

makes the first split-dollar loan under the split-dollar life insurance arrangement. This representation must include the names, addresses, and taxpayer identification numbers of the borrower, lender, and any indirect participants. Unless otherwise stated therein, this representation applies to all subsequent split-dollar loans made pursuant to the split-dollar life insurance arrangement. Each party should retain an original of the representation as part of its books and records and should attach a copy of this representation to its Federal income tax return for any taxable year in which the lender makes a loan to which the representation applies.

(e) *Below-market split-dollar loans—*
(1) *Scope—(i) In general.* This paragraph (e) applies to below-market split-dollar loans enumerated under section 7872(c)(1), which include gift loans, compensation-related loans, and corporation-shareholder loans. The characterization of a split-dollar loan under section 7872(c)(1) and of the imputed transfers under section 7872(a)(1) and (b)(1) depends upon the relationship between the lender and the borrower or the lender, borrower, and any indirect participant. For example, if the lender is the borrower's employer, the split-dollar loan is generally a compensation-related loan, and any imputed transfer from the lender to the borrower is generally a payment of compensation. The loans covered by this paragraph (e) include indirect loans between the parties. See paragraph (e)(2) of this section for the treatment of certain indirect split-dollar loans. See paragraph (f) of this section for the treatment of any stated interest or OID on split-dollar loans. See paragraph (j) of this section for additional rules that apply to a split-dollar loan that provides for one or more contingent payments.

(ii) *Significant-effect split-dollar loans.* If a direct or indirect below-market split-dollar loan is not enumerated in section 7872(c)(1)(A), (B), or (C), the loan is a significant-effect loan under section 7872(c)(1)(E).

(2) *Indirect split-dollar loans—(i) In general.* If, based on all the facts and circumstances, including the relationship between the borrower or lender and some third person (the indirect participant), the effect of a below-market split-dollar loan is to transfer value from the lender to the indirect participant and from the indirect participant to the borrower, then the below-market split-dollar loan is restructured as two or more successive below-market loans (the deemed loans) as provided in this paragraph (e)(2). The transfers of value

described in the preceding sentence include (but are not limited to) a gift, compensation, a capital contribution, and a distribution under section 301 (or, in the case of an S corporation, under section 1368). The deemed loans are—

(A) A deemed below-market split-dollar loan made by the lender to the indirect participant; and

(B) A deemed below-market split-dollar loan made by the indirect participant to the borrower.

(ii) *Application.* Each deemed loan is treated as having the same provisions as the original loan between the lender and borrower, and section 7872 is applied to each deemed loan. Thus, for example, if, under a split-dollar life insurance arrangement, an employer (lender) makes an interest-free split-dollar loan to an employee's child (borrower), the loan is restructured as a deemed compensation-related below-market split-dollar loan from the lender to the employee (the indirect participant) and a second deemed gift below-market split-dollar loan from the employee to the employee's child. In appropriate circumstances, section 7872(d)(1) may limit the interest that accrues on a deemed loan for Federal income tax purposes. For loan arrangements between husband and wife, see section 7872(f)(7).

(iii) *Limitations on investment interest for purposes of section 163(d).* For purposes of section 163(d), the imputed interest from the indirect participant to the lender that is taken into account by the indirect participant under this paragraph (e)(2) is not investment interest to the extent of the excess, if any, of—

(A) The imputed interest from the indirect participant to the lender that is taken into account by the indirect participant; over

(B) The imputed interest to the indirect participant from the borrower that is recognized by the indirect participant.

(iv) *Examples.* The provisions of this paragraph (e)(2) are illustrated by the following examples:

Example 1. (i) On January 1, 2009, Employer X and Individual A enter into a split-dollar life insurance arrangement under which A is named as the policy owner. A is the child of B, an employee of X. On January 1, 2009, X makes a \$30,000 premium payment, repayable upon demand without interest. Repayment of the premium payment is fully recourse to A. The payment is a below-market split-dollar demand loan. A's net investment income for 2009 is \$1,100, and there are no other outstanding loans between A and B. Assume that the blended annual rate for 2009 is 5 percent, compounded annually.

(ii) Based on the relationships among the parties, the effect of the below-market split-dollar loan from X to A is to transfer value from X to B and then to transfer value from B to A. Under paragraph (e)(2) of this section, the below-market split-dollar loan from X to A is restructured as two deemed below-market split-dollar demand loans: a compensation-related below-market split-dollar loan between X and B and a gift below-market split-dollar loan between B and A. Each of the deemed loans has the same terms and conditions as the original loan.

(iii) Under paragraph (e)(3) of this section, the amount of forgone interest deemed paid to B by A in 2009 is \$1,500 ($[\$30,000 \times 0.05] - 0$). Under section 7872(d)(1), however, the amount of forgone interest deemed paid to B by A is limited to \$1,100 (A's net investment income for the year). Under paragraph (e)(2)(iii) of this section, B's deduction under section 163(d) in 2009 for interest deemed paid on B's deemed loan from X is limited to \$1,100 (the interest deemed received from A).

Example 2. (i) The facts are the same as the facts in *Example 1*, except that T, an irrevocable life insurance trust established for the benefit of A (B's child), is named as the policy owner. T is not a grantor trust.

(ii) Based on the relationships among the parties, the effect of the below-market split-dollar loan from X to T is to transfer value from X to B and then to transfer value from B to T. Under paragraph (e)(2) of this section, the below-market split-dollar loan from X to T is restructured as two deemed below-market split-dollar demand loans: a compensation-related below-market split-dollar loan between X and B and a gift below-market split-dollar loan between B and T. Each of the deemed loans has the same terms and conditions as the original loan.

(iii) Under paragraph (e)(3) of this section, the amount of forgone interest deemed paid to B by T in 2009 is \$1,500 ($[\$30,000 \times 0.05] - 0$). Section 7872(d)(1) does not apply because T is not an individual. The amount of forgone interest deemed paid to B by T is \$1,500. Under paragraph (e)(2)(iii) of this section, B's deduction under section 163(d) in 2009 for interest deemed paid on B's deemed loan from X is \$1,500 (the interest deemed received from T).

(3) *Split-dollar demand loans—(i) In general.* This paragraph (e)(3) provides rules for testing split-dollar demand loans for sufficient interest, and, if the loans do not provide for sufficient interest, rules for the calculation and treatment of forgone interest on these loans. See paragraph (g) of this section for additional rules that apply to a split-dollar loan providing for certain variable rates of interest.

(ii) *Testing for sufficient interest.* Each calendar year that a split-dollar demand loan is outstanding, the loan is tested to determine if the loan provides for sufficient interest. A split-dollar demand loan provides for sufficient interest for the calendar year if the rate (based on annual compounding) at