

applies only to the taxpayer that owns the life insurance contract. If the owner of the contract provides any of the rights or benefits under the contract to another taxpayer, that provision of rights and benefits is subject to tax under the rules that otherwise follow from the relationship between the parties. For example, this result applies whenever an employer that owns a life insurance contract compensates an employee by giving the employee rights to the policy cash value. In that case, the employer (as the owner of the contract) enjoys tax-deferred inside build-up under section 72(e), but the employee has gross income under section 61(a)(1) equal to the value of the economic benefit attributable to the employee's rights to the policy cash value. Thus, the regulations are consistent with section 72(e).

Other commentators generally acknowledged that the 2003 proposed regulations properly tax the non-owner whenever the non-owner has "current access" to the policy cash value in an equity arrangement but argued that the tax should be imposed under section 83 rather than under section 61. In effect, these commentators argued that the employee's current access to policy cash value should give rise to transfers of property with respect to portions of the life insurance contract. The commentators argued that the primary difference between this suggested approach and the approach set out in the 2003 proposed regulations would be the treatment of inside build-up on amounts already taxed to the non-owner. Specifically, the commentators argued that, under the proposed section 83 approach, inside build-up on amounts already taxed to the non-owner would be tax-free to the non-owner under section 72(e); under the approach of the 2003 proposed regulations, the subsequent inside build-up is tax-deferred to the owner but not to the non-owner.

The IRS and Treasury believe that the approach set out in the 2003 proposed regulations remains appropriate and so have not followed the suggestion to adopt a section 83 approach. Section 83 applies only in connection with a transfer of property, but a non-owner may have currently includible income by reason of another rule—such as the doctrines of constructive receipt, cash equivalence, or economic benefit. It would be inappropriate to limit current taxation to circumstances that constitute transfers of property under section 83, and it would be inappropriate in this context to apply section 83 to circumstances that give rise to income

under other Code provisions or judicial doctrines.

Several commentators raised questions about the effect of state law limitations on access to policy cash value by the owner's creditors. These commentators read Example 2 in the 2003 proposed regulations as stating that any such state law restriction would in and of itself cause the non-owner to have current access to the policy cash value. Thus, these commentators argued, the 2003 regulations potentially imposed current tax on the policy cash value of any non-equity arrangement where state law limited the rights of the owner's creditors to reach the policy cash value. However, Example 2 indicated that the owner there had the right to receive the lesser of the policy cash value or total premiums; in other words, Example 2 indicated that the arrangement was an equity arrangement. The final regulations clarify that the non-owner has current access to policy cash value only if, under the arrangement, the non-owner has a current or future right to policy cash value; the non-owner will not have any such right in a true non-equity arrangement. If the non-owner does have such a right, any restriction on the owner's creditors to reach policy cash value, whether established by contract or by local law, results in an economic benefit to the non-owner.

Several commentators objected to the rule in the 2003 proposed regulations that the non-owner has current access to any portion of the policy cash value that cannot be accessed by the owner. These commentators argued that as long as policy cash value can be accessed by the owner's creditors in the event of insolvency, the owner should not be viewed as providing any economic benefit to the non-owner. That objection, however, overlooks the economic reality of an equity split-dollar life insurance arrangement. If the owner commits funds to a life insurance contract and undertakes that it will not withdraw those funds from the insurance contract, the amounts so committed do not remain a general asset of the owner. The owner of the life insurance contract in such an arrangement has parted with the ownership and use of the funds for the benefit of the non-owner. This contrasts with an irrevocable rabbi trust, where the employer effectively remains the tax owner of the assets held by the trustee and the rabbi trust assets may still be (and very often are) invested in the employer's business.

In response to the suggestions of commentators, the final regulations provide that the policy cash value, like

the amount of current life insurance protection, is determined as of the last day of the non-owner's taxable year unless the parties agree to use the policy anniversary date. The final regulations retain the anti-abuse rule preventing the parties from manipulating the policy cash value for purposes of determining the value of the economic benefit that the non-owner must take into account and extend that rule to the value of the current life insurance protection.

Taxpayers should note that, in certain cases, a separate tax rule may require a non-owner to include an amount in gross income under an equity split-dollar life insurance arrangement at a time earlier than would be required under these regulations. For example, section 457(f) generally requires an employee of a tax-exempt organization (other than a church organization under section 3121(w)(3)) or of a state or local government to include deferred compensation in gross income when the employee's rights to the deferred compensation are not subject to a substantial risk of forfeiture. An equity split-dollar life insurance arrangement governed by the economic benefit regime constitutes a deferred compensation arrangement.

Accordingly, an employee of a tax-exempt organization or of a state or local government may have to include an amount in gross income attributable to an equity split-dollar life insurance arrangement even if the employee does not have current access to the policy cash value under these regulations.

#### Other Tax Consequences

These final regulations retain the rule of the 2002 proposed regulations that the non-owner has no investment in the contract under section 72(e) prior to a transfer of the contract. The final regulations also retain the rule that any amount paid by the non-owner to the owner for any economic benefit is included in the owner's gross income.

Several commentators objected to the rule providing no investment in the contract to the non-owner for amounts paid to the owner. They argued that section 72(e)(6) provides for such investment in the contract. Commentators also objected to the rule requiring that the owner include in gross income any amount paid by the non-owner. These commentators argued that the owner does not have an accession to wealth as a result of the non-owner's payments because such payments ordinarily are made to fulfill the non-owner's obligation under the split-dollar life insurance arrangement to pay part of the premiums of the life insurance contract.