RATES FOR IMPUTED INCOME FOR POST 9-17-2003 SPLIT DOLLAR ARRANGEMENTS

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SPLIT-DOLLAR ECONOMIC BENEFIT COMPUTATIONS

Can an "insurer's lower published premium rates" be used to determine the Cost of Insurance Protection under a split-dollar arrangement entered into after September 17, 2003?

This report investigates whether or not it is permissible to use an insurer's lower published premium rates (instead of using IRS Table 2001) when computing imputed income under the economic benefit regime for a non-equity split-dollar life insurance arrangement entered into (or materially modified) after 9/17/2003.

BACKGROUND

On September 17, 2003, the IRS published final regulations for Split-Dollar Life Insurance Arrangements ("Final Rules")[1]. The preamble to the Final Rules state that "the tax treatment of a non-equity split-dollar arrangement generally follows the tax treatment of a non-equity split-dollar arrangement under Rev. Rul. 64–328 (1964–2 C.B. 11) and its progeny." Fully tracking through the progeny of Rev. Rul. 64-328 is beyond the scope of this report; however, of note, Rev. Rul. 66-110 set forth the ability to use "current published premium rates" in lieu of the higher P.S. 58 Rates previously prescribed. In Notice 2002-8, the IRS provided the following temporary guidance:[2]

> For arrangements entered into before the effective date of future guidance, to the extent provided by Rev. Rul. 66-110, 1966-1 C.B. 12, as amplified by Rev. Rul. 67-154, 1967-1 C.B. 11, taxpayers may continue to determine the value of current life insurance protection by using the insurer's lower published premium rates that are available to all standard risks for initial issue one-year term insurance. However, for arrangements entered into after January 28, 2002, and before the effective date of future guidance, for periods after December 31, 2003, the Service will not consider an insurer's published premium rates to be available to all standard risks who apply for term insurance unless (i) the insurer generally makes the availability of such rates known to persons who apply for term insurance coverage

[1] § 1.61–22 was added to the CFR
[2] Section III, Paragraph 3 of Notice 2002-8

from the insurer, and (ii) the insurer regularly sells term insurance at such rates to individuals who apply for term insurance coverage through the insurer's normal distribution channels.

The excerpt above has several noteworthy elements. First, as written, it applies to arrangements "entered into before the effective date of future guidance." Hence, one might conclude that the release of the Final Rules in September 2003 effectively terminates the applicability of this guidance for split-dollar arrangements entered into after 9/17/2003. Second, relative to Rev. Rul. 66-110, this paragraph institutes additional requirements for the use of the insurer's rates, i.e., such rates must be made known to persons applying for insurance and must be issued through "normal distribution channels."

It is our understanding that several insurance carriers continue to maintain and publish premium rate tables for use in calculating imputed income for split-dollar arrangements (including those entered into after 9/17/2003). We are not aware of any insurance carrier that represents that the use of such rates is explicitly permitted under IRS rules. However, the practice seems to be fairly common.

While there may be some evidence suggesting that the use of insurer's rates is permissible, we do not observe any clear authority to do so.

FINAL RULES

The Final Rules were published 9/17/2003. As noted above, the publication of the Final Rules in the Federal Register included a statement that non-equity split-dollar arrangements would generally follow the established tax treatment under Rev. Rul. 64-328 and its progeny. In the actual regulation, the IRS stated that the "cost of current life insurance protection" equals the amount of current life insurance protection (i.e., the split dollar death benefit) multiplied by the premium factor "designated or permitted" in guidance published in the Internal Revenue Bulletin. The Final Rules did not re-establish or explain the permissibility (or lack thereof) of using insurer's published premium rates.

Thus, the key question appears to be whether the ongoing use of insurer's published premium rates is "designated or permitted" in guidance published in the Internal Revenue Bulletin. The Internal Revenue Bulletin is the authoritative instrument of the Commissioner for the publication of official rulings and procedures of the IRS.

The publication of the Final Rules also included a statement that the IRS and Treasury were concurrently publishing Rev. Rul. 2003-105 "to obsolete certain revenue rulings with respect to split-dollar life insurance arrangements entered into or materially modified after September 17, 2003."

REV. RUL. 2003-105

In Rev. Rul. 2003-105, the following listing was set forth as being obsolete to the extent described (emphasis added):

- Rev. Rul. 79-50, 1979-1 C.B. 139
- Rev. Rul. 78-420, 1978-2 C.B. 67
- Rev. Rul. 66-110, 1966-1 C.B. 12 (except as provided in Section III, Paragraph 3 of Notice 2002-8, 2002-1 C.B. 398, and Notice 2002-59, 2002-36 I.R.B. 481)
- Rev. Rul. 64-328, 1964-2 C.B. 11.

Rev. Rul. 2003-105 also made clear that for any split-dollar arrangements entered into before 9/17/2003, taxpayers could continue to rely on these revenue rulings, to the extent described in Notice 2002-8.

It is not clear to us what the IRS intended the emphasized exception identified in Rev. Rul. 66-110 to accomplish. The referenced paragraph of Notice 2002-8 is the same paragraph excerpted above that allowed the use of insurer's rates provided certain requirements were met. Again, that paragraph applied to arrangements "entered into before the effective date of future guidance" and the additional requirements applied to arrangements entered into after 1/28/2002. Therefore, it is possible that Rev. Rul. 2003-105 was effectively maintaining Rev. Rul. 66-110 for its application to split-dollar arrangements entered into after 9/17/2003.

CONCLUSION

To our knowledge, the IRS has not clarified the permissibility of using insurer's published premium rates since Notice 2002-8. Perhaps the Final Rules are not considered "further guidance." If guidance is only in the form of Revenue Rulings and Notices, then perhaps the later bound of applicability of Section III, Paragraph 3 of Notice 2002-8 has not yet been reached. As noted previously, it is our understanding that insurer's premium rates continue to be commonly used for imputed income on post-9/17/2003 arrangements.

To the extent that insurer's premium rates are contemplated for use, we recommend documenting information regarding the qualification of such rates under the rules (both for arrangements prior to 1/28/2002 and for those subject to the expanded qualifications identified in Notice 2002-8).

Relative to insurer's lower published rates, using Table 2001 rates for split-dollar arrangements entered into after 9/17/2003 would be a conservative choice.

We hope you find this report useful in reviewing the topic. We do not provide tax or accounting advice, nor should this report be construed as such. However, we hope to equip you with information needed to reach your own conclusion on appropriate rates to use for computing imputed income under the economic benefit regime for a non-equity split-dollar life insurance arrangement entered into (or materially modified) after 9/17/2003.

We hope you find this memo useful in reviewing the topic. If you would like more information, please contact us.