

in the view of the IRS and the Treasury, taxpayers effectively have the ability to elect which regime will apply by designating one party or the other as the owner of the life insurance contract.

One commentator asserted that there is no authority under section 7872 to treat payments made pursuant to split-dollar life insurance arrangements as loans. Therefore, this commentator recommends that taxation of split-dollar life insurance arrangements under section 7872 should occur only if affirmatively elected by the parties to the arrangement. The IRS and Treasury believe there is sufficient authority to require the application of section 7872 to split-dollar life insurance arrangements. There is no legislative history indicating that Congress did not intend section 7872 to apply to payments made pursuant to these arrangements.

A number of commentators expressed concern about the possible application of section 402 of the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley), Public Law 107-204, to all or certain split-dollar life insurance arrangements entered into by companies subject to Sarbanes-Oxley. These regulations do not address this issue, as interpretation and administration of Sarbanes-Oxley fall within the jurisdiction of the Securities and Exchange Commission.

The final regulations adopt the general rule in the 2002 proposed regulations for determining which regime applies to a split-dollar life insurance arrangement. The 2002 proposed regulations provided a special rule that the economic benefit regime applied to a split-dollar life insurance arrangement if the arrangement is entered into in connection with the performance of services, and the employee or service provider is not the owner of the life insurance contract; or the arrangement is entered into between a donor and a donee (for example, a life insurance trust) and the donee is not the owner of the life insurance contract. The final regulations adopt this special rule, but provide that this rule applies when the employer, service recipient or donor is the owner.

The final regulations add a rule regarding the treatment of a transfer of a life insurance contract under a split-dollar life insurance arrangement from an owner to a non-owner when payments under the arrangement had been treated, prior to transfer, as split-dollar loans under § 1.7872-15. Under this rule, the economic benefit regime applies to the split-dollar life insurance arrangement from the date of the transfer and the payments made (both before and after the transfer) are not

treated as split-dollar loans on or after the date of the transfer. The transferor of the life insurance contract must fully take into account all economic benefits provided under the split-dollar life insurance arrangement.

Owners and Non-Owners

The final regulations generally retain the rules in the 2002 proposed regulations for determining the owner and the non-owner of the life insurance contract. Thus, the owner generally is the person named as the policy owner. If two or more persons are designated as the policy owners, the first-named person generally is treated as the owner of the entire contract.

Several commentators argued that determining tax ownership based on whom the parties name as the policy owner of the life insurance contract represents a departure from general tax principles. Commentators suggested that a split-dollar life insurance arrangement is like any co-ownership situation in which two or more parties agree to share in the costs and benefits of a policy such that each party will be entitled to exercise certain rights with respect to the underlying policy and will have certain responsibilities.

The IRS and Treasury disagree with that argument. Split-dollar life insurance arrangements are structured in myriad ways, some formally as loans to the employee (for example, collateral-assignment arrangements), some formally as co-ownership arrangements between the employer and the employee, and some as arrangements in which the employer is, in form, the sole owner (for example, endorsement arrangements). In addition, split-dollar life insurance arrangements ordinarily involve division of the benefits and costs of the life insurance contract, but the division of benefits ordinarily does not correspond to the division of costs. Because the division of the burdens and benefits of the life insurance contract vary widely in split-dollar life insurance arrangements, and because title ownership generally is a factor in determining tax ownership, it is reasonable to determine tax ownership based on who is the named owner of the policy. In addition, this rule provides a clear objective standard so that both taxpayers and the IRS can readily determine which regime applies under the final regulations.

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, those persons are treated as owners of separate contracts for

purposes of these regulations (although not for purposes of section 7702 and other rules for the taxation of life insurance contracts). 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. For example, if an employer and an employee own a life insurance contract and share equally in all rights, benefits and obligations under the contract, they are treated as owning two separate contracts; ordinarily neither contract would be treated as part of a split-dollar life insurance arrangement. However, if the employer and the employee agree to enter into a split-dollar life insurance arrangement with respect to what otherwise would have been treated as the employer's (or the employee's) separate contract, the purported undivided interests will be disregarded, and the entire arrangement will be treated as a split-dollar life insurance arrangement. The Commissioner will consider all of the facts and circumstances of an arrangement to determine whether the parties have appropriately characterized the arrangement as one involving undivided interests and, therefore, not subject to these regulations.

The final regulations provide attribution rules for compensatory split-dollar life insurance arrangements. Under these rules, the employer or service recipient will be treated as the owner of the life insurance contract if the contract is owned by a member of the employer's controlled group (determined under the rules of sections 414(b) and 414(c)), a trust described in section 402(b) (sometimes referred to as a "secular trust"), a grantor trust treated as owned by the employer (including a rabbi trust), or a welfare benefit fund (within the meaning of section 419(e)(1)).

The final regulations retain the special rule for non-equity split-dollar life insurance arrangements. Under this special rule, non-equity arrangements entered into in a compensatory context or a gift context will be subject to the economic benefit regime. The final regulations provide rules for determining the tax treatment of the arrangement if the parties subsequently modify the arrangement so that it is no longer a non-equity arrangement. If, immediately after the modification, the employer, service recipient, or donor is the owner of the life insurance contract (determined without regard to the special rule for non-equity arrangements), the employer, service recipient, or donor continues to be treated as the owner of the life