

(j) *Split-dollar loans that provide for contingent payments*—(1) *In general.* Except as provided in paragraph (j)(2) of this section, this paragraph (j) provides rules for a split-dollar loan that provides for one or more contingent payments. This paragraph (j), rather than § 1.1275–4, applies to split-dollar loans that provide for one or more contingent payments.

(2) *Exceptions*—(i) *Certain contingencies.* For purposes of this section, a split-dollar loan does not provide for contingent payments merely because—

(A) The loan provides for options described in paragraph (e)(4)(iii)(B) of this section (for example, certain call options, put options, and options to extend); or

(B) The loan is described in paragraph (e)(5) of this section (relating to certain split-dollar term loans, such as a split-dollar term loan payable not later than the death of an individual).

(ii) *Insolvency and default.* For purposes of this section, a payment is not contingent merely because of the possibility of impairment by insolvency, default, or similar circumstances. However, if any payment on a split-dollar loan is nonrecourse to the borrower, the payment is a contingent payment for purposes of this paragraph (j) unless the parties to the arrangement make the written representation provided for in paragraph (d)(2) of this section.

(iii) *Remote and incidental contingencies.* For purposes of this section, a payment is not a contingent payment merely because of a contingency that, as of the date the split-dollar loan is made, is either remote or incidental (within the meaning of § 1.1275–2(h)).

(iv) *Exceptions for certain split-dollar loans.* This paragraph (j) does not apply to a split-dollar loan described in § 1.1272–1(d) (certain debt instruments that provide for a fixed yield) or a split-dollar loan described in paragraph (g) of this section (relating to split-dollar loans providing for certain variable rates of interest).

(3) *Contingent split-dollar method*—(i) *In general.* If a split-dollar loan provides for one or more contingent payments, then the parties account for the loan under the contingent split-dollar method. In general, except as provided in this paragraph (j), this method is the same as the noncontingent bond method described in § 1.1275–4(b).

(ii) *Projected payment schedule*—(A) *Determination of schedule.* No comparable yield is required to be determined. The projected payment schedule for the loan includes all

noncontingent payments and a projected payment for each contingent payment. The projected payment for a contingent payment is the lowest possible value of the payment. The projected payment schedule, however, must produce a yield that is not less than zero. If the projected payment schedule produces a negative yield, the schedule must be reasonably adjusted to produce a yield of zero.

(B) *Split-dollar term loans payable upon the death of an individual.* If a split-dollar term loan described in paragraph (e)(5)(ii)(A) or (v)(A)(1) of this section provides for one or more contingent payments, the projected payment schedule is determined based on the term of the loan as determined under paragraph (e)(5)(ii)(C) or (v)(B)(2) of this section, whichever is applicable.

(C) *Certain split-dollar term loans conditioned on the future performance of substantial services by an individual.* If a split-dollar term loan described in paragraph (e)(5)(iii)(A)(1) or (v)(A)(2) of this section provides for one or more contingent payments, the projected payment schedule is determined based on the term of the loan as determined under paragraph (e)(5)(iii)(C) or (v)(B)(2) of this section, whichever is applicable.

(D) *Demand loans.* If a split-dollar demand loan provides for one or more contingent payments, the projected payment schedule is determined based on a reasonable assumption as to when the lender will demand repayment.

(E) *Borrower/lender consistency.* Contrary to § 1.1275–4(b)(4)(iv), the lender rather than the borrower is required to determine the projected payment schedule and to provide the schedule to the borrower and to any indirect participant as described in paragraph (e)(2) of this section. The lender's projected payment schedule is used by the lender, the borrower, and any indirect participant to compute interest accruals and adjustments.

(iii) *Negative adjustments.* If the issuer of a split-dollar loan is not allowed to deduct interest or OID (for example, because of section 163(h) or 264), then the issuer is not required to include in income any negative adjustment carryforward determined under § 1.1275–4(b)(6)(iii)(C) on the loan, except to the extent that at maturity the total payments made over the life of the loan are less than the issue price of the loan.

(4) *Application of section 7872*—(i) *Determination of below-market status.* The yield based on the projected payment schedule determined under paragraph (j)(3) of this section is used to determine whether the loan is a below-

market split-dollar loan under paragraph (e) of this section.

(ii) *Adjustment upon the resolution of a contingent payment.* To the extent that interest has accrued under section 7872 on a split-dollar loan and the interest would not have accrued under this paragraph (j) in the absence of section 7872, the lender is not required to recognize income under § 1.1275–4(b) for a positive adjustment and the borrower is not treated as having interest expense for a positive adjustment. To the same extent, there is a reversal of the tax consequences imposed under paragraph (e) of this section for the prior imputed transfer from the lender to the borrower. This reversal is taken into account in determining adjusted gross income.

(5) *Examples.* The following examples illustrate the rules of this paragraph (j). For purposes of this paragraph (j)(5), assume that the contingent payments are neither remote nor incidental. The examples are as follows:

*Example 1.* (i) On January 1, 2010, Employer *T* and Employee *G* enter into a split-dollar life insurance arrangement under which *G* is named as the policy owner. On January 1, 2010, *T* makes a \$100,000 premium payment. On December 31, 2013, *T* will be repaid an amount equal to the premium payment plus an amount based on the increase, if any, in the price of a specified commodity for the period the loan is outstanding. The premium payment is a split-dollar term loan. Repayment of both the premium payment and the interest due thereon is recourse to *G*. Assume that the appropriate AFR for this loan, based on annual compounding, is 7 percent. Both *T* and *G* use the calendar year as their taxable years.

(ii) Under this paragraph (j), the split-dollar term loan between *T* and *G* provides for a contingent payment. Therefore, the loan is subject to the contingent split-dollar method. Under this method, the projected payment schedule for the loan provides for a noncontingent payment of \$100,000 and a projected payment of \$0 for the contingent payment (because it is the lowest possible value of the payment) on December 31, 2013.

(iii) Based on the projected payment schedule and a discount rate of 7 percent, compounded annually (the appropriate AFR), the present value of the payments under the loan is \$76,289.52. Under paragraphs (e)(4) and (j)(4)(i) of this section, the loan does not provide for sufficient interest because the loan's imputed loan amount of \$76,289.52 (the present value of the payments) is less than the amount loaned of \$100,000. Therefore, the loan is a below-market split-dollar term loan and the loan is recharacterized as consisting of two portions: an imputed loan amount of \$76,289.52 and an imputed transfer of \$23,710.48 (amount loaned of \$100,000 minus the imputed loan amount of \$76,289.52).

(iv) In accordance with section 7872(b)(1) and paragraph (e)(4)(iv) of this section, on the