



FINANCIAL SERVICES

- Insurance Tax Bulletin

PRICEWATERHOUSECOOPERS 

Split-dollar Life Insurance Arrangement Modifications

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The IRS recently released Notice 2008-42, which addresses the application of Sections 101(j) and 264(f) to life insurance contracts that are subject to split-dollar life insurance arrangements. Under Notice 2008-42, a modification of a split-dollar life insurance arrangement that does not entail any change to the life insurance contract underlying the arrangement will not be treated as a material change in the life insurance contract for purposes of Sections 101(j) and 264(f).

The rules for the taxation of participants in a split-dollar life insurance arrangement are provided in Sections 1.61-22, 1.301-1(q), and 1.7872-15 of the Income Tax Regulations. The regulations generally apply to any split-dollar life insurance arrangement entered into after September 17, 2003. Additionally, if an arrangement entered into on or before September 17, 2003, is materially modified after September 17, 2003, the arrangement is treated as a new arrangement entered into on the date of the modification.

Section 101(j)(1) generally provides that death benefits from an employer-owned life insurance contract in excess of premiums paid are taxable unless certain exceptions are met. Section 101(j) applies to life insurance contracts issued after August 17, 2006. Contracts issued after that date pursuant to a Section 1035 exchange for a contract issued on or before that date are not considered to be new contracts unless there is a material change to the contract. Otherwise, contracts issued on or before August 17, 2006, are grandfathered and not subject to the requirements of Section 101(j).

Section 264(f)(1) generally eliminates a taxpayer's deduction for the portion of the taxpayer's interest expense which is allocable to unborrowed policy cash value" with respect to a life insurance policy or an annuity or endowment contract. Section 264(f) applies to contracts issued after June 8, 1997. Any material increase in the death benefit or other material change in the contract issued before this date is treated as a new contract. Otherwise, contracts issued on or before June 8, 1997, are grandfathered and not subject to the requirements of Section 264(f).

In Notice 2008-42, the IRS noted that Sections 101(j) and 264(f) apply to "life insurance contracts," as defined in Section 7702. The IRS further noted that under Section 7702, the term "life insurance contract" generally does not encompass the terms of an arrangement, such as a split-dollar arrangement, of which the contract is a part. Accordingly, the IRS determined that if the parties to a split-dollar life insurance arrangement modify the terms of the arrangement but do not modify the terms of the life insurance contract underlying the arrangement, the modification will not be treated as a material change in the life insurance contract for purposes of Section 101(j) and 264(f), even if the modification is treated as a material modification of the split-dollar arrangement for purposes of Section 1.61-22(j).

PwC Observes: Notice 2008-42 provides welcome assurance to taxpayers who modified the split-dollar arrangement between the parties subsequent to September 17, 2003 but have not modified their underlying insurance contracts.

For additional information please call Anthony DiGilio at (202) 414-1702 or contact your local insurance tax professional. Please visit us at: <http://www.pwc.com/us/insurance/tax>

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