

unpaid interest (including any OID) on all outstanding split-dollar loans in the order the interest accrued; to principal on the outstanding split-dollar loans in the order in which the loans were made; to payments of amounts previously paid by the lender pursuant to the split-dollar life insurance arrangement that were not reasonably expected to be repaid; and to any other payment with respect to a split-dollar life insurance arrangement. One commentator suggested limiting the payments to which the payment ordering rule applies to those that are made to or for the benefit of the lender. The final regulations adopt this suggestion in the payment ordering rule in § 1.7872–15(k).

#### e. Employment Taxes and Self-Employment Tax

An imputed transfer under § 1.7872–15 that is treated as an imputed transfer of compensation will have consequences for the Federal Insurance Contributions Act (FICA) and the Federal Unemployment Tax Act (FUTA) if the adjustment represents wages to the borrower. In response to questions regarding the consequences of an imputed transfer for employment and self-employment tax purposes, the regulations under sections 1402(a), 3121(a), 3231(e), and 3306(b) were clarified to reference § 1.7872–15 as well as § 1.61–22.

#### 5. Gift Tax Treatment of Split-Dollar Life Insurance Arrangements

The final regulations apply for gift tax purposes, including private split-dollar life insurance arrangements. Thus, if an irrevocable life insurance trust is the owner of the life insurance contract underlying the split-dollar life insurance arrangement, and a reasonable person would expect that the donor, or the donor's estate, will recover an amount equal to the donor's premium payments, those premium payments are treated as loans made by the donor to the trust and are subject to § 1.7872–15. In such a case, payment of a premium by the donor is treated as a split-dollar loan to the trust in the amount of the premium payment. If the loan is repayable upon the death of the donor, the term of the loan is the donor's life expectancy determined under the appropriate table under § 1.72–9 as of the date of the payment and the value of the gift is the amount of the premium payment less the present value (determined under section 7872 and § 1.7872–15) of the donor's right to receive repayment. If, however, the donor makes premium payments that are not split-dollar loans, then the

premium payments are governed by general gift tax principles. In such a case, with each premium payment, the donor is treated as making a gift to the trust equal to the amount of that payment.

Different rules apply, however, if the donor is treated under § 1.61–22(c) as the owner of the life insurance contract underlying the split-dollar life insurance arrangement. Under these circumstances, the donor is treated as making a gift to the trust. The value of the gift is the value of the economic benefits provided to the trust, less the amount of any premium paid by the trustee. For example, assume that under the terms of the split-dollar life insurance arrangement, on termination of the arrangement or the donor's death, the donor or donor's estate is entitled to receive an amount equal to the greater of the aggregate premiums paid by the donor or the cash surrender value of the contract. In this case, the donor makes a gift to the trust equal to the cost of the current life insurance protection provided to the trust less any premium amount paid by the trustee. (Thus, a payment by the donor will not constitute a gift if the trust pays the portion of the premium equal to the cost of the current life insurance protection and the donor pays the balance of the premium.) On the other hand, if the donor or the donor's estate is entitled to receive an amount equal to the lesser of the aggregate premiums paid by the donor, or the cash surrender value of the contract, the amount of the economic benefits provided to the trust by the donor equals the cost of any current life insurance protection provided to the trust, the amount of policy cash value to which the trust 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 trust (to the extent not actually taken into account for a prior taxable year). The value of the donor's gift of economic benefits equals the value of those economic benefits provided to the trust for the year minus the amount of premiums paid by the trustee.

As discussed earlier, the final regulations treat the donor as the owner of a life insurance contract where the donee is named as the policy owner if, under the split-dollar life insurance arrangement, the only economic benefit provided to the donee by the donor under the arrangement is the value of current life insurance protection. Any amount paid by a donee, directly or indirectly, to the donor for such current life insurance protection would

generally be included in the donor's gross income.

Where the donor is the owner of the life insurance contract that is part of the split-dollar life insurance arrangement, amounts received by the irrevocable insurance trust (either directly or indirectly) under the contract (for example, as a policy owner dividend or proceeds of a specified policy loan) are treated as gifts by the donor to the irrevocable insurance trust as provided in § 1.61–22(e). The donor must also treat as a gift to the trust the amount set forth in § 1.61–22(g) upon the transfer of the life insurance contract (or undivided interest therein) from the donor to the trust.

The gift tax consequences of the transfer of an interest in a life insurance contract to a third party will continue to be determined under established gift tax principles notwithstanding who is treated as the owner of the life insurance contract under the final regulations. See, for example, Rev. Rul. 81–198 (1981–2 C.B. 188). Similarly, for estate tax purposes, regardless of who is treated as the owner of a life insurance contract under the final regulations, the inclusion of the policy proceeds in a decedent's gross estate will continue to be determined under section 2042. Thus, the policy proceeds will be included in the decedent's gross estate under section 2042(1) if receivable by the decedent's executor, or under section 2042(2) if the policy proceeds are receivable by a beneficiary other than the decedent's estate and the decedent possessed any incidents of ownership with respect to the policy. One commentator requested that these regulations address the extent to which a decedent's interest in a co-owned policy is included in that decedent's gross estate under section 2042, but the IRS and Treasury believe that issue is beyond the scope of these regulations and may be addressed in future guidance.

#### 6. Effective Date and Obsolescence of Prior Guidance

These final regulations apply to any split-dollar life insurance arrangement entered into after September 17, 2003. Additionally, these final regulations apply to any split-dollar life insurance arrangement entered into on or before September 17, 2003 if the arrangement is materially modified after September 17, 2003. However, a split-dollar life insurance arrangement that is otherwise described in Section IV, Paragraph 4 of Notice 2002–8 (2002–1 C.B. 398) will not be treated as materially modified for these purposes if the change in the split-dollar life insurance arrangement is