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## SPLIT DOLLAR LOAN PRIVATE LETTER RULINGS

Under final regulations effective September 17, 2003, a split-dollar life insurance arrangement may be taxed under either the “economic benefit” regime (if the donor or employer is the deemed owner of the life insurance contract) or the “loan” regime (if the donee or employee is the deemed owner of the life insurance contract).

Under the loan regime, income is imputed to the donee or employee to the extent required under the Section 7872 Treasury regulations. Generally, no income will be imputed if the split-dollar agreement requires “adequate stated interest” to be paid or accrued at or above the “applicable Federal rate” in effect on the date the loan is made.

Nonrecourse loans (loans as to which the lender agrees to look only to the collateral - the life insurance policy and proceeds - for repayment) are tested differently for purposes of Section 7872 compliance. Where, as is typical, a split-dollar loan is nonrecourse to the borrower (in other words, secured only by the life insurance policy), the payment is treated as a “contingent” payment. To avoid contingent payment treatment (which generally will result in the imposition of unfavorable assumptions when testing the loan for adequate stated interest), the parties to the loan must represent in writing (and must attach to the parties’ returns), no later than the due date for the return of the borrower or lender for the year in which the first split-dollar loan is made, that a “reasonable person” would expect that all payments under the loan will be made. In recently released private letter rulings, the taxpayers, who were employee participants in a split-dollar life insurance arrangement, requested an extension of time to file the required written representations.

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Under the facts of a private letter ruling (PLR), Employer and Employer’s parent (“Parent”) are both nonprofit corporations. Since Year 1, Parent has had in place a split-dollar life insurance plan (SDP) for the benefit of a number of key employees of Parent and its subsidiaries, including Employer. In Year 2, Parent hired Company A to consult on matters relating to the split-dollar program and to administer the program. Company A recommended revising the split-dollar plan and in Year 3, Parent implemented a new split-dollar life insurance program. Company B subsequently acquired Company A and became Parent’s consultant and administrator of the split-dollar program. In Year 5, Parent implemented a new split-dollar life insurance program (“current SDP”) upon the recommendation of Company B. The current SDP was entered into after the Treasury Department’s issuance, in 2003, of the final split-dollar regulations.

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Under the current SDP, Employer pays the premiums on the split dollar life insurance policy owned by each of its employees. The premium payments made by Employer are treated as split-dollar loans, whereby Employer is the lender and each of the employees is the borrower. Each taxpayer represents that his loan is to have a stated interest rate equal to the applicable federal rate so as not to be “below-market split-dollar loans” under the regulations. Employer made the first loan under the current SDP to Taxpayer in Year 5.

Taxpayer in each case represents that he or she lacked knowledge and experience with regard to split-dollar life insurance arrangements and the split-dollar regulations, and therefore, relied on Employer’s guidance, representations, conclusions, and information regarding the current SDP. Employer, in turn, relied on Company B’s guidance in developing, implementing, and administering the current SDP. Unfortunately, despite this guidance, neither Employer nor the employees filed the required representations, regarding the nonrecourse nature of the split-dollar loan, with their respective Year 5 tax returns.

In Year 6, Company B ceased administering the current SDP and Employer hired Company C to administer the current SDP.

Due to the decline in the value of common stocks and many bonds from Year 6 to early Year 7, the cash surrender values of the life insurance policies under the current SDP declined, and Employer obtained legal advice to ascertain options for revising or terminating the current SDP. Employer’s attorneys advised Employer that, under applicable State law, the loans under the current SDP were not recourse loans, but rather nonrecourse loans secured by the life insurance policies. Subsequently, in each case Employer informed Taxpayer that his loan was nonrecourse and that a written representation should have been filed by both Taxpayer and Employer with the Year 5 returns to ensure that payments on the loans were not treated as contingent payments. Employer thereafter asked that Taxpayer file a request for an extension of time to make the written representations.

“Section 9100 relief” is relief from certain regulatory deadlines that may be granted upon conditions prescribed in regulations. Under, Treas. Reg. § 301.9100-3(a), where an automatic extension of time is not available (as in the instant ruling) the taxpayer must provide evidence satisfactorily establishing that the taxpayer acted reasonably and in good faith and that granting relief will not prejudice the Government.

A taxpayer will be deemed to have acted reasonably and in good faith if the taxpayer satisfies at least one of the following five criteria: (i) the request for relief was made before the Service discovered the failure to make the regulatory election; (ii) the failure to make the election was due to intervening events beyond the taxpayer’s control; (iii) after exercising reasonable diligence, the taxpayer was unaware of the necessity for the election; (iv) the taxpayer reasonably relied on the written advice of the Service; or (v) the taxpayer reasonably relied upon a qualified tax professional, including a tax professional employed by

the taxpayer, and that tax professional failed to make or failed to advise the taxpayer to make the election.

The regulations provide that a taxpayer has not reasonably relied on a qualified tax professional if the taxpayer knew, or should have known, that the professional was either (i) not competent to render advice on the regulatory election, or (ii) not aware of all relevant facts. In addition, a taxpayer will not be deemed to have acted reasonably and in good faith if the taxpayer does one of the following: (i) seeks to alter a return position for which an

accuracy-related penalty has been or could be imposed under section 6662 at the time the taxpayer requests relief and the new position requires or permits a regulatory election for which relief is requested; (ii) was informed in all material respects of the required election and the subsequent tax consequences, but chose not to make the election; or (iii) uses hindsight in requesting relief.

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The regulations also state that the interests of the Government are prejudiced if granting relief would result in the taxpayer having a lower liability in the aggregate for all years to which the regulatory election applies than the taxpayer would have had if the election had been timely made (taking into account the time value of money).

Given the foregoing requirements, each Taxpayer made the following representations: The granting of Section 9100 relief would not result in Taxpayer having a lower tax liability in the aggregate for all years to which the election applies than it would have had if the election had been timely made (taking into account the time value of money); Taxpayer did not knowingly choose not to file the election; and Taxpayer did not use hindsight in requesting relief. Finally, each Taxpayer represented that he or she was not seeking to alter a return position for which an accuracy-related penalty has been or could be imposed. In support of its ruling request, each Taxpayer also submitted the affidavits of Taxpayer, Employer's Chief Executive Officer, Employer's tax return preparer, and Employer's counsel regarding the events that led to Taxpayer's failure to file the required representation.

On these facts, the IRS concluded that the requirements for granting a reasonable extension of time to file the written representations as required under the split-dollar regulations were met. Each Taxpayer was therefore granted a period of time, not to exceed 30 days from the date of the PLR, to prepare and have both parties to the loan sign the written representation. The Service further stated that, "provided that the written representation is timely signed by both parties to the loan as required by this letter and filed with the Taxpayer's tax return for Year 8, the written representation will be deemed effective for all years in which the Arrangement has been in effect." A copy of the representation also should be filed with Taxpayer's returns in any subsequent year in which Employer makes a split-dollar loan to Taxpayer.

These letter rulings illustrate that the nonrecourse/contingent payment loan rules as applied to split-dollar life insurance arrangements may be a trap for the unwary.

## PENSION PLAN AMOUNTS FOR 2011

The Internal Revenue Service (IRS) has announced various cost of living adjustments affecting dollar limitations for pension plans and other retirement-related items for 2011. In general, the limits either remain unchanged, or the inflation adjustments for 2011 will be small. Highlights include:

The contribution limit for employees who participate in section 401(k), 403(b), or 457(b) plans, and the federal government's Thrift Savings Plan remains unchanged at \$16,500.

The catch-up contribution limit under those plans for those aged 50 and over remains unchanged at \$5,500.

The deduction for taxpayers making contributions to a traditional IRA is phased out for singles and heads of household who are active participants in an employer-sponsored retirement plan and have modified adjusted gross incomes (AGI) between \$56,000 and \$66,000, unchanged from 2010. For married couples filing jointly, in which the spouse who makes the IRA contribution is an active participant in an employer-sponsored retirement plan, the income phase-out range is \$90,000 to \$110,000, up from \$89,000 to \$109,000. For an IRA contributor who

is not an active participant in an employer-sponsored retirement plan and is married to someone who is an active participant, the deduction is phased out if the couple's income is between \$169,000 and \$179,000, up from \$167,000 and \$177,000.

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The AGI phase-out range for taxpayers making contributions to a Roth IRA is \$169,000 to 179,000 for married couples filing jointly, up from \$167,000 to \$177,000 in 2010. For singles and heads of household, the income phase-out range is \$107,000 to \$122,000, up from \$105,000 to \$120,000. For a married individual filing a separate return who is an active participant in an employer-sponsored retirement plan, the phase-out range remains \$0 to \$10,000.

The limitation for defined contribution plans remains unchanged for 2011 at \$49,000.

The limitation regarding SIMPLE retirement accounts remains unchanged at \$11,500.

## INCOME TAX BRACKETS NOT RELEASED, BUT OTHER NUMBERS ARE RELEASED

Because there has not been action in Congress about income tax brackets, the Internal Revenue Service (IRS) has not released the income tax brackets for 2011. But some other inflation-adjusted amounts were released by the IRS.

For 2011, the limitations regarding eligible long-term care premiums includible in the term “medical care,” are as follows:

Attained Age Before the Close of the Taxable Year	Limitation on Premiums
40 or less	\$340
More than 40 but not more than 50	\$640
More than 50 but not more than 60	\$1,270
More than 60 but not more than 70	\$3,390
More than 70	\$4,240

Also, for 2011, the per diem limitation regarding periodic payments received under a qualified long-term care insurance contract or periodic payments received under a life insurance contract that are treated as paid by reason of the death of a chronically ill individual, is \$300.

For calendar year 2011, the gift tax exclusion stays at \$13,000 per person. Also, for 2011, the gift tax exclusion for a gift to a non-citizen spouse increases to \$136,000 from \$134,000.

The information presented here is not intended as tax or other legal advice. For application of this information to your specific situation, you should consult an attorney. Contact your representative for more information and assistance in obtaining life insurance and other products to help meet your financial planning needs.

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