

Split-Dollar Life Insurance Arrangements

Notice 2002-59

SECTION 1. PURPOSE

This notice explains the standards for valuing current life insurance protection under a split-dollar life insurance arrangement.

SECTION 2. BACKGROUND

.01 Rev. Rul. 64-328, 1964-2 C.B. 11, held that the table of one-year premium rates set forth in Rev. Rul. 55-747, 1955-2 C.B. 228, commonly referred to as the "P.S. 58" rates, may be used to determine the value of the current life insurance protection provided to an employee under a split-dollar life insurance arrangement. Rev. Rul. 66-110, 1966-1 C.B. 12, amplified Rev. Rul. 64-328 in this respect by holding that the insurer's published premium rates for one-year term insurance may be used to measure the value of the current life insurance protection if those rates are available to all standard risks and are lower than the P.S. 58 rates. Rev. Rul. 67-154, 1967-1 C.B. 11, modified Rev. Rul. 66-110 by holding that an insurer's published term rates must be available for initial issue insurance (as distinguished from rates for dividend options) in order to be substituted for the P.S. 58 rates set forth in Rev. Rul. 55-747.

.02 Notice 2001-10, 2001-1 C.B. 459, revoked Rev. Rul. 55-747 and provided that, for taxable years beginning after December 31, 2001, the Treasury Department and the Internal Revenue Service would no longer treat or accept the P.S. 58 rates set forth therein as a proper measure of the value of current life insurance protection for Federal tax purposes. One concern expressed in Notice 2001-10 with regard to the P.S. 58 rates was that certain taxpayers were using P.S. 58 rates to understate the economic benefits provided under certain split-dollar life insurance arrangements, a practice never authorized by published guidance.

Notice 2001-10 set forth a new table of one-year term premiums, captioned as Table 2001, to determine the value of current life insurance protection on a single life pro-

vided under a split-dollar life insurance arrangement for taxable years ending after January 29, 2001. Under Notice 2001-10, Table 2001 is to serve as an "interim substitute" for the P.S. 58 rates. Notice 2001-10 also allowed taxpayers to continue to determine the value of current life insurance protection by using the insurer's lower published premium rates that are available to all standard risks for initial issue one-year term insurance as set forth in Rev. Rul. 66-110, subject to additional limitations provided in that notice.

.03 Notice 2002-8, 2002-4 I.R.B. 398, revokes Notice 2001-10 and provides that, pending the consideration of comments and publication of further guidance, Rev. Rul. 55-747 remains revoked, as provided in and with the transitional relief described in Part IV.B.1 of Notice 2001-10. For split-dollar life insurance arrangements entered into before the effective date of future guidance, Notice 2002-8 allows taxpayers to use the premium rates in Table 2001 to determine the value of current life insurance protection on a single life. Notice 2002-8 also provides that taxpayers should make appropriate adjustments to the Table 2001 rates if the life insurance protection covers more than one life. For arrangements entered into before the effective date of future guidance, Notice 2002-8 provides that, to the extent provided by Rev. Rul. 66-110, as amplified by Rev. Rul. 67-154, taxpayers may continue to determine the value of current life insurance protection by using the insurer's lower published premium rates that are available to all standard risks for initial issue one-year term insurance, subject to certain express limitations. Thus, until the publication of further guidance and subject to the narrow exception in Part III.1 of Notice 2002-8, taxpayers may value the current life insurance protection by using either the premium rates in Table 2001 or the insurer's published premium rates (as described in the preceding sentence), provided that those published premium rates are lower than the rates set forth in Table 2001 (hereinafter the "insurer's lower published premium rates").

.04 On July 9, 2002, Treasury and the Service published proposed regulations relating to split-dollar life insurance arrangements (67 Fed. Reg. 45414). The proposed regulations reserve on the valuation of eco-

conomic benefits received under an equity split-dollar life insurance arrangement under the economic benefit regime. However, for an equity split-dollar life insurance arrangement entered into on or before the date of publication of final regulations, in order for the parties to rely on the proposed regulations, the value of all economic benefits taken into account by the parties under the economic benefit regime must exceed the value of the current life insurance protection (determined using the life insurance premium factor designated in guidance published in the Internal Revenue Bulletin), 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 proposed regulations provide no new guidance on the valuation of current life insurance protection. In a footnote quoted immediately below, however, the preamble of those proposed regulations indicates that Part III.1 of Notice 2002–8 provides for only limited availability of the P.S. 58 rates for taxable years beginning after December 31, 2001:

Notice 2002–8 also provides that an employer and employee may continue to use the P.S. 58 rates set forth in Rev. Rul. 55–747 (1955–2 C.B. 228), which was revoked by Notice 2001–10, only with respect to split-dollar life insurance arrangements entered into before January 28, 2002, in which a contractual arrangement between the employer and employee provides that the P.S. 58 rates will be used to determine the value of the current life insurance protection provided to the employee (or to the employee and one or more additional persons). Taxpayers may not use the P.S. 58 rates for “reverse” split-dollar life insurance arrangements or for split-dollar life insurance arrangements outside of the compensatory context.

SECTION 3. VALUATION OF CURRENT LIFE INSURANCE PROTECTION

.01 Treasury and the Service understand that, under certain split-dollar life insurance arrangements (some of which are referred to as “reverse” split-dollar), one party holding a right to current life insur-

ance protection uses 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. The use of such techniques by any party to understate the value of these other policy benefits distorts the income, employment, or gift tax consequences of the arrangement and does not conform to, and is not permitted by, any published guidance.

.02 A party participating in a split-dollar life insurance arrangement may use the premium rates in Table 2001 or the insurer’s lower published premium rates only for the purpose of valuing current life insurance protection for Federal tax purposes when, and to the extent, such protection is conferred as an economic benefit by one party on another party, determined without regard to consideration or premiums paid by such other party. (*See*, for example, benefits described in Rev. Rul. 64–328 (in the compensatory context), Rev. Rul. 78–420, 1978–2 C.B. 67 (in the gift context), and Rev. Rul. 79–50, 1979–1 C.B. 138 (in the corporation-shareholder context).) Thus, if one party has any right to current life insurance protection, neither the premium rates in Table 2001 nor the insurer’s lower published premium rates may be relied upon to value such party’s current life insurance protection for the purpose of establishing the value of any policy benefits to which another party may be entitled.

For example, if a donor pays the premiums on a life insurance policy that is part of a split-dollar life insurance arrangement between the donor and a trust and, under the arrangement, the trust has the right to current life insurance protection, the current life insurance protection has been conferred as an economic benefit by the donor on the trust, and the donor is permitted to value such current life insurance protection for Federal tax purposes using either the premium rates in Table 2001 or the insurer’s lower published premium rates. In contrast, if a donor pays the premiums on a life insurance policy that is part of a split-dollar life insurance arrangement between the donor and a trust, and the donor (or the donor’s estate) has the right to current life insurance protection under the policy, neither the premium rates in Table 2001 nor the insurer’s lower published premium rates may be relied upon to value the donor’s current life insurance protection for the pur-

pose of establishing the value of the policy benefits conferred upon the trust for Federal tax purposes. Similar results obtain if the trust pays for all or a portion of its share of the policy benefits provided under the split-dollar life insurance arrangement.

SECTION 4. DRAFTING INFORMATION

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