year of the arrangement) equals the excess of the death benefit of the life insurance contract (including paid-up additions thereto) over the total amount payable to the owner ***[#read "Premium Payor"]***(including any outstanding policy loans that offset amounts otherwise payable to the owner) under the split-dollar life insurance arrangement, less the portion of the policy cash value actually taken into account under paragraph (d)(1) of this section or paid for by the non-owner ***[#read "Benefit Recipient"]***under paragraph (d)(1) of this section for the current taxable year or any prior taxable year.

(ii) Cost of current life insurance protection. The cost of current life insurance protection provided to the non-owner for any year (or any portion thereof in the case of the first year or the last year of the arrangement) equals the amount of the current life insurance protection provided to the non-owner ***[#read "Benefit Recipient"]*** (determined under paragraph (d)(3)(i) of this section) multiplied by the life insurance premium factor designated or permitted in guidance published in the Internal Revenue Bulletin (see §601.601(d)(2)(ii) of this chapter). ***[#This is generally for post-2003 Regulation split-dollar arrangements the Table***

2001 Rate per thousand multiplied by the number of thousands of life insurance coverage.]

(4) Policy cash value.

(i) In general. For purposes of this paragraph (d), policy cash value is determined disregarding surrender charges or other similar charges or reductions. Policy cash value includes policy cash value attributable to paid-up additions. **[#See discussion above concerning concerns the IRS had with employer/employee split-dollar arrangements providing employees purportedly tax free access to cash value in a policy owned by the employer. If additional insurance is purchased for the employee this use of cash value is in reality an additional economic benefit to the employee and will accordingly be treated as compensation income.]**

(ii) Current access. For purposes of this paragraph (d), a non-owner has current access to that portion of the policy cash value—

(A) To which, under the arrangement, the non-owner has a current or future right; and

(B) That currently is directly or indirectly accessible by the non-owner, inaccessible to the owner, or inaccessible to the owner's general creditors. **[#This is written in the disjunctive so that any one of the three criteria: accessibility to the employee/Benefit Recipient; or inaccessible to the employer/owner/Premium Payor; or inaccessible to the employer/owner/Premium Payor's creditors will suffice.]**

(5) Valuation date.

(i) General rules. For purposes of this paragraph (d), the amount of the current life insurance protection and the policy cash value shall be determined on the same valuation date. The valuation date is the last day of the non-owner's **[#read Benefit Recipient's]** taxable year **[#this will typically be December 31]**, unless the owner and non-owner agree to instead use the policy anniversary date as the valuation date. Notwithstanding the previous sentence, if the split-dollar life insurance arrangement terminates during the taxable year of the non-owner, the value of such economic benefits is determined on the day that the arrangement terminates.

(ii) Consistency requirement. The owner and non-owner of the split-dollar life insurance arrangement must use the same valuation date. In addition, the same valuation date must be used for all years prior to termination of the split-dollar life insurance arrangement unless the parties receive consent of the Commissioner to change the valuation date.

(iii) Artifice or device. Notwithstanding paragraph (d)(5)(i) of this section, if any artifice or device is used to understate the amount of any economic benefit on the valuation date in paragraph (d)(5)(i) of this section, then, for purposes of this paragraph (d), the date on which the amount of the economic benefit is determined is the date on which the amount of the economic benefit is greatest during that taxable year. ***[#This is another kitchen sink provision, but with a vengeance. A clear IRS objective in the Regulations was to preclude areas of perceived abuse that had developed under the umbrella of split-dollar as aggressively expanded by some taxpayers, not to undermine the use of the technique. The Regulations are replete with admonitions against what the IRS considered abusive behavior. For taxpayers, navigating between Scylla and Charybdis of these provisions is the key to split-dollar success.]***

(iv) Special rule for certain taxes. For purposes of employment tax (as defined in paragraph (c)(5) of this section), self-employment tax (as defined in paragraph (c)(6) of this section), and sections 6654 and 6655 (relating to the failure to pay estimated income tax), the portions of the current life insurance protection and the policy cash value that are treated as provided by the owner ***[#read employer or more generally the Premium Payor]*** to the non-owner ***[#read employee or more generally the Benefit Recipient]*** shall be treated as so provided on the last day of the taxable year of the non-owner ***[#For most employees and trusts this will be December 31.]*** Notwithstanding the previous sentence, if the split-dollar life insurance arrangement terminates during the taxable year of the non-owner, such portions of the current life insurance protection and the policy cash value shall be treated as so provided on the day that the arrangement terminates.

(6) Examples. The following examples illustrate the rules of this paragraph (d). Except as otherwise provided, both examples assume the following facts: employer (R) is the owner ***[#Read "Premium Payor".]*** (as defined in paragraph (c)(1)(i) of this section) and employee (E) is the non-owner ***[#Read "Benefit Recipient".]*** (as defined in paragraph (c)(2)(i) of this section) of a life insurance contract that is part of a split-

dollar life insurance arrangement that is subject to the provisions of paragraphs (d) through (g) of this section [**#i.e., not subject to the 7872-15 Regulations governing split-dollar loan arrangements**]; the contract is a life insurance contract as defined in section 7702 and not a modified endowment contract as defined in section 7702A [**#This refers to modified endowment contracts, or more affectionately "MECs", which include single-premium policies and other policies under which substantially all of the premiums are paid in the first few years of the contract. earnings. Distributions (including loans) from MEC policies are treated first as income, then as a return of the owner's investment in the MEC contract.**]; R does not withdraw or obtain a loan of any portion of the policy cash value and does not surrender any portion of the life insurance contract; the compensation paid to E is reasonable [**#This point raises an issue to be cautious of in planning employment related split-dollar arrangements especially in closely held businesses. The business will not be able to disguise what would otherwise be unreasonable or excessive compensation as split-dollar economic benefits and avoid the tax, or legal, consequences of excessive compensation. This comment suggests that the economic benefits under a split-dollar arrangement should be aggregated with all other compensation for purposes of determining whether or not overall compensation is unreasonable or excessive.**]; E is not provided any economic benefits described in paragraph (d)(2)(iii) of this section; E does not make any premium payments [**#which means that the employee will at minimum be receiving an economic benefit equivalent to the term cost of the insurance coverage involved, e.g., as calculated under Table 2001**]; E's taxable year is the calendar year; the value of the economic benefits is determined on the last day of E's taxable year [**#it could have, under (d)(5)(i) been the policy anniversary date, but this example used the tax year**]; and E reports on E's Federal income tax return for each year that the split-dollar life insurance arrangement is in effect the amount of income required to be reported under paragraph (d) of this section. The examples are as follows:

Example (1). (i) Facts. On January 1 of year 1, R and E enter into the split-dollar life insurance arrangement. Under the arrangement, R pays all of the premiums [**#Since the employer is paying 100% of the premiums there has to be an economic benefit to the employee of the Table 2001 (or other) term cost, and this benefit in the employment context would be taxable as compensation income to the employee**] on the life insurance contract until the termination of the arrangement or E's death. The arrangement provides that upon termination of the arrangement or E's death, R is entitled to receive the lesser of the aggregate premiums paid or the policy cash value of the contract [**#This is an "equity" type arrangement in that the excess of cash value over aggregate premiums will, if any, will inure to**

the benefit of the employee] and E is entitled to receive any remaining amounts. Under the terms of the arrangement and applicable state law, the policy cash value is fully accessible by R and R's creditors ***[#this violates two of the three criteria in Regulation Section (d)(4)(ii)(B), above]*** but E has the right to borrow or withdraw at any time the portion of the policy cash value exceeding the amount payable to R. To fund the arrangement ***[#this makes the cash value accessible by the employee, and hence the increase in the cash surrender value in any year will be taxable as available, see Regulation Section (d)(4)(ii)(B)]***, R purchases a life insurance contract with constant death benefit protection equal to \$1,500,000 ***[#The constant death benefit structure means that as the amount due the employer from the policy increases to repay the employer as Premium Payor for the aggregate premiums advanced, the value of the net insurance coverage to the employee will decrease over time]***. R makes premium payments on the life insurance contract of \$60,000 in each of years 1, 2, and 3. The policy cash value equals \$55,000 as of December 31 of year 1, \$140,000 ***[#as compared to the \$120,000 of premiums paid in years 1 and 2 the cash value exceeds premiums and the repayment to the employer is limited to the \$120,000 (\$60,000 x 2) advanced. The \$20,000 excess, according to the facts, should be "accessible" to the employee and have a compensation tax consequence.]*** as of December 31 of year 2, and \$240,000 as of December 31 of year 3.

(ii) Analysis. Under the terms of the split-dollar life insurance arrangement, E has the right for year 1 and all subsequent years to borrow or withdraw the portion of the policy cash value exceeding the amount payable to R. Thus, under paragraph (d)(4)(ii) of this section, E has current access to such portion of the policy cash value for each year that the arrangement is in effect. In addition, because R pays all of the premiums on the life insurance contract, R provides to E all of the economic benefits that E receives under the arrangement. Therefore, under paragraph (d)(1) of this section, E includes in gross income the value of all economic benefits described in paragraphs (d)(2)(i) and (ii) of this section provided to E under the arrangement.

(iii) Results for year 1. For year 1, E is provided, under paragraph (d)(2)(ii) of this section, \$0 of policy cash value (excess of \$55,000 policy cash value determined as of December 31 of year 1 over \$55,000 payable to R ***[#note that only \$55,000 is deemed payable to the employer because the cash surrender value is under the \$60,000 in premiums paid by the employer]***). For year 1, E is also provided, under paragraph (d)(2)(i) of this section, current life insurance protection of \$1,445,000 (\$1,500,000 minus \$55,000 payable to R). Thus, E includes in gross income for year 1 the cost of \$1,445,000 of current life insurance protection. ***[#Generally, under a post-2003 Regulation regime this***

cost will be calculated based on the insurance rates per thousand dollars of insurance coverage from the Table 2001.]

(iv) Results for year 2. For year 2, E is provided, under paragraph (d)(2)(ii) of this section, \$20,000 of policy cash value (\$140,000 policy cash value determined as of December 31 of year 2 minus \$120,000 payable to R) ***[#This \$20,000 is perhaps not "provided" but is "accessible" under Regulation Section (d)(4)(ii)(B) by the employee via the employee's right, for example, to borrow or withdraw the cash surrender value in the policy in excess of the amounts due to be repaid to the employer, which is \$20,000 in year 2.]*** For year 2, E is also provided, under paragraph (d)(2)(i) of this section, current life insurance protection of \$1,360,000 (\$1,500,000 minus the sum of \$120,000 payable to R and the aggregate of \$20,000 of policy cash value that E actually includes in income on E's year 1 and year 2 federal income tax returns). Thus, E includes in gross income for year 2 the sum of \$20,000 of policy cash value and the cost of \$1,360,000 of current life insurance protection. ***[#as noted above for post-2003 Regulation split-dollar economic benefit arrangements this will be calculated from the Table 2001 rates. Also, note that if the aggregate of regular compensation paid to employee, plus the \$20,000, plus the Table 2001 rate for the \$1,360,000 life insurance coverage in aggregate exceed what is "reasonable compensation" to employee, there may be additional adverse tax consequences. See language in Regulation Section (d)(6) above and comments on that provision. If the employer was an S corporation and employee were also a shareholder, there could be the risk of a second class of stock being created.]***

(v) Results for year 3. For year 3, E is provided, under paragraph (d)(2)(ii) of this section, \$40,000 of policy cash value (\$240,000 policy cash value determined as of December 31 of year 3 minus the sum of \$180,000 payable to R and \$20,000 of aggregate policy cash value that E actually included in gross income on E's year 1 and year 2 federal income tax returns). For year 3, E is also provided, under paragraph (d)(2)(i) of this section, current life insurance protection of \$1,260,000 (\$1,500,000 minus the sum of \$180,000 payable to R ***[#\$60,000 annual premium x 3 years of payments]*** and \$60,000 of aggregate policy cash value that E actually includes in gross income on E's year 1, year 2, and year 3 federal income tax returns). Thus, E includes in gross income for year 3 the sum of \$40,000 of policy cash value ***[#actual cash value in year 3 per the example was \$240,000, but \$180,000 is due to employer in repayment of the premiums paid, leaving \$60,000 of cash value. This amount is reduced by the \$20,000 of cash surrender value that was included in employee's income in year 2 as discussed above. Thus, the net is \$40,000.]*** and the cost of \$1,260,000 of current life insurance protection.

Example (2). (i) Facts. The facts are the same as in Example 1 [**# 'cause that was so much fun why not do more!**] except that E cannot directly or indirectly access any portion of the policy cash value, but the terms of the split-dollar life insurance arrangement or applicable state law provide that the policy cash value in excess of the amount payable to R is inaccessible to R's general creditors. [**# Recall that in the earlier in this Regulations, in Section (d)(4)(ii)(B), there were three disjunctive factors to be considered in determining whether the employee had access to a policy cash value for purposes of causing inclusion in the employee's income. The three factors are: cash value that currently is directly or indirectly accessible by the non-owner, inaccessible to the owner, or, the factor noted here, inaccessible to the owner's general creditors.**].

(ii) Analysis. Under the terms of the split-dollar life insurance arrangement or applicable state law, the portion of the policy cash value exceeding the amount payable to R is inaccessible to R's general creditors and E has a current or future right to that portion of the cash value. Thus, under paragraph (d)(4)(ii) of this section, E has current access to such portion of the policy cash value for each year that the arrangement is in effect. In addition, because R pays all of the premiums on the life insurance contract, R provides to E all of the economic benefits that E receives under the arrangement. Therefore, under paragraph (d)(1) of this section, E includes in gross income the value of all economic benefits described in paragraphs (d)(2)(i) and (ii) of this section provided to E under the arrangement. [**# This means the employee includes in income as compensation income the value, in most instances, under applicable IRS tables, now Table 2001, of the current insurance protection, and the cash value in excess of the premiums to be repaid to the employer, and in excess of cash values included in the employee's income in prior years.**].

(iii) Results for years 1, 2 and 3. The results for this example are the same as the results in Example 1.

(e) Amounts received under the contract.

(1) In general. Except as otherwise provided in paragraph (f)(3) of this section, any amount received under a life insurance contract that is part of a split-dollar life insurance arrangement subject to the rules of paragraphs (d) through (g) of this section (including, but not limited to, a policy owner dividend, proceeds of a specified policy loan described in paragraph (e)(2) of this section, or the proceeds of a withdrawal from or partial surrender of the life insurance contract) is treated, to the extent provided directly or indirectly to a non-owner [**# e.g. the ILIT in a traditional private or family split-dollar arrangement with the insured/Premium Payor/"owner" being the deemed the "owner**

under the preceding sections of this Regulation’] of the life insurance contract, as though such amount had been paid to the owner of the life insurance contract and then paid by the owner to the non-owner. The amount received is taxable to the owner in accordance with the rules of section 72 [***# IRC Sec. 72(a) provides that gross income includes any amount received ...under a... life insurance contract. Gross income does not include that part of any amount received as an annuity under a ... life insurance contract which bears the same ratio to such amount as the investment in the contract ... bears to the expected return under the contract...IRC Sec. 72(b)(1)***]. The non-owner (and the owner for gift tax and employment tax purposes) must take the amount described in paragraph (e)(3) of this section into account as a payment of compensation, a distribution under section 301, a contribution to capital, a gift, or other transfer depending on the relationship between the owner and the non-owner. [***#See discussion above. Generally, employees recognize compensation income, shareholders dividend income and donors a gift tax consequence***].

(2) Specified policy loan. A policy loan [***This refers to a loan from the insurance company to the owner of the cash surrender value and not a loan from a third party like an employer to fund premiums.***] is a specified policy loan to the extent—

- (i) The proceeds of the loan are distributed directly from the insurance company to the non-owner
- (ii) A reasonable person would not expect that the loan will be repaid by the non-owner; or
- (iii) The non-owner's obligation to repay the loan to the owner is satisfied or is capable of being satisfied upon repayment by either party to the insurance company.

(3) Amount required to be taken into account. With respect to a non-owner (and the owner for gift tax and employment tax purposes, the amount described in this paragraph (e)(3) is equal to the excess of—

- (i) The amount treated as received by the owner under paragraph (e)(1) of this section; over
- (ii) The amount of all economic benefits described in paragraphs (d)(2)(ii) and (iii) of this section actually taken into account by the non-owner (and the owner for gift tax and employment tax purposes) plus any consideration described in paragraph (d)(1) of this section paid by the non-owner for such economic benefits described in paragraphs (d)(2)(ii) and (iii) of this section. The amount determined under the preceding sentence applies only to the extent that neither this paragraph (e)(3)(ii) nor paragraph

(g)(1)(ii) of this section previously has applied to such economic benefits.

(f) Other tax consequences.

(1) Introduction. In the case of a split-dollar life insurance arrangement subject to the rules of paragraphs (d) through (g) of this section, this paragraph (f) sets forth other tax consequences to the owner and non-owner of a life insurance contract that is part of the arrangement for the period prior to the transfer (as defined in paragraph (c)(3) of this section) of the contract (or an undivided interest therein) from the owner to the non-owner. See paragraph (g) of this section and §1.83-6(a)(5) [**# “In the case of a transfer of a life insurance contract (or an undivided interest therein) described in §1.61-22(c)(3) in connection with the performance of services, a deduction is allowable under paragraph (a)(1) of this section to the person for whom the services were performed. The amount of the deduction, if allowable, is equal to the sum of the amount included as compensation in the gross income of the service provider under...”**”] for tax consequences upon the transfer of the contract (or an undivided interest therein).

(2) Investment in the contract.

(i) To the non-owner. A non-owner [**# Read “Benefit Recipient”**] does not receive any investment in the contract under section 72(e)(6) with respect to a life insurance contract that is part of a split-dollar life insurance arrangement subject to the rules of paragraphs (d) through (g) of this section [**# Conceptually this makes sense since the Benefit Recipient, e.g., the ILIT will likely be paying only the hypothetical term cost while the Premium Payor will be paying the differential of the total actual cost over the hypothetical term cost. If the non-owner or Benefit Recipient is only paying a one-year term cost there should be no logic behind any basis in the contract being created for that party**].

(ii) To owner. Any premium paid by an owner [**# Read “Premium Payor”**] under a split-dollar life insurance arrangement subject to the rules of paragraphs (d) through (g) of this section is included in the owner's investment in the contract under section 72(e)(6). No premium or amount described in paragraph (d) of this section is deductible by the owner (except as otherwise provided in §1.83-6(a)(5)). Any amount paid by a non-owner [**#Read “Benefit Recipient”**], directly or indirectly, to the owner of the life insurance contract for current life insurance protection or for any other economic benefit under the life insurance contract is

included in the owner's gross income and is included in the owner's investment in the life insurance contract for purposes of section 72(e)(6) (but only to the extent not otherwise so included by reason of having been paid by the owner as a premium or other consideration for the contract). ***[The owner has basis in the life insurance policy equal to the entire policy premium payments. The non-owner in an economic benefit arrangement never has basis.]***

(3) Treatment of death benefit proceeds. [#In general, the provisions following confirm that the general intended outcome that life insurance proceeds are income tax free, should be achieved, absent other circumstances to the contrary. Thus, a split-dollar arrangement will generally not taint otherwise tax free life insurance proceeds as taxable.]

(i) Death benefit proceeds to beneficiary (other than the owner) ***[#In a non-equity split-dollar arrangement this is the employee or the ILIT.]*** Any amount paid to a beneficiary (other than the owner) by reason of the death of the insured is excluded from gross income by such beneficiary under section 101(a) as an amount received under a life insurance contract to the extent such amount is allocable to current life insurance protection provided to the non-owner pursuant to the split-dollar life insurance arrangement ***[#IRC Sec. 101(a)(1): gross income does not include amounts received (whether in a single sum or otherwise) under a life insurance contract, if such amounts are paid by reason of the death of the insured.]***, the cost of which was paid by the non-owner ***[#If the employee or ILIT pays for the term cost of the insurance they the cost of the life insurance protection was paid for and no income or gift will result.]***, or the value of which the non-owner actually took into account pursuant to paragraph (d)(1) of this section. ***[#if the employee, for example, pays nothing, unless that term cost was included in the employee's income, the employee's beneficiaries could recognize income on receipt of the insurance proceeds.]***

(ii) Death benefit proceeds to owner ***[#Read "Premium Payor", e.g., the donor in a private split-dollar arrangement where the donor/grantor/insured/owner enters into a split-dollar agreement with his or her ILIT.]*** as beneficiary. Any amount paid or payable to an owner in its capacity as a beneficiary by reason of the death of the insured is excluded from gross income of the owner under section 101(a) as an amount received under a life insurance contract to the extent such amount is not allocable to current life insurance protection provided to the non-owner

pursuant to the split-dollar life insurance arrangement, the cost of which was paid by the non-owner, or the value of which the non-owner actually took into account pursuant to paragraph (d)(1) of this section.

(iii) Transfers of death benefit proceeds. Death benefit proceeds paid to a party to a split-dollar life insurance arrangement (or the estate or beneficiary of that party) that are not excludable from that party's income under section 101(a) to the extent provided in paragraph (f)(3)(i) or (ii) of this section, are treated as transferred to that party in a separate transaction. **[#e.g., if a child or ILIT of an employee were to receive the death benefits pursuant to the split-dollar arrangement, if income had to be recognized, the employee or the employee's estate would first recognize income, then there would be deemed a further transfer from the employee's estate to that named beneficiary. This is consistent with the concepts contained in earlier provisions of these Regulations.]** The death benefit proceeds treated as so transferred will be taxed in a manner similar to other transfers. For example, if death benefit proceeds paid to an employee, the employee's estate, or the employee's beneficiary are not excludable from the employee's gross income under section 101(a) to the extent provided in paragraph (f)(3)(i) of this section, then such payment is treated as a payment of compensation by the employer to the employee. **[#In the context of a shareholder, the treatment would be a distribution generally taxed as a dividend. In the context of a private split-dollar arrangement the tax characterization would be as a gift.]**

(g) Transfer of entire contract or undivided interest therein.

(1) In general. Upon a transfer within the meaning of paragraph (c)(3) of this section of a life insurance contract (or an undivided interest therein) to a non-owner (transferee), the transferee (and the owner (transferor) for gift tax and employment tax purposes) **[#For example, the donor/grantor/insured/owner transfers a policy or interest in a policy to the ILIT.]** takes into account the excess of the fair market value of the life insurance contract (or the undivided interest therein) transferred to the transferee at that time over the sum of—

(i) The amount the transferee pays to the transferor to obtain the contract (or the undivided interest therein); and

(ii) The amount of all economic benefits described in paragraph (d)(2)(ii) and (iii) of this section actually taken into account by the transferee (and the transferor for gift tax and employment tax

purposes), plus any consideration described in paragraph (d)(1) of this section paid by the transferee for such economic benefits described in paragraphs (d)(2)(ii) and (iii) of this section. The amount determined under the preceding sentence applies only to the extent that neither this paragraph (g)(1)(ii) nor paragraph (e)(3)(ii) of this section previously has applied to such economic benefits. ***[#If the donor/grantor/insured/"owner" transfers a policy to the ILIT there will be a gift tax consequence based on the fair value of the policy reduced by anything the ILIT either pays the donor/grantor, or amounts the ILIT previously had to recognize under these regulations (e.g., the amount of policy cash value to which the non-owner/ILIT had access in prior taxable years).]***

(2) Determination of fair market value. For purposes of paragraph (g)(1) of this section, the fair market value of a life insurance contract is the policy cash value and the value of all other rights under such contract (including any supplemental agreements thereto and whether or not guaranteed), other than the value of current life insurance protection ***[#The value of current life insurance protection is excluded from the policy value because under the paradigm of the economic benefit split-dollar regulations would be paid for, or included in the income of, the Benefit Recipient.]*** Notwithstanding the preceding sentence, the fair market value of a life insurance contract for gift tax purposes is determined under §25.2512-6(a) of this chapter. ***[#This Regulation provides that 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...]***

(3) Exception for certain transfers in connection with the performance of services. To the extent the ownership of a life insurance contract (or undivided interest in such contract) is transferred in connection with the performance of services, paragraph (g)(1) of this section does not apply until such contract (or undivided interest in such contract) is taxable under section 83. ***[#If a life insurance policy on***

the life of the employee is transferred to the employee, any cash surrender value in excess of the amount payable to the employer (e.g., as a return of premiums advanced by the employer), plus amounts previously included in the employee's income (e.g., on account of cash value that was previously accessible to the employee), will be taxed under IRC Sec. 83. For purposes of paragraph (g)(1) of this section, fair market value is determined disregarding any lapse restrictions and at the time the transfer of such contract (or undivided interest in such contract) is taxable under section 83.

(4) Treatment of non-owner after transfer.

(i) In general. After a transfer of an entire life insurance contract (except when such transfer is in connection with the performance of services and the transfer is not yet taxable under section 83), the person who previously had been the non-owner is treated as the owner of such contract for all purposes ***[#e.g., the employee, shareholder, or ILIT become the owner under the economic benefit paradigm.]*** including for purposes of paragraph (b) of this section and for purposes of §1.61-2(d)(2)(ii)(A). After the transfer of an undivided interest in a life insurance contract (or, if later, at the time such transfer is taxable under section 83), the person who previously had been the non-owner is treated as the owner of a separate contract consisting of that interest for all purposes, including for purposes of paragraph (b) of this section and for purposes of §1.61-2(d)(2)(ii)(A).

(ii) Investment in the contract after transfer.

(A) In general. The amount treated as consideration paid to acquire the contract under section 72(g)(1) ***[# IRC Sec. 72(g) provides: "Where any contract (or any interest therein) is transferred (by assignment or otherwise) for a valuable consideration, to the extent that the contract (or interest therein) does not, in the hands of the transferee, have a basis which is determined by reference to the basis in the hands of the transferor, then...." IRC Sec. 72(g)(1) provides: "(1) for purposes of this section , only the actual value of such consideration, plus the amount of the premiums and other consideration paid by the transferee after the transfer, shall be taken into account in computing the aggregate amount of the premiums or other consideration paid for the contract."]*** in order to determine the aggregate premiums paid by the transferee for purposes of section 72(e)(6)(A) after the transfer (or, if

later, at the time such transfer is taxable under section 83), equals the greater of the fair market value of the contract or the sum of the amounts determined under paragraphs (g)(1)(i) and (ii) of this section.

(B) Transfers between a donor and a donee. In the case of a transfer of a contract between a donor and a donee, the amount treated as consideration paid by the transferee to acquire the contract under section 72(g)(1), in order to determine the aggregate premiums paid by the transferee for purposes of section 72(e)(6)(A) after the transfer, equals the sum of the amounts determined under paragraphs (g)(1)(i) and (ii) of this section [***#actual payments for the policy and economic benefits recognized as income.***] except that—

(1) The amount determined under paragraph (g)(1)(i) of this section includes the aggregate of premiums or other consideration paid or deemed to have been paid by the transferor [***#The transferor is the donor/grantor/insured in many private split-dollar arrangements.***]; and

(2) The amount of all economic benefits determined under paragraph (g)(1)(ii) of this section actually taken into account by the transferee does not include such benefits to the extent such benefits were excludable from the transferee's gross income at the time of receipt.

(C) Transfers of an undivided interest in a contract. If a portion of a contract is transferred to the transferee, then the amount to be included as consideration paid to acquire the contract is determined by multiplying the amount determined under paragraph (g)(4)(ii)(A) [***#consideration paid***] of this section (as modified by paragraph (g)(4)(ii)(B) of this section, if the transfer is between a donor and a donee) by a fraction, the numerator of which is the fair market value of the portion transferred and the denominator of which is the fair market value of the entire contract.

(D) Example. The following example illustrates the rules of this paragraph (g)(4)(ii):

Example. (i) In year 1, donor D and donee E enter into a split-dollar life insurance arrangement as defined in

paragraph (b)(1) of this section. D is the owner of the life insurance contract under paragraph (c)(1) of this section. The life insurance contract is not a modified endowment contract as defined in section 7702A [**#See MEC discussion above**]. In year 5, D gratuitously transfers the contract, within the meaning of paragraph (c)(3) of this section, to E. At the time of the transfer, the fair market value of the contract is \$200,000 and D had paid \$50,000 in premiums under the arrangement. In addition, by the time of the transfer, E had current access to \$80,000 of policy cash value which was excludable from E's gross income under section 102 [**# IRC Sec. 102(a) provides: "Gross income does not include the value of property acquired by gift, bequest, devise, or inheritance."**].

(ii) E's investment in the contract is \$50,000, consisting of the \$50,000 of premiums paid by D. The \$80,000 of policy cash value to which E had current access is not included in E's investment in the contract because such amount was excludable from E's gross income when E had current access to that policy cash value.

(iii) No investment in the contract for current life insurance protection. Except as provided in paragraph (g)(4)(ii)(B) of this section, no amount allocable to current life insurance protection provided to the transferee (the cost of which was paid by the transferee or the value of which was provided to the transferee) is treated as consideration paid to acquire the contract under section 72(g)(1) to determine the aggregate premiums paid by the transferee for purposes of determining the transferee's investment in the contract under section 72(e) after the transfer [**# This latter rule is fair and logical in that the donee, perhaps an ILIT, paid for current term protection and that amount would theoretically expire each year and not provide basis.**].

(h) Examples. The following examples illustrate the rules of this section. Except as otherwise provided, each of the examples assumes that the employer (R) is the owner (as defined in paragraph (c)(1) of this section) **#This latter result is not the common approach in private split-dollar utilized in estate planning in that the typical arrangement would have an ILIT as the owner under paragraph (c)(1) based on the ILIT being listed as the owner, however, under paragraph (c)(1)(ii)(A)(1), the "owner" for purposes of these economic benefit regulations would in fact be deemed to be the insured/grantor/Premium Payor.**]of a life insurance contract that is part of a split-dollar life insurance arrangement subject to the rules of paragraphs

(d) through (g) of this section, that the employee (E) is not provided any economic benefits described in paragraph (d)(2)(iii) of this section, that the life insurance contract is not a modified endowment contract under section 7702A, that the compensation paid to E is reasonable, and that E makes no premium payments [***#This latter assumption is not the common approach in private split-dollar utilized in estate planning in that the typical arrangement would be for the ILIT to pay the cost of annual term coverage, e.g., as determined under Table 2001.***]. The examples are as follows:

Example (1). (i) In year 1, R purchases a life insurance contract on the life of E. R is named as the policy owner of the contract. R and E enter into an arrangement under which R will pay all the premiums [***#So that this will be an economic benefit to the Employee=E.***] on the life insurance contract until the termination of the arrangement or E's death. Upon termination of the arrangement or E's death, R is entitled to receive the greater of the aggregate premiums or the policy cash value of the contract [***#So that this is a non-equity arrangement.***]. The balance of the death benefit will be paid to a beneficiary designated by E.

(ii) Because R is designated as the policy owner of the contract, R is the owner of the contract under paragraph (c)(1)(i) of this section. In addition, R would be treated as the owner of the contract regardless of whether R were designated as the policy owner under paragraph (c)(1)(i) of this section because the split-dollar life insurance arrangement is described in paragraph (c)(1)(ii)(A)(1) of this section. E is a non-owner of the contract. Under the arrangement between R and E, a portion of the death benefit is payable to a beneficiary designated by E. The arrangement is a split-dollar life insurance arrangement under paragraph (b)(1) or (2) of this section. Because R pays all the premiums on the life insurance contract, R provides to E the entire amount of the current life insurance protection E receives under the arrangement. Therefore, for each year that the split-dollar life insurance arrangement is in effect, E must include in gross income under paragraph (d)(1) of this section the value of current life insurance protection described in paragraph (d)(2)(i) of this section provided to E in each year [***#Generally, until further IRS guidance/tables are forthcoming, this will generally be the amount determined under Table 2001.***]

Example (2). (i) The facts are the same as in Example 1 except that, upon termination of the arrangement or E's death, R is entitled to receive the lesser of the aggregate premiums or the policy cash value of the contract [***#This change in facts converts what was a non-equity arrangement into an equity split-dollar arrangement.***] Under the terms of the arrangement and applicable state law, the policy cash value is fully accessible by R and R's creditors but E has the right to borrow or withdraw at any time the portion of the policy cash value exceeding the amount payable to R. [***#The right to borrow against or withdraw the cash value makes that amount accessible to the employee and hence subject to income taxation.***]

(ii) Because R is designated as the policy owner, R is the owner of the contract under paragraph (c)(1)(i) of this section. E is a non-owner of the contract. For each year that the split-dollar life insurance arrangement is in effect, E has the right to borrow or withdraw at any time the portion of the policy cash value exceeding the amount payable to R. Thus, under paragraph (d)(4)(ii) of this section, E has current access to such portion of the policy cash value for each year that the arrangement is in effect. [**“Current access” is the moniker for the mechanism that endeavors to tax the Benefit Recipient at the earliest possible time the cash surrender value in a policy can be reached.**] In addition, because R pays all the premiums on the life insurance contract, R provides to E all the economic benefits that E receives under the arrangement. Therefore, for each year that the split-dollar life insurance arrangement is in effect, E must include in gross income under paragraph (d)(1) of this section, the value of all economic benefits described in paragraph (d)(2)(i) and (ii) of this section provided to E in each year [**The employee reports the value of the term coverage, e.g., as determined under Table 2001, and the incremental cash value that the employee can reach that has not previously been taxed in the employee’s income.**].

Example (3). (i) The facts are the same as in Example 1 except that in year 5, R and E modify the split-dollar life insurance arrangement to provide that, upon termination of the arrangement or E's death, R is entitled to receive the greater of the aggregate premiums or one-half the policy cash value of the contract. Under the terms of the modified arrangement and applicable state law, the policy cash value is fully accessible by R and R's creditors but E has the right to borrow or withdraw at any time the portion of the policy cash value exceeding the amount payable to R.

(ii) For each year that the split-dollar life insurance arrangement is in effect, E must include in gross income under paragraph (d)(1) of this section the value of the economic benefits described in paragraph (d)(2)(i) of this section provided to E under the arrangement during that year. In year 5 (and subsequent years), E has the right to borrow or withdraw at any time the portion of the policy cash value exceeding the amount payable to R. Thus, under paragraph (d)(4)(ii) of this section, E has current access to such portion of the policy cash value. Thus, in year 5 (and each subsequent year), E must also include in gross income under paragraph (d)(1) of this section the value of the economic benefits described in paragraph (d)(2)(ii) of this section provided to E in each year.

(iii) The arrangement is not described in paragraph (c)(1)(ii)(A)(1) of this section after it is modified in year 5. Because R is the designated owner of the life insurance contract, R continues to be treated as the owner of the contract under paragraph (c)(1)(ii)(B)(1) of this section after the arrangement is modified. In addition, because the modification made by R and E in year 5 does not involve the transfer (within the meaning of paragraph (c)(3) of this section) of an undivided interest in the life insurance contract from R to E, the modification is not a transfer for purposes of paragraph (g) of this section.

Example (4). (i) The facts are the same as in Example 2 except that in year 7, R and E modify the split-dollar life insurance arrangement to provide that, upon termination of the arrangement or E's death, R will be paid the lesser of 80 percent of the aggregate premiums or the policy cash value of the contract. Under the terms of the modified arrangement and applicable state law, the policy cash value is fully accessible by R and R's creditors but E has the right to borrow or withdraw at any time the portion of the policy cash value exceeding the lesser of 80 percent of the aggregate premiums paid by R or the policy cash value of the contract.

(ii) Commencing in year 7 (and in each subsequent year), E must include in gross income the economic benefits described in paragraph (d)(2)(ii) of this section as provided in this Example 4(ii) rather than as provided in Example 2(ii). Thus, in year 7 (and in each subsequent year) E must include in gross income under paragraph (d) of this section, the excess of the policy cash value over the lesser of 80 percent of the aggregate premiums paid by R or the policy cash value of the contract (to the extent E did not actually include such amounts in gross income for a prior taxable year). In addition, in year 7 (and each subsequent year) E must also include in gross income the value of the economic benefits described in paragraph (d)(2)(i) of this section provided to E under the arrangement in each such year.

Example (5). (i) The facts are the same as in Example 3 except that in year 7, E is designated as the policy owner. At that time, E's rights to the contract are substantially vested as defined in §1.83-3(b). **[#Had it not been vested under Section 83 the tax consequence would be deferred.]**

(ii) In year 7, R is treated as having made a transfer (within the meaning of paragraph (c)(3) of this section) of the life insurance contract to E. E must include in gross income the amount determined under paragraph (g)(1) of this section.

(iii) After the transfer of the contract to E, E is the owner of the contract and any premium payments by R will be included in E's income under paragraph (b)(5) of this section and §1.61-2(d)(2)(ii)(A) (unless R's payments are split-dollar loans as defined in §1.7872-15(b)(1)).

Example (6). (i) In year 1, E and R enter into a split-dollar life insurance arrangement as defined in paragraph (b)(2) of this section. Under the arrangement, R is required to make annual premium payments of \$10,000 and E is required to make annual premium payments of \$500. In year 5, a \$500 policy owner dividend payable to E is declared by the insurance company. E directs the insurance company to use the \$500 as E's premium payment for year 5. **[# Since Employee had control and directed the \$500, it is taxable as compensation to the Employee.]**

(ii) For each year the arrangement is in effect, E must include in gross income the value of the economic benefits provided during the year, as required by

paragraph (d)(2) of this section, over the \$500 premium payments paid by E. In year 5, E must also include in gross income as compensation the excess, if any, of the \$500 distributed to E from the proceeds of the policy owner dividend over the amount determined under paragraph (e)(3)(ii) of this section. **[#The amount of all economic benefits described in paragraphs (d)(2)(ii) and (iii) actually taken into account by the non-owner, to the extent not taxed in prior years].**

(iii) R must include in income the premiums paid by E during the years the split-dollar life insurance arrangement is in effect, including the \$500 of the premium E paid in year 5 with proceeds of the policy owner dividend. R's investment in the contract is increased in an amount equal to the premiums paid by E, including the \$500 of the premium paid by E in year 5 from the proceeds of the policy owner dividend. In year 5, R is treated as receiving a \$500 distribution under the contract, which is taxed pursuant to section 72.

Example (7). (i) The facts are the same as in Example 2 except that in year 10, E withdraws \$100,000 from the cash value of the contract.

(ii) In year 10, R is treated as receiving a \$100,000 distribution from the insurance company. This amount is treated as an amount received by R under the contract and taxed pursuant to section 72. This amount reduces R's investment in the contract under section 72(e). R is treated as paying the \$100,000 to E as cash compensation, and E must include that amount in gross income less any amounts determined under paragraph (e)(3)(ii) of this section. **[#This illustrates the step by step transactional analysis required by previous provisions of these regulations.]**

Example (8). (i) The facts are the same as in Example 7 except E receives the proceeds of a \$100,000 specified policy loan directly from the insurance company.

(ii) The transfer of the proceeds of the specified policy loan to E is treated as a loan by the insurance company to R. Under the rules of section 72(e), the \$100,000 loan is not included in R's income and does not reduce R's investment in the contract. R is treated as paying the \$100,000 of loan proceeds to E as cash compensation. E must include that amount in gross income less any amounts determined under paragraph (e)(3)(ii) of this section.

(i) [Reserved]

(j) Effective date.

(1) General rule.

(i) In general. This section applies to any split-dollar life insurance arrangement (as defined in paragraph (b)(1) or (2) of this section) entered into after September 17, 2003.

(ii) Determination of when an arrangement is entered into. For purposes of paragraph (j) of this section, a split-dollar life insurance arrangement is entered into on the latest of the following dates [**#Note the “latest of” requirement. These rules basically prevent any split-dollar arrangement that was not virtually completed by the effective date from avoiding these regulations.**]:

(A) The date on which the life insurance contract under the arrangement is issued;

(B) The effective date of the life insurance contract under the arrangement;

(C) The date on which the first premium on the life insurance contract under the arrangement is paid;

(D) The date on which the parties to the arrangement enter into an agreement with regard to the policy; or

(E) The date on which the arrangement satisfies the definition of a split-dollar life insurance arrangement (as defined in paragraph (b)(1) or (2) of this section).

(2) Modified arrangements treated as new arrangements.

(i) In general. For purposes of paragraph (j)(1) of this section, if an arrangement entered into on or before September 17, 2003 is materially modified after September 17, 2003, the arrangement is treated as a new arrangement entered into on the date of the modification.

(ii) Non-material modifications. [**#Note that the Regulations don't define what is a material modification, rather they in a very limited manner describe a few almost inconsequential changes as being “non-material” such that the implication is that anything not on this limited listing below may be material.**] The following is a non-exclusive list of changes that are not material modifications under paragraph (j)(2)(i) of this section (either alone or in conjunction with other changes listed in paragraphs (j)(2)(ii)(A) through (I) of this section)—

(A) A change solely in the mode of premium payment (for example, a change from monthly to quarterly premiums);

(B) A change solely in the beneficiary of the life insurance contract, unless the beneficiary is a party to the arrangement;

(C) A change solely in the interest rate payable under the life insurance contract on a policy loan;

(D) A change solely necessary to preserve the status of the life insurance contract under section 7702;

(E) A change solely to the ministerial provisions of the life insurance contract (for example, a change in the address to send payment);

(F) A change made solely under the terms of any agreement (other than the life insurance contract) that is a part of the split-dollar life insurance arrangement if the change is non-discretionary by the parties and is made pursuant to a binding commitment (whether set forth in the agreement or otherwise) in effect on or before September 17, 2003;

(G) A change solely in the owner of the life insurance contract as a result of a transaction to which section 381(a) applies and in which substantially all of the former owner's assets are transferred to the new owner of the policy;

(H) A change to the policy solely if such change is required by a court or a state insurance commissioner as a result of the insolvency of the insurance company that issued the policy; or

(I) A change solely in the insurance company that administers the policy as a result of an assumption reinsurance transaction between the issuing insurance company and the new insurance company to which the owner and the non-owner were not a party.

(iii) Delegation to Commissioner. The Commissioner, in revenue rulings, notices, and other guidance published in the Internal Revenue Bulletin, may provide additional guidance with respect to other modifications that are not material for purposes of paragraph (j)(2)(i) of this section. See §601.601(d)(2)(ii) of this chapter.

[T.D. 9092, 9/11/2003](#).

