Office of Chief Counsel
Internal Revenue Service
memorandum

CC:NER:BRK:TL-N-5934-98
TKerrigan
FEB 0 4 1999

date:

to: District Director, Brooklyn
Attention: Examination Division
Examination Branch II - Group 1209 (CEP)

from: District Counsel
Brooklyn CC:NER:BRK

---

subject: [redacted] **- Split Dollar Life Insurance**
U.I.L. No. 0061.00-00

THIS DOCUMENT MAY INCLUDE CONFIDENTIAL INFORMATION SUBJECT TO THE ATTORNEY-CLIENT AND DELIBERATIVE PROCESS PRIVILEGES, AND MAY ALSO HAVE BEEN PREPARED IN ANTICIPATION OF LITIGATION. THIS DOCUMENT SHOULD NOT BE DISCLOSED TO ANYONE OUTSIDE THE IRS, INCLUDING THE TAXPAYERS INVOLVED, AND ITS USE WITHIN THE IRS SHOULD BE LIMITED TO THOSE WITH A NEED TO REVIEW THE DOCUMENT IN RELATION TO THE MATTER OF THE CASES DISCUSSED HEREIN. THIS DOCUMENT IS ALSO TAX INFORMATION OF THE INSTANT TAXPAYERS WHICH IS SUBJECT TO I.R.C. § 6103.

This memorandum is in reply to your request for advice concerning the tax consequences of "split-dollar" life insurance arrangements and the economic benefits flowing from them. In formulating our response, we have relied upon the supporting facts outlined by Team Coordinator John Doughty. The information submitted for our consideration is set forth below.

FACTS

The relevant facts, as we understand them to be, are as follows: [redacted] and [redacted] are executives of [redacted]. [redacted] is the President and Chief Executive Officer of [redacted]. [redacted] is the Chairman of [redacted] and [redacted] In [redacted], [redacted]. entered into agreements with both [redacted] and [redacted] to purchase "split-dollar" life insurance policies. Under these "split-dollar" arrangements, the corporation and trusts established by [redacted] and [redacted] joined in purchasing [redacted] life insurance contracts for each executive. The agreements provide that the corporation pays that part of the annual premium which represents the increase in the cash surrender value each year, and the trusts pay the balance of the annual premium. The annual premiums for the tax years [redacted]

and [redacted] exceeded $[redacted]. In the event of the death of the insured, the corporation is entitled to receive out of the proceeds of the policy an amount equal to all premiums paid by it at the time the death benefits are paid. The trusts are the named beneficiaries of the policies and receive the balance of any remaining proceeds. [redacted] represented to the examiner that the trust contributions were determined in accordance with rates supplied by the respective insurance companies for one-year term life insurance. The contributions made by the [redacted] Trust were $[redacted] and $[redacted] in [redacted] and [redacted], respectively. The contributions made by the [redacted] Trust were $[redacted] and $[redacted] in [redacted] and [redacted], respectively. For comparison purposes, the examiner calculated the term life portions of the policies using the "PS 58" rates as set forth in Rev. Rul. 55-747, 1955-2 C.B. 228. The examiner determined that the trust share of the premiums using this alternative method was $[redacted] and $[redacted] in [redacted] and [redacted], respectively for the [redacted] Trust and $[redacted] and $[redacted] in [redacted] and [redacted], respectively for the [redacted] Trust. Due to the large discrepancy between the company's computations and the "PS 58" calculations, the examiner has concerns whether proper premium rates were substituted for those in Rev. Rul. 55-747, 1955-2 C.B. 228, and used by the taxpayer to determine the cost of insurance in connection with the "split-dollar" arrangements with the respective trusts.

ISSUE

Whether the parties used proper rates to determine the trusts' share of the cost of insurance in connection with the "split-dollar" life insurance arrangements discussed above.

LEGAL ANALYSIS

I.R.C. § 61(a)(1) broadly defines gross income as "all income from whatever source derived," including "[c]ompensation for services, including fees, commissions, fringe benefits, and similar items." The Supreme Court has construed this provision to encompass the value of all economic benefits conferred upon an employee by the employer. See Commissioner v. LoBue, 351 U.S. 243, 246 (1956); Commissioner v. Smith, 324 U.S. 177, 181 (1945); Old Colony Trust Co. v. Commissioner, 279 U.S. 716, 729 (1929).

The payment by an employer of premiums on insurance policies on the life of an employee for the employee's benefit is presumed to be compensation for services. Yuengling v. Commissioner, 69 F.2d 971, 972 (3d Cir. 1934); Miller v. Commissioner, 144 F.2d

287, 289 (4th Cir. 1944); Commissioner v. Bonwit, 87 F.2d 764, 765 (2d Cir. 1937), cert. denied, 302 U.S. 694 (1937); Lee v. United States, 219 F. Supp. 225, 228 (W.D.S.C. 1963).

In the "split-dollar" arrangements described above, the corporation and principals jointly purchased life insurance contracts in which there are substantial investment elements. The trusts pay the portion of the annual premiums that cover the annual risk charge and the administrative charge (the current cost of insurance coverage; i.e., term life insurance coverage), while the corporation pays the portion of the premium that relates to the investment component. The corporation is entitled to recover, out of the policy proceeds, an amount equal to the cash surrender value of the policy or at least an amount equal to the payments made by the employer or the corporation; i.e., the investment component. The beneficiaries are entitled to receive the balance of the policy proceeds; i.e., the risk component.

The benefit of these arrangements to [redacted] and [redacted] is that the amounts paid as premiums by the corporation enable the insurance company to generate funds that then pay for the current cost of insurance coverage in later years. The practical effect is that although the [redacted], through their trusts, pay a substantial part of the first premium, the portion of the annual premium paid by them rapidly decreases. The benefit to the corporation is that the amounts paid as premium payments by the corporation are recovered out of the policy proceeds, thereby limiting the cost to the corporation to the loss of the interest on the amount advanced as premium payments.[1/]

The Service has provided specific guidance with respect to "split-dollar" life insurance. Rev. Rul. 64-328, 1964-2 C.B. 11, holds that under these type of "split-dollar" arrangements, the employee must include in gross income an amount equal to the one-year term cost of the declining life insurance protection to which the employee is entitled from year to year (less the portion, if any, provided by the employee). The ruling further holds that the cost of the life insurance protection per $1,000,

---

[1/] Neither the corporation nor the insured is entitled to deduct premiums paid under the arrangements described herein. I.R.C. § 264(a)(1) prohibits a taxpayer from deducting amounts paid as premiums on any life insurance policy covering the life of any officer, employee, or other person financially interested in any trade or business carried on by the taxpayer, when the taxpayer is directly or indirectly a beneficiary under such policy. The insured would be denied a deduction because any payments made are a personal expense.

as shown in Rev. Rul. 55-747, 1955-2 C.B. 228, may be used to compute the one-year term cost.

Rev. Rul. 66-110, 1966-1 C.B. 12, amplified by Rev. Rul. 67-154, 1967-1 C.B. 11, provides that in any case where the current published premium rates per $1,000 of insurance protection charged by an insurer for individual one-year term life insurance available to all standard risks are lower than those set forth in Rev. Rul. 55-747, 1955-2 C.B. 228, such published rates may be used in place of the rates set forth in that revenue ruling for determining the cost of insurance in connection with individual policies issued by the same insurer and used for split dollar arrangements.

Rev. Rul. 67-154, 1967-1 C.B. 11, provides that in referring to rates that may be substituted for those in Rev. Rul. 55-747, 1955-2 C.B. 228, Rev. Rul. 66-110, 1966-1 C.B. 12, contemplates gross premium rates charged by an insurer for initial issue insurance, available to all standard risks. Rev. Rul. 67-154, 1967-1 C.B. 11, further provides that dividend option rates are not available to all standard risks since "an individual seeking to purchase only a basic policy of term insurance could not obtain it at those rates."

CONCLUSION

Based on the analysis above, we believe that this issue requires further factual development before either proposing any adjustment or accepting the calculations used by the taxpayer. Accordingly, we recommend that you obtain copies of the insurance policies at issue and copies of the anniversary statements, which will provide information as to the cash value of the policy and any dividends paid. You may also want to consider contacting the insurance companies directly and verifying that the premium rates used to compute trust contributions are actual published rates for one-year term insurance available for all standard risks. Please be advised that the requirements of Rev. Rul. 66-110, 1966-1 C.B. 12, will be satisfied only if an individual seeking to purchase only a basic policy of initial issue term insurance could obtain it at those rates. Accordingly, the rates used by the parties may not be applicable to only nonsmokers, they may not be applicable only to policies in excess of a certain dollar amount, they may not be dividend option rates, and they may not be applicable to, for example, only five-year term insurance.

The differences between the company's computations and the "PS 58" calculations, standing alone, is insufficient to establish that the company's initial calculations were not determined in accordance with the Service's rulings concerning

"split-dollar" insurance policies but does warrant further investigation. We note that the "PS 58" costs in Rev. Rul. 55-747, 1955-2 C.B. 228, which provides the table of uniform one-year premiums per $1,000 of term insurance, have never been updated by the Service. Therefore, the actual cost of term life insurance coverage offered by insurance companies nearly forty years later may be considerably lower than the rates contained in Rev. Rul. 55-747, 1955-2 C.B. 228.

Please be advised that this opinion is based upon the facts set forth herein. It might change if the facts are determined to be incorrect. If the facts are determined to be incorrect, this opinion should not be relied upon. You should be aware that, under routine procedures which have been established for opinions of this type, we have referred this memorandum to the Office of Chief Counsel for review. That review might result in modifications to the conclusions herein. We will inform you of the result of the review as soon as we hear from that office. In the meantime, the conclusions reached in this opinion should be considered to be only preliminary.

If you have any questions or require additional information, please call Thomas Kerrigan at (516) 688-1702.

DONALD SCHWARTZ
District Counsel

By: Jody Tancer
JODY TANCER
Assistant District Counsel

cc: Assistant Chief Counsel (Field Service)