

**ACTION:** Notice of proposed rulemaking and notice of public hearing.

**SUMMARY:** This document contains proposed regulations relating to the valuation of economic benefits under certain equity split-dollar life insurance arrangements. The proposed regulations will provide needed guidance to persons who enter into split-dollar life insurance arrangements. This document also provides notice of a public hearing on the proposed regulations.

**DATES:** Written or electronic comments must be received by July 8, 2003. Requests to speak and outlines of topics to be discussed at the public hearing scheduled for July 29, 2003, must be received by July 8, 2003.

**ADDRESSES:** Send submissions to CC:PA:RU (REG-164754-01), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:RU (REG-164754-01), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC or sent electronically, via the IRS Internet site at [www.irs.gov/reg](http://www.irs.gov/reg). The public hearing will be held in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

**FOR FURTHER INFORMATION CONTACT:** Concerning the regulations, please contact Elizabeth Kaye at (202) 622-4920. To be placed on the attendance list for the hearing, please contact LaNita Van Dyke at (202) 622-7180.

#### **SUPPLEMENTARY INFORMATION:**

#### **Background and Overview of Notice of Proposed Rulemaking**

##### *1. Summary of the Prior Notice of Proposed Rulemaking*

On July 9, 2002, a notice of proposed rulemaking (REG-164754-01) was published in the **Federal Register** (67 FR 45414) proposing comprehensive rules for the income, gift, and employment taxation of equity and non-equity split-dollar life insurance arrangements (the 2002 proposed regulations). The 2002 proposed regulations will apply to split-dollar life insurance arrangements entered into after the date final regulations are published in the **Federal Register** and to arrangements entered into on or before that date that are materially modified after that date. Under certain conditions, taxpayers may rely on the 2002 proposed regulations for split-dollar life insurance arrangements entered into on

or before the date final regulations are published in the **Federal Register**.

In general, a split-dollar life insurance arrangement is an arrangement between two or more parties to allocate the policy benefits and, in some cases, the costs of a life insurance contract. Under a so-called equity split-dollar life insurance arrangement, one party to the arrangement typically receives an interest in the policy cash value (or equity) of the life insurance policy disproportionate to that party's share of policy premiums. That party also typically receives the benefit of current life insurance protection under the arrangement. Under a so-called non-equity split-dollar life insurance arrangement, one party typically provides the other party with current life insurance protection but not any interest in the policy cash value.

The 2002 proposed regulations provide two mutually exclusive regimes for taxation of split-dollar life insurance arrangements—a loan regime and an economic benefit regime. Under the loan regime (which is set forth in § 1.7872-15 of the 2002 proposed regulations), the non-owner of the life insurance contract is treated as loaning the amount of its premium payments to the owner of the contract. The loan regime generally will govern the taxation of collateral assignment arrangements. Under the economic benefit regime (which is set forth in § 1.61-22(d) through (g) of the 2002 proposed regulations), the owner of the life insurance contract is treated as providing economic benefits to the non-owner of the contract. The economic benefit regime generally will govern the taxation of endorsement arrangements.

The 2002 proposed regulations reserved on the rules for valuing economic benefits provided to the non-owner under an equity split-dollar life insurance arrangement governed by the economic benefit regime, pending receipt of comments from interested parties. The preamble to the 2002 proposed regulations notes that any proposal “for a specific methodology should be objective and administrable” and describes a potential approach under which the non-owner would include in income the difference between current premium payments and the net present value of the amount to be repaid to the owner in the future.

A public hearing on the 2002 proposed regulations was held on October 23, 2002. In addition, interested parties have submitted detailed comments on the 2002 proposed regulations, including comments on the valuation of economic benefits provided to a non-owner under an equity split-

dollar life insurance arrangement governed by the economic benefit regime.

#### *2. Explanation of Provisions and Summary of Comments*

##### *a. Overview*

These proposed regulations, which supplement the 2002 proposed regulations, provide guidance on the valuation of economic benefits (including the valuation of an interest in policy cash value) under an equity split-dollar life insurance arrangement governed by the economic benefit regime. These proposed regulations apply for purposes of Federal income, employment, and gift taxes.

These proposed regulations address only those comments received by the IRS and the Treasury Department on the valuation of economic benefits under an equity split-dollar life insurance arrangement governed by the economic benefit regime. Comments received on other issues regarding the 2002 proposed regulations and comments on these proposed regulations will be addressed when both sets of proposed regulations are finalized.

These proposed regulations provide that in the case of an equity split-dollar life insurance arrangement, the value of the economic benefits provided to the non-owner under the arrangement for a taxable year equals the cost of any current life insurance protection provided to the non-owner, the amount of policy cash value to which the non-owner has current access (to the extent that such amount was not actually taken into account for a prior taxable year), and the value of any other economic benefits provided to the non-owner (to the extent not actually taken into account for a prior taxable year). The terms *owner* and *non-owner* are defined in § 1.61-22(c)(1) and (2) of the 2002 proposed regulations.

##### *b. Current Access to Policy Cash Value*

Generally, under an equity split-dollar life insurance arrangement governed by the economic benefit regime, the owner of the life insurance contract pays policy premiums, thereby establishing a pool of assets with respect to which the non-owner has certain rights under the arrangement (for example, rights of withdrawal, borrowing, surrender, or assignment). Additionally, the pool of assets is held by a third party, the life insurance company, effectively placing the cash value beyond the reach of the employer or the employer's general creditors in many cases. Thus, an equity split-dollar life insurance arrangement confers on the non-owner rights to