

is treated as waived, cancelled, or forgiven by the lender under this paragraph (h). However, the amount treated as retransferred under paragraph (h)(1)(i) of this section is not increased by the deferral charge in paragraph (h)(4) of this section.

(2) *Split-dollar term loans.* In the case of a split-dollar term loan, the amount of interest deemed transferred and retransferred for purposes of paragraph (h)(1) of this section is determined as follows:

(i) If the loan's stated rate is less than or equal to the appropriate AFR (the AFR used to test the loan for sufficient interest under paragraph (e) of this section), the amount of interest deemed transferred and retransferred pursuant to this paragraph (h) is the excess of the amount of interest payable at the stated rate over the interest actually paid.

(ii) If the loan's stated rate is greater than the appropriate AFR (the AFR used to test the loan for sufficient interest under paragraph (e) of this section), the amount of interest deemed transferred and retransferred pursuant to this paragraph (h) is the excess, if any, of the amount of interest payable at the AFR over the interest actually paid.

(3) *Split-dollar demand loans.* In the case of a split-dollar demand loan, the amount of interest deemed transferred and retransferred for purposes of paragraph (h)(1) of this section is equal to the aggregate of—

(i) For each year that the split-dollar demand loan was outstanding in which the loan was a below-market split-dollar demand loan, the excess of the amount of interest payable at the stated rate over the interest actually paid allocable to that year; plus

(ii) For each year that the split-dollar demand loan was outstanding in which the loan was not a below-market split-dollar demand loan, the excess, if any, of the amount of interest payable at the appropriate rate used for purposes of imputation for that year over the interest actually paid allocable to that year.

(4) *Deferral charge.* The Commissioner may prescribe the method for determining the deferral charge treated as retransferred by the lender to the borrower under paragraph (h)(1) of this section. Until the Commissioner prescribes otherwise, the deferral charge is determined under paragraph (h)(4)(i) of this section for a split-dollar term loan subject to paragraph (h)(2) of this section and under paragraph (h)(4)(ii) of this section for a split-dollar demand loan subject to paragraph (h)(3) of this section.

(i) *Split-dollar term loan.* The deferral charge for a split-dollar term loan subject to paragraph (h)(2) of this

section is determined by multiplying the hypothetical underpayment by the applicable underpayment rate, compounded daily, for the period from the date the split-dollar loan was made to the date the interest is waived, cancelled, or forgiven. The hypothetical underpayment is equal to the amount determined under paragraph (h)(2) of this section, multiplied by the highest rate of income tax applicable to the borrower (for example, the highest rate in effect under section 1 for individuals) for the taxable year in which the split-dollar term loan was made. The applicable underpayment rate is the average of the quarterly underpayment rates in effect under section 6621(a)(2) for the period from the date the split-dollar loan was made to the date the interest is waived, cancelled, or forgiven.

(ii) *Split-dollar demand loan.* The deferral charge for a split-dollar demand loan subject to paragraph (h)(3) of this section is the sum of the following amounts determined for each year the loan was outstanding (other than the year in which the waiver, cancellation, or forgiveness occurs): For each year the loan was outstanding, multiply the hypothetical underpayment for the year by the applicable underpayment rate, compounded daily, for the applicable period. The hypothetical underpayment is equal to the amount determined under paragraph (h)(3) of this section for each year, multiplied by the highest rate of income tax applicable to the borrower for that year (for example, the highest rate in effect under section 1 for individuals). The applicable underpayment rate is the average of the quarterly underpayment rates in effect under section 6621(a)(2) for the applicable period. The applicable period for a year is the period of time from the last day of that year until the date the interest is waived, cancelled, or forgiven.

(5) *Examples.* The provisions of this paragraph (h) are illustrated by the following examples:

Example 1. (i) On January 1, 2009, Employer Y and Employee B entered into a split-dollar life insurance arrangement under which B is named as the policy owner. On January 1, 2009, Y made a \$100,000 premium payment, repayable on December 31, 2011, with interest of 5 percent, compounded annually. The premium payment is a split-dollar term loan. Assume the short-term AFR (based on annual compounding) at the time the loan was made was 5 percent. Repayment of both the premium payment and the interest due thereon was fully recourse to B. On December 31, 2011, Y is repaid \$100,000 but Y waives the remainder due on the loan (\$15,762.50). Both Y and B use the calendar year as their taxable years.

(ii) When the split-dollar term loan was made, the loan was not a below-market loan under paragraph (e)(4)(ii) of this section. Under paragraph (f) of this section, Y was required to accrue compound interest of 5 percent each year the loan remained outstanding. B, however, was not entitled to any deduction for this interest under paragraph (c) of this section.

(iii) Under paragraph (h)(1) of this section, the waived amount is treated as if, on December 31, 2011, it had in fact been paid to Y and was then retransferred by Y to B. The amount deemed transferred to Y and retransferred to B equals the excess of the amount of interest payable at the stated rate (\$15,762.50) over the interest actually paid (\$0), or \$15,762.50. In addition, the amount deemed retransferred to B is increased by the deferral charge determined under paragraph (h)(4) of this section. Because of the employment relationship between Y and B, the total retransferred amount is treated as compensation paid by Y to B.

Example 2. (i) On January 1, 2009, Employer Y and Employee B entered into a split-dollar life insurance arrangement under which B is named as the policy owner. On January 1, 2009, Y made a \$100,000 premium payment, repayable on the demand of Y, with interest of 7 percent, compounded annually. The premium payment is a split-dollar demand loan. Assume the blended annual rate (based on annual compounding) in 2009 was 5 percent and in 2010 was 6 percent. Repayment of both the premium payment and the interest due thereon was fully recourse to B. On December 31, 2010, Y demands repayment and is repaid its \$100,000 premium payment in full; however, Y waives all interest due on the loan. Both Y and B use the calendar year as their taxable years.

(ii) For each year that the split-dollar demand loan was outstanding, the loan was not a below-market loan under paragraph (e)(3)(ii) of this section. Under paragraph (f) of this section, Y was required to accrue compound interest of 7 percent each year the loan remained outstanding. B, however, was not entitled to any deduction for this interest under paragraph (c) of this section.

(iii) Under paragraph (h)(1) of this section, a portion of the waived interest is treated as if, on December 31, 2010, it had in fact been paid to Y and was then retransferred by Y to B. The amount of interest deemed transferred to Y and retransferred to B equals the excess, if any, of the amount of interest payable at the blended annual rate for each year the loan is outstanding over the interest actually paid with respect to that year. For 2009, the interest payable at the blended annual rate is \$5,000 (\$100,000 × 0.05). For 2010, the interest payable at the blended annual rate is \$6,000 (\$100,000 × 0.06). Therefore, the amount of interest deemed transferred to Y and retransferred to B equals \$11,000. In addition, the amount deemed retransferred to B is increased by the deferral charge determined under paragraph (h)(4) of this section. Because of the employment relationship between Y and B, the total retransferred amount is treated as compensation paid by Y to B.

(i) [Reserved]