Internal Revenue
bulletin

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HIGHLIGHTS OF THIS ISSUE

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Notice 2002–52, page 187.
This notice clarifies proposed regulations (REG–105369–00, 2002–18, I.R.B. 828) under sections 141 and 148 of the Code relating to certain natural gas prepayments.

Notice 2002–53, page 187.
2002 enhanced oil recovery credit. The enhanced oil recovery credit for taxable years beginning in the 2002 calendar year is determined without regard to the phase-out for crude oil price increases provided in section 43(b) of the Code.

Notice 2002–54, page 189.
2002 marginal production rates. This notice announces the applicable percentage under section 613A of the Code to be used in determining percentage depletion for marginal properties for the 2002 calendar year.

REG–106871–00, page 190.
Proposed regulations under section 671 of the Code define widely held fixed investment trusts, clarify the reporting obligations of the trustees and middlemen connected with these trusts, and provide for the communication of necessary tax information to beneficial owners. REG–209813–96 withdrawn.

REG–164754–01, page 212.
Proposed regulations under section 61 of the Code provide comprehensive guidance on split-dollar life insurance arrangements for federal income, employment, and gift tax purposes. In general, the regulations provide two mutually exclusive regimes for the taxation of these arrangements: the economic benefit regime and the loan regime. A public hearing is scheduled for October 23, 2002.

GIFT TAX

REG–164754–01, page 212.
Proposed regulations under section 61 of the Code provide comprehensive guidance on split-dollar life insurance arrangements for federal income, employment, and gift tax purposes. In general, the regulations provide two mutually exclusive regimes for the taxation of these arrangements: the economic benefit regime and the loan regime. A public hearing is scheduled for October 23, 2002.

EMPLOYMENT TAX

REG–164754–01, page 212.
Proposed regulations under section 61 of the Code provide comprehensive guidance on split-dollar life insurance arrangements for federal income, employment, and gift tax purposes. In general, the regulations provide two mutually exclusive regimes for the taxation of these arrangements: the economic benefit regime and the loan regime. A public hearing is scheduled for October 23, 2002.

ADMINISTRATIVE

Announcement 2002–67, page 237.
This document contains corrections to the dates and/or locations of public hearings for several proposed regulations.

Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

The IRS Mission

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions and Other Related Items, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

Part IV.—Items of General Interest.

This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

The first Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis, and are published in the first Bulletin of the succeeding semiannual period, respectively.

For sale by the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402.

Part III. Administrative, Procedural, and Miscellaneous

Clarification of Proposed Regulations Relating to Tax-Exempt Bonds Issued by State or Local Governments (REG–113526–98; REG–105369–00)

Notice 2002–52

PURPOSE

On April 17, 2002, the Treasury Department and the Internal Revenue Service published in the Federal Register proposed regulations under sections 141 and 148 of the Internal Revenue Code relating to tax-exempt bonds issued by state or local governments (REG–113526–98; REG–105369–00, 2002–18 I.R.B. 828) (the proposed regulations). This notice clarifies the application of certain provisions of the proposed regulations relating to natural gas prepayments.

BACKGROUND

The proposed regulations propose to amend the definition of private loan in § 1.141–5(c) and the definition of investment-type property in § 1.148–1(e). In particular, the proposed regulations address the circumstances in which a prepayment for property or services will be treated as a loan for purposes of the private loan financing test of section 141(c), or will give rise to investment-type property under section 148(b)(2)(D). Among other things, the proposed regulations add an exception to the definitions of private loan and investment-type property for natural gas prepayments that meet certain requirements set forth in § 1.148–1(e)(2)(ii) of the proposed regulations.

Section 1.148–1(e)(2)(ii)(C) of the proposed regulations states that a transaction will not fail to qualify for this exception by reason of any commodity swap contract that may be entered into between the issuer and an unrelated party (other than the gas supplier), or between the gas supplier and an unrelated party (other than the issuer), so long as each swap contract is an independent contract. For this purpose, § 1.148–1(e)(2)(ii)(C) provides that a swap contract is an independent contract if the obligation of each party to perform under the swap contract is not dependent on performance by any person (other than the other party to the swap contract) under another contract (for example, a gas supply contract or another swap contract).

Questions have arisen regarding the characterization in § 1.148–1(e)(2)(ii)(C) of when a swap contract will constitute an independent contract. Comments have been received indicating that the practices and policies of certain state and local governments require that if an issuer enters into a commodity swap contract, the swap contract must terminate if the supplier of the commodity being hedged fails to deliver the commodity to the issuer.

CLARIFICATION OF PROPOSED REGULATIONS

For purposes of § 1.148–1(e)(2)(ii)(C) of the proposed regulations, a natural gas commodity swap contract will not fail to be an independent contract solely because the swap contract may terminate in the event of a failure of a gas supplier to deliver gas for which the swap contract is a hedge. Comments are requested on the limitations on commodity swap contracts contained in § 1.148–1(e)(2)(ii)(C) of the proposed regulations.

Issuers may rely on this notice as if it were included in the proposed regulations.

FURTHER INFORMATION

For further information regarding this notice, contact Johanna Som de Cerff at (202) 622–3980 (not a toll-free call).

2002 Section 43 Inflation Adjustment

Notice 2002–53

Section 43(b)(3)(B) of the Internal Revenue Code requires the Secretary to publish an inflation adjustment factor. The enhanced oil recovery credit under § 43 for any taxable year is reduced if the "reference price," determined under § 29(d)(2)(C), for the calendar year preceding the calendar year in which the taxable year begins is greater than $28 multiplied by the inflation adjustment factor for that year.

The term "inflation adjustment factor" means, with respect to any calendar year, a fraction the numerator of which is the GNP implicit price deflator for the preceding calendar year and the denominator of which is the GNP implicit price deflator for 1990.

Because the reference price for the 2001 calendar year ($21.86) does not exceed $28 multiplied by the inflation adjustment factor for the 2002 calendar year, the enhanced oil recovery credit for qualified costs paid or incurred in 2002 is determined without regard to the phase-out for crude oil price increases.

Table 1 contains the GNP implicit price deflator used for the 2002 calendar year, as well as the previously published GNP implicit price deflators used for the 1991 through 2001 calendar years.

Notice 2002–53 TABLE 1

GNP IMPLICIT PRICE DEFLATORS

Calendar Year	*GNP Implicit Price Deflator*
1990	112.9 (used for 1991)
1991	117.0 (used for 1992)
1992	120.9 (used for 1993)
1993	124.1 (used for 1994)
1994	126.0 (used for 1995)
1995	107.5 (used for 1996)*
1996	109.7 (used for 1997)
1997	112.35 (used for 1998)**
1998	112.64 (used for 1999)
1999	104.59 (used for 2000)***
2000	106.89 (used for 2001)
2001	109.31 (used for 2002)

* Beginning in 1995, the GNP implicit price deflator was rebased relative to 1992. The 1990 GNP implicit price deflator used to compute the 1996 § 43 inflation adjustment factor is 93.6.

** Beginning in 1997, two digits follow the decimal point in the GNP implicit price deflator. The 1990 GNP price deflator used to compute the 1998 § 43 inflation adjustment factor is 93.63.

*** Beginning in 1999, the GNP implicit price deflator was rebased relative to 1996. The 1990 GNP implicit price deflator used to compute the 2000 § 43 inflation adjustment factor is 86.53.

Table 2 contains the inflation adjustment factor and the phase-out amount for taxable years beginning in the 2002 calendar year as well as the previously published inflation adjustment factors and phase-out amounts for taxable years beginning in 1991 through 2001 calendar years.

Notice 2002–53 TABLE 2

INFLATION ADJUSTMENT FACTORS AND
PHASE-OUT AMOUNTS

Calendar Year	*Inflation Adjustment Factor*	*Phase-out Amount*
1991	1.0000	0
1992	1.0363	0
1993	1.0708	0
1994	1.0992	0
1995	1.1160	0
1996	1.1485	0
1997	1.1720	0
1998	1.1999	0
1999	1.2030	0
2000	1.2087	0
2001	1.2353	0
2002	1.2633	0

DRAFTING INFORMATION

The principal author of this notice is Jaime Park of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice, contact Ms. Park at (202) 622-3120 (not a toll-free call).

2002 Marginal Production Rates

Notice 2002–54

Section 613A(c)(6)(C) of the Internal Revenue Code defines the term "applicable percentage" for purposes of determining percentage depletion for oil and gas produced from marginal properties. The applicable percentage is the percentage (not greater than 25 percent) equal to the sum of 15 percent, plus one percentage point for each whole dollar by which $20 exceeds the reference price (determined under § 29(d)(2)(C)) for crude oil for the calendar year preceding the calendar year in which the taxable year begins. The reference price determined under § 29(d)(2)(C) for the 2001 calendar year is $21.86.

Table 1 contains the applicable percentages for marginal production for taxable years beginning in calendar years 1991 through 2002.

Notice 2002–54 Table 1

APPLICABLE PERCENTAGE FOR MARGINAL PRODUCTION

Calendar Year	*Applicable Percentage*
1991	15 percent
1992	18 percent
1993	19 percent
1994	20 percent
1995	21 percent
1996	20 percent
1997	16 percent
1998	17 percent
1999	24 percent
2000	19 percent
2001	15 percent
2002	15 percent

The principal author of this notice is Jaime Park of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice, contact Ms. Park at (202) 622-3120 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Withdrawal of Previous Notice of Proposed Rulemaking

Reporting for Widely Held Fixed Investment Trusts

REG–106871–00 and REG–209813–96

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and withdrawal of previous notice of proposed rulemaking.

SUMMARY: This document contains the withdrawal of proposed regulations (REG–209813–96), published on August 13, 1998, in the **Federal Register** (63 FR 43354). This document also contains new proposed regulations that define widely held fixed investment trusts, clarify the reporting obligations of the trustees of these trusts and the middlemen connected with these trusts, and provide for the communication of necessary tax information to beneficial owners of trust interests.

DATES: Written or electronic comments and requests for a public hearing must be received by September 17, 2002.

ADDRESSES: Send submissions to: CC:ITA:RU (REG–106871–00), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may also be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:ITA:RU (REG–106871–00), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC or sent electronically, via the IRS Internet site at: *www.irs.gov/regs*.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Faith Colson, (202) 622–3060 or Viva Hammer, (202) 622–0869; concerning submission of comments, Guy Traynor, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information in this notice of proposed rulemaking has been previously reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1540.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to the collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

This document contains reproposed amendments to the Income Tax Regulations (26 CFR part 1) under section 671. These reproposed amendments are to be issued under the authority of section 7805.

On August 13, 1998, the IRS and Treasury published in the **Federal Register** (63 FR 43354) a notice of proposed rulemaking (REG–209813–96, 1998–2 C.B. 259) under sections 671, 6049 and 6109. A public hearing was held on November 5, 1998. No oral comments were made at the public hearing. Written comments were received.

After consideration of the written comments received, the IRS and Treasury believe that it is appropriate to repropose these regulations. Accordingly, the provisions of the proposed regulations published in August of 1998, are withdrawn, and these reproposed regulations are now being issued.

A fixed investment trust is an arrangement classified as a trust under § 301.7701–4(c). Beneficial interests in these trusts are divided into unit interests. The IRS treats these trusts as grantor trusts under subpart E, part I, subchapter J, chapter 1 of the Internal Revenue Code (Code) and the owners of the beneficial interests, or units, as grantors. See Rev. Rul. 84–10 (1984–1 C.B. 155); Rev. Rul. 61–175 (1961–2 C.B. 128). Interests in these trusts are often held in the street name of a middleman, who holds such interests on behalf of the beneficial owners. Thus, trustees ordinarily do not know the identity of the beneficial owners and are not in a position to communicate information directly to them. These reproposed regulations provide tax information reporting rules that specifically require the sharing of tax information among trustees, middlemen, and the beneficial owners of domestic fixed investment trusts in which any interest is held by a middleman.

Although the reproposed regulations retain the scope and framework provided under the 1998 proposed regulations, the reproposed regulations allow more flexibility regarding the format and frequency in which trust information is communicated from trustees to middlemen. In addition, the reproposed regulations simplify the rules contained in the 1998 proposed regulations for the reporting of a sale or disposition of a trust asset.

Explanation of Provisions

I. *Scope and General Framework of Reporting Rules*

These reproposed regulations apply to all widely held fixed investment trusts. In the 1998 proposed regulations, a *widely held fixed investment trust* (WHFIT) was defined as a fixed investment trust in which any interest is held by a middleman. The term *middleman* included but was not limited to, a custodian of a person's account, a nominee, and a broker holding an interest for a customer in street name. In the preamble to the 1998 proposed regulations, comments were requested on the application and scope of these definitions. No comments were received and those definitions are retained in these reproposed regulations except that the definition of a WHFIT is modified to clarify that a trust must be classified as a United States person under section 7701(a)(30)(E) to be a WHFIT.

A notice of proposed rulemaking (REG–108553–00, 2000–1 C.B. 452), published in the **Federal Register** (65 FR 60822) on October 12, 2000, specified safe harbors under which certain investment trusts would be classified as United States persons under section 7701(a)(30)(E). Commentators responding to those proposed regulations noted that certain fixed investment trusts would be outside those safe harbors and would accordingly be treated as foreign trusts. As a result of those trusts being treated as foreign trusts, United States investors in those trusts would be subject to the reporting rules under section 6048. The commentators suggested that United States investors in those trusts should not be subject to reporting under section 6048 and to the corresponding penalties in section 6677 for failure to comply with the section 6048 reporting requirements. Final regulations (T.D. 8962, 2001–35 I.R.B. 201) under 7701 were published in the **Federal Register** (66 FR 41778) on August 9, 2001. The preamble to those final regulations states that because a guidance project concerning reporting requirements for all widely held fixed investment trusts was under consideration, those final regulations would not specifically address the section 6048 reporting issue raised by the commentators. The IRS and Treasury continue to study how to facilitate the application of the section 6048 rules to foreign fixed investment trusts and request practical suggestions on this issue, including how Forms 3520 and 3520A can be adapted for use with foreign fixed investment trusts.

The information reporting framework in the 1998 proposed regulations was similar to that for regular interests in a real estate mortgage investment conduit (REMIC). See § 1.6049–7. Under this framework, the responsibility for information reporting lies primarily with the person in the ownership chain who holds an interest for a beneficial owner and is, therefore, in the best position to communicate with, and provide trust tax information to, the beneficial owner. Thus, a brokerage firm that holds an interest in a WHFIT for an individual as a middleman is to report WHFIT tax information with respect to that individual to the IRS on Forms 1099 and furnish WHFIT tax information to the individual. Similarly, if an interest in a WHFIT is held directly by an individual and not through a middleman, the trustee is to report to the IRS and provide WHFIT tax information directly to the individual. One commentator suggested a different framework: one similar to the rules in § 1.6031(b)–1T and § 1.6031(c)–1T regarding partnership interests held by nominees. Under § 1.6031(b)–1T and § 1.6031(c)–1T, nominees are required to provide information regarding the identity of a partner to the partnership. The partnership must then provide necessary tax information directly to the partner. Given that this suggestion was merely an alternative to that commentator's preferred solution of simplifying the reporting requirements provided by the 1998 proposed regulations, and that no other commentators raised concerns about the framework, the reproposed regulations retain the REMIC framework.

II. *Trustee's Requirement to Calculate and Provide WHFIT Information*

A. *General rules*

Under the 1998 proposed regulations and the reproposed regulations, a trustee is no longer required to file a Form 1041, with an attached statement, for a WHFIT. See § 1.671–4(a). Instead, a trustee must provide trust tax information to requesting persons (middlemen and others). In addition, if a beneficial owner that is not an exempt recipient, holds an interest in a WHFIT directly with the trust, and not through a middleman, the trustee must also file a Form 1099 with respect to that owner and furnish trust tax information to that owner.

Consistent with the taxation of grantor trusts, the 1998 proposed regulations required trustees to provide trust tax information in a manner that was sufficient for requesting persons to determine the exact items of income, deduction, and credit of the WHFIT that were attributable to a unit interest holder. In addition, the 1998 proposed regulations required trustees to calculate and provide WHFIT information on a quarterly basis. In drafting the 1998 proposed regulations, the IRS and Treasury believed that quarterly reporting was necessary for requesting persons to have sufficient information to determine the trust items that were attributable to a unit interest holder who held a unit interest for less than an entire calendar year or a unit interest holder not using a calendar year as the holder's taxable year.

Several commentators, in describing current tax reporting practices, indicated that trustees do not provide trust tax information in a manner that would enable a requesting person to determine the exact amounts of trust items that are attributable to a unit interest holder. With respect to the requirement of quarterly reporting in the 1998 proposed regulations, several commentators responded that many trustees only provide tax reporting information on a calendar year basis. These commentators contended that quarterly reporting unnecessarily increased a trustee's reporting burden fourfold. These commentators argued that WHFIT tax information only needs to be calculated and provided on a calendar year basis for trustees and middlemen to fulfill Form 1099 reporting requirements. Other commentators responded that some WHFITs provide information on a monthly basis.

In response to these comments, the reproposed regulations remove the quarterly reporting requirement contained in the 1998 proposed regulations. Under the reproposed regulations, trustees may choose either a calendar month, calendar quarter, or a full or half calendar year reporting period provided that the information supplied by the trustee under the chosen reporting period enables the WHFIT items attributable to a particular unit interest holder to be determined with reasonable accuracy, regardless of the holder's taxable year or the period of time that the unit interest holder held its interest.

The reproposed regulations provide that once a reporting period has been chosen by a trustee, the trustee must use that reporting period throughout the trust's existence. It is expected that requesting persons (in particular, middlemen) will develop a method for processing information from a WHFIT that takes into account the reporting period chosen by the trustee. The consistency requirement was included in the reproposed regulations in response to concerns that requesting persons would be required to change their processing systems if the trustee changes the WHFIT's reporting period. The IRS and Treasury invite comments on the necessity of the consistency requirement and on whether an alternative approach would be more effective in facilitating the processing of information by requesting persons.

Because requesting persons may be required to process WHFIT tax information provided by many different trustees, the reproposed regulations also require trustees to provide trust tax information in a manner that is consistent with industry practice. Thus, a requesting person using current industry practice must be able to process the WHFIT tax information provided by the trustee.

The reproposed regulations require that the information provided by the trustee be presented in a manner such that a requesting person is able to separately state any WHFIT item that, if taken into account separately by a beneficial owner, could result in an income tax liability for the beneficial owner different from that which would result if the beneficial owner did not take the item into account separately. Examples of the types of information that are to be provided under this provision include: (i) items of tax preference subject to the alternative minimum tax imposed by section 55; (ii) investment interest and investment income and expense necessary to compute limitations under section 163(d); (iii) income from oil and gas subject to depletion under sections 613 and 613A; (iv) most depreciation and depletion expenses; and (v) intangible drilling and development costs (see section 263(c)). This provision is not intended to require asset-by-asset reporting.

B. *Method of accounting*

A beneficial owner of a unit interest must report WHFIT items consistent with the owner's method of accounting. See, for example, Rev. Rul. 84–10. For administrative convenience and with the intent of being consistent with industry practice, under the 1998 proposed regulations, a WHFIT was to calculate and provide WHFIT tax information using the cash receipts and disbursements method of accounting. Several commentators confirmed that the majority of WHFITs currently use the cash receipts and disbursements method of accounting. Under the reproposed regulations, WHFIT tax information must be calculated and provided using the cash receipts and disbursements method of accounting except where another method is required by the Code or regulations with respect to a specific trust item. Accordingly, a WHFIT must provide information necessary for unit interest holders to comply with the rules of subtitle A, chapter 1, subchapter P, part V, subpart A, which require the inclusion of accrued amounts with respect to original issue discount (OID), and section 860B(b), which requires the inclusion of accrued amounts with respect to a REMIC regular interest.

The reproposed regulations also provide that if a WHFIT is marketed to accrual method taxpayers and the WHFIT holds assets for which the timing of the recognition of income is materially affected by the use of the accrual method, trust tax information must be calculated and provided using the accrual method of accounting.

C. *Information to be provided by all WHFITs*

The information to be provided by the trustee under the reproposed and 1998 proposed regulations is similar. The tax reporting information the trustee is to calculate and provide under the reproposed regulations includes:

1. All Items of Income, Deduction, and Credit

Under both the reproposed and the 1998 proposed regulations, the trustee must provide information with respect to all items of income (including OID), deduction (including affected expenses (as defined in § 1.67–2T(i)(1))), and credit of the WHFIT. In furnishing information regarding the items of income, the trustee must provide the gross amount of trust income generated by trust assets. Thus, if a WHFIT receives a payment net of an expense or expenses, the payment must be grossed up to reflect the deducted expense so that the WHFIT's income and expenses can be properly reported by unit interest holders. The trustee must also have, and make available, information regarding the WHFIT's expenses, including affected expenses.

2. Information to Enable Unit Interest Holders to Determine Gain or Loss on the Sale or Disposition of a WHFIT Asset

The reproposed regulations simplify, but do not eliminate, reporting by the trustee with respect to the sale or disposition of a WHFIT asset.

The reporting rules in the 1998 proposed regulations were designed to provide a unit interest holder with sufficient information to calculate the unit interest holder's approximate gain or loss on the sale or disposition of an asset by the WHFIT. To that end, trustees were required to provide information regarding the amount of the gross proceeds from the sale or disposition of a WHFIT asset, the date of sale or disposition of the asset, and the percentage of the asset that has been sold or disposed of. In addition, trustees were required to provide a schedule showing the portion (expressed as a percentage) of the total fair market value of all the assets held by the WHFIT that the asset sold or disposed of represented as of the last day of each quarter that the asset was held by the WHFIT. The 1998 proposed regulations also required that this information be provided on an asset-by-asset approach.

Commentators stated that, for various reasons, it would be impossible, or, at the very least, extremely costly and burdensome for trustees to comply with the reporting rules contained in the 1998 proposed regulations. These commentators urged the IRS and Treasury to adopt reporting rules that require trustees and middlemen to only provide information regarding the amount of gross proceeds that are distributed to a unit interest holder.

These commentators noted that many trustees and middlemen currently only provide information regarding the amount of gross proceeds that are distributed. Commentators also noted, however, that as a result of this reporting, many beneficial owners treat the distribution of gross proceeds by the WHFIT as a return of the beneficial owner's investment. Therefore, any gain, loss, discount, or premium that should be recognized by a beneficial owner as a result of the sale or disposition of a trust asset is deferred until the beneficial owner either exhausts its basis in its unit interest or sells or redeems its unit interest. Commentators nevertheless contended that the resulting tax deferral did not justify the reporting obligations imposed by the 1998 proposed regulations. As support, commentators contended that to maintain their status as trusts under § 301.7701–4(c), WHFITs sell or dispose of their assets only infrequently.

In response to these comments, the reproposed regulations provide that the information to be reported with respect to an asset sale or disposition depends on whether the WHFIT's asset sales or dispositions for the calendar year exceed a *de minimis* amount. If trust sales proceeds for a given calendar year equal or are less than 5% of the fair market value of the assets of the trust as of January 1 of that year, a trust meets the *de minimis* test for the calendar year. The reproposed regulations define trust sales proceeds as the gross proceeds received by a WHFIT with respect to a sale or disposition of an asset by the WHFIT. If a trust meets the *de minimis* test, the trustee need only provide information that enables requesting persons to calculate the amount of trust sales proceeds that are attributable to a unit interest holder.

If asset sales and dispositions exceed the *de minimis* amount, the trustee must provide, with respect to each sale or disposition: (i) the date of the sale; (ii) information regarding trust sale proceeds; (iii) information that will enable a unit interest holder to allocate with reasonable accuracy a portion of its basis in its unit interest to the sale or disposition; and (iv) information that will enable a unit interest holder to allocate with reasonable accuracy a portion of its market discount or premium, if any, to the sale or disposition.

Commentators on the 1998 proposed regulations indicated that, in providing information regarding gross proceeds, trustees and middlemen only provide unit interest holders with information regarding the amount of gross proceeds that have been distributed to them, not the amount that is attributable to each unit interest holder. Under these reproposed regulations, trustees and middlemen, when providing gross proceeds information, must provide information regarding the amount of gross proceeds that are attributable to the holder.

3. Information With Respect to Redemptions and Sales of Unit Interests

Specific guidelines for the reporting of the redemption of a unit interest from a WHFIT and for the reporting of a sale of a unit interest on a secondary market were not provided under the 1998 proposed regulations. In response to the comments received with respect to the 1998 proposed regulations, the reproposed regulations now provide guidance on the reporting of these transactions.

4. Other information

The reproposed regulations require the trustee to provide any other information necessary for a unit interest holder that is a beneficial owner of a unit interest to report, with reasonable accuracy, the items of income, deduction, and credit attributable to the portion of the trust treated as owned by the unit interest holder under section 671. Several commentators objected to the inclusion of a similar requirement in the 1998 proposed regulations. The IRS and Treasury note that WHFITs are used to hold a wide variety of assets. This provision is intended to clarify that trustees must accommodate beneficial owners' needs for appropriate information with respect to the assets held by the WHFIT. This provision is also intended to clarify that the information provided by the trustee must accommodate the different tax attributes of the beneficial owners of the WHFIT. This provision, however, is not intended to require asset-by-asset reporting.

D. *Additional information to be provided by the trustee of a widely held mortgage trust*

Commentators on the 1998 proposed regulations identified specific concerns regarding the tax information reporting obligations of the trustee of a WHFIT that primarily holds mortgages as its assets. The IRS and Treasury believe that changes in the reproposed regulations that apply to all WHFITs address some of these concerns. In response to other concerns raised by the commentators, the reproposed regulations provide certain rules tailored specifically to widely held mortgage trusts (WHMTs). The reproposed regulations define a WHMT as a WHFIT, substantially all the assets of which, measured by value, are mortgages, amounts received on mortgages, and reasonably required reserve funds.

1. Receipt of Scheduled and Unscheduled Principal Payments

Commentators requested clarification regarding the reporting of the trust's receipts of scheduled and unscheduled principal payments on the mortgages held by the WHMT. Under the reproposed regulations, trustees must calculate and provide information regarding these principal receipts, and, as with all information provided by the trustee, it must be done in a manner that enables a requesting person to determine with reasonable accuracy the principal receipts attributable to a unit interest holder. Scheduled and unscheduled principal receipts are aggregated with the WHMT's proceeds from sales and dispositions of mortgages and reported as trust sales proceeds to the IRS on Form 1099. Unless a trustee reports under the safe harbor for certain WHMTs, scheduled and unscheduled principal receipts and trust sales proceeds are reported separately to beneficial owners.

2. Sales and Dispositions of Mortgages

Commentators requested that the IRS and Treasury clarify that certain transactions that regularly occur during the administration of a WHMT do not trigger the reporting rules for sales and dispositions provided under the 1998 proposed regulations. These transactions involve the sale of a mortgage by a WHMT to the guarantor, sponsor, or previous owner for an amount equal to its unpaid principal balance plus accrued but unpaid interest. Commentators maintained that the costs involved in reporting these transactions as sales or dispositions under the 1998 proposed regulations outweighed the benefit of reporting the required information to unit interest holders. The IRS and Treasury believe that the *de minimis* test in the reproposed regulations alleviates the reporting burden concerns expressed by the commentators responding to the 1998 proposed regulations. Therefore, in general, the reproposed regulations provide no special WHMT rules for reporting these transactions and, under the reproposed regulations, these transactions are reported the same as any other sale or disposition engaged in by a WHFIT.

The reproposed regulations do, however, adjust the *de minimis* test for WHMTs. In response to concerns regarding provisions in the 1998 proposed regulations that require a trustee of a WHMT to assign a fair market value to mortgages held by a WHMT, the reproposed regulations provide that the trustee is to use the aggregate outstanding principal balance of the WHMT's mortgages for purposes of applying the *de minimis* test. Scheduled and unscheduled principal receipts are not included in the amount of trust sales proceeds for purposes of determining whether a WHMT has met the *de minimis* test.

3. Reporting Information With Respect to Market Discount

The 1998 proposed regulations required, with respect to a WHFIT that holds a pool of debt instruments subject to section 1272(a)(6)(C)(iii), that trustees and middlemen provide information to enable beneficial owners to comply with market discount rules and where applicable, section 1272(a)(6) (as amended by section 1004 of the Taxpayer Relief Act of 1997, Public Law 105–34 (111 Stat. 766, 911) (1997)).

Several commentators questioned the application of this reporting requirement in the 1998 proposed regulations. These commentators asserted that, in the absence of additional guidance under section 1272(a)(6)(C)(iii), it was unclear which WHFITs held a pool of debt instruments subject to that section and accordingly were required to report market discount information and information consistent with section 1272(a)(6)(C)(iii) to comply with the 1998 proposed regulations. These commentators requested that this reporting requirement be deferred until substantive guidance is provided regarding the application of section 1272(a)(6)(C)(iii).

In response to this comment, the IRS and Treasury note that, under section 1276(a)(3), beneficial owners of a unit interest are required to include in gross income, as ordinary income, the partial payment of a debt instrument to the extent that such payment does not exceed the accrued market discount on the debt instrument. The IRS and Treasury also note that unit interest holders in a WHMT consistently receive partial payments on the mortgages held by the WHMT and that, absent information being provided by the trustee, unit interest holders in a WHMT do not have the information necessary to calculate their accrued market discount under section 1276(a)(3) and, therefore, cannot properly report the tax consequences of their ownership of the unit interest. For this reason, the reproposed regulations require trustees and middlemen of all WHMTs to provide information to enable unit interest holders to calculate market discount by any reasonable manner that is consistent with section 1276(a)(3). Pending the issuance of guidance under section 1272(a)(6)(C)(iii), a trustee may, but is not required, by these reproposed regulations, to provide market discount and OID information that is calculated consistent with the application of section 1272(a)(6)(C)(iii). The reproposed regulations only provide reporting rules. Substantive rules regarding OID and market discount are provided in subtitle A, chapter 1, subchapter P, part V of the Code and the regulations thereunder.

Commentators also contended that substantive guidance was lacking regarding the methodology to be used by unit interest holders in accruing market discount under section 1276(a)(3). The commentators contended that the requirement to provide market discount information should be deferred until guidance regarding methodology is issued.

Section 1803(a)(13)(A) of the Tax Reform Act of 1986 (TRA 1986) Public Law 99–514 (100 Stat. 2085) amended section 1276 to include sections 1276(a)(3) and (b)(3). Section 1276(b)(3) provides that the computation of the accrual of market discount with respect to partial principal payments is to be provided by Treasury regulations. To date, no regulations have been issued under section 1276(b)(3). The IRS and Treasury note, however, that although no regulations have been issued under section 1276(b)(3), the conference report accompanying the amendment to section 1276 provides that until such time as the Treasury Department issues such regulations, the conferees intend that market discount be accrued as provided in the conference report. See H.R. Rep. No. 841, 99th Cong., 2nd Sess., at II–842 (1986). Accordingly, the IRS and Treasury believe that there is sufficient guidance regarding the methodology for accruing market discount under section 1276(a)(3) to impose as a current requirement that trustees provide market discount information that enables a unit interest holder to determine the portion of the holder's market discount that has accrued during the reporting period by any manner reasonably consistent with section 1276(a)(3). In addition, the reproposed regulations include a safe harbor for certain WHMTs for providing market discount information that is considered to be reasonably consistent with section 1276(a)(3). The safe harbor requires the use of the prepayment assumption used in pricing the original issue of unit interests.

4. Reporting Information With Respect to Amortizable Bond Premium

The 1998 proposed regulations imposed no reporting requirements on trustees and middlemen with respect to amortizable bond premium. Some owners of unit interests that acquire their interests at a premium may have amortizable bond premium within the meaning of section 171. In response to comments received with respect to the 1998 proposed regulations, as well as in connection with other matters, the IRS and Treasury note that not all owners of unit interests may receive sufficient information to reasonably determine the amount of any amortizable bond premium on mortgages held by a WHMT. For this reason, the reproposed regulations include a general requirement that trustees and middlemen of all WHMTs provide information to enable unit interest holders to determine the amount of the unit interest holder's amortizable bond premium, if any, in any manner that is reasonably consistent with section 171. The IRS and Treasury are continuing to study and request comments on an appropriate safe harbor for reporting premium information for unit interest holders that buy their interests at a premium.

D. *Safe harbor factors*

Several commentators reported that many trustees currently provide tax information to middlemen through the use of "factors." These trustees assume that middlemen maintain a record of certain trust information with respect to the unit interest holders for whom the middlemen hold an interest. Trustees provide these middlemen with data, called factors, which are ratios. Trustees assume that middlemen will use these factors to extrapolate by multiplication necessary trust tax information with respect to their unit interest holders from the information that middlemen already have in their records. The factors provided by a trustee depend on the type of assets held by the WHFIT and the tax items to be determined. Some trustees provide factors on a calendar year basis and some provide factors on a monthly basis. As an example, the comments received with respect to the 1998 proposed regulations indicated that the trustees of many WHFITs assume that middlemen receive and maintain a record of the amount of cash distributed to (or credited to the account of) a unit interest holder from the WHFIT during the calendar year. These trustees provide middlemen with factors that when multiplied by the amount of cash from the WHFIT distributed by a middleman to (or credited to the account of) a unit interest holder during the calendar year, enable a middleman to determine the amount of trust income and the amount of trust expenses that are attributable to the unit interest holder for the calendar year.

The reproposed regulations provide as safe harbors, examples of methods for calculating certain factors that the IRS and Treasury believe will enable requesting persons to determine, with reasonable accuracy, the trust items attributable to a unit interest holder. Section 1.671–5(g) of the reproposed regulations provides safe harbor methods for calculating factors that provide information with respect to sales and dispositions of trust assets, trust income, trust expenses, OID, and market discount for certain WHMTs. The reproposed regulations condition the application of the safe harbors on the WHMT meeting certain requirements. The IRS and Treasury request comments on how the safe harbors provided in proposed § 1.671–5(g) can be modified and extended to WHMTs not meeting the requirements in the reproposed regulations.

Section 1.671–5(f) of the reproposed regulations provides safe harbor methods for calculating certain factors that provide similar information for WHFITs other than WHMTs. The IRS and Treasury request comments regarding the applicability of the safe harbors in proposed § 1.671–5(f) to WHFITs that hold assets other than stock and debt instruments and whether different safe harbors are needed for those WHFITs.

The IRS and Treasury also request comments on how the safe harbors provided in § 1.671–5(f) and (g) of the reproposed regulations can be modified to better conform to industry practice while providing the IRS and beneficial owners with necessary WHFIT tax information. In addition, the IRS and Treasury request comments from requesting persons on their ability to process WHFIT tax information that is provided to them in the form of factors.

E. *Time and manner for providing WHFIT information*

1. Trustee may Identify a Trust Representative and Publish Trust Information on the Internet

Under both the 1998 proposed regulations and the reproposed regulations, the trustee must identify the name, address, and telephone number of a representative or official of the WHFIT who will provide the trust information required to be provided by the trustee. In addition to the list of places described in the 1998 proposed regulations where the trustee may publish this information, the reproposed regulations also permit the trust representative to be identified in the trust's prospectus or on the trustee's Internet site. When providing this information under the reproposed regulations, the trustee must also identify the reporting period that the trustee will use to calculate and provide trust information. Further, the reproposed regulations permit the trust information described in § 1.671–5(c) of the reproposed regulations to be furnished to requesting persons on the trustee's Internet site or on another Internet site designated by the trustee.

2. Extension of Time for Furnishing Trust Information for Certain WHFITs

With respect to most WHFITs, the reproposed regulations retain the requirement of the 1998 proposed regulations that WHFIT information be provided on or before the later of the 30th day after the close of the reporting period for which the information is requested, or, the 14th day after the receipt of the request to provide information. Under the reproposed regulations, if substantially all of the assets of the WHFIT are unit interests in another WHFIT or regular interests in a REMIC, the reproposed regulations allow the trustee until on or before the later of the 44th day after the close of the reporting period for which the information is requested, or, the 28th day after the receipt of the request to provide trust information.

III. *Rules for Providing Trust Information to the IRS and to Beneficial Owners*

A. *In general*

Under the 1998 proposed regulations and the reproposed regulations, a middleman is required to file Forms 1099 with the Internal Revenue Service and to furnish a tax information statement to the beneficial owner of a unit interest. If a beneficial owner holds an interest directly with a trustee, the trustee is required to file Forms 1099 with the Internal Revenue Service and to furnish the statement to the beneficial owner. A Form 1099 and a statement are not required for a beneficial owner that is an exempt recipient.

The reproposed regulations provide rules for determining the information to be provided on the Forms 1099 required to be filed with the Internal Revenue Service with respect to a beneficial owner and for determining the information to be provided on the tax information statement required to be furnished to the owner. First, the information provided on the Forms 1099 and the tax information statement must be consistent with the information required to be provided by the trustee under § 1.671–5(c) of the reproposed regulations. Second, the information provided must reflect with reasonable accuracy the trust items that are attributable to the beneficial owner. Third, the statement must separately state any trust item that if taken into account separately by the beneficial owner, could result in an income tax liability for that owner different from that which would result if the owner did not take the item into account separately.

In addition, the reproposed regulations require that the information provided on the Forms 1099 and the tax information statement be determined as provided in § 1.671–5(f) or (g), as appropriate, if the trustee has provided information in accordance with the safe harbors described in those paragraphs. One commentator requested that trustees and middlemen be permitted to provide factors to beneficial owners. Under this approach, a beneficial owner would have the burden of understanding and applying the factors to determine the amounts of income, deductions, and credits of the WHFIT that are attributable to the owner. The reproposed regulations provide that middlemen, and trustees, where appropriate, must provide the IRS and beneficial owners with the amounts of income, deduction, and credit of a WHFIT that are attributable to a beneficial owner. It is not permissible for middlemen and trustees to merely provide factors to a beneficial owner.

B. *Reporting with respect to foreign unit interest holders*

The 1998 proposed regulations did not address reporting with respect to unit interest holders that are not United States persons. In response to comments received with respect to the 1998 proposed regulations, the reproposed regulations clarify that payments made from a WHFIT to a unit interest holder that is not a United States person are to be withheld and reported in accordance with Subtitle A, Chapter 3 of the Code and the regulations thereunder.

IV. *Clarification of the Relationship Between These Reporting Rules and Other Reporting Rules*

The preamble to the 1998 proposed regulations noted that appropriate adjustments to other information reporting rules may be necessary to make them compatible with those proposed regulations. One such provision is § 1.6049–5(a)(6), which was cited by one commentator as an example of a provision allowing the amount of interest to be reported to the IRS to be based on the interest paid as stated on the investor's certificate, rather than the interest on the notes or obligations underlying the certificate. To be consistent with the taxation of a grantor trust, the reproposed regulations revise § 1.6049–5(a)(6) to clarify that the income to be reported with respect to WHFITs is the gross amount of income earned by trust assets.

In addition, comments received with respect to the 1998 proposed regulations requested clarification of the relationship between the reporting rules in the proposed regulations and the reporting rules in subpart B, part III, subchapter A, chapter 61 of the Code (Information Returns Concerning Transactions with Other Persons) (Subpart B). In response, the reproposed regulations provide that if reporting is required under the reproposed regulations and Subpart B, the reproposed regulations will control. The reproposed regulations also provide that the rules of Subpart B are incorporated into the reproposed regulations to the extent that those rules are not inconsistent with the reporting rules in the reproposed regulations.

Proposed Effective Date

These regulations are proposed to be applicable beginning January 1, 2004.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the regulations generally clarify existing reporting obligations and are expected, for the most part, to have a minimal impact on industry practice. Thus, the regulations will not result in a significant economic impact on any entity subject to the regulations. Further, the reporting burdens in these regulations will fall primarily on large brokerage firms, large banks, and other large entities acting as trustees or middlemen, most of which are not small entities within the meaning of the Regulatory Flexibility Act (5 U.S.C. chapter 6). Thus, a substantial number of small entities will not be affected. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any electronic or written comments (a signed original and eight (8) copies) that are submitted timely (in the manner described in the ADDRESSES caption) to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these regulations is Faith Colson, Office of Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

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Proposed Amendments to the Regulations

Accordingly, 26 CFR parts 1, 301 and 602 are proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.671–4 is amended by revising paragraph (a) to read as follows:

§ 1.671–4 Method of reporting.

(a) *Portion of trust treated as owned by the grantor or another person*. Except as otherwise provided in paragraph (b) of this section and § 1.671–5, items of income, deduction, and credit attributable to any portion of a trust which, under the provisions of subpart E (section 671 and following), part I, subchapter J, chapter 1 of the Internal Revenue Code, is treated as owned by the grantor or another person are not reported by the trust on Form 1041, "*U.S. Income Tax Return for Estates and Trusts*," but are shown on a separate statement to be attached to that form. Section 1.671–5 provides special reporting rules for widely held fixed investment trusts. Section 301.7701–4(e)(2) of this chapter provides guidance on how the reporting rules in this paragraph (a) apply to an environmental remediation trust.

* * * * *

Par. 3. Section 1.671–5 is added to read as follows:

§ 1.671–5 Reporting for widely held fixed investment trusts.

(a) *Table of contents*. This table of contents lists the major paragraph headings for this section.

(iii) Requirement to provide market discount information.
(iv) Requirement to provide premium information.
(3) Example of safe harbor.
(i) Facts.
(ii) Trustee reporting.
(iii) Broker's use of the information provided by trustee.
(h) Requirement that middlemen furnish information to exempt recipients and noncalendar-year taxpayers.
(1) In general.
(2) Time and manner of providing information.
(3) Clearing organization.
(i) Reserved.
(j) Exempt recipients.
(1) Requirement that exempt recipient include accurate trust information in computing taxable income.
(2) Exempt recipients defined.
(i) Persons described in paragraph 1.6049–4(c)(1)(ii) of this chapter.
(ii) Middlemen.
(iii) Real estate mortgage investment conduit.
(iv) A WHFIT.
(v) Certain trusts and estates.
(k) Coordination with information reporting rules under subpart B, part III, subchapter A, chapter 61 of the Internal Revenue Code (Information Returns Concerning Transactions With Other Persons).
(l) Backup withholding requirements.
(m) Penalties for failure to comply.
(n) Effective date.

(b) *Definitions*. Solely for purposes of this § 1.671–5:

(1) An *asset* includes any real or personal, tangible or intangible property held by the trust, including an interest in a contract.

(2) An *affected expense* is an expense described in § 1.67–2T(i)(1).

(3) The *cash held for distribution* is the amount of cash that would be payable to unit interest holders if the amount of a distribution were required to be determined as of the date in question.

(4) A *distribution paid on redemption of a unit interest* is the portion of a redemption price that represents the cash held for distribution with respect to the redeemed unit interest.

(5) An *exempt recipient* is any person described in paragraph (j)(2) of this section.

(6) The *gross proceeds paid on redemption of a unit interest* is the portion of the redemption price that represents payment for the assets held by the trust (other than cash held for distribution) with respect to the redeemed unit interest.

(7) A *middleman* is any person who, at any time during the calendar year, holds an interest in an arrangement classified as a trust under § 301.7701–4(c) of this chapter, on behalf of, or for the account of, another person, or who otherwise acts in a capacity as an intermediary for the account of another person. A middleman includes, but is not limited to—

(i) A custodian of a person's account, such as a bank, financial institution, or brokerage firm acting as custodian of an account;

(ii) A nominee, including the joint owner of an account or instrument except if the joint owners are husband and wife; and

(iii) A broker (as defined in section 6045(c)(1) and § 1.6045–1(a)(1)) holding an interest for a customer in street name.

(8) A *mortgage* is an obligation that is principally secured by an interest in real property within the meaning of § 1.860G–2(a).

(9) The *redemption price* is the total amount paid to a unit interest holder upon redemption of a unit interest.

(10) A *reporting period* is the period chosen under paragraph (c)(1)(ii) of this section by the trustee for providing trust information to requesting persons.

(11) A *requesting person* is a person specified in paragraph (c)(6)(i) of this section who is entitled under this § 1.671–5 to request the trust information specified in paragraphs (c)(2) and (3) of this section.

(12) The *start-up date* is the date on which substantially all of the assets and the contracts for the purchase of assets have been deposited with the trustee of the widely held fixed investment trust.

(13) *Trust sale proceeds* are the gross proceeds (see § 1.6045–1(d)(5)) received by a trust with respect to the sale or disposition of an asset held by a trust.

(14) A *unit interest holder* is any person who holds a direct or indirect interest, including a beneficial interest, in a widely held fixed investment trust at any time during the calendar year.

(15) A *widely held fixed investment trust* (WHFIT) is an arrangement classified as a trust under § 301.7701–4(c) of this chapter in which any interest in the trust is held by a middleman; provided the trust is a United States person under section 7701(a)(30)(E), and the unit interest holders of the trust are treated as owners under subpart E, part I, subchapter J, chapter 1 of the Internal Revenue Code.

(16) A *widely held mortgage trust* (WHMT) is a WHFIT, substantially all the assets of which, measured by value, are mortgages, amounts received on mortgages, and reasonably required reserve funds. A WHFIT does not fail to meet this definition merely because it holds, during a brief initial funding period, both cash and short-term contracts for the purchase of mortgages.

(c) *Trustee's obligation to furnish information*—(1) *In general*. Upon request, a trustee of a WHFIT must provide to any requesting person, for the reporting period requested, the information described in paragraph (c)(2) of this section and, in the case of a WHMT, the information described in paragraph (c)(3) of this section. The information provided by the trustee must be determined in accordance with the following rules.

(i) *Calculation and presentation*. WHFIT information must be provided in any manner that—

(A) Enables a requesting person to determine with reasonable accuracy the WHFIT items described in paragraphs (c)(2) and (3) of this section that are attributable to a unit interest holder for the taxable year of that unit interest holder;

(B) Conforms, generally, with industry practice for the reporting of the WHFIT items described in paragraphs (c)(2) and (3) of this section for the type of asset or assets held by the WHFIT; and

(C) Enables a requesting person to separately state any WHFIT item that, if taken into account separately by a beneficial owner of a unit interest, would result in an income tax liability different from that which would result if the owner did not take the item into account separately.

(ii) *Reporting period*—(A) *General rule*. Provided a trustee uses the same reporting period throughout the trust's existence and the information provided by the trustee meets the requirements of paragraph (c)(1)(i) of this section, WHFIT information may be determined and provided on the basis of a calendar month, calendar quarter, or half or full calendar year.

(B) *Reporting period for original issue discount and market discount*. Notwithstanding paragraph (c)(1)(ii)(A) of this section, a trustee must determine the information required to be provided with respect to original issue discount (OID), market discount, and premium using a semi-annual, or shorter, reporting period.

(iii) *Accounting method*—(A) *General rule*. WHFIT information must be calculated and provided using the cash receipts and disbursements method of accounting except where another method is required by the Internal Revenue Code or regulations with respect to a specific trust item. Accordingly, a trustee must provide information necessary for unit interest holders to comply with the rules of subtitle A, chapter 1, subchapter P, part V, subpart A which require the inclusion of accrued amounts with respect to OID, and section 860B(b) which requires the inclusion of accrued amounts with respect to a REMIC regular interest.

(B) *Exception for WHFITs marketed predominantly to taxpayers on the accrual method*. If the trustee or the trust's sponsor has knowledge that a WHFIT is marketed primarily to accrual method unit interest holders and the WHFIT holds assets for which the timing of the recognition of income is materially affected by the use of the accrual method of accounting, the WHFIT must prepare and report trust information using the accrual method of accounting.

(iv) *Gross income requirement*. The amount of trust income reported by the trustee must be the amount of gross income generated by the WHFIT's assets. Thus, in the case of a WHFIT that receives a payment net of an expense or expenses, the payment must be grossed up to reflect the deducted expense or expenses. See paragraph (c)(2)(iii) of this section regarding reporting with respect to sales and dispositions.

(2) *Information to be provided by all trusts*. With respect to all WHFIT's—

(i) *Trust identification*. The trustee must provide information identifying the WHFIT, including—

(A) The name of the WHFIT;

(B) The name and address of the trustee;

(C) The employer identification number of the WHFIT; and

(D) The Committee on Uniform Security Indentification Procedure (CUSIP) number, account number, serial number, or other identifying number of the WHFIT.

(ii) *Items of income, deduction, and credit*. The trustee must provide information detailing—

(A) All items of gross income;

(B) All items of deduction; and

(C) All items of credit.

(iii) *Asset sales and dispositions*—(A) *The de minimis test*. The information to be reported under this paragraph (c)(2)(iii) with respect to asset sales and dispositions depends on whether the WHFIT meets a *de minimis* test with respect to sales and dispositions for the calendar year.

(*1*) *De minimis test*. A WHFIT meets the *de minimis* test if trust sales proceeds for the calendar year equal or are less than five percent of the aggregate fair market value of all assets held by the trust as of January 1st of that year, or the start-up date, if the trust was not in existence on January 1st.

(*2*) *Effect of clean-up call*. If a WHFIT fails to meet the *de minimis* test in this paragraph (c)(2)(iii) solely as the result of a clean-up call (the redemption of all unit interests in termination of the WHFIT when the administrative costs of the trust outweigh the benefits of maintaining the trust), the WHFIT will be treated as having met the *de minimis test* in this paragraph (c)(2)(iii).

(B) *Information required to be provided for WHFITs meeting the de minimis test*. If a WHFIT meets the *de minimis* test of this paragraph (c)(2)(iii) for a calendar year, the trustee must provide the date of each sale or disposition and information regarding the trust sale proceeds received by the trust with respect to the sale or disposition. The trustee must also provide requesting persons with a statement that the WHFIT met the *de minimis* test of this paragraph (c)(2)(iii) for the calendar year.

(C) *Additional information required to be provided for WHFITs not meeting the de minimis test*. If a WHFIT does not meet the *de minimis* test of this paragraph (c)(2)(iii) for a calendar year, the trustee must provide with respect to each sale or disposition of WHFIT assets—

(*1*) The date of each sale or disposition;

(*2*) Information regarding the trust sale proceeds received by the WHFIT with respect to the sale or disposition;

(*3*) Information that will enable a unit interest holder to allocate with reasonable accuracy a portion of the holder's basis in the unit interest to the sale or disposition; and

(*4*) Information that will enable a unit interest holder to allocate with reasonable accuracy a portion of the unit interest holder's market discount or premium, if any, to the sale or disposition.

(D) *Application of this paragraph to a WHMT*—In the case of a WHMT, the trust meets the *de minimis* test in this paragraph (c)(2)(iii) if trust sales proceeds for the calendar year equal or are less than five percent of the aggregate outstanding principal balance of all mortgages held by the WHMT as of January 1st of that year, or the start-up date, if the trust was not in existence on January 1st. For purposes of applying the *de minimis* test in this paragraph (c)(2)(iii), scheduled and unscheduled principal payments are not included in the amount of trust sales proceeds.

(iv) *Information on redemptions and sales of WHFIT unit interests*— (A) *Redemptions*. For each date on which the redemption price of a unit interest is determined, the trustee must provide information to enable a requesting person to determine—

(*1*) The redemption price per unit interest on that date;

(*2*) The gross proceeds paid on redemption of a unit interest on that date; and

(*3*) The income that should be attributed to a unit interest for the portion of the reporting period that a redeeming unit interest holder held the unit interest.

(B) *Sale of a unit interest*— If a secondary market for the unit interests of the

WHFIT is established, the trustee must provide for each day of the reporting period, information to enable a requesting person to determine the undistributed WHFIT income, per unit interest, held by the WHFIT as of the date of sale.

(v) *Other information*. The trustee must provide any other information necessary for a unit interest holder that is the beneficial owner of a unit interest to report, with reasonable accuracy, the items of income, deduction, and credit attributable to the portion of the trust treated as owned by the unit interest holder under section 671 for the requested reporting period or any other reporting period.

(3) *Additional information to be provided for a WHMT*. In addition to meeting the requirements of paragraph (c)(2) of this section, the trustee must provide—

(i) *Market discount information*. Information that enables a unit interest holder to determine, in any manner that is reasonably consistent with section 1276(a)(3), the portion of the unit interest holder's market discount, if any, that has accrued during the reporting period.

(ii) *Premium information*. Information that enables a unit interest holder to determine, in any manner that is reasonably consistent with section 171, the amount of the unit interest holder's amortizable bond premium, if any, for the reporting period.

(iii) *Principal payment information*. Information regarding principal payments, both scheduled and unscheduled, received by the WHMT on mortgages held by the WHMT.

(4) *Identifying the trust reporting period and the representative who will provide information*—The trustee must identify a representative of the WHFIT who will provide the information specified in this paragraph (c) and the reporting period which will be used by the trustee. The name, address, and telephone number of the representative and the reporting period must be—

(i) Printed in a publication generally read by, and available to, requesting persons;

(ii) Stated in the trust's prospectus; or

(iii) Posted on the trustee's internet site.

(5) *Time and manner of providing information*—(i) *Time*—(A) *In general*. Except as provided in paragraph (c)(5)(i)(B) of this section, a trustee must provide the information specified in this paragraph (c) to requesting persons on or before the later of—

(*1*) The 30th day after the close of the reporting period or periods for which the information was requested; or

(*2*) The day that is 14 days after the receipt of the request.

(*B*) *Trusts holding interests in REMICs or other WHFITs*. If substantially all the assets of a WHFIT are unit interests in other WHFITs, REMIC regular interests, or both, a trustee must provide the information specified in this paragraph (c) on or before the later of—

(*1*) The 44th day after the close of the reporting period or periods for which the information was requested; or

(*2*) The day that is 28 days after the receipt of the request.

(ii) *Manner*. The information specified in this paragraph (c) must be provided—

(A) By written statement sent by first class mail to the address provided by the requesting person;

(B) By causing it to be printed in a publication generally read by and available to requesting persons and by notifying the requesting person in writing of the publication in which it will appear, the date on which it will appear, and, if possible, the page on which it will appear;

(C) By causing it to be posted on an internet site and by notifying requesting persons in writing of the internet site on which it will appear; or

(D) By any other method agreed to by the trustee and requesting persons.

(6) *Requesting information from a WHFIT*—(i) *Requesting persons*. The following persons that hold an interest in a WHFIT may request the information specified in this paragraph (c) from that WHFIT—

(A) Any middleman;

(B) Any broker who holds a unit interest on its own behalf;

(C) Any other exempt recipient who holds an interest directly and not through a middleman;

(D) Any noncalendar-year unit interest holder who holds a WHFIT interest directly and not through a middleman; and

(E) A representative or agent for a person specified in this paragraph (c)(6).

(ii) *Manner of requesting information*. In requesting WHFIT information, a requesting person must specify the WHFIT and the reporting period or periods for which information is requested.

(iii) *Period of time during which a requesting person may request WHFIT information*. During the WHFIT's existence and for three years following the date of the WHFIT's termination, a requesting person may request information for any of the WHFIT's reporting periods.

(7) *Trustee's requirement to retain records*. During the existence of the WHFIT and for at least five years following the date of termination, the trustee must maintain in its records a copy of the information provided to requesting persons for each reporting period and such supplemental data as may be necessary to establish that the information provided to requesting persons is correct and meets the requirements of this paragraph (c).

(d) *Form 1099 requirement for trustees and middlemen*—(1) *Obligation to file Form 1099 with the Internal Revenue Service*—(i) *In general*. Except as provided in paragraphs (d)(1)(ii) and (iii) of this section—

(A) Every trustee must file with the Internal Revenue Service the appropriate Forms 1099, reporting the information specified in paragraph (d)(2) of this section with respect to any unit interest holder who holds an interest in the WHFIT directly and not through a middleman; and

(B) Every middleman must file with the Internal Revenue Service the appropriate Forms 1099, reporting the information specified in paragraph (d)(2) of this section with respect to any unit interest holder on whose behalf or account the middleman holds an interest in the WHFIT or acts in a capacity of an intermediary.

(ii) *Forms 1099 not required for exempt recipients*. A Form 1099 is not required with respect to a unit interest holder that is an exempt recipient. If the trustee or middleman backup withholds under section 3406 on payments made to an exempt recipient (because, for example, the exempt recipient has failed to furnish a Form W–9 on request), then the trustee or middleman is required to file a Form 1099 under this paragraph, unless the trustee or middleman refunds the amount withheld in accordance with § 31.6413(a)–3 of this chapter. Paragraph (j) of this section describes unit interest holders that may be treated as exempt recipients.

(iii) *Reporting with respect to foreign persons*. Payments made by a WHFIT to a unit interest holder that is not a United States person must be reported as provided under subtitle A, chapter 3 of the Internal Revenue Code (sections 1441 through 1464) and the regulations thereunder and are not reported under this paragraph (d).

(2) *Information to be reported*—(i) *Determining amounts to be provided on Forms 1099*—(A) *In General*. The information provided for a calendar year by a trustee or middleman to the Internal Revenue Service on the appropriate Forms 1099 must be consistent with the information provided by the trustee under paragraph (c) of this Section and must reflect with reasonable accuracy the WHFIT items that are attributable to a unit interest holder.

(B) *Use of safe harbor information*. If the trustee, in providing WHFIT information, uses the safe harbors in paragraph (f)(1) or (g)(1) of this section, then the trustee or middleman must calculate the information to be provided to the Internal Revenue Service on the Forms 1099 in accordance with paragraph (f)(2) or (g)(2) of this section, as appropriate.

(ii) *Information to be provided on Form 1099*. The trustee or middleman must include on the appropriate Forms 1099—

(A) *Taxpayer information*. The name, address, and taxpayer identification number of the unit interest holder.

(B) *Information regarding the person filing the Form 1099*. The name, address, taxpayer identification number, and telephone number of the person required to file the Form 1099.

(C) *Gross income*. The amount of gross income (including OID) of the WHFIT attributable to the unit interest holder for the calendar year.

(D) *Trust sale proceeds*. The trust sale proceeds that are attributable to the unit interest holder for the calendar year. With respect to a unit interest holder in a WHMT, the amount reported under this paragraph (d)(2)(ii)(D) includes the principal receipts that are attributable to that unit interest holder for the calendar year.

(E) *Gross proceeds paid on unit interest redemptions*—(*1*) *In general*. The gross proceeds paid on redemption of a unit interest to the unit interest holder for the calendar year, if any.

(*2*) *In-kind redemption*. If a unit interest holder redeems a unit interest solely for a *pro-rata* share of the assets of the WHFIT plus the undistributed cash income, the value of the assets received by the unit interest holder as a result of the redemption is not reported to the IRS as gross proceeds paid on redemption of a unit interest. The gross income attributable to the redeemed unit interest for the calendar year must be reported under paragraph (d)(2)(ii)(C) of this section.

(F) *Gross proceeds paid on the sale of a unit interest on a secondary market*. The gross proceeds paid to a unit interest holder for the sale of a unit interest or interests on a secondary market established for the WHFIT for the calendar year, if any.

(G) *Other information*. Any other information required by the Forms 1099.

(3) *Time and manner of filing Forms 1099*. The Forms 1099 required to be filed under this paragraph (d) must be filed on or before February 28th (March 31, if filed electronically) of the year following the year for which the Forms 1099 are being filed. The returns must be filed with the appropriate Internal Revenue Service Center, at the address listed in the instructions for the Forms 1099. For extensions of time for filing returns under this section, see § 1.6081–1, the instructions for the Forms 1099, and applicable revenue procedures (see § 601.601(d)(2) of this chapter). For magnetic media filing requirements, see § 301.6011–2 of this chapter. Trust sale proceeds, gross proceeds paid on unit interest redemption, and gross proceeds paid on the sale of a unit interest are to be reported on the same type of Form 1099 as that required for reporting gross proceeds under section 6045.

(e) *Requirement of furnishing a statement to the unit interest holder*—(1) *In general*. Every trustee or middleman required to file appropriate Forms 1099 under paragraph (d) of this section with respect to a unit interest holder must furnish to that unit interest holder (the person whose identifying number is required to be shown on the form) a written statement showing both the information described in paragraph (e)(2) of this section, and, in the case of a WHMT, the information described in paragraph (e)(3) of this section. The information provided must be in accordance with the following rules—

(i) *General rule for determining information for statement*. The information provided on the written statement furnished to the unit interest holder for the calendar year by the trustee or middleman must be consistent with the information provided by the trustee under paragraph (c) of this section and the information provided on the Forms 1099 filed with the IRS under paragraph (d) of this section. The information provided must reflect with reasonable accuracy the WHFIT items that are attributable to the unit interest holder.

(ii) *Required use of safe harbor information*. If the trustee, in providing WHFIT information, has used the safe harbors in paragraph (f)(1) or (g)(1) of this section, the trustee or middleman must calculate the information to be provided on the written statement furnished to the unit interest holder in accordance with paragraph (f)(2) or (g)(2) of this section, as appropriate.

(iii) *Requirement to separately state relevant WHFIT items*. The trustee or middleman must separately state any items that if taken into account separately by that unit interest holder would result in an income tax liability different from that which would result if the item was not taken into account separately.

(2) *Information required to be provided on written statement with respect to all WHFITs*. For the calendar year, the written statement furnished to the unit interest holder must meet the following requirements—

(i) *WHFIT information*. The written statement must identify the WHFIT. The written statement must include the information required to be provided by the trustee under paragraph (c)(2)(i)(A) of this section, regarding the name of the WHFIT, and paragraph (c)(2)(i)(D) of this section, regarding the identifying number of the WHFIT.

(ii) *Identification of the person furnishing the statement*. The written statement must provide the name, address, and taxpayer identification number of the person required to furnish the statement.

(iii) *Items of income, deduction, and credit*. The written statement must detail all items of income (including OID), deduction, and credit that are attributable to the unit interest holder.

(iv) *Asset sales and dispositions*—(A) *Information to be reported with respect to a WHFIT meeting the de minimis test*. If the WHFIT has met the *de minimis* test of paragraph (c)(2)(iii) of this section, the written statement need only provide information detailing the trust sale proceeds that are attributable to the unit interest holder.

(B) *Information to be reported with respect to trust not meeting the de minimis test*. If the trust has not met the *de minimis* test of paragraph (c)(2)(iii) of this section, the written statement must provide with respect to each sale or disposition of a WHFIT asset—

(*1*) The date of sale or disposition;

(*2*) Information regarding the trust sale proceeds that are attributable to the unit interest holder;

(*3*) Information that will enable the unit interest holder to allocate with reasonable accuracy a portion of the holder's basis in the holder's unit interest to the sale or disposition; and

(*4*) Information that will enable a unit interest holder to allocate with reasonable accuracy a portion of the unit interest holder's market discount or amortizable bond premium, if any, to the sale or disposition.

(v) *Information on the redemption or sale of a unit interest*—The written statement must provide the unit interest holder with information regarding the gross proceeds paid on redemption for each unit interest redeemed during the calendar year and the gross proceeds paid on the sale of a unit interest for each unit interest sold during the calendar year.

(vi) *Other information*. The written statement must include any other information necessary the unit interest holder to report, with reasonable accuracy, the items of income, deduction, and credit attributable to the portion of the trust treated as owned by the unit interest holder under section 671 for the current calendar year, or any other year.

(vii) *Required statement*. The written statement must inform the unit interest holder that the items of income, deduction, and credit, and any other information shown on the statement, must be taken into account in computing the taxable income and credits of the unit interest holder on the income tax return of the unit interest holder.

(3) *Additional information to be provided on written statement with respect to WHMTs*. For the calendar year, in addition to meeting the requirements of paragraph (e)(2) of this section, the written statement furnished to the unit interest holder of a WHMT must also meet the following requirements—

(i) *Information regarding market discount and premium*. The written statement must include the information regarding market discount and premium that is required to be provided by the trustee under paragraphs (c)(3)(i) and (ii) of this section.

(ii) *Information regarding principal payments*. The written statement must include information regarding the principal payments, scheduled and unscheduled, received by the WHMT that are attributable to the unit interest holder.

(4) *Due date and other requirements with respect to the statement required to be furnished to the unit interest holder*. The statement required to be furnished to the unit interest holder under this paragraph (e) for a calendar year must be furnished to the holder before March 16 of the year following the year for which the statement is being furnished. The person sending the statement must maintain in its records a copy of the statement furnished to the unit interest holder and supplemental data as may be required to establish the correctness of the statement for a period of 5 years from the due date for furnishing such statement.

(f) *Safe harbors for providing information for WHFITs other than WHMTs*—(1) *Safe harbors for trustee reporting of WHFIT information*—(i) *In general*. Except in the case of a WHMT, a trustee of a WHFIT that reports an item under a safe harbor in this paragraph (f)(1), is deemed to provide and calculate that WHFIT item in accordance with the rules of paragraph (c)(1)(i) of this section. Any item reported under a safe harbor in this paragraph (f)(1) must include a statement giving notice to that effect when providing information to a requesting person.

(ii) *Safe harbor for reporting WHFIT income and expenses*. A trustee satisfies this safe harbor for providing income and expense information by first determining the total amount of WHFIT distributions (both actual and deemed) for the calendar year and then expressing each income or expense item as a fraction of the total amount of WHFIT distributions. These fractions (hereafter called factors) must be accurate to at least four decimal places.

(A) *Step one: Determine the total amount of WHFIT distributions for the calendar year*. The trustee determines the total amount of WHFIT distributions (actual and deemed) for the calendar year. If the calculation of total amount of WHFIT distributions under this paragraph (f)(1)(ii)(A) results in a zero or a negative number, the trustee may not determine income and expense information under the safe harbor in this paragraph. The *total amount of WHFIT distributions* equals the amount of WHFIT funds paid out to the unit interest holders (including amounts paid as of the result of redemptions) for the calendar year—

(*1*) Increased by—

(*i*) All amounts that would have been distributed during the calendar year but were instead reinvested pursuant to a reinvestment plan; and

(*ii*) All cash held for distribution to unit interest holders as of December 31 of the year for which the trustee is reporting; and

(*2*) Decreased by—

(*i*) All cash distributed during the current year that was included in a year-end cash allocation factor (see paragraph (f)(1)(ii)(C)(*1*) of this section) of a prior year; and

(*ii*) All gross proceeds paid on redemption of a unit interest for the calendar year.

(*3*) For the purpose of calculating the the amount of WHFIT funds paid out to unit interest holders and for the purpose of calculating all gross proceeds paid on redemption of a unit interest for the calendar year, *pro-rata* in-kind redemptions made during the calendar year are disregarded.

(B) *Step two: Determine factors that express the ratios of WHFIT income and expenses to the total amount of WHFIT distributions*. The trustee determines factors that express the ratios of WHFIT income and expenses to the total amount of WHFIT distributions as follows—

(*1*) *Income factors*. For each type of income earned by a WHFIT for the calendar year, the trustee determines the ratio of—

(*i*) The gross amount of that type of income; divided by

(*ii*) The total amount of WHFIT distributions for the calendar year.

(2) *Expense factors*. For each type of expense paid by a WHFIT during the calendar year, the trustee determines the ratio of—

(*i*) The gross amount of that type of expense; divided by

(*ii*) The total amount of WHFIT distributions for the calendar year.

(C) *Step three: Determine adjustments for reconciling the total amount of WHFIT distributions (determined under step one) with amounts actually paid to unit interest holders*. Paragraph (f)(1)(ii)(B) of this section (step two) requires an item of income or expense to be expressed as a ratio of that item to the total amount of WHFIT distributions (as determined under step one). A unit interest holder's share of the total amount of WHFIT distributions may differ from the amount actually paid to that unit interest holder. A trustee, therefore, must provide information that will be used to compute a unit interest holder's share of the total amount of WHFIT distributions based on the amount actually paid to the unit interest holder. A trustee satisfies this requirement by providing a current year-end cash allocation factor and a prior year cash allocation factor.

(*1*) The *current year-end cash allocation factor* is—

(*i*) The amount of cash held for distribution to unit interest holders by the WHFIT as of December 31 of the year for which the trustee is reporting; divided by

(*ii*) The number of unit interests outstanding as of December 31.

(*2*) The *prior year cash allocation factor* is—

(*i*) The amount of the distribution during the current calendar year that was included in determining a year-end cash allocation factor for a prior year; divided by

(*ii*) The number of unit interests outstanding on the date of the distribution.

(D) *Requirement that trustee furnish additional information to requesting persons*. In the case where the safe harbor factors provided by the trustee under this paragraph (f)(1)(ii) cannot be used to determine with reasonable accuracy the income and expense attributable to a unit interest holder, upon request of the person responsible for filing the Form 1099 under paragraph (d) of this section, the trustee must provide to the person additional information to enable the income and expense attributable to the unit interest holder to be determined with reasonable accuracy. See paragraph (f)(2)(i)(A)(*3*)(*ii*) of this section.

(iii) *Safe harbor for reporting OID*. With respect to information regarding OID, the trustee may satisfy paragraph (c)(1)(i) of this section by providing, for each reporting period, any day of which is in that calendar year, the aggregate daily accrual of OID per $1,000 of original principal amount.

(iv) *Safe harbor for reporting information with respect to sales of WHFIT assets*— (A) *Safe harbor for a WHFIT meeting the de minimis test*. If a WHFIT meets the *de minimis* test of paragraph (c)(2)(iii) of this section regarding sales and dispositions of WHFIT assets, the trustee satisfies this safe harbor for WHFITs meeting the *de minimis* test by providing a list of dates (from earliest to latest) on which WHFIT assets were sold or disposed of during the calendar year and by including for each date identified, the total amount of trust sale proceeds per unit interest received by the WHFIT for all sales or dispositions of WHFIT assets on that date.

(B) *Safe harbor for WHFIT not meeting the de minimis test*— If a WHFIT does not meet the *de minimis* test under paragraph (c)(2)(iii) of this section regarding sales and dispositions of trust assets, the trustee satisfies this safe harbor for WHFITs not meeting the *de minimis* test by providing—

(*1*) A list of dates (from earliest to latest) on which sales or dispositions of WHFIT assets occurred during the calendar year and by providing for each date identified—

(*i*) The trust sales proceeds received by the trust, per unit interest, with respect to the sales and dispositions, on that date;

(*ii*) The portion of all assets (expressed as a percentage) held by the WHFIT that the assets sold or disposed of on that date represented.

(*2*) Determination of the portion of all assets held by the WHFIT that the assets sold or disposed of represented—

(*i*) If a WHFIT terminates within twenty four months of the start-up date of the WHFIT, the portion of the total fair market value of all assets held by the WHFIT that the assets sold or disposed of represented shall be based on the fair market value of the WHFIT's assets as of the start-up date; or

(*ii*) If a WHFIT terminates more than twenty four months after the start-up date of the WHFIT, the portion of the total fair market value of all assets held by the WHFIT that the assets sold or disposed of represented shall be based on the fair market value of the WHFIT's assets as of the date of the sale or disposition.

(v) *Safe harbor for reporting redemptions and sales of unit interests on a secondary market*—(A) *Redemptions*. For each date on which the redemption price of a unit interest is determined, the trustee must provide—

(*1*) The gross proceeds paid on redemption on a unit interest on that date; and

(*2*) The distribution paid on redemption of a unit interest on that date.

(B) *Sale of a unit interest on a secondary market*. For each day of the calendar year, the trustee must provide the amount of a distribution a unit interest holder would be entitled to with respect to a unit interest had the amount of a distribution been determined on that date.

(2) *Use of information provided by trustees under safe harbors*. If a trustee reports a WHFIT item in accordance with a safe harbor described in paragraph (f)(1) of this section, then the information provided with respect to that item on the Forms 1099 required under paragraph (d) of this section and on the statement required to be furnished under paragraph

(e) of this section must be determined as provided in this paragraph (f)(2).

(i) *Use of information provided in accordance with the safe harbor for reporting WHFIT income and expense*. If a trustee determines WHFIT income and expenses under paragraph (f)(1)(ii) of this section, then the trustee or middleman must determine the amount of each type of income and expense attributable to a unit interest holder as follows—

(A) *Step one: Determine the total amount of WHFIT distributions attributable to the unit interest holder*. To determine the total amount of WHFIT distributions attributable to a unit interest holder, the amount paid to the unit interest holder during the calendar year (including amounts paid as the result of redemptions) is—

(*1*) Increased by—

(*i*) All amounts that would have been distributed during the calendar year to the unit interest holder but were reinvested pursuant to a reinvestment plan (unless another person (for example, the custodian of the reinvestment plan) is responsible for reporting these amounts under paragraph (d) of this section);

(*ii*) An amount equal to the current year-end cash allocation factor (provided by the trustee in accordance with paragraph (f)(1)(ii)(C)(*1*) of this section) multiplied by the number of unit interests held by the unit interest holder as of December 31; and

(*iii*) The amount of a distribution the unit interest holder would be entitled to had the amount of a distribution been determined on the date the unit interest holder sold a unit interest or interests on a secondary market established for the WHFIT. See paragraph (f)(1)(v)(B) of this section.

(*2*) Decreased by—

(*i*) An amount equal to the prior year cash allocation factor (provided by the trustee in accordance with paragraph (f)(1)(ii)(C)(*2*) of this section) multiplied by the number of unit interests held by the unit interest holder on the date of the distribution;

(*ii*) An amount equal to all gross proceeds paid on redemption of a unit interest to the unit interest holder for the calendar year; and

(*iii*) The amount of any distribution received by a unit interest holder during the calendar year with respect to a unit interest acquired on the secondary market established for the WHFIT that is attributable to another unit interest holder under paragraph (f)(2)(i)(A)(*1*)(*iii*) of this section.

(3) *Rules applicable to this paragraph (f)(2)(i)*—(*i*) *Treatment of in-kind distributions under this paragraph (f)(2)(i)*. The value of the assets distributed to a unit interest holder as a result of a *pro-rata* in-kind redemption are not included in the amount paid to the unit interest holder or the gross proceeds paid on redemption of a unit interest for purposes of this paragraph (f)(2)(i).

(*ii*) *The total amount of distributions attributable to a unit interest holder calculated under this paragraph (f)(2)(i)(A) equals zero or less*. If the total amount of distributions attributable to a unit interest holder, calculated under this paragraph (f)(2)(i)(A), equals zero or less, the middleman or trustee may not report the income and expense attributable to the unit interest holder under this paragraph (f)(2)(i). The middleman or trustee must request additional information from the trustee of the WHFIT to enable the trustee and middleman to determine with reasonable accuracy the items of income and expense that are attributable to the unit interest holder.

(B) *Step two: Apply the factors provided by the trustee to determine the items of income and expense that are attributable to the unit interest holder*. The amount of each type of income (other than OID) and each type of expense attributable to a unit interest holder is determined as follows—

(*1*) *Application of income factors*. For each income factor provided by the trustee for the calendar year, the trustee or middleman multiplies—

(*i*) The income factor; by

(*ii*) The total amount of WHFIT distributions attributable to the unit interest holder for the calendar year (as determined in paragraph (f)(2)(i)(A) of this section).

(*2*) *Application of expense factors*. For each expense factor provided by the trustee for the calendar year, the trustee or middleman multiplies—

(*i*) The expense factor; by

(*ii*) The total amount of WHFIT distributions attributable to the unit interest holder for the calendar year (as determined in paragraph (f)(2)(i)(A) of this section).

(ii) *Use of safe harbor for reporting OID*. With respect to each reporting period any day of which is in the calendar year, the amount of OID that is allocable to each unit interest held by a unit interest holder is determined by multiplying—

(A) The product of the OID factor and the original principal balance of the unit interest divided by 1,000; by

(B) The number of days during the OID reporting period in that calendar year that the unit interest holder held the unit interest.

(iii) *Use of safe harbor for reporting information with respect to sales or dispositions*—(A) *In general*—(1) *Information reported on Form 1099*. A trustee or middleman preparing a Form 1099 need provide only the amount of trust sales proceeds (as determined under paragraph (f)(2)(iii)(B) of this section) that are attributable to a unit interest holder for the calendar year. See paragraph (d)(2)(ii)(D) of this section.

(*2*) *Information provided on statement furnished to unit interest holder*—(*i*) *Information for WHFITs meeting the de minimis test*. If a WHFIT meets the *de minimis* test of paragraph (c)(2)(iii) of this section, the written statement required to be furnished to the unit interest holder under paragraph (e) of this section need provide to the unit interest holder only the amount of trust sale proceeds (as determined under paragraph (f)(2)(iii)(B) of this section) that are attributable to the unit interest holder for the calendar year.

(*ii*) *Information for WHFITs not meeting the de minimis test*. If a WHFIT does not meet the *de minimis* test in paragraph (c)(2)(iii) of this section, the written statement required to be furnished to the unit interest holder under paragraph (e) of this section must include a list of dates (in order, from earliest to latest) on which sales or dispositions of trust assets occurred during the calendar year and by providing for each date identified—

(*A*) The trust sales proceeds received by the trust with respect to the sales or dispositions of trust assets on that date that are attributable to the unit interest holder; and

(*B*) The information provided by the trustee under paragraph (f)(1)(iv)(B)(*2*) of this section regarding the portion of all assets (expressed as a percentage) held by the WHFIT that the assets sold or disposed of on that date represented.

(B) *Determining the trust sales proceeds that are attributable to the unit interest holder for the calendar year*. To determine the trust sale proceeds attributable to a unit interest holder for the calendar year, the aggregate trust sale proceeds, per unit interest, received by the WHFIT on each date on which trust assets were sold or disposed of is multiplied by the number of unit interests held by the unit interest holder on that date and aggregated for the year.

(3) *Example of use of safe harbors*. The following example illustrates the use of the safe harbor factors in this paragraph (f) to calculate and provide WHFIT information:

Example—(i) *Facts*—(A) *In general*—(*1*) Trust is a WHFIT that holds common stock in ten different corporations and has 100 unit interests outstanding. The agreement governing Trust requires Trust to distribute the cash held by Trust reduced by accrued but unpaid expenses on April 15, July 15, and October 15 of the 2004 calendar year. The agreement also provides that the unit interests will be redeemed by Trust for an amount equal to the value of the unit interest, as of the close of business, on the day that the unit interest is tendered for redemption. There is no reinvestment plan and there is no secondary market for sales of trust interests.

(*2*) Broker holds ten unit interests in Trust in street name for each of *J* and *S*. *J* and *S* are individual, cash basis taxpayers.

(*3*) As of December 31, 2003, Trust holds $12x for distribution to unit interest holders on the next distribution date and has no accrued but unpaid expenses. Trustee includes the $12x in determining the year-end cash allocation factor for December 31, 2003.

(B) *Trust events occurring during the 2004 calendar year*—(*1*) During 2004, Trust receives $588x in dividend income and $12x in interest income from investment of WHFIT funds pending distribution to unit interest holders, and pays $45x in expenses, all of which are affected expenses.

(*2*) Trust makes all three of its required distributions. On April 15, Trust distributes $135x which includes the $12x included in determining the year-end cash allocation factor for December 31 of the prior year. On July 15, Trust distributes $135x. On October 15, Trust distributes $123x.

(*3*) On December 10, *J* tenders one of *J*'s unit interests to Trustee for redemption. Trustee determines that the redemption price of a unit interest on December 10 is $116x, of which, $115x represents the gross proceeds paid on redemption of a unit interest and $1x represents a distribution paid on redemption of a unit interest.

(*4*) On December 12, Trustee sells shares of common stock for $115x. The $115x represents less than five percent of the aggregate fair market value of the common stock held by Trust as of January 1. On December 17, Trustee pays $116x to Broker on *J*'s behalf for the redemption of the unit interest. *J* is the only unit interest holder to redeem a unit interest during the calendar year.

(*5*) As of December 31, Trust holds cash of $173x and has incurred $15x in expenses that Trust has not paid.

(C) *Broker's actions during the 2004 calendar year*. During 2004, Broker credits the accounts of both *J* and *S* with their respective shares of the distributions made by Trust. Specifically, Broker credits each account with $13.50x for the April 15 distribution, $13.50x for the July 15 distribution and $12.30x for the October 15 distribution. In addition, Broker credits *J*'s account with $116x for *J*'s redemption of the unit interest. Consequently, as of December 31, Broker has credited $155.30x to *J*'s account and $39.30x to *S*'s account.

(ii) *Trustee reporting*—(A) Trustee is within the safe harbors of this paragraph (f)(1) if Trustee provides the following information to requesting persons—

Factor for dividend income	1.0889
Factor for interest income	.0222
Factor for affected expenses	.0833
Current year-end cash allocation factor	1.5960
Prior year cash allocation factor	.1200
Gross proceeds paid on redemption of a unit interest as of 12/10/04	115
Distribution paid on redemption of a unit interest as of 12/10/04	1
Trust sales proceeds per unit interest for 12/12/04	1.1616

(B) Trustee determines this information as follows—

(*1*) *Step one: Trustee determines the total amount of WHFIT distributions for the calendar year*. The total amount of WHFIT distributions (actual and deemed) for the calendar year for purposes of determining the safe harbor factors is $540x. This amount consists of the amounts paid on each scheduled distribution date during the calendar year ($135x, $135x, and $123x), and the total amount paid to *J* as a result of *J*'s redemption of a unit interest ($116x) ($135x + $135x + $123x + $116x = $509x)—

(*i*) Increased by all cash held for distribution to unit interest holders as of December 31, 2004 ($158x), which is the cash held as of December 31, 2004 ($173x), reduced by the accrued but unpaid expenses as of December 31, 2004 ($15x), and

(*ii*) Decreased by —

(*A*) All amounts distributed during the calendar year but included in the year-end cash allocation factor from a prior year ($12x); and

(*B*) All gross proceeds paid on redemption of a unit interest for the calendar year ($115x).

(*2*) *Step two: Trustee determines factors that express the ratio of WHFIT income (other than OID) and expenses to the total amount of WHFIT distributions*. Trustee determines the factors for each type of income earned by Trust and each type of expense as follows—

(*i*) *Factor for dividend income*. The factor for dividend income is 1.0889 which represents the ratio of—

(*A*) The gross amount of dividends ($588x); divided by

(*B*) The total amount of WHFIT distributions for the calendar year ($540x).

(*ii*) *Factor for interest income*. The factor for interest income is .0222, which represents the ratio of—

(*A*) The gross amount of other income ($12x); divided by

(*B*) The total amount of WHFIT distributions for the calendar year ($540x).

(*iii*) *Expense Factor*. The factor for affected expenses is .0833 which represents the ratio of—

(*A*) The gross amount of affected expenses paid by Trust for the calendar year ($45x); divided by

(*B*) The total amount of WHFIT distributions for the calendar year ($540).

(*3*) *Step three: Trustee determines adjustments for reconciling the total amount of WHFIT distributions with amounts paid to unit interest holders*. To enable requesting persons to determine the total amount of WHFIT distributions that are attributable to a unit interest holder based on amounts actually paid to the unit interest holder, the trustee must provide both a current year-end cash allocation factor and a prior year cash allocation factor.

(*i*) *Current year-end cash allocation factor*. The adjustment factor for cash held by Trust at year end is 1.5960 which represents—

(*A*) The cash held for distribution as of December 31, 2004 ($158x), (the amount of cash held by Trust on December 31, 2004 ($173x), reduced by accrued but unpaid expenses ($15x)); divided by

(*B*) The number of unit interests outstanding at year-end, (99).

(*ii*) *Prior Year Cash Allocation Factor*. The adjustment factor for distributions of year-end cash from the prior year is .1200 which represents—

(*A*) The amount of the distribution during the current calendar year that was included in a year-end cash allocation factor for a prior year ($12x); divided by

(*B*) The number of units outstanding at the time of the distribution, (100).

(*4*) *Trust sales proceeds information*. To satisfy the safe harbor, Trustee provides a list of dates on which trust assets were sold during the calendar year, and the amount of trust sales proceeds received as the result of the sale or disposition, per unit interest. In this case, only one sale took place during the calendar year, on December 12, 2004, and the amount of trust sale proceeds received per unit interest on that date is $1.1616 ($115x/99).

(iii) *Broker's use of information provided by Trustee*—(A) Broker uses the information furnished by Trustee under the safe harbors to determine that the following items are attributable to *J* and *S*—

With respect to *J*	
Dividend Income	$ 58.21x
Interest Income	1.19x
Affected Expenses	4.45x
Trust sale proceeds	10.45x
Gross proceeds paid on redemption of a unit interest	115.00x
With respect to *S*	
Dividend Income	$ 58.87x
Interest Income	1.20x
Affected Expenses	4.50x
Trust sale proceeds	11.62x

(B) Broker determines this information as follows—

(*1*) *Step one: Broker determines the total amount of WHFIT distributions attributable to J and S*. The total amount of WHFIT distributions attributable to *J* is $53.46x and the total amount of WHFIT distributions attributable to *S* is $54.06. These amounts represent the total amount paid to *J* ($155.30x) and *S* ($39.30x)—

(*i*) Increased by an amount equal to the current year-end cash allocation factor (1.5960) multiplied by the number of unit interests held by *J* (9) and *S* (10) as of December 31, 2004, that is for *J*, $14.36x; and for *S*, $15.96x;

(*ii*) Decreased by—

(*A*) An amount equal to the prior year cash allocation factor (.1200) multiplied by the number of unit interests held by *J* (10) and *S* (10) at the time of the distribution, that is for *J* and *S*, $1.20x, each;

(*B*) An amount equal to all gross proceeds paid on redemption of a unit interest to the unit interest holder for the calendar year, or that is, for *J* ($115x).

(*2*) *Step two: Broker applies the factors provided by Trustee to determine the Trust's income and expenses that are attributable to* J and *S*. The amounts of each type of income (other than OID) and expense that are attributable to *J* and *S* are determined by multiplying the factor for that type of income or expense by the total amount of WHFIT distributions attributable to *J* and *S* as follows—

(*i*) *Application of factor for dividends*. The amount of dividend income attributable to *J* is $58.21x and the amount of dividend income attributable to *S* is $58.87x. Broker determines these amounts by multiplying the total amount of WHFIT distributions attributable to *J* and to *S* ($53.46x and $54.06x, respectively) by the factor for dividends (1.0889).

(*ii*) *Application of factor for interest income*. The amount of interest income attributable to *J* is $1.19x and the amount of interest income attributable to *S* is $1.20x. Broker determines these amounts by multiplying the total amount of WHFIT distributions attributable to *J* and to *S* ($53.46x and $54.06x, respectively) by the factor for interest (.0222).

(*iii*) *Application of factor for affected expenses*. The amount of affected expenses attributable to *J* is $4.45x and the amount of affected expenses attributable to *S* is $4.50x. Broker determines these amounts by multiplying the total amount of WHFIT distributions attributable to *J* and to *S* ($53.46x and $54.06x, respectively) by the factor for affected expenses (.0833).

(*3*) *Broker determines the amount of trust sale proceeds attributable to J and S*. The amount of trust sale proceeds attributable to *J* is $10.45x and the amount of trust sale proceeds attributable to *S* is $11.61x. Broker determines these amounts by multiplying the number of unit interests held by *J* (9) and by *S* (10) on the date of sale, December 12, 2004, by the trust sale proceeds per unit interest on that date (1.1616). *J* also recognizes gain or loss on *J*'s redemption of a unit interest on December 10, 2004, based on the amount of gross proceeds paid on redemption of a unit interest ($115x) and *J*'s basis in the redeemed unit interest.

(g) *Safe Harbor for certain WHMTs*—(1) *Safe harbors for trustee reporting of trust information*—(i) *In general*. A trustee of a WHMT that meets the requirements of paragraph (g)(1)(ii) of this section and that reports a WHMT item or items under the safe harbor established for it in this paragraph (g)(1) is deemed to provide and calculate the WHMT item or items in accordance with the rules of paragraph (c)(1)(i) of this section. Any item reported under a safe harbor in this paragraph (g)(1) must include a statement giving notice to that effect when providing information to a requesting person.

(ii) *Requirements for use of safe harbors*. To use the safe harbors provided under this paragraph (g)(1), a WHMT must meet the following requirements—

(A) The WHMT must meet the *de minimis* sales and dispositions test under paragraph (c)(2)(iii) of this section;

(B) All sales and dispositions made by the WHMT during the calendar year must be for an amount equal to the unpaid principal balance plus the accrued but unpaid interest of the mortgage at the time of the sale or disposition;

(C) The trust must make monthly distributions of income and principal to unit interest holders;

(D) All unit interests in the WHMT must represent the right to receive *pro-rata* shares of both the income and the principal payments received by the WHMT on the mortgages it holds;

(E) The WHMT must report under this paragraph (g)(1)(ii) for the entire calendar year; and

(F) The assets of the WHMT are limited to—

(*1*) Mortgages with uniform characteristics;

(*2*) Amounts received on mortgages and held for distribution to unit interest holders; and

(*3*) Reasonably required reserve funds.

(G) The aggregate outstanding principal balance as defined in paragraph (g)(1)(iii)(D) of this section as of the WHMT's start-up date must equal the aggregate of the original face amounts of all issued unit interests.

(iii) *Safe harbor for reporting WHMT income, expenses, principal receipts, and sales and dispositions of mortgages*. A trustee satisfies this safe harbor for providing information with respect to income, expense, principal receipts, and sales and dispositions by complying with each step of the safe harbor provided in this paragraph (g)(1)(iii).

(A) *Step one: Trustee determines monthly pool factors that provide information regarding the WHMT's receipt of principal payments and the WHMT's receipt of proceeds from sales and dispositions of mortgages*. The trustee must, for each month of the calendar year and for January of the following calendar year, calculate and provide the ratio (expressed as a decimal carried to at least eight places and called a *pool factor*) of—

(*1*) The amount that represents the aggregate outstanding principal balance of the WHMT as of the first business day of the month; divided by

(*2*) The amount that represents the aggregate outstanding principal balance of the WHMT as of the start-up day.

(B) *Step two: Trustee determines monthly expense factors that provide information regarding WHMT expenses*. For each month of the calendar year and for each type of expense paid by the WHMT during that month, the trustee calculates and provides the ratio (expressed as a decimal carried to at least eight places and called an *expense factor*) of—

(*1*) The gross amount, for the month, of each type of expense; divided by

(*2*) The amount that represents the aggregate outstanding principal balance of the WHMT as of the start-up day, divided by 1,000.

(C) *Step three: Trustee determines monthly income factors that provide information regarding the trust's gross monthly income*. For each month of the calendar year and for each type of gross income earned by the WHMT during that month, the trustee calculates and provides the ratio (expressed as a decimal carried to at least eight places and called an *income factor*) of—

(*1*) The gross amount, for the month, of each type of income; divided by

(*2*) The amount that represents the aggregate outstanding principal balance of the WHMT as of the start-up date, divided by 1,000.

(D) *Definition of aggregate outstanding principal balance*. For purposes of this paragraph (g)(1)(iii), the amount of the aggregate outstanding principal balance of a WHMT is the aggregate of—

(*1*) The outstanding principal balance of all mortgages held by the WHMT;

(*2*) The amounts received on mortgages and held for distribution by the WHMT; and

(*3*) The amount of the reserve fund.

(iv) *Safe harbor for reporting OID information*—(A) *Safe harbor for reporting OID prior to the issuance of final regulations under section 1272(a)(6)(C)(iii)*. With respect to information regarding OID, the trustee, prior to the issuance of final regulations under Section 1272(a)(6)(C)(iii), may satisfy paragraph (c)(1)(i) of this section by providing, for each reporting period during the calendar year, the aggregate daily accrual of OID per $1,000 of aggregate outstanding principal balance as of the start-up day. In calculating the aggregate daily accrual of OID per unit interest, the trustee must use a method that utilizes the prepayment assumption used in pricing the original issue of unit interests.

(B) *Safe harbor for reporting OID after the issuance of final regulations under Section 1272(a)(6)(C)(iii)*. [Reserved]

(v) *Safe Harbor for reporting market discount information*—(A) *Safe harbor for reporting market discount information prior to the issuance of final regulations under sections 1272(a)(6)(C)(iii) and 1276(b)(3)*. With respect to information regarding market discount, the trustee, prior to the issuance of final regulations under sections 1272(a)(6)(C)(iii) and 1276(b)(3), may satisfy the requirements of paragraph (c)(1)(i) of this section by providing—

(*1*) In the case of a WHMT holding mortgages issued with OID, the ratio (expressed as a decimal carried to at least eight places) of—

(*i*) The OID accrued during the reporting period calculated in accordance with paragraph (g)(1)(iv) of this section; divided by

(*ii*) The total remaining OID as of the beginning of the reporting period as determined under paragraph (g)(1)(v)(A)(*3*) of this section; or

(*2*) In the case of a WHMT holding mortgages not issued with OID, the ratio (expressed as a decimal carried to at least eight places) of—

(*i*) The amount of stated interest paid to the WHMT during the reporting period; divided by

(*ii*) The total amount of stated interest remaining to be paid to the WHMT as of the beginning of the reporting period as determined under paragraph (g)(1)(v)(A)(*3*) of this section.

(*3*) *Computing the total amount of stated interest remaining to be paid and the total remaining OID at the beginning of a period*. To compute the total amount of stated interest remaining to be paid to the WHMT as of the beginning of the reporting period and the total remaining OID as of the beginning of the reporting period, the trustee must use a method that utilizes the prepayment assumption used in pricing the original issue of unit interests.

(B) *Safe harbor for reporting market discount information following the issuance of final regulations under sections 1272(a)(6)(C)(iii) and 1276(b)(3)*. [Reserved]

(vi) *Safe harbor for reporting premium information*. [Reserved]

(2) *Use of information provided by a trustee under the safe harbor*. If a trustee reports an item in accordance with a safe harbor described in paragraph (g)(1) of this section, then the information provided, with respect to that WHMT item, on the Forms 1099 required to be filed with the IRS under paragraph (d) of this section and on the statement required to be furnished to the unit interest holder under paragraph (e) of this section must be determined as provided in this paragraph (g)(2).

(i) *Use of information provided in accordance with the safe harbor for reporting WHMT income, expenses, receipt of principal payments, and sales and dispositions of mortgages*. The amount of each type of income and expense, principal payments, and proceeds from sales and dispositions of mortgages that are attributable to a unit interest holder for each month of the calendar year is computed as follows:

(A) *Step one: Determine the monthly amount of principal receipts and the amount of proceeds from the sales and dispositions of mortgages that are attributable to each unit interest*—(*1*) *Use of factor*. For each month of the calendar year that a unit interest was held on the record date, the amount of principal receipts and the amount of proceeds from sales and dispositions of mortgages that are attributable to each unit interest is determined by multiplying—

(*i*) The original face amount of the unit interest; by

(*ii*) The difference between the pool factor for the current month and the pool factor for the following month.

(*2*) *Reporting of principal receipts and proceeds from sales and dispositions of mortgages*. The aggregate of the amount of principal receipts and proceeds from sales and dispositions of mortgages that are attributable to each unit interest for the calendar year are reported to the IRS on Form 1099 as trust sales proceeds.

(B) *Step two: Apply the expense factors provided by the trustee to determine the amount of each type of expense that is attributable to each unit interest*. For each month of the calendar year that a unit interest was held on the record date, the amount of each type of expense that is attributable to each unit interest is determined by multiplying—

(*1*) The original face amount of the unit interest divided by 1000; by

(*2*) The expense factor for that month and that type of expense.

(C) *Step three: Apply the income factors provided by the trustee to determine the amount of each type of income that is attributable to each unit interest*. For each month of the calendar year that a unit interest was held on the record date, the amount of each type of income that is attributable to each unit interest is determined by multiplying—

(*1*) The original face amount of the unit interest divided by 1000; by

(*2*) The income factor for that month and that type of income.

(D) *Definitions for this paragraph (g)(2)(i)*. For purposes of this paragraph (g)(2)(i)—

(*1*) The *record date* is the date used by the WHMT to determine the owner of the unit interest for the purpose of distributing the payment for the month.

(*2*) The *original face amount of the unit interest* is the original principal amount of a unit interest on its issue date.

(ii) *Use of OID factor to determine the OID attributable to a unit interest holder*. With respect to each OID reporting period, the amount of OID that is attributable to each unit interest held by a unit interest holder is determined by multiplying—

(A) The product of the OID factor by the original face amount of the unit interest divided by 1,000; by

(B) The number of days during the OID reporting period that the unit interest holder held the unit interest.

(iii) *Requirement to provide market discount information*. The market discount information provided by the trustee in accordance with paragraph (g)(1)(v) of this section must be provided to the unit interest holder in, or with, the written statement required to be furnished to the unit interest holder under paragraph (e) of this section.

(iv) *Requirement to provide premium information*. [Reserved]

(3) *Example of safe harbor*. The following example illustrates the use of the safe harbor factors in paragraphs (g)(1) and (2) of this section to calculate and provide trust information:

Example. (i) *Facts*—(A) *In general*. *X* is a WHMT. As of January 1, 2004, *X*'s assets consist of 100 15-year mortgages, each having an unpaid principal balance of $125,000 and a fixed, annual interest rate of 7.25 percent. *X*'s unit interest holders are entitled to monthly, *pro-rata* distributions of the principal payments received by *X* . *X*'s unit interest holders are also entitled to monthly, *pro-rata* distributions of the interest earned on the mortgages held by *X*, reduced by expenses. Unit interests are issued in increments of $5,000 with a $25,000 minimum. Broker holds a unit interest in *X*, with an original face amount of $25,000, in street name, for *J* during the entire 2004 calendar year.

(B) *Trust events during the 2004 calendar year*. During the 2004 calendar year, *X* collects all interest and principal payments when due and makes all monthly distributions when due. One mortgage is repurchased from *X* in July for $122,249, the mortgage's unpaid principal balance interest at the time. During November, another mortgage is prepaid in full. *X* earns $80 interest income each month from the temporary investment of *X*'s funds pending distribution to the unit interest holders. All of *X*'s expenses are affected expenses. The aggregate outstanding principal balance of *X*, *X*'s interest income, and *X*'s expenses, for each month of the 2004 calendar year are as follows:

Month	Principal Balance	Income	Expenses
January	12,500,000	75,601	5,288
February	12,461,413	75,368	5,273
March	12,422,593	75,133	5,256
April	12,383,538	74,897	5,240
May	12,344,247	74,660	5,244
June	12,304,719	74,421	5,207

Month	Principal Balance	Income	Expenses
July	12,264,953	74,181	5,191
August	12,102,696	73,200	5,122
September	12,062,850	72,960	5,106
October	12,022,763	72,717	5,089
November	11,982,433	72,474	5,073
December	11,821,235	71,500	5,006
January	11,780,829		

(ii) *Trustee reporting*—(A) Trustee, *X*'s fiduciary, comes within the safe harbors of paragraph (g)(1)(iii) of this section by providing the following information to requesting persons:

Month	Pool Factor	Income Factor	Expense Factor
January	1.00000000	6.04808000	.42304000
February	.99691304	6.02944000	.42184000
March	.99380744	6.01064000	.42048000
April	.99068304	5.99176000	.41920000
May	.98753976	5.97280000	.41952000
June	.98437752	5.95368000	.41656000
July	.98119624	5.93448000	.41528000
August	.96821568	5.85600000	.40976000
September	.96502800	5.83680000	.40848000
October	.96182104	5.81736000	.40712000
November	.95859464	5.79792000	.40584000
December	.94569880	5.72000000	.40048000
January	.94246632		

(B) Trustee determines this information as follows:

(*1*) *Step one: Trustee determines monthly pool factors that provide information regarding X's receipt of principal payments and X's receipt of proceeds from sales and dispositions of mortgages*. Trustee calculates and provides *X*'s pool factor for each month of the 2004 calendar year. For the month of January the pool factor is 1.0, which represents the ratio of—

(*i*) The amount that represents the aggregate outstanding principal balance of *X* (12,500,000) as of the first business day of January; divided by

(*ii*) The amount that represents the aggregate outstanding principal balance of *X* (12,500,000) as of the start-up day.

(*2*) *Step two: Trustee determines monthly expense factors that provide information regarding X's expenses*. Trustee calculates and provides the expense factors for each month of the 2004 calendar year. During 2004, *X* has only affected expenses, and therefore, will only have one expense factor for each month. The expense factor for the month of January is .42304000 which represents the ratio of—

(*i*) The gross amount of expenses paid during January by *X* (5,288); divided by

(*ii*) The amount that represents the aggregate outstanding principal balance of *X* as of the start-up date (12,500,000) divided by 1,000 (12,500).

(*3*) *Step three: Trustee determines monthly income factors that provide information regarding X's gross monthly income*. Trustee calculates and provides the income factors for each month of the 2004 calendar year. During 2004, *X* has only interest income, and therefore, will only have one income factor for each month. The income factor for the month of January is 6.04808000 which represents the ratio of—

(*i*) The gross amount of interest income earned by *X* during January ($75,601); divided by

(*ii*) The amount that represents that aggregate outstanding principal balance of *X* as of the start-up date (12,500,000), divided by 1,000 (12,500).

(iii) *Broker's use of the information provided by Trustee*—(A) Broker uses the information provided by Trustee under the safe harbor to determine that the following trust items are attributable to *J*:

Month	Trust Sale Proceeds	Affected Expenses	Gross Interest Income
January	$ 77.17	$ 10.58	$ 151.20
February	77.64	10.55	150.74
March	78.11	10.51	150.27
April	78.58	10.48	149.79
May	79.06	10.49	149.32
June	79.53	10.41	148.84

Month	Trust Sale Proceeds	Affected Expenses	Gross Interest Income
July	324.51	10.38	148.36
August	79.69	10.24	146.40
September	80.17	10.21	145.92
October	80.66	10.18	145.43
November	322.40	10.15	144.95
December	80.81	10.01	143.00
Total	$1438.33	$124.19	$1774.22

(B) Broker determines this information as follows:

(*1*) *Step one: Broker determines the amount of principal receipts and the amount of proceeds from sales and dispositions of mortgages that are attributable to J for the 2004 calendar year*. Broker determines the amount of principal receipts and the amount of proceeds from the sales and dispositions of mortgages that are attributable to *J* for each month of the 2004 calendar year. For the month of January, Broker determines that the amount of principal receipts and the amount of proceeds from the sales and dispositions of mortgages that are attributable to *J* is $77.17. Broker determines this by multiplying the original face amount of *J*'s unit interest ($25,000) by .00308696, the difference between the pool factor for January (1.00000000), the current month, and the pool factor for February (.99691304) the following month. Broker reports the aggregate of the monthly amounts of principal receipts and amounts of proceeds from sales and dispositions that are attributable to *J* for the 2004 calendar year as trust sales proceeds on the Form 1099 filed with the IRS.

(*2*) *Step two: Broker applies the expense factors provided by Trustee to determine the amount of expenses that are attributable to J for the 2004 calendar year*. Broker determines the amount of *X*'s expenses that are attributable to *J* for each month of the 2004 calendar year. For the month of January, Broker determines that the amount of expenses attributable to *J* is $10.58. Broker determines this by multiplying the original face amount of *J*'s unit interest (25,000) divided by 1,000 (25) by the expense factor for January (.42304000). Broker determines the expenses that are attributable to *J* for the 2004 calendar year by aggregating the monthly amounts.

(*3*) *Step three: Broker applies the income factors provided by Trustee to determine the amount of gross interest income attributable to J for the 2004 calendar year*. Broker determines the amount of gross interest income that is attributable to *J* for each month of the 2004 calendar year. For the month of January, Broker determines that the amount of gross interest income attributable to *J* is $151.20. Broker determines this by multiplying the original face amount of *J*'s unit interest (25,000) divided by 1,000 (25), by the income factor for January (6.04808000). Broker determines the amount of the gross interest income that is attributable to *J* for the 2004 calendar year by aggregating the monthly amounts.

(h) *Requirement that middlemen furnish information to exempt recipients and noncalendar-year taxpayers*—(1) *In general*. A middleman that holds a unit interest on behalf of, or for the account of, any exempt recipient listed in paragraph (j)(2) of this Section and any noncalendar-year unit interest holder must provide to such exempt recipient or noncalendar-year unit interest holder, upon request, the information provided by the trustee to the middleman under paragraph (c) of this section.

(2) *Time and manner of providing information*. The middleman must provide the requested information in writing to any such requester on or before the later of the 44th day after the close of the reporting period for which the information was requested, or the day that is 28 days after the receipt of the request. A middleman must provide information with respect to a WHFIT holding an interest in another WHFIT or a WHFIT holding an interest in a REMIC on or before the later of the 58th day after the close of the reporting period for which the information was requested, or the day that is 42 days after the receipt of the request.

(3) *Clearing organization*. A clearing organization described in § 1.163–5(c)(2)(i)(D)(*8*) is not required to furnish information to exempt recipients or noncalendar-year taxpayers under this paragraph.

(i) [Reserved]

(j) *Exempt recipients*—(1) *Requirement that exempt recipient include accurate trust information in computing taxable income*. Under this § 1.671–5, trustees and middlemen are not required to file Forms 1099 with respect to a unit interest holder that is an exempt recipient or furnish statements to a unit interest holder that is an exempt recipient. An exempt recipient that is a beneficial owner must, however, obtain trust information and must include the items of income, deduction, and credit of the trust in computing its taxable income and credits on its income tax return.

(2) *Exempt recipients defined*. For purposes of this section, an exempt recipient includes—

(i) *Persons described in § 1.6049–4(c)(1)(ii)*. Any person described in § 1.6049–4(c)(1)(ii) is an exempt recipient.

(ii) *Middlemen*. Middlemen, as defined in paragraph (b)(7) of this section, are exempt recipients.

(iii) *Real estate mortgage investment conduit*. A real estate mortgage investment conduit, as defined in section 860D(a), is an exempt recipient.

(iv) *A WHFIT*. A WHFIT, as defined in paragraph (b)(15) of this section, is an exempt recipient.

(v) *Certain trusts and estates*. A trust or an estate for which the trustee or middleman of the WHFIT is also required to file a Form 1041, "*U.S. Income Tax Return for Estates and Trusts*," in its capacity as a fiduciary of that trust or estate is an exempt recipient.

(k) *Coordination with information reporting rules under subpart B, part III, subchapter A, chapter 61 of the Internal Revenue Code (Information Returns Concerning Transactions With Other Persons)*. In general, in cases where reporting is required for a WHFIT under both this § 1.671–5 and under subpart B, part III, subchapter A, chapter 61 of the Internal Revenue Code (Sections 6041 through 6050S) (Information Reporting Sections), the reporting rules for WHFITs under this § 1.671–5 control. The provisions of the Information Reporting Sections and the regulations thereunder are incorporated into this § 1.671–5 as applicable, except that those rules do not apply to the extent that they are inconsistent with the provisions of this § 1.671–5.

(l) *Backup withholding requirements*. Every trustee and middleman required to file a Form 1099 under this section § 1.671–5 is a payor within the meaning of § 31.3406(a)–2 of this chapter, and must backup withhold as required under section 3406 and any regulations thereunder.

(m) *Penalties for failure to comply*. Every trustee and middleman who fails to comply with the reporting obligations imposed by this § 1.671–5 is subject to penalties under sections 6721, 6722, and any other applicable penalty provisions.

(n) *Effective date*. These regulations are applicable beginning January 1, 2004.

Par. 4. Section 1.6041–9 is added to read as follows:

§ 1.6041–9 Coordination with reporting rules for widely held fixed investment trusts under § 1.671–5.

See § 1.671–5 for the reporting rules for widely held fixed investment trusts as defined under that section. For purposes of section 6041, middlemen and trustees of widely held fixed investment trust are deemed to have management and oversight functions in connection with payments made by the widely held fixed investment trust.

Par. 5. Section 1.6042–5 is added to read as follows:

§ 1.6042–5 Coordination with reporting rules for widely held fixed investment trusts under § 1.671–5.

See § 1.671–5 for the reporting rules for widely held fixed investment trusts as defined under that section.

Par. 6. Section 1.6045–1 is amended by adding paragraph (d)(7) to read as follows:

§ 1.6045–1 Returns of information of brokers and barter exchanges.

* * * * *

(d) * * *

(7) *Coordination with reporting rules for widely held fixed investment trusts under § 1.671–5*. See § 1.671–5 for the reporting rules for widely held fixed investment trusts as defined under that section.

* * * * *

Par. 7. Section 1.6049–4 is amended by adding paragraph (c)(3) to read as follows:

§ 1.6049–4 Return of information as to interest paid and original issue discount includible in gross income after December 31, 1982.

* * * * *

(c) * * *

(3) *Coordination with reporting rules for widely held fixed investment trusts under § 1.671–5*. See § 1.671–5 for the reporting rules for widely held fixed investment trusts as defined under that section.

* * * * *

Par. 8. In § 1.6049–5, paragraph (a)(6) is revised to read as follows:

§ 1.6049–5 Interest and original issue discount subject to reporting after December 31, 1982.

(a) * * *

(6) Interest paid on amounts held by investment companies as defined in section 3 of the Investment Company Act (15 U.S.C. section 80–a) and on amounts paid on pooled funds or trusts. The interest to be reported with respect to a widely held fixed investment trust, as defined in § 1.671–5(b)(15), shall be the interest earned on the assets held by the trust. See § 1.671–5 for the reporting rules for widely held fixed investment trusts as defined under that section.

* * * * *

Par. 9. Section 1.6050N–2 is added to read as follows:

§ 1.6050N–2 Coordination with reporting rules for widely held fixed investment trusts under § 1.671–5.

See § 1.671–5 for the reporting rules for widely held fixed investment trusts as defined under that section.

PART 301—PROCEDURE AND ADMINISTRATION

Par. 10. The authority citation for part 301 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 11. Section 301.6109–1 is amended by revising the last sentence of paragraph (a)(2)(i) to read as follows:

§ 301.6109–1 Identifying numbers.

(a) * * *

(2) * * * (i) * * * If the trustee has not already obtained a taxpayer identification number for the trust, the trustee must obtain a taxpayer identification number for the trust as provided in paragraph (d)(2) of this section in order to report pursuant to § 1.671–4(a), (b)(2)(i)(B), (b)(3)(i), or 1.671–5 of this chapter.

* * * * *

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 12. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 13. In § 602.101, paragraph (b) is amended by adding the entry “1.671–5” in numerical order to the table to read as follows:

§ 602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.671–5	1545–1540
* * * * *	

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on June 19, 2002, 8:45 a.m., and published in the issue of the Federal Register for June 20, 2002, 67 F.R. 41892)

Notice of Proposed Rulemaking and Notice of Public Hearing

Split-Dollar Life Insurance Arrangements

REG–164754–01

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations relating to the income, employment, and gift taxation of split-dollar life insurance arrangements. The proposed regulations will provide needed guidance to persons who enter into split-dollar life insurance arrangements. This document also provides notice of a public hearing on the proposed regulations.

DATES: Written or electronic comments must be received by October 7, 2002. Requests to speak and outlines of topics to be discussed at the public hearing scheduled for October 23, 2002, must be received by October 9, 2002.

ADDRESSES: Send submissions to CC:ITA:RU (REG–164754–01), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:ITA:RU (REG–164754–01), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC or sent electronically, via the IRS Internet site at *www.irs.gov/regs*. The public hearing will be held in room 4718, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the section 61 regulations, please contact Elizabeth Kaye at (202) 622–4920; concerning the section 83 regulations, please contact Erinn Madden at (202) 622–6030; concerning the section 301 regulations, please contact Krishna Vallabhaneni at (202) 622–7550; concerning the section 7872 regulations, please contact Rebecca Asta at (202) 622–3940; and concerning the application of these regulations to the Federal gift tax, please contact Lane Damazo at (202) 622–3090. To be placed on the attendance list for the hearing, please contact LaNita M. Vandyke at (202) 622–7180.

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, W:CAR: MP:FP:S, Washington, DC 20224. Comments on the collection of information should be received by September 7, 2002. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the IRS, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

The collections of information in this proposed regulation are in § 1.7872–15(d)(2)(ii) and (j)(3)(ii). These collections of information are required by the IRS to verify consistent treatment by the borrower and lender of split-dollar loans with nonrecourse or contingent payments. In addition, in the case of a split-dollar loan that provides for nonrecourse payments, the collections of information are required to obtain a benefit. The likely respondents are parties entering into split-dollar loans with nonrecourse or contingent payments.

Estimated total annual reporting and/or recordkeeping burden: 32,500 hours.

Estimated average annual burden hours per respondent and/or recordkeeper: 17 minutes.

Estimated number of respondents and/or recordkeepers: 115,000.

Estimated annual frequency of responses: on occasion.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

BACKGROUND AND EXPLANATION OF PROVISIONS

1. *Current Law*

Section 61 provides that gross income includes all income from whatever source derived. Section 1.61–2(d) describes the taxation of premiums paid by an employer or service recipient for life insurance on the life of an employee or independent contractor if the proceeds of the life insurance are payable to the beneficiary of the employee.

Section 83 provides rules for taxing a transfer of property in connection with the performance of services. Generally, if property is transferred to any person other than the service recipient in connection with the performance of services, the excess of the fair market value of such property (determined without regard to lapse restrictions) over the amount paid for such property is included in the gross income of the service provider in the first taxable year in which the service provider's rights in such property are either transferable or not subject to a substantial risk of forfeiture, whichever is applicable. Under § 1.83–1(a)(2), the cost of life insurance protection under a life insurance contract, retirement income contract, endowment contract, or other contract providing life insurance protection generally is taxable under section 61 and the regulations thereunder during the period such contract is substantially nonvested (that is, prior to the time when rights to the contract are either transferable or not subject to a substantial risk of forfeiture). The cost of such life insurance protection is the reasonable net premium cost, as determined by the Commissioner, of the current life insurance protection (as defined in § 1.72–16(b)(3)) provided by such contract. Under § 1.83–3(e), in the case of a transfer of a life insurance contract, retirement income contract, endowment contract, or other contract providing life insurance protection, only the cash surrender value of the contract is considered property.

Section 163(h) disallows a deduction for personal interest paid or accrued during the taxable year for taxpayers other than corporations. For purposes of section 163(h), personal interest is any interest other than the following: interest paid or accrued on indebtedness properly allocable to a trade or business; any investment interest within the meaning of section 163(d); any interest which is taken into account under section 469 in computing passive income or loss; any qualified residence interest; any interest payable under section 6601 on any unpaid portion of the tax imposed by section 2001 for the period during which an extension of time for payment is in effect; and any interest allowable for deduction under section 221 (relating to interest on education loans).

Section 264(a)(1) provides that no deduction is allowed for premiums on any life insurance policy if the taxpayer is directly or indirectly a beneficiary under the policy. Section 264(a)(2) provides that no deduction is allowed, except as provided in section 264(e), for any interest paid or accrued on indebtedness with respect to a life insurance policy owned by the taxpayer and covering the life of any individual.

Section 301 provides that distributions of property made by a corporation to a shareholder with respect to its stock may constitute a dividend includible in the gross income of the shareholder.

Sections 163(e) and 1271 through 1275 provide rules for the treatment of original issue discount (OID) on debt instruments. In general, the holder and the issuer of a debt instrument take the OID into account as it accrues on the basis of the debt instrument's yield to maturity.

Section 7872 provides rules for certain direct and indirect below-market loans enumerated in section 7872(c)(1). The legislative history of section 7872 states that the term *loan* is to be interpreted broadly for purposes of section 7872, potentially encompassing "any transfer of money that provides the transferor with a right to repayment." H.R. Rep. 98–861, 98th Cong., 2d Sess. 1018 (1984). In general, section 7872 recharacterizes a below-market loan (a loan in which the interest rate charged is less than the applicable Federal rate (AFR)) as an arm's-length transaction in which the lender makes a loan to the borrower at the AFR, coupled with a payment or payments to the borrower sufficient to fund all or part of the interest that the borrower is treated as paying on that loan. The amount, timing, and characterization of the imputed payments to the borrower under a below-market loan depend on the relationship between the borrower and the lender and whether the loan is characterized as a demand loan or a term loan. For example, in the case of a compensation-related below-market loan within the meaning of section 7872(c)(1)(B), the imputed payments are treated as payments of compensation.

Section 7872 generally provides that, in the case of any below-market loan that is a gift or demand loan subject to section 7872, forgone interest is treated as transferred from the lender to the borrower and retransferred from the borrower to the lender as interest on the last day of the calendar year for each year the loan is outstanding.

Section 7872 generally provides that, in the case of any below-market loan that is a term loan subject to section 7872, the lender is treated as having transferred, on the day the loan is made, an amount equal to the excess of the amount loaned over the present value of all payments which are required to be made under the terms of the loan. This amount is treated as retransferred by the borrower to the lender as OID over the term of the loan.

Rev. Rul. 64–328, 1964–2 C.B. 11, and Rev. Rul. 66–110, 1966–1 C.B. 12, address the Federal income tax treatment of a split-dollar life insurance arrangement under which an employer and an employee join in the purchase of a life insurance contract on the life of the employee and provide for the allocation of policy benefits. The rulings conclude that all economic benefits provided by the employer to the employee under such an arrangement are taxed to the employee. Thus, under the rulings, the employee generally must include in compensation income for each taxable year during which the arrangement remains in effect (i) the annual cost of the life insurance protection provided to the employee, reduced by any payments made by the employee for such life insurance protection, (ii) any policy owner dividends or similar distributions provided to the employee under the life insurance contract (including any dividends, as described in Rev. Rul. 66–110, used to provide additional policy benefits), and (iii) any other economic benefits provided to the employee under the arrangement. Neither ruling distinguishes, for tax purposes, between an arrangement in which the employer owns the life insurance contract (as in a so-called endorsement arrangement) and an arrangement in which the employee owns the contract (as in a so-called collateral assignment arrangement).

Rev. Rul. 79–50, 1979–1 C.B. 138, provides that, in a split-dollar life insurance arrangement similar to the one described in Rev. Rul. 64–328 between a corporation and a shareholder, the shareholder must include in income the value of the insurance protection in excess of the premiums paid by the shareholder, and must treat such amounts as provided in section 301(c).

Notice 2001–10, 2001–1 C.B. 459, set forth rules for the taxation of split-dollar life insurance arrangements in which the employee has an interest in the cash surrender value of the life insurance contract (so-called equity split-dollar life insurance arrangements). Notice 2001–10 generally provided, under specified conditions, for the taxation of equity split-dollar life insurance arrangements under either the rules of sections 61 and 83 or the rules of section 7872.

Notice 2002–8, 2002–4 I.R.B. 398, which revoked Notice 2001–10, provides guidance with respect to split-dollar life insurance arrangements entered into before the date final regulations concerning such arrangements are published in the **Federal Register**. The notice indicates that taxpayers may treat current life insurance protection provided under such an arrangement as an economic benefit and that the IRS will not treat the arrangement as having been terminated if the parties continue to treat and report the value of the current life insurance protection in that manner. Notice 2002–8 provides that, alternatively, the parties may treat the premiums or other payments as loans from the sponsor of the arrangement (typically, the employer) to the other party. In these cases, the IRS will not challenge a taxpayer's reasonable efforts to comply with the requirements of sections 1271 through 1275 and section 7872. In addition, all payments by the sponsor from the inception of the arrangement (reduced by any repayments to the sponsor) before the first taxable year in which the payments are treated as loans must be treated as loans entered into at the beginning of such first taxable year.[1]

Notice 2002–8 also describes the anticipated proposed regulations on split-dollar life insurance arrangements. The notice states that the rules would require taxation of a split-dollar life insurance arrangement under one of two mutually exclusive regimes: an economic benefit regime and a loan regime.

2. *Overview of the Proposed Regulations*

These proposed regulations provide guidance on the taxation of split-dollar life insurance arrangements, including equity split-dollar life insurance arrangements. The proposed regulations apply for purposes of Federal income, employment, and gift taxes. For example, the proposed regulations apply to a split-dollar life insurance arrangement between an employer and an employee, between a corporation and a shareholder, and between a donor and a donee.

Definition of split-dollar life insurance arrangement

The proposed regulations generally define a split-dollar life insurance arrangement as any arrangement (that is not part of a group term life insurance plan described in section 79) between an owner of a life insurance contract and a non-owner of the contract under which either party to the arrangement pays all or part of the premiums, and one of the parties paying the premiums is entitled to recover (either conditionally or unconditionally) all or any portion of those premiums and such recovery is to be made from, or is secured by, the proceeds of the contract. This definition is intended to apply broadly and will cover an arrangement, for example, under which the non-owner of a contract provides funds directly to the owner of the contract with which the owner pays premiums, as long as the non-owner is entitled to recover (either conditionally or unconditionally) all or a portion of the funds from the contract proceeds (for example, death benefits) or has an interest in the contract to secure the right of recovery. In addition, the amount to be recovered by the party paying the premiums need not be determined by reference to the amount of those premiums. The definition is not intended to cover the purchase of an insurance contract in which the only parties to the arrangement are the policy owner and the life insurance company acting only in its capacity as issuer of the contract.

A special rule applies in the case of an arrangement entered into in connection with the performance of services. Under this special rule, a split-dollar life insurance arrangement is any arrangement (whether or not described in the general rule) between an owner and a non-owner of a life insurance contract under which the employer or service recipient pays, directly or indirectly, all or any portion of the premiums and the beneficiary of all or any portion of the death benefit is designated by the employee or service provider or is any person whom the employee or service provider would reasonably be expected to name as beneficiary. (Like the general rule, this special rule does not apply to any arrangement covered by section 79.) This special rule also applies to arrangements between a corporation and another person in that person's capacity as a shareholder in the corporation under which the corporation pays, directly or indirectly, all or any portion of the premiums and the beneficiary of all or a portion of the death benefit is a person designated by, or would be reasonably expected to be designated by, the shareholder. As in the case of the general definition, the special rule is not intended to cover the purchase of an insurance contract in which the only parties to the arrangement are the policy owner and the life insurance company acting only in its capacity as issuer of the contract.

Mutually exclusive regimes

As indicated in Notice 2002–8, the proposed regulations provide two mutually exclusive regimes for taxing split-dollar life insurance arrangements. A split-dollar life insurance arrangement (as defined in the proposed regulations) is taxed under either the economic benefit regime or the loan regime. The proposed regulations provide rules that determine which tax regime applies to a split-dollar life insurance arrangement.

[1] Notice 2002–8 also provides that an employer and employee may continue to use the P.S. 58 rates set forth in Rev. Rul. 55–747, 1955–2 C.B. 228, which has revoked by Notice 2001–10, only with respect to split-dollar life insurance arrangements entered into before January 28, 2002, in which a contractual arrangement between the employer and employee provides that the P.S. 58 rates will be used to determine the value of the current life insurance protection provided to the employee (or to the employee and one or more additional persons). Taxpayers may not use the P.S. 58 rates for "reverse" split-dollar life insurance arrangements or for split-dollar life insurance arrangements outside of the compensatory context.

Under the economic benefit regime (generally set forth in § 1.61–22 of the proposed regulations), the owner of the life insurance contract is treated as providing economic benefits to the non-owner of the contract. The economic benefit regime generally will govern the taxation of endorsement arrangements. In addition, a special rule requires the economic benefit regime to apply (and the loan regime not to apply) to any split-dollar life insurance arrangement if (i) the arrangement is entered into in connection with the performance of services, and the employee or service provider is not the owner of the life insurance contract, or (ii) the arrangement is entered into between a donor and a donee (for example, a life insurance trust) and the donee is not the owner of the life insurance contract.

Under the loan regime (generally set forth in § 1.7872–15 of the proposed regulations), the non-owner of the life insurance contract is treated as loaning premium payments to the owner of the contract. Except for specified arrangements, the loan regime applies to any split-dollar loan (as defined in the proposed regulations). The loan regime generally will govern the taxation of collateral assignment arrangements.

Thus, in contrast to Rev. Rul. 64–328 and Rev. Rul. 66–110, the proposed regulations generally provide substantially different tax consequences to the parties depending on which party owns the life insurance contract.

The proposed regulations also require both the owner and the non-owner of a life insurance contract that is part of a split-dollar life insurance arrangement (as defined either in the general rule or the special rule) to fully and consistently account for all amounts under the arrangement under the rules of either § 1.61–22 or § 1.7872–15.

For purposes of both the general rule and the special rule, unless the non-owner's payments are certain payments made in consideration for economic benefits, general Federal income, employment, and gift tax principles apply to the arrangement. For example, if an employer pays premiums on a contract owned by an employee and the payments are not split-dollar loans under § 1.7872–15, the employee must include the full amount of the payments in gross income at the time they are paid by the employer to the extent that the employee's rights to the life insurance contract are substantially vested. Also, to the extent an owner's repayment obligation is waived, cancelled, or forgiven at any time under an arrangement that prior to the cancellation of indebtedness was treated as a split-dollar loan, the owner and non-owner must account for the amount waived, cancelled, or forgiven in accordance with the relationship between the parties. Thus, if the arrangement were in a compensatory context, the owner of the contract (the employee) and the non-owner (the employer) would account for the amount as compensation. See *OKC Corp. and Subsidiaries v. Commissioner*, 82 T.C. 638 (1984) (whether the cancellation of a debt is ordinary income to the debtor depends upon the nature of the payment); *Newmark v. Commissioner*, 311 F.2d 913 (2d Cir. 1962) (discharge of indebtedness constituted a payment for services in an employment situation).

Owners and non-owners

The proposed regulations provide rules for determining the owner and the non-owner of the life insurance contract. The owner is the person named as the policy owner. If two or more persons are designated as the policy owners, the first-named person generally is treated as the owner of the entire contract. However, if two or more persons are named as the policy owners and each such person has an undivided interest in every right and benefit of the contract, those persons are treated as owners of separate contracts. For example, if an employer and an employee jointly own a life insurance contract and share equally in all rights and benefits under the contract, they are treated as owning two separate contracts (and, ordinarily, neither contract would be treated as part of a split-dollar life insurance arrangement).

The general rule that the person named as the policy owner is treated as the owner of the life insurance contract is subject to two exceptions involving situations in which the only benefits available under the split-dollar life insurance arrangement would be the value of current life insurance protection (that is, so-called non-equity arrangements). Under the first exception, an employer or service recipient is treated as the owner of the contract under a split-dollar life insurance arrangement that is entered into in connection with the performance of services if, at all times, the only economic benefits available to the employee or service provider under the arrangement would be the value of current life insurance protection. Similarly, a donor is treated as the owner of a life insurance contract under a split-dollar life insurance arrangement that is entered into between a donor and a donee (for example, a life insurance trust) if, at all times, the only economic benefits available to the donee under the arrangement would be the value of current life insurance protection. The proposed regulations reserve on the issue of the consequences of a modification to these arrangements (for example, such as subsequently providing the employee or donee with an interest in the cash value of the life insurance contract). The IRS and the Treasury Department request comments on the rule the final regulations should adopt regarding the consequences of modifying these arrangements.

The non-owner is any person other than the owner of the life insurance contract having any direct or indirect interest in such contract (other than a life insurance company acting solely in its capacity as issuer of a life insurance contract). For example, an employee whose spouse is designated by the employer as the beneficiary of a life insurance contract that is owned by the employer would have an indirect interest in the contract and, therefore, would be treated as a non-owner.

3. *Taxation Under the Economic Benefit Regime*

a. *In general*

Section 1.61–22(d) provides that, as a general rule for split-dollar life insurance arrangements that are taxed under the economic benefit regime, the owner of the life insurance contract is treated as providing economic benefits to the non-owner of the contract, and those economic benefits must be accounted for fully and consistently by both the owner and the non-owner. The value of the economic benefits, reduced by any consideration paid by the non-owner to the owner, is treated as transferred from the owner to the non-owner. The tax consequences of that transfer will depend on the relationship between the owner and the non-owner. Thus, the transfer may constitute a payment of compensation, a distribution under section 301, a gift, or a transfer having a different tax character.

Non-Equity Split-Dollar Life Insurance Arrangements

Under a non-equity split-dollar life insurance arrangement, the owner is treated as providing current life insurance protection (including paid-up additions) to the non-owner. The amount of the current life insurance protection provided to the non-owner for a taxable year equals the excess of the average death benefit of the life insurance contract over the total amount payable to the owner under the split-dollar life insurance arrangement. The total amount payable to the owner is increased by the amount of any outstanding policy loan. The cost of the current life insurance protection provided to the non-owner in any year equals the amount of the current life insurance protection provided to the non-owner multiplied by the life insurance premium factor designated or permitted in guidance published in the Internal Revenue Bulletin. For example, assume that employer R is the owner of a $1,000,000 life insurance contract that is part of a split-dollar life insurance arrangement between R and employee E. Under the arrangement, R pays all of the $10,000 annual premiums and is entitled to receive the greater of its premiums or the cash surrender value of the contract when the arrangement terminates or E dies. Assume that through year 10 of the arrangement R has paid $100,000 of premiums and that in year 10 the cost of term insurance for E is $1.00 for $1,000 of insurance and the cash surrender value of the contract is $200,000. Under § 1.61–22, in year 10, E must include in compensation income $800 ($1,000,000 – $200,000, or $800,000 payable to R, multiplied by .001 (E's premium rate factor)). If, however, E paid $300 of the premium, E would include $500 in compensation income.

The Treasury Department and the IRS request comments on whether there is a need for more specific guidance in computing the cost of a death benefit that varies during the course of a taxable year. Comments are requested concerning, for example, whether a convention requiring the amount of the death benefit to be recomputed on a quarterly or semi-annual basis would properly balance the accurate computation of the death benefit against compliance and administrative burdens.

Equity Split-Dollar Life Insurance Arrangements

Under § 1.61–22(d)(3), the owner and the non-owner also must account fully and consistently for any right in, or benefit of, a life insurance contract provided to the non-owner under an equity split-dollar life insurance arrangement. For example, in a compensatory context in which the contract is owned by the employer, the employee must include in gross income the value of any interest in the cash surrender value of the contract provided to the employee during a taxable year.

This result is consistent with the conclusion in Rev. Rul. 66–110 that an employee must include in gross income the value of all economic benefits provided under a split-dollar life insurance arrangement. More broadly, this result is consistent with the fact that a non-owner who has an interest in the cash surrender value of a life insurance contract under an equity split-dollar life insurance arrangement is in a better economic position than a non-owner who has no such interest under a non-equity arrangement.

In general, a mere unfunded, unsecured promise to pay money in the future — as in a standard nonqualified deferred compensation plan covering an employee — does not result in current income. However, a non-owner's interest in a life insurance contract under an equity split-dollar life insurance arrangement is less like that of an employee covered under a standard nonqualified deferred compensation arrangement and more like that of an employee who obtains an interest in a specific asset of the employer (such as where the employer makes an outright purchase of a life insurance contract for the benefit of the employee). The employer's right to a return of its premiums, which characterizes most equity split-dollar life insurance arrangements, affects only the valuation of the employee's interest under the arrangement and, therefore, the amount of the employee's current income.

Specific guidance regarding valuation of economic benefits under an equity split-dollar life insurance arrangement is reserved in § 1.61–22, pending comments from interested parties concerning an appropriate valuation methodology and views on whether such a methodology should be adopted as a substantive rule or as a safe harbor. Any proposal for a specific methodology should be objective and administrable. One potential approach for valuation might involve subtracting from current premium payments made by the contract owner the net present value of the amount to be repaid to the owner in the future.

Other Tax Consequences

Because § 1.61–22(c) treats one party to the split-dollar life insurance arrangement as the owner of the entire contract, the non-owner has no investment in the contract under section 72(e). Thus, no amount paid by the non-owner under a split-dollar life insurance arrangement, whether or not designated as a premium, and no amount included in the non-owner's gross income as an economic benefit, is treated as investment in the contract under section 72(e)(6) for the non-owner. However, as described below, special rules apply in the case of a transfer of the contract from the owner to the non-owner.

Any premium paid by the owner is included in the owner's investment in the contract under section 72(e)(6). However, no premium payment and no economic benefit includible in the non-owner's gross income is deductible by the owner (except as otherwise provided under section 83 when the contract is transferred to the non-owner and the transfer is taxable in accordance with the rules of that section). Any amount paid by the non-owner to the owner for any economic benefit is included in the owner's gross income. Such amount is also included in the owner's investment in the contract (but only to the extent not otherwise so included by reason of having been paid by the owner as a premium or other consideration for the contract).

b. *Taxation of amounts received under the life insurance contract*

Any amount received under the life insurance contract (other than an amount received by reason of death) and provided, directly or indirectly, to the non-owner is treated as though paid by the insurance company to the owner and then by the owner to the non-owner. This rule applies to a policy owner dividend, the proceeds of a specified policy loan (as defined in § 1.61–22(e)), a withdrawal, or the proceeds of a partial surrender. The owner is taxed on the amount in accordance with the rules of section 72. The non-owner (and the owner for gift tax and employment tax purposes) must take the amount into account as a payment of compensation, a distribution under section 301, a gift, or other transfer depending on the non-owner's relationship to the owner. However, the amount that must be taken into account is reduced by the sum of (i) the value of all economic benefits actually taken into account by the non-owner (and the owner for gift tax and employment tax purposes) reduced (but not below zero) by the amounts that would have been taken into account were the arrangement a non-equity split-dollar life insurance arrangement and (ii) any consideration paid by the non-owner for all economic benefits reduced (but not below zero) by any consideration paid by the non-owner that would have been allocable to economic benefits provided to the non-owner were the arrangement a non-equity split-dollar life insurance arrangement. However, the preceding sentence applies only to the extent such economic benefits were not previously used to reduce an earlier amount received under the contract.

The same result applies in the case of a specified policy loan. A policy loan is a specified policy loan to the extent (i) the proceeds of the loan are distributed directly from the insurance company to the non-owner; (ii) a reasonable person would not expect that the loan will be repaid by the non-owner; or (iii) the non-owner's obligation to repay the loan to the owner is satisfied, or is capable of being satisfied, upon repayment by either party to the insurance company. Because the employee is not the owner of the contract, the specified policy loan will not be treated as a loan to the employee but as a loan to the employer (the owner of the contract), followed by a payment of cash compensation from the employer to the employee.

Amounts received by reason of death are treated differently. Under § 1.61–22(f), any amount paid to a beneficiary (other than the owner) by reason of the death of the insured is excludable from the beneficiary's gross income under section 101(a) as an amount received under a life insurance contract. This result applies only to the extent that such amount is allocable to current life insurance protection provided to the non-owner pursuant to the split-dollar life insurance arrangement, the cost of which was paid by the non-owner, or the value of which the non-owner actually took into account under the rules set forth in § 1.61–22. Amounts received by a non-owner in its capacity as a lender are generally not amounts received by reason of the death of the insured under section 101(a). Cf. Rev. Rul. 70–254, 1970–1 C.B. 31.

c. *Transfer of life insurance contract to the non-owner*

Section 1.61–22(g) provides rules for the transfer of a life insurance contract (or an undivided interest therein) from the owner to the non-owner. Consistent with the general rule for determining ownership, § 1.61–22(g) provides that a transfer of a life insurance contract (or an undivided interest therein) underlying a split-dollar life insurance arrangement occurs on the date that the non-owner becomes the owner of the entire contract (or the undivided interest therein). Thus, a transfer of the contract does not occur merely because the cash surrender value of the contract exceeds the premiums paid by the owner or the amount ultimately repayable to the owner on termination of the arrangement or the death of the insured. In addition, there is no transfer of the contract if the owner merely endorses a percentage of the cash surrender value of the contract (or similar rights in the contract) to the non-owner. Unless and until ownership of the contract is formally changed, the owner will continue to be treated as the owner for all Federal income, employment, and gift tax purposes.

At the time of a transfer, there generally must be taken into account for Federal income, employment, and gift tax purposes the excess of the fair market value of the life insurance contract (or the undivided interest therein) transferred to the non-owner (transferee) over the sum of (i) the amount the transferee pays to the owner (transferor) to obtain the contract (or the undivided interest therein), (ii) the value of all economic benefits actually taken into account by the non-owner (and the owner for gift tax and employment tax purposes) reduced (but not below zero) by the amounts that would have been taken into account were the arrangement a non-equity split-dollar life insurance arrangement, and (iii) any consideration paid by the non-owner for all economic benefits reduced (but not below zero) by any consideration paid by the non-owner that would have been allocable to economic benefits provided to the non-owner were the arrangement a non-equity split-dollar life insurance arrangement. However, clauses (ii) and (iii) of the preceding sentence apply only to the extent those economic benefits were not previously used to reduce an earlier amount received under the contract. For this purpose, the fair market value of the life insurance contract is the cash surrender value and the value of all other rights under the contract (including any supplemental agreements, whether or not guaranteed), other than the value of the current life insurance protection. For example, the fair market value of the contract includes the value of a guaranteed right to an above-market rate of return (to the extent not already reflected in the cash surrender value).

In a transfer subject to section 83, fair market value is determined disregarding any lapse restrictions. In addition, the timing of the transferee's inclusion is determined under the rules of section 83. Therefore, a transfer will not give rise to gross income until the transferee's rights to the contract (or undivided interest in the contract) are substantially vested (unless the transferee makes a section 83(b) election). Section 1.83–6(a)(5) of the proposed regulations allows the service recipient's deduction at that time.

Under the general rule, the amount treated as consideration paid to acquire the contract under section 72(g)(1) equals the greater of the fair market value of the contract or the sum of the amount the transferee pays to obtain the contract plus the amount of unrecovered economic benefits previously taken into account or paid for by the transferee. Thus, these amounts become the transferee's investment in the contract under section 72(e) immediately after the transfer.

In the case of a transfer between a donor and a donee, the amount treated as consideration paid by the transferee to acquire the contract under section 72(g)(1) to determine the transferee's investment in the contract under section 72(e) immediately after the transfer is the sum of (i) the amount the transferee pays to obtain the contract, (ii) the aggregate of premiums or other consideration paid or deemed to have been paid by the transferor, and (iii) the amount of unrecovered economic benefits previously either taken into account by the transferee (excluding the amount of those benefits that was excludable from the transferee's gross income at the time of receipt) or paid for by the transferee.

After a transfer of an entire life insurance contract, the transferee becomes the owner for Federal income, employment, and gift tax purposes, including for purposes of the split-dollar life insurance rules. Thus, if the transferor pays premiums after the transfer, the payment of those premiums may be includible in the transferee's gross income if the payments are not split-dollar loans under § 1.7872–15. After the transfer of an undivided interest in a life insurance contract, the transferee is treated as the new owner of a separate contract for all purposes. However, if a transfer of a life insurance contract or an undivided interest in the contract is made in connection with the performance of services and the transfer is not yet taxable under section 83 (because rights to the contract or the undivided interest are substantially nonvested and no section 83(b) election is made), the transferor continues to be treated as the owner of the contract.

4. *Taxation Under the Loan Regime*

a. *In general*

Under § 1.7872–15, a payment made pursuant to a split-dollar life insurance arrangement is a split-dollar loan and the owner and non-owner are treated, respectively, as borrower and lender if (i) the payment is made either directly or indirectly by the non-owner to the owner; (ii) the payment is a loan under general principles of Federal tax law or, if not a loan under general principles of Federal tax law, a reasonable person would expect the payment to be repaid in full to the non-owner (whether with or without interest); and (iii) the repayment is to be made from, or is secured by, either the policy's death benefit proceeds or its cash surrender value. The Treasury Department and the IRS recognize that, in the earlier years during which a split-dollar life insurance arrangement is in effect, policy surrender and load charges may significantly reduce the policy's cash surrender value, resulting in under-collateralization of a non-owner's right to be repaid its premium payments. Nevertheless, so long as a reasonable person would expect the payment to be repaid in full, the payment is a split-dollar loan under § 1.7872–15. The Treasury Department and the IRS believe that Congress generally intended that section 7872 would govern the treatment of an arrangement the substance of which is a loan from one party to another and that there was no congressional intent to make section 7872 inapplicable to split-dollar life insurance arrangements if the arrangements are, in substance, loans.

If a payment on a split-dollar loan is nonrecourse to the borrower and the loan does not otherwise provide for contingent payments, § 1.7872–15 treats the loan as a split-dollar loan that provides for contingent payments unless the parties to the split-dollar life insurance arrangement provide a written representation with respect to the loan to which the payment relates. In general, unless the parties represent that a reasonable person would expect that all payments under the loan will be made, the loan will be treated as a loan that provides for contingent payments. This written representation requirement is intended to help ensure that the parties to the arrangement treat the payments consistently.

If a split-dollar loan does not provide for sufficient interest, the loan is a below-market split-dollar loan subject to section 7872 and § 1.7872–15. If the split-dollar loan provides for sufficient interest, then, except as provided in § 1.7872–15, the loan is subject to the general rules for debt instruments (including the rules for OID). In general, interest on a split-dollar loan is not deductible by the borrower under sections 264 and 163(h). Section 1.7872–15 provides special rules for split-dollar loans that provide for certain variable rates of interest, contingent interest payments, and lender or borrower options. Section 1.7872–15 also provides rules for split-dollar loans on which stated interest is subsequently waived, cancelled, or forgiven by the lender, and for below-market split-dollar loans with indirect participants.

b. *Treatment of below-market split-dollar loans*

If a split-dollar loan is a below-market loan, then, in general, the loan is recharacterized as a loan with interest at the AFR, coupled with an imputed transfer by the lender to the borrower. The timing, amount, and characterization of the imputed transfers between the lender and borrower of the loan will depend upon the relationship between the lender and the borrower (for example, the imputed transfer is generally characterized as a compensation payment if the lender is the borrower's employer), and whether the loan is a demand loan or a term loan.

For purposes of § 1.7872–15, a below-market split-dollar loan made from a lender to a borrower with a relationship not enumerated in section 7872(c)(1)(A), (B), or (C) is treated as a significant-effect loan under section 7872(c)(1)(E). However, if the effect of a split-dollar loan is attributable to the relationship between the lender or borrower and an indirect participant (for example, when a split-dollar loan is made from an employer to the child of an employee), the below-market split-dollar loan is restructured as two or more successive below-market loans. Any deduction allowable to the indirect participant under section 163(d) for investment interest deemed paid is limited to the amount of investment interest deemed received by the indirect participant.

Split-Dollar Demand Loans

A split-dollar demand loan is any split-dollar loan that is payable in full at any time on the demand of the lender (or within a reasonable time after the lender's demand). Each calendar year that a split-dollar demand loan is outstanding, the loan is tested to determine if the loan provides for sufficient interest. A split-dollar demand loan provides for sufficient interest for the calendar year if the rate (based on annual compounding) at which interest accrues on the loan's adjusted issue price during the year is no lower than the blended annual rate for the year. The use of an annual rate, rather than a semiannual rate, provides a simplified method to determine whether a split-dollar loan provides for sufficient interest and, if the split-dollar loan is below-market, to compute the loan's forgone interest.

In the case of a below-market split-dollar demand loan, the amount of forgone interest for a calendar year is the excess of (i) the amount of interest that would have been payable on the loan for the calendar year if interest accrued on the loan's adjusted issue price at the appropriate AFR and were payable annually over (ii) any interest that accrues on the loan during the year. In general, this excess amount is treated as transferred by the lender to the borrower and retransferred as interest by the borrower to the lender at the end of each calendar year that the loan remains outstanding.

Split-Dollar Term Loans

A split-dollar term loan is any loan that is not a split-dollar demand loan. A split-dollar term loan does not provide for sufficient interest if the amount loaned exceeds the imputed loan amount, which is the present value of all payments due under the loan, determined as of the date the loan is made, using a discount rate equal to the AFR in effect on that date. The AFR used for purposes of the preceding sentence must be appropriate for the loan's term (short-term, mid-term, or long-term) and the compounding period used in computing the present value.

With respect to a below-market split-dollar term loan, the amount of the imputed transfer by the lender to the borrower is the excess of the amount loaned over the imputed loan amount. In general, a split-dollar term loan is treated as having OID equal to the amount of the imputed transfer, in addition to any other OID on the loan (determined without regard to § 1.7872–15).

The term of a split-dollar term loan generally is the term stated in the split-dollar life insurance arrangement. However, special rules apply if the loan is subject to certain borrower or lender options. For purposes of determining a loan's term, the borrower or the lender is projected to exercise or not exercise an option or combination of options in a manner that minimizes the loan's overall yield.

Special rules also are provided for split-dollar term loans payable upon the death of an individual, certain split-dollar term loans that are conditioned on the future performance of substantial services by an individual, and gift split-dollar term loans. Under § 1.7872–15, these split-dollar loans are split-dollar term loans for purposes of determining whether the loan provides for sufficient interest. However, if the loan does not provide for sufficient interest when the loan is made, forgone interest is determined on the loan annually similar to a split-dollar demand loan. The rate used to determine the amount of forgone interest each year is the AFR based on the term of the loan rather than the blended annual rate. A below-market gift split-dollar term loan is treated as a term loan for gift tax purposes.

c. *Loans that provide for contingent payments*

A split-dollar loan that provides for one or more contingent payments is accounted for by the parties under the contingent split-dollar method, a method similar to the noncontingent bond method described in § 1.1275–4(b). Under this method, the lender prepares a projected payment schedule that includes all of the noncontingent payments and a projected payment for each contingent payment. Any contingent payment provided for under the terms of a split-dollar loan is projected to resolve to its lowest possible value. However, the projected payment schedule must produce a yield that is not less than zero. The projected payment schedule is used to determine the yield of the split-dollar loan. This yield is then used to determine the accruals of interest (OID) on the loan and to determine whether the loan is a below-market loan for purposes of section 7872 and § 1.7872–15. For example, a split-dollar loan providing for contingent payments is treated as a below-market split-dollar loan if the yield based on the projected payment schedule is less than the appropriate AFR.

If, when a contingency resolves, the actual amount of a contingent payment is different than the projected payment, appropriate adjustments are made by the parties to reflect the difference when the contingency resolves. For example, if a contingent split-dollar loan was treated as a below-market split-dollar loan based on the projected payment schedule and the actual yield on the loan turns out to be greater than the appropriate AFR when the contingency resolves, the parties will take appropriate adjustments into account for any prior imputed transfers under section 7872 and § 1.7872–15 at that time.

d. *Split-dollar loans with stated interest that is subsequently waived, cancelled or forgiven*

If a split-dollar loan provides for stated interest that is subsequently waived, cancelled or forgiven, appropriate adjustments are made by the parties to reflect the difference between the interest payable at the stated rate and the interest actually paid by the borrower at that time. An adjustment (for example, an imputed transfer of compensation) may have consequences for the Federal Insurance Contributions Act (FICA) and the Federal Unemployment Tax Act (FUTA) if the adjustment represents wages to the borrower.

e. *Payment ordering rules*

Payments made by a borrower to a lender pursuant to a split-dollar life insurance arrangement are applied in the following order: to accrued but unpaid interest (including any OID) on all outstanding split-dollar loans in the order the interest accrued; to principal on the outstanding split-dollar loans in the order in which the loans were made; to payments of amounts previously paid by the lender pursuant to the split-dollar life insurance arrangement that were not reasonably expected to be repaid; and to any other payment with respect to a split-dollar life insurance arrangement. Comments are requested on this rule and other alternative rules, which include applying payments to both the accrued but unpaid interest and principal on each split-dollar loan in the order in which the loans were made, and applying payments *pro-rata* on all existing split-dollar loan balances.

5. *Transfer Tax Treatment of Split-Dollar Life Insurance Arrangements*

The proposed regulations will apply for gift tax purposes in situations involving private split-dollar life insurance arrangements. Thus, if, under the proposed regulations, an irrevocable insurance trust is the owner of the life insurance contract underlying the split-dollar life insurance arrangement, and a reasonable person would expect that the donor, or the donor's estate, will recover an amount equal to the donor's premium payments, those premium payments are treated as loans made by the donor to the trust and are subject to § 1.7872–15. In such a case, payment of a premium by the donor is treated as a split-dollar loan to the trust in the amount of the premium payment. If the loan is repayable upon the death of the donor, the term of the loan is the donor's life expectancy determined under the appropriate table under § 1.72–9 as of the date of the payment and the value of the gift is the amount of the premium payment less the present value (determined under section 7872 and § 1.7872–15) of the donor's right to receive repayment. If, however, the donor makes premium payments that are not split-dollar loans, then the premium payments are governed by general gift tax principles. In such a case, with each premium payment, the donor is treated as making a gift to the trust equal to the amount of that payment.

Different rules apply, however, if the donor is treated under § 1.61–22(c) as the owner of the life insurance contract underlying the split-dollar life insurance arrangement and the donor is entitled to recover (either conditionally or unconditionally) all or any portion of the premium payments and such recovery is to be made from, or is secured by, the proceeds of the life insurance contract. Under these circumstances, the donor is treated as making a gift of economic benefits to the irrevocable insurance trust when the donor makes any premium payment on the life insurance contract. For example, assume that under the terms of the split-dollar life insurance arrangement, on termination of the arrangement or the donor's death, the donor or donor's estate is entitled to receive an amount equal to the *greater* of the aggregate premiums paid by the donor or the cash surrender value of the contract. In this case, each time the donor pays a premium, the donor makes a gift to the trust equal to the cost of the current life insurance protection provided to the trust less any premium amount paid by the trustee. On the other hand, if the donor or the donor's estate is entitled to receive an amount equal to the *lesser* of the aggregate premiums paid by the donor, or the cash surrender value of the contract, the amount of the donor's gift to the trust upon the payment of a premium equals the value of the economic benefits attributable to the trust's entire interest in the contract (reduced by any consideration the trustee paid for the interest).

As discussed earlier, § 1.61–22(c) treats the donor as the owner of a life insurance contract even if the donee is named as the policy owner if, under the split-dollar life insurance arrangement, the only amount that would be treated as a transfer by gift by the donor under the arrangement would be the value of current life insurance protection. However, any amount paid by a donee, directly or indirectly, to the donor for such current life insurance protection would generally be included in the donor's gross income.

Similarly, if the donor is the owner of the life insurance contract that is part of the split-dollar life insurance arrangement, amounts received by the irrevocable insurance trust (either directly or indirectly) under the contract (for example, as a policy owner dividend or proceeds of a specified policy loan) are treated as gifts by the donor to the irrevocable insurance trust as provided in § 1.61–22(e). The donor must also treat as a gift to the trust the amount set forth in § 1.61–22(g) upon the transfer of the life insurance contract (or undivided interest therein) from the donor to the trust.

The gift tax consequences of the transfer of an interest in a life insurance contract to a third party will continue to be determined under established gift tax principles notwithstanding who is treated as the owner of the life insurance contract under the proposed regulations. See, for example, Rev. Rul. 81–198, 1981–2 C.B. 188. Similarly, for estate tax purposes, regardless of who is treated as the owner of a life insurance contract under these proposed regulations, the inclusion of the policy proceeds in a decedent's gross estate will continue to be determined under section 2042. Thus, the policy proceeds will be included in the decedent's gross estate under section 2042(1) if receivable by the decedent's executor, or under section 2042(2) if the policy proceeds are receivable by a beneficiary other than the decedent's estate and the decedent possessed any incidents of ownership with respect to the policy.

6. *Other Applications of These Regulations*

The proposed regulations provide for conforming changes to the definition of wages under sections 3121(a), 3231(e), 3306(b), and 3401(a) and self-employment income under section 1402(a). The rules also apply for purposes of characterizing distributions from a corporation to a shareholder under section 301.

7. *Revenue Rulings to Become Obsolete*

Concurrent with the publication of final regulations relating to split-dollar life insurance arrangements in the **Federal Register**, the IRS will obsolete the following revenue rulings with respect to split-dollar life insurance arrangements entered into *after* the date the final regulations are published in the **Federal Register**: Rev. Rul. 64–328, 1964–2 C.B. 11; Rev. Rul. 66–110, 1966–1 C.B. 12; Rev. Rul. 78–420, 1978–2 C.B. 68, (with respect to income tax consequences); Rev. Rul. 79–50, 1979–1 C.B. 138; and Rev. Rul. 81–198, 1981–2 C.B. 188 (with respect to income tax consequences). Taxpayers entering into split-dollar life insurance arrangements on or before the date of publication of the final regulations may continue to rely on these revenue rulings to the extent described in Notice 2002–8.

The Treasury Department and the IRS request comments concerning whether any other revenue rulings or guidance published in the Internal Revenue Bulletin should be reconsidered in connection with the publication of final regulations relating to split-dollar life insurance arrangements in the **Federal Register**.

PROPOSED EFFECTIVE DATE

These proposed regulations are proposed to apply to any split-dollar life insurance arrangement entered into after the date these regulations are published as final regulations in the **Federal Register**. In addition, under the proposed regulations, an arrangement entered into on or before the date final regulations are published in the **Federal Register** and that is materially modified after that date is treated as a new arrangement entered into on the date of the modification. Comments are requested regarding whether certain material modifications should be disregarded in determining whether an arrangement is treated as a new arrangement for purposes of the effective date rule. For example, comments are requested whether an arrangement entered into on or before the effective date should be subject to these rules if the only material modification to the arrangement after that date is an exchange of an insurance policy qualifying for nonrecognition treatment under section 1035.

Taxpayers are reminded that Notice 2002–8 provides guidance with respect to arrangements entered into before the effective date of these regulations.

In addition, taxpayers may rely on these proposed regulations for the treatment of any split-dollar life insurance arrangement entered into on or before the date final regulations are published in the **Federal Register** provided that all parties to the split-dollar life insurance arrangement treat the arrangement consistently. Thus, for example, an owner and a non-owner of a life insurance contract that is part of a split-dollar life insurance arrangement may not rely on these proposed regulations if one party treats the arrangement as subject to the economic benefit rules of § 1.61–22 and the other party treats the arrangement as subject to the loan rules of § 1.7872–15. Moreover, parties to an equity split-dollar life insurance arrangement subject to the economic benefit regime may rely on these proposed regulations only if the value of all economic benefits taken into account by the parties exceeds the value of the economic benefits the parties would have taken into account if the arrangement were a non-equity split-dollar life insurance arrangement (determined using the Table 2001 rates in Notice 2002–8), thereby reflecting the fact that such an arrangement provides the non-owner with economic benefits that are more valuable than current life insurance protection.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory flexibility assessment is not required. It is hereby certified that the collection of information requirements in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the regulations merely require a taxpayer to prepare a written representation that contains minimal information (if the loan provides for nonrecourse payments) or a projected payment schedule (if the loan provides for contingent payments). In addition, the preparation of these documents should take no more than .28 hours per taxpayer. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written or electronic comments (a signed original and eight (8) copies) that are submitted timely to the IRS. The Treasury Department and IRS specifically request comments on the clarity of the proposed rules and how they may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for October 23, 2002, beginning at 10 a.m. in room 4718 of the Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. All visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written comments and an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by October 9, 2002. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the schedule of speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal authors of these proposed regulations are Rebecca Asta of the Office of Associate Chief Counsel (Financial Institutions and Products), Lane Damazo of the Office of Associate Chief Counsel (Passthroughs and Special Industries), Elizabeth Kaye of the Office of Associate Chief Counsel (Income Tax and Accounting), Erinn Madden of the Office of Associate Chief Counsel (Tax-Exempt and Governmental Entities), and Krishna Vallabhaneni of the Office of Associate Chief Counsel (Corporate). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 31 are proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.7872–15 also issued under 26 U.S.C. 1275 and 7872. * * *

Par. 2. Section 1.61–2 is amended by:

1. Redesignating paragraphs (d)(2)(ii)(*a*) and (*b*) as paragraphs (d)(2)(ii)(A) and (B), respectively.

2. Adding two sentences immediately following the second sentence in newly designated paragraph (d)(2)(ii)(A).

The additions read as follows:

§ 1.61–2 Compensation for services, including fees, commissions, and similar items.

* * * * *

(d) * * *

(2) * * *

(ii)(A) *Cost of life insurance on the life of the employee*. * * * For example, if an employee or independent contractor is the owner (as defined in § 1.61–22(c)(1)) of a life insurance contract and the payments under such contract are not split-dollar loans under § 1.7872–15(b)(1), the employee or independent contractor must include in income the amount of any such payments by the employer or service recipient with respect to such contract during any year to the extent that the employee's or independent contractor's rights to the life insurance contract are substantially vested (within the meaning of § 1.83–3(b)). This result is the same regardless of whether the employee or independent contractor had at all times been the owner of the life insurance contract or the contract previously had been owned by the employer or service recipient as part of a split-dollar life insurance arrangement (as defined in § 1.61–22(b)(1) or (2)) and had been transferred by the employer or service recipient to the employee or independent contractor under § 1.61–22(g). * * *

* * * * *

Par. 3. Section 1.61–22 is added to read as follows:

§ 1.61–22 Taxation of split-dollar life insurance arrangements.

(a) *Scope*—(1) *In general*. This section provides rules for the taxation of a split-dollar life insurance arrangement for purposes of the income tax, the gift tax, the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA), the Railroad Retirement Tax Act (RRTA), and the Self-Employment Contributions Act of 1954 (SECA). For the Collection of Income Tax at Source on Wages, this section also provides rules for the taxation of a split-dollar life insurance arrangement, other than a payment under a split-dollar life insurance arrangement that is a split-dollar loan under § 1.7872–15(b)(1). In general, a split-dollar life insurance arrangement (as defined in paragraph (b) of this section) is subject to the rules of either paragraphs (d) through (g) of this section or § 1.7872–15. For rules to determine which rules apply to a split-dollar life insurance arrangement, see paragraph (b)(3) of this section.

(2) *Overview*. Paragraph (b) of this section defines a split-dollar life insurance arrangement and provides rules to determine whether an arrangement is subject to the rules of paragraphs (d) through (g) of this section, § 1.7872–15, or general tax rules. Paragraph (c) of this section defines certain other terms. Paragraph (d) of this section sets forth rules for the taxation of economic benefits provided under a split-dollar life insurance arrangement. Paragraph (e) of this section sets forth rules for the taxation of amounts received under a life insurance contract that is part of a split-dollar life insurance arrangement. Paragraph (f) of this section provides rules for additional tax consequences of a split-dollar life insurance arrangement, including the treatment of death benefits. Paragraph (g) of this section provides rules for the transfer of a life insurance contract (or an undivided interest in the contract) that is part of a split-dollar life insurance arrangement. Paragraph (h) of this section provides examples illustrating the application of this section. Paragraph (j) of this section provides the effective date of this section.

(b) *Split-dollar life insurance arrangement*—(1) *In general*. A split-dollar life insurance arrangement is any arrangement between an owner and a non-owner of a life insurance contract that satisfies the following criteria—

(i) Either party to the arrangement pays, directly or indirectly, all or any portion of the premiums on the life insurance contract, including a payment by means of a loan to the other party that is secured by the life insurance contract;

(ii) At least one of the parties to the arrangement paying premiums under paragraph (b)(1)(i) of this section is entitled to recover (either conditionally or unconditionally) all or any portion of those premiums and such recovery is to be made from, or is secured by, the proceeds of the life insurance contract; and

(iii) The arrangement is not part of a group-term life insurance plan described in section 79.

(2) *Special rule*—(i) *In general*. Any arrangement between an owner and a non-owner of a life insurance contract is treated as a split-dollar life insurance arrangement (regardless of whether the criteria of paragraph (b)(1) of this section are satisfied) if the arrangement is described in paragraph (b)(2)(ii) or (iii) of this section.

(ii) *Compensatory arrangements*. An arrangement is described in this paragraph (b)(2)(ii) if the following criteria are satisfied—

(A) The arrangement is entered into in connection with the performance of services and is not part of a group-term life insurance plan described in section 79;

(B) The employer or service recipient pays, directly or indirectly, all or any portion of the premiums; and

(C) The beneficiary of all or any portion of the death benefit is designated by the employee or service provider or is any person whom the employee or service provider would reasonably be expected to designate as the beneficiary.

(iii) *Shareholder arrangements*. An arrangement is described in this paragraph (b)(2)(iii) if the following criteria are satisfied—

(A) The arrangement is entered into between a corporation and another person in that person's capacity as a shareholder in the corporation;

(B) The corporation pays, directly or indirectly, all or any portion of the premiums; and

(C) The beneficiary of all or any portion of the death benefit is designated by the shareholder or is any person whom the shareholder would reasonably be expected to designate as the beneficiary.

(3) *Determination of whether this section or § 1.7872–15 applies to a split-dollar life insurance arrangement*—(i) *Split-dollar life insurance arrangements involving split-dollar loans under*

§ 1.7872–15. Except as provided in paragraph (b)(3)(ii) of this section, paragraphs (d) through (g) of this section do not apply to any split-dollar loan as defined in § 1.7872–15(b)(1). Section 1.7872–15 applies to any such loan. See paragraph (b)(5) of this section for the treatment of payments made by a non-owner under a split-dollar life insurance arrangement that are not split-dollar loans.

(ii) *Exceptions*. Paragraphs (d) through (g) of this section apply (and § 1.7872–15 does not apply) to any split-dollar life insurance arrangement if—

(A) The arrangement is entered into in connection with the performance of services, and the employee or service provider is not the owner of the life insurance contract (or is not treated as the owner of the contract under paragraph (c)(1)(ii)(A)(*1*) of this section); or

(B) The arrangement is entered into between a donor and a donee (for example, a life insurance trust) and the donee is not the owner of the life insurance contract (or is not treated as the owner of the contract under paragraph (c)(1)(ii)(A)(*2*) of this section).

(4) *Consistency requirement*. Both the owner and the non-owner of a life insurance contract that is part of a split-dollar life insurance arrangement described in paragraph (b)(1) or (2) of this section must fully and consistently account for all amounts under the arrangement under paragraph (b)(5) of this section, paragraphs (d) through (g) of this section, or under § 1.7872–15.

(5) *Non-owner payments that are not split-dollar loans*. If a non-owner of a life insurance contract makes premium payments (directly or indirectly) under a split-dollar life insurance arrangement, and the payments are neither split-dollar loans nor consideration for economic benefits described in paragraph (d) of this section, then neither the rules of paragraphs (d) through (g) of this section nor the rules in § 1.7872–15 apply to such payments. Instead, general income tax, employment tax, and gift tax principles apply to the premium payments. See, for example, § 1.61–2(d)(2)(ii)(A).

(6) *Waiver, cancellation, or forgiveness*. If a repayment obligation described in § 1.7872–15(a)(2) is waived, cancelled, or forgiven at any time, then the parties must take the amount waived, cancelled, or forgiven into account in accordance with the relationships between the parties (for example, as compensation in the case of an employee-employer relationship).

(c) *Definitions*. The following definitions apply for purposes of this section:

(1) *Owner*—(i) *In general*. With respect to a life insurance contract, the person named as the policy owner of such contract generally is the owner of such contract. If two or more persons are named as policy owners of a life insurance contract and each person has all the incidents of ownership with respect to an undivided interest in the contract, each person is treated as the owner of a separate contract to the extent of such person's undivided interest. If two or more persons are named as policy owners of a life insurance contract but each person does not have all the incidents of ownership with respect to an undivided interest in the contract, the person who is the first-named policy owner is treated as the owner of the entire contract.

(ii) *Special rule for certain arrangements*—(A) *In general*. Notwithstanding paragraph (c)(1)(i) of this section—

(*1*) An employer or service recipient is treated as the owner of a life insurance contract under a split-dollar life insurance arrangement that is entered into in connection with the performance of services if, at all times, the arrangement is described in paragraph (d)(2) of this section; and

(*2*) A donor is treated as the owner of a life insurance contract under a split-dollar life insurance arrangement that is entered into between a donor and a donee (for example, a life insurance trust) if, at all times, the arrangement is described in paragraph (d)(2) of this section.

(B) *Modifications*. [Reserved]

(iii) *Attribution rules*. [Reserved]

(2) *Non-owner*. With respect to a life insurance contract, a non-owner is any person (other than the owner of such contract) that has any direct or indirect interest in such contract (but not including a life insurance company acting only in its capacity as the issuer of a life insurance contract).

(3) *Transfer of entire contract or undivided interest therein*. A transfer of the ownership of a life insurance contract (or an undivided interest in such contract) that is part of a split-dollar life insurance arrangement occurs on the date that a non-owner becomes the owner (within the meaning of paragraph (c)(1) of this section) of the entire contract or of an undivided interest in the contract.

(4) *Undivided interest*. An undivided interest in a life insurance contract consists of an identical fractional or percentage interest in each right and benefit under the contract.

(5) *Employment tax*. The term employment tax means the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA), the Railroad Retirement Tax Act (RRTA), the Self-Employment Contributions Act of 1954 (SECA), and the Collection of Income Tax at Source on Wages.

(d) *Economic benefits provided under a split-dollar life insurance arrangement*—(1) *In general*. Under a split-dollar life insurance arrangement subject to the rules of paragraphs (d) through (g) of this section, the owner of the life insurance contract is treated as providing economic benefits to the non-owner of the life insurance contract. Those economic benefits must be accounted for fully and consistently by both the owner and the non-owner pursuant to the rules of this paragraph (d). The value of the economic benefits, reduced by any consideration paid by the non-owner to the owner, is treated as transferred from the owner to the non-owner. Depending on the relationship between the owner and the non-owner, the economic benefits may constitute a payment of compensation, a distribution under section 301, a gift, or a transfer having a different tax character. Further, depending on the relationship between or among a non-owner and one or more other persons, the economic benefits may be treated as provided from the owner to the non-owner and as separately provided from the non-owner to such other person or persons (for example, as a payment of compensation from an employer to an employee and as a gift from the employee to the employee's children).

(2) *Non-equity split-dollar life insurance arrangements*. In the case of a split-dollar life insurance arrangement subject to the rules of paragraphs (d) through (g) of this section under which the only economic benefit provided to the non-owner

is current life insurance protection (including paid-up additions thereto), the amount of the current life insurance protection provided to the non-owner for a taxable year equals the excess of the average death benefit of the life insurance contract over the total amount payable to the owner under the split-dollar life insurance arrangement. The total amount payable to the owner is increased by the amount of any outstanding policy loan. The cost of the current life insurance protection provided to the non-owner in any year equals the amount of the current life insurance protection provided to the non-owner multiplied by the life insurance premium factor designated or permitted in guidance published in the Internal Revenue Bulletin (see § 601.601(d)(2)(ii) of this chapter).

(3) *Equity split-dollar life insurance arrangements*—(i) *In general*. In the case of a split-dollar life insurance arrangement subject to the rules of paragraphs (d) through (g) of this section other than an arrangement described in paragraph (d)(2) of this section, any right in, or benefit of, a life insurance contract (including, but not limited to, an interest in the cash surrender value) provided during a taxable year to a non-owner under a split-dollar life insurance arrangement is an economic benefit for purposes of this paragraph (d).

(ii) *Valuation of economic benefits*. [Reserved]

(e) *Amounts received under the contract*—(1) *In general*. Except as otherwise provided in paragraph (f)(2)(ii) of this section, any amount received under a life insurance contract that is part of a split-dollar life insurance arrangement subject to the rules of paragraphs (d) through (g) of this section (including, but not limited to, a policy owner dividend, proceeds of a specified policy loan described in paragraph (e)(2) of this section, or the proceeds of a withdrawal from or partial surrender of the life insurance contract) is treated, to the extent provided directly or indirectly to a non-owner of the life insurance contract, as though such amount had been paid to the owner of the life insurance contract and then paid by the owner to the non-owner who is a party to the split-dollar life insurance arrangement. The amount received is taxable to the owner in accordance with the rules of section 72. The non-owner (and the owner for gift tax and employment tax purposes) must take the amount described in paragraph (e)(3) of this section into account as a payment of compensation, a distribution under section 301, a gift, or other transfer depending on the relationship between the owner and the non-owner.

(2) *Specified policy loan*. A policy loan is a specified policy loan to the extent—

(i) The proceeds of the loan are distributed directly from the insurance company to the non-owner;

(ii) A reasonable person would not expect that the loan will be repaid by the non-owner; or

(iii) The non-owner's obligation to repay the loan to the owner is satisfied or is capable of being satisfied upon repayment by either party to the insurance company.

(3) *Amount required to be taken into account*. With respect to a non-owner (and the owner for gift tax and employment tax purposes), the amount described in this paragraph (e)(3) is equal to the excess of—

(i) The amount treated as received by the owner under paragraph (e)(1) of this section; over

(ii) The amount of all economic benefits described in paragraph (d)(3) of this section actually taken into account under paragraph (d)(1) of this section by the transferee (and the transferor for gift tax and employment tax purposes) reduced (but not below zero) by any amounts that would have been taken into account under paragraph (d)(1) of this section if paragraph (d)(2) of this section were applicable to the arrangement plus any consideration paid by the non-owner for all economic benefits described in paragraph (d)(3) of this section reduced (but not below zero) by any consideration paid by the non-owner that would have been allocable to amounts described in paragraph (d)(2) of this section if paragraph (d)(2) of this section were applicable to the arrangement. The amount determined under the preceding sentence applies only to the extent that neither this paragraph (e)(3)(ii) nor paragraph (g)(1)(ii) of this section previously has applied to such economic benefits.

(f) *Other tax consequences*—(1) *Introduction*. In the case of a split-dollar life insurance arrangement subject to the rules of paragraphs (d) through (g) of this section, this paragraph (f) sets forth other tax consequences to the owner and non-owner of a life insurance contract that is part of the arrangement for the period prior to the transfer (as defined in paragraph (c)(3) of this section) of the contract (or an undivided interest therein) from the owner to the non-owner. See paragraph (g) of this section and § 1.83–6(a)(5) for tax consequences upon the transfer of the contract (or an undivided interest therein).

(2) *To non-owner*—(i) *In general*. A non-owner does not receive any investment in the contract under section 72(e)(6) with respect to a life insurance contract that is part of a split-dollar life insurance arrangement subject to the rules of paragraphs (d) through (g) of this section.

(ii) *Death proceeds to beneficiary (other than the owner)*. Any amount paid to a beneficiary (other than the owner) by reason of the death of the insured is excluded from gross income by such beneficiary under section 101(a) as an amount received under a life insurance contract to the extent such amount is allocable to current life insurance protection provided to the non-owner pursuant to the split-dollar life insurance arrangement, the cost of which was paid by the non-owner, or the value of which the non-owner actually took into account pursuant to paragraph (d) of this section.

(3) *To owner*. Any premium paid by an owner under a split-dollar life insurance arrangement subject to the rules of paragraphs (d) through (g) of this section is included in the owner's investment in the contract under section 72(e)(6). No premium or amount described in paragraph (d) of this section is deductible by the owner (except as otherwise provided in § 1.83–6(a)(5)). Any amount paid by a non-owner, directly or indirectly, to the owner of the life insurance contract for current life insurance protection or for any other economic benefit under the life insurance contract is included in the owner's gross income and is included in the owner's investment in the life insurance contract for purposes of section 72(e)(6) (but only to the extent not otherwise so included by reason of having been paid

by the owner as a premium or other consideration for the contract).

(g) *Transfer of entire contract or undivided interest therein*—(1) *In general*. Upon a transfer within the meaning of paragraph (c)(3) of this section of a life insurance contract (or an undivided interest therein) to a non-owner (transferee), the transferee (and the owner (transferor) for gift tax and employment tax purposes) takes into account the excess of the fair market value of the life insurance contract (or the undivided interest therein) transferred to the transferee at that time over the sum of—

(i) The amount the transferee pays to the transferor to obtain the contract (or the undivided interest therein); and

(ii) The amount of all economic benefits described in paragraph (d)(3) of this section actually taken into account under paragraph (d)(1) of this section by the transferee (and the transferor for gift tax and employment tax purposes) reduced (but not below zero) by any amounts that would have been taken into account under paragraph (d)(1) of this section if paragraph (d)(2) of this section were applicable to the arrangement plus any consideration paid by the non-owner for all economic benefits described in paragraph (d)(3) of this section reduced (but not below zero) by any consideration paid by the non-owner that would have been allocable to amounts described in paragraph (d)(2) of this section if paragraph (d)(2) of this section were applicable to the arrangement. The amount determined under the preceding sentence applies only to the extent that neither paragraph (e)(3)(ii) of this section nor this paragraph (g)(1)(ii) previously has applied to such economic benefits.

(2) *Determination of fair market value*. For purposes of paragraph (g)(1) of this section, the fair market value of a life insurance contract is the cash surrender value and the value of all other rights under such contract (including any supplemental agreements thereto and whether or not guaranteed), other than the value of current life insurance protection.

(3) *Exception for certain transfers in connection with the performance of services*. To the extent the ownership of a life insurance contract (or undivided interest in such contract) is transferred in connection with the performance of services, paragraph (g)(1) of this section does not apply until such contract (or undivided interest in such contract) is taxable under section 83. For purposes of paragraph (g)(1) of this section, fair market value is determined disregarding any lapse restrictions and at the time the transfer of such contract (or undivided interest in such contract) is taxable under section 83.

(4) *Treatment of non-owner after transfer*—(i) *In general*. After a transfer of an entire life insurance contract (except when such transfer is in connection with the performance of services and the transfer is not yet taxable under section 83), the person who previously had been the non-owner is treated as the owner of such contract for all purposes, including for purposes of paragraph (b) of this section and for purposes of § 1.61–2(d)(2)(ii)(A). After the transfer of an undivided interest in a life insurance contract (or, if later, at the time such transfer is taxable under section 83), the person who previously had been the non-owner is treated as the owner of a separate contract consisting of that interest for all purposes, including for purposes of paragraph (b) of this section and for purposes of § 1.61–2(d)(2)(ii)(A). However, such person will continue to be treated as a non-owner with respect to any undivided interest in the contract not so transferred (or not yet taxable under section 83).

(ii) *Investment in the contract after transfer*—(A) *In general*. The amount treated as consideration paid to acquire the contract under section 72(g)(1) to determine the aggregate premiums paid by the transferee for purposes of determining the transferee's investment in the contract under section 72(e) after the transfer (or, if later, at the time such transfer is taxable under section 83) equals the greater of the fair market value of the contract or the sum of the amounts determined under paragraphs (g)(1)(i) and (ii) of this section.

(B) *Transfers between a donor and a donee*. In the case of a transfer of a contract between a donor and a donee, the amount treated as consideration paid by the transferee to acquire the contract under section 72(g)(1) to determine the aggregate premiums paid by the transferee for purposes of determining the transferee's investment in the contract under section 72(e) after the transfer equals the sum of the amounts determined under paragraphs (g)(1)(i) and (ii) of this section except that—

(*1*) The amount determined under paragraph (g)(1)(i) of this section includes the aggregate of premiums or other consideration paid or deemed to have been paid by the transferor; and

(*2*) The amount of all economic benefits determined under paragraph (g)(1)(ii) of this section actually taken into account by the transferee does not include such benefits to the extent such benefits were excludable from the transferee's gross income at the time of receipt.

(C) *Transfers of an undivided interest in a contract*. If a portion of a contract is transferred to the transferee, then the amount to be included as consideration paid to acquire the contract is determined by multiplying the amount determined under paragraph (g)(4)(ii)(A) of this section (as modified by paragraph (g)(4)(ii)(B) of this section, if the transfer is between a donor and a donee) by a fraction, the numerator of which is the fair market value of the portion transferred and the denominator of which is the fair market value of the entire contract.

(D) *Example*. The following example illustrates the rules of this paragraph (g)(4)(ii):

Example. (i) In year 1, donor D and donee E enter into a split-dollar life insurance arrangement as defined in paragraph (b)(1) of this section. D is the owner of the life insurance contract under paragraph (c)(1) of this section. The life insurance contract is not a modified endowment contract as defined in section 7702A. In year 5, D gratuitously transfers the contract, within the meaning of paragraph (c)(3) of this section, to E. At the time of the transfer, the fair market value of the contract is $200,000 and D had paid $50,000 in premiums under the arrangement. In addition, at the time of the transfer, E had previously received $80,000 of benefits described in paragraph (d)(3) of this section, which were excludable from E's gross income under section 102.

(ii) E's investment in the contract is $50,000, consisting of the $50,000 of premiums paid by D. The $80,000 of benefits described in paragraph (d)(3) of this section that E received is not included in E's investment in the contract because such amounts were excludable from E's gross income at the time of receipt.

(iii) *No investment in the contract for current life insurance protection*. No amount allocable to current life insurance protection provided to the transferee (the cost of which was paid by the transferee or the value of which was provided to the transferee) is treated as consideration paid to acquire the contract under section 72(g)(1) to determine the aggregate premiums paid by the transferee for purposes of determining the transferee's investment in the contract under section 72(e) after the transfer.

(h) *Examples*. The following examples illustrate the rules of this section. Except as otherwise provided, each of the examples assumes that the employer (R) is the owner (as defined in paragraph (c)(1) of this section) of a life insurance contract that is part of a split-dollar life insurance arrangement subject to the rules of paragraphs (d) through (g) of this section, that the life insurance contract is not a modified endowment contract under section 7702A, that the compensation paid to the employee (E) is reasonable, and that E makes no premium payments. The examples are as follows:

Example 1. (i) In year 1, R purchases a life insurance contract on the life of E. R is named as the policy owner of the contract. R and E enter into an arrangement under which R will pay all the premiums on the life insurance contract until the termination of the arrangement or E's death. Upon termination of the arrangement or E's death, R is entitled to receive the greater of the aggregate premiums or the cash surrender value of the contract. The balance of the death benefit will be paid to a beneficiary designated by E.

(ii) Because R is designated as the policy owner, R is the owner of the contract under paragraph (c)(1) of this section. E is a non-owner of the contract. Under the arrangement between R and E, a portion of the death benefit is payable to a beneficiary designated by E. The arrangement is a split-dollar life insurance arrangement under paragraph (b)(1) or (2) of this section. For each year that the split-dollar life insurance arrangement is in effect, the arrangement is described in paragraph (d)(2) of this section and E must include in income the value of current life insurance protection, as required by paragraph (d)(2) of this section.

Example 2. (i) The facts are the same as in *Example 1* except that, upon termination of the arrangement or E's death, R is entitled to receive the lesser of the aggregate premiums or the cash surrender value of the contract.

(ii) For each year that the split-dollar life insurance arrangement is in effect, the arrangement is described in paragraph (d)(3) of this section and E must include in gross income the value of the economic benefit attributable to E's interest in the life insurance contract, as required by paragraph (d)(3) of this section.

Example 3. (i) The facts are the same as in *Example 1* except that in year 5, R and E modify the split-dollar life insurance arrangement to provide that, upon termination of the arrangement or E's death, R is entitled to receive the greater of the aggregate premiums or one-half the cash surrender value of the contract.

(ii) In year 5 (and subsequent years), the arrangement is described in paragraph (d)(3) of this section and E must include in gross income the value of the economic benefit attributable to E's interest in the life insurance contract, as required by paragraph (d)(3) of this section. Because the modification made by R and E in year 5 does not involve the transfer (within the meaning of paragraph (c)(3) of this section) of an undivided interest in the life insurance contract from R to E, the modification is not a transfer for purposes of paragraph (g) of this section.

Example 4. (i) The facts are the same as in *Example 2* except that in year 7, R and E modify the split-dollar life insurance arrangement to provide that, upon termination of the arrangement or E's death, R will be paid the lesser of 80 percent of the aggregate premiums or the cash surrender value of the contract.

(ii) The arrangement is described in paragraph (d)(3) of this section. In year 7 (and in subsequent years), E must include in gross income the value of the increased economic benefits described in paragraph (d)(3) of this section resulting from the contract modification under which E obtains rights to a larger amount of the cash value of the contract (attributable to the fact that R will forgo the right to recover 20 percent of the premiums R pays).

Example 5. (i) The facts are the same as in *Example 3* except that in year 7, E is designated as the policy owner. At that time, E's rights to the contract are substantially vested as defined in § 1.83–3(b).

(ii) In year 7, R is treated as having made a transfer (within the meaning of paragraph (c)(3) of this section) of the life insurance contract to E. E must include in gross income the amount determined under paragraph (g)(1) of this section.

(iii) After the transfer of the contract to E, E is the owner of the contract and any premium payments by R will be included in E's income under paragraph (b)(5) of this section and § 1.61–2(d)(2)(ii)(A) (unless R's payments are split-dollar loans as defined in § 1.7872–15(b)(1)).

Example 6. (i) In year 1, E and R enter into a split-dollar life insurance arrangement as defined in paragraph (b)(2) of this section. Under the arrangement, R is required to make annual premium payments of $10,000 and E is required to make annual premium payments of $500. In year 5, a $500 policy owner dividend payable to E is declared by the insurance company. E directs the insurance company to use the $500 as E's premium payment for year 5.

(ii) For each year the arrangement is in effect, the arrangement is described in paragraph (d)(3) of this section and E must include in gross income the value of the economic benefits granted during the year, as required by paragraph (d)(3) of this section over the $500 premium payments paid by E. In year 5, E must also include in gross income as compensation the excess, if any, of the $500 distributed to E from the proceeds of the policy owner dividend over the amount determined under paragraph (e)(3)(ii) of this section.

(iii) R must include in income the premiums paid by E during the years the split-dollar life insurance arrangement is in effect, including the $500 of the premium E paid in year 5 with proceeds of the policy owner dividend. R's investment in the contract is increased in an amount equal to the premiums paid by E, including the $500 of the premium paid by E in year 5 from the proceeds of the policy owner dividend. In year 5, R is treated as receiving a $500 distribution under the contract, which is taxed pursuant to section 72.

Example 7. (i) The facts are the same as in *Example 2* except that in year 10, E withdraws $100,000 from the cash value of the contract.

(ii) In year 10, R is treated as receiving a $100,000 distribution from the insurance company. This amount is treated as an amount received by R under the contract and taxed pursuant to section 72. This amount reduces R's investment in the contract under section 72(e). R is treated as paying the $100,000 to E as cash compensation, and E must include that amount in gross income less any amounts determined under paragraph (e)(3)(ii) of this section.

Example 8. (i) The facts are the same as in *Example 7* except E receives the proceeds of a $100,000 specified policy loan directly from the insurance company.

(ii) The transfer of the proceeds of the specified policy loan to E is treated as a loan by the insurance company to R. Under the rules of section 72(e), the $100,000 loan is not included in R's income and does not reduce R's investment in the contract. R is treated as paying the $100,000 of loan proceeds to E as cash compensation. E must include that amount in gross income less any amounts determined under paragraph (e)(3)(ii) of this section.

(i) [Reserved]

(j) *Effective date*—(1) *General rule*. This section applies to any split-dollar life insurance arrangement (as defined in paragraph (b)(1) or (2) of this section) entered into after the date the final regulations are published in the **Federal Register**.

(2) *Early reliance*—(i) *General rule*. Taxpayers may rely on this section for the treatment of any split-dollar life insurance arrangement (as defined in paragraph (b)(1) or (2) of this section) entered into on or before the date described in paragraph (j)(1) of this section, provided that all taxpayers who are parties to the arrangement treat the arrangement consistently under this section and, in the case of an arrangement described in paragraph (d)(3) of this section, also satisfy the requirements in paragraph (j)(2)(ii) of this section.

(ii) *Equity split-dollar life insurance arrangements*. Parties to an arrangement described in paragraph (d)(3) of this section may rely on this section only if the value of all economic benefits taken into account by the parties exceeds the value of the economic benefits the parties would have taken into account if paragraph (d)(2) of this section were applicable to the arrangement (determined using the life insurance premium factor designated in guidance published in the Internal Revenue Bulletin (see

§ 601.601(d)(2)(ii) of this chapter)), thereby reflecting the fact that such an arrangement provides the non-owner with economic benefits that are more valuable than current life insurance protection.

(3) *Modified arrangements treated as new arrangements*. An arrangement entered into on or before the date set forth in paragraph (j)(1) of this section that is materially modified after the date set forth in paragraph (j)(1) of this section is treated as a new arrangement entered into on the date of the modification.

Par. 4. Section 1.83–1 is amended by:

1. Removing the second sentence of paragraph (a)(2).

2. Adding a sentence at the end of paragraph (a)(2).

The addition reads as follows:

§ 1.83–1 Property transferred in connection with the performance of services.

(a) * * *

(2) *Life insurance*. * * * For the taxation of life insurance protection under a split-dollar life insurance arrangement (as defined in § 1.61–22(b)(1) or (2)), see § 1.61–22.

* * * * *

Par. 5. Section 1.83–3 is amended by:

1. Adding a sentence at the end of paragraph (a)(1).

2. Revising the penultimate sentence in paragraph (e).

The addition and revision read as follows:

§ 1.83–3 Meaning and use of certain terms.

(a) * * * (1) * * * For special rules applying to the transfer of a life insurance contract (or an undivided interest therein) that is part of a split-dollar life insurance arrangement (as defined in § 1.61–22(b)(1) or (2)), see § 1.61–22(g).

* * * * *

(e) * * * In the case of a transfer of a contract, or any undivided interest therein, providing death benefit protection (including a life insurance contract, retirement contract, or endowment contract) after the date the final regulations are published in the **Federal Register**, the cash surrender value and all other rights under such contract (including any supplemental agreements thereto and whether or not guaranteed), other than current life insurance protection, are treated as property for purposes of this section. * * *

* * * * *

Par. 6. Section 1.83–6 is amended as follows:

1. Redesignating paragraph (a)(5) as paragraph (a)(6).

2. Adding a new paragraph (a)(5).

The addition reads as follows:

§ 1.83–6 Deduction by employer.

(a) * * *

(5) *Transfer of life insurance contract (or an undivided interest therein)*—(i) *General rule*. In the case of a transfer of a life insurance contract (or an undivided interest therein) described in § 1.61–22(c)(3) in connection with the performance of services, a deduction is allowable under paragraph (a)(1) of this section to the person for whom the services were performed. The amount of the deduction, if allowable, is equal to the sum of the amount included as compensation in the gross income of the service provider under § 1.61–22(g)(1) and the amount determined under § 1.61–22(g)(1)(ii).

(ii) *Effective date*—(A) *General rule*. Paragraph (a)(5)(i) of this section applies to any split-dollar life insurance arrangement (as defined in § 1.61–22(b)(1) or (2)) entered into after the date the final regulations are published in the **Federal Register**.

(B) *Early reliance*—(1) *General rule*. Taxpayers may rely on this paragraph (a)(5) for the treatment of any split-dollar life insurance arrangement (as defined in § 1.61–22(b)(1) or (2)) entered into on or before the date described in paragraph (a)(5)(ii)(A) of this section, provided that all taxpayers who are parties to the arrangement treat the arrangement consistently under § 1.61–22(d) through (g) and, in the case of an arrangement described in § 1.61–22(d)(3), also satisfy the requirements in paragraph (a)(5)(ii)(B)(*2*) of this section.

(*2*) *Equity split-dollar life insurance arrangements*. Parties to an arrangement described in § 1.61–22(d)(3) may rely on this paragraph (a)(5) only if the value of all economic benefits taken into account by the parties exceeds the value of the economic benefits the parties would have taken into account if § 1.61–22(d)(2) were applicable to the arrangement (determined using the life insurance premium factor designated in guidance published in the Internal Revenue Bulletin (see § 601.601(d)(2)(ii) of this chapter)), thereby reflecting the fact that such an arrangement provides the non-owner with economic benefits that are more valuable than current life insurance protection.

(C) *Modified arrangements treated as new arrangements*. An arrangement entered into on or before the date set forth in paragraph (a)(5)(ii)(A) of this section that is materially modified after the date set forth in paragraph (a)(5)(ii)(A) of this section is treated as a new arrangement entered into on the date of the modification.

* * * * *

Par. 7. In § 1.301–1, paragraph (q) is added to read as follows:

§ 1.301–1 Rules applicable with respect to distributions of money and other property.

* * * * *

(q) *Split-dollar and other life insurance arrangements*—(1) *Split-dollar life insurance arrangements*—(i) *Distribution of economic benefits*. The provision by a corporation to its shareholder pursuant to a split-dollar life insurance arrangement, as defined in § 1.61–22(b)(1) or (2), of economic benefits described in § 1.61–22(d) or of amounts described in § 1.61–22(e) is treated as a distribution of property, the amount of which is determined under § 1.61–22(d) and (e), respectively.

(ii) *Distribution of entire contract or undivided interest therein*. A transfer (within the meaning of § 1.61–22(c)(3)) of the ownership of a life insurance contract (or an undivided interest therein) that is part of a split-dollar life insurance arrangement is a distribution of property, the amount of which is determined pursuant to § 1.61–22(g)(1) and (2).

(2) *Other life insurance arrangements*. A payment by a corporation on behalf of a shareholder of premiums on a life insurance contract or an undivided interest

therein that is owned by the shareholder constitutes a distribution of property, even if such payment is not part of a split-dollar life insurance arrangement under § 1.61–22(b).

(3) *When distribution is made*—(i) *In general*. Except as provided in paragraph (q)(3)(ii) of this section, paragraph (b) of this section shall apply to determine when a distribution described in paragraph (q)(1) or (2) of this section is taken into account by a shareholder.

(ii) *Exception*. Notwithstanding paragraph (b) of this section, a distribution described in paragraph (q)(1)(ii) of this section shall be treated as made by a corporation to its shareholder at the time that the life insurance contract, or an undivided interest therein, is transferred (within the meaning of § 1.61–22(c)(3)) to the shareholder.

(4) *Effective date*—(i) *General rule*. This paragraph (q) applies to split-dollar and other life insurance arrangements entered into after the date the final regulations are published in the **Federal Register**.

(ii) *Early reliance*—(A) *General rule*. Taxpayers may rely on this paragraph (q) for the treatment of any split-dollar life insurance arrangement (as defined in § 1.61–22(b)(1) or (2)) entered into on or before the date described in paragraph (q)(4)(i) of this section, provided that all taxpayers who are parties to the arrangement treat the arrangement consistently under § 1.61–22(d) through (g) and, in the case of an arrangement described in § 1.61–22(d)(3), also satisfy the requirements in paragraph (q)(4)(ii)(B) of this section.

(B) *Equity split-dollar life insurance arrangements*. Parties to an arrangement described in § 1.61–22(d)(3) may rely on this paragraph (q) only if the value of all economic benefits taken into account by the parties exceeds the value of the economic benefits the parties would have taken into account if § 1.61–22(d)(2) were applicable to the arrangement (determined using the life insurance premium factor designated in guidance published in the Internal Revenue Bulletin (see § 601.601(d)(2)(ii) of this chapter)), thereby reflecting the fact that such an arrangement provides the non-owner with economic benefits that are more valuable than current life insurance protection.

(iii) *Modified arrangements treated as new arrangements*. An arrangement entered into on or before the date set forth in paragraph (q)(4)(i) of this section that is materially modified after the date set forth in paragraph (q)(4)(i) of this section is treated as a new arrangement entered into on the date of the modification.

Par. 8. Section 1.1402(a)–18 is added to read as follows:

§ 1.1402(a)–18 Split-dollar life insurance arrangements.

See § 1.61–22 for rules relating to the treatment of split-dollar life insurance arrangements.

Par. 9. Section 1.7872–15 is added to read as follows:

§ 1.7872–15 Split-dollar loans.

(a) *General rules*—(1) *Introduction*. This section applies to split-dollar loans as defined in paragraph (b)(1) of this section. If a split-dollar loan is not a below-market loan, then, except as provided in this section, the loan is governed by the general rules for debt instruments (including the rules for original issue discount (OID) under sections 1271 through 1275 and the regulations thereunder). If a split-dollar loan is a below-market loan, then, except as provided in this section, the loan is governed by section 7872 and the regulations thereunder. The timing, amount, and characterization of the imputed transfers between the lender and borrower of a below-market split-dollar loan depend upon the relationship between the parties and upon whether the loan is a demand loan or a term loan. For additional rules relating to the treatment of split-dollar life insurance arrangements, see § 1.61–22.

(2) *Loan treatment*—(i) *General rule*. A payment made pursuant to a split-dollar life insurance arrangement is treated as a loan for Federal tax purposes, and the owner and non-owner are treated, respectively, as the borrower and the lender, if—

(A) The payment is made either directly or indirectly by the non-owner to the owner (including a premium payment made by the non-owner directly to the insurance company with respect to the policy held by the owner);

(B) The payment is a loan under general principles of Federal tax law or, if it is not a loan under general principles of Federal tax law, a reasonable person would expect the payment to be repaid in full to the non-owner (whether with or without interest); and

(C) The repayment is to be made from, or is secured by, either the policy's death benefit proceeds or its cash surrender value.

(ii) *Payments that are only partially repayable*. For purposes of § 1.61–22 and this section, if a non-owner makes a payment pursuant to a split-dollar life insurance arrangement and the non-owner is entitled to repayment of some but not all of the payment, the payment is treated as two payments: one that is repayable and one that is not. Thus, paragraph (a)(2)(i) of this section refers to the repayable payment.

(iii) *Treatment of payments that are not split-dollar loans*. See § 1.61–22(b)(5) for the treatment of payments by a non-owner that are not split-dollar loans.

(iv) *Examples*. The provisions of this paragraph (a)(2) are illustrated by the following examples:

Example 1. Assume an employee owns a life insurance policy under a split-dollar life insurance arrangement, the employer makes premium payments on this policy, there is a reasonable expectation that the payments will be repaid, and the repayments are secured by the policy. Under paragraph (a)(2)(i) of this section, each premium payment is a loan for Federal tax purposes.

Example 2. (i) Assume an employee owns a life insurance policy under a split-dollar life insurance arrangement and the employer makes premium payments on this policy. The employer is entitled to be repaid 80 percent of each premium payment, and the repayments are secured by the policy. Under paragraph (a)(2)(ii) of this section, the taxation of 20 percent of each premium payment is governed by § 1.61–22(b)(5). If there is a reasonable expectation that the remaining 80 percent of a payment will be repaid in full, then, under paragraph (a)(2)(i) of this section, the 80 percent is a loan for Federal tax purposes.

(ii) If less than 80 percent of a premium payment is reasonably expected to be repaid, then this paragraph (a)(2) does not cause any of the payment to be a loan for Federal tax purposes. If the payment is not a loan under general principles of Federal tax law, the entire premium payment is governed by § 1.61–22(b)(5).

(3) *No de minimis exceptions*. For purposes of this section, section 7872 is applied to a split-dollar loan without regard to the *de minimis* exceptions in section 7872(c)(2) and (3).

(b) *Definitions*. For purposes of this section, the terms *split-dollar life insurance arrangement*, *owner*, and *non-owner* have the same meanings as provided in § 1.61–22(b) and (c). In addition, the following definitions apply for purposes of this section:

(1) A *split-dollar loan* is a loan described in paragraph (a)(2)(i) of this section.

(2) A *split-dollar demand loan* is any split-dollar loan that is payable in full at any time on the demand of the lender (or within a reasonable time after the lender's demand).

(3) A *split-dollar term loan* is any split-dollar loan other than a split-dollar demand loan. See paragraph (e)(5) of this section for special rules regarding certain split-dollar term loans payable on the death of an individual, certain split-dollar term loans conditioned on the future performance of substantial services by an individual, and gift split-dollar term loans.

(c) *Interest deductions for split-dollar loans*. The borrower may not deduct any qualified stated interest, OID, or imputed interest on a split-dollar loan. See sections 163(h) and 264(a). In certain circumstances, an indirect participant may be allowed to deduct qualified stated interest, OID, or imputed interest on a deemed loan. See paragraph (e)(2)(iii) of this section (relating to indirect loans).

(d) *Treatment of split-dollar loans providing for nonrecourse payments*—(1) *In general*. Except as provided in paragraph (d)(2) of this section, if a payment on a split-dollar loan is nonrecourse to the borrower, the payment is a contingent payment for purposes of this section. See paragraph (j) of this section for the treatment of a split-dollar loan that provides for one or more contingent payments.

(2) *Exception for certain loans with respect to which the parties to the split-dollar life insurance arrangement make a representation*—(i) *Requirements*. An otherwise noncontingent payment on a split-dollar loan that is nonrecourse to the borrower is not a contingent payment under this section if the following requirements are satisfied—

(A) The split-dollar loan provides for interest payable at a stated rate that is either a fixed rate or a variable rate described in paragraph (g) of this section; and

(B) The parties to the split-dollar life insurance arrangement represent in writing that a reasonable person would expect that all payments under the loan will be made.

(ii) *Time and manner for providing written representation*. The Commissioner may prescribe the time and manner for providing the written representation required by paragraph (d)(2)(i)(B) of this section. Until the Commissioner prescribes otherwise, the written representation that is required by paragraph (d)(2)(i)(B) of this section must meet the requirements of this paragraph (d)(2)(ii). Both the borrower and the lender must sign the representation not later than the last day (including extensions) for filing the Federal income tax return of the borrower or lender, whichever is earlier, for the taxable year in which the lender makes the first split-dollar loan under the split-dollar life insurance arrangement. This representation must include the names, addresses, and taxpayer identification numbers of the borrower, lender, and any indirect participants. Unless otherwise stated therein, this representation applies to all subsequent split-dollar loans made pursuant to the split-dollar life insurance arrangement. Each party should retain an original of the representation as part of its books and records and should attach a copy of this representation to its Federal income tax return for any taxable year in which the lender makes a loan to which the representation applies.

(e) *Below-market split-dollar loans*—(1) *Scope*—(i) *In general*. This paragraph (e) applies to below-market split-dollar loans enumerated under section 7872(c)(1), which include gift loans, compensation-related loans, and corporation-shareholder loans. The characterization of a split-dollar loan under section 7872(c)(1) and of the imputed transfers under section 7872(a)(1) and (b)(1) depends upon the relationship between the lender and the borrower or the lender, borrower, and any indirect participant. For example, if the lender is the borrower's employer, the split-dollar loan is generally a compensation-related loan, and any imputed transfer from the lender to the borrower is generally a payment of compensation. The loans covered by this paragraph (e) include indirect loans between the parties. See paragraph (e)(2) of this section for the treatment of certain indirect split-dollar loans. See paragraph (f) of this section for the treatment of any stated interest or OID on split-dollar loans. See paragraph (j) of this section for additional rules that apply to a split-dollar loan that provides for one or more contingent payments.

(ii) *Significant-effect split-dollar loans*. If a direct or indirect below-market split-dollar loan is not enumerated in section 7872(c)(1)(A), (B), or (C), the loan is a significant-effect loan under section 7872(c)(1)(E).

(2) *Indirect split-dollar loans*—(i) *In general*. If, based on all the facts and circumstances, including the relationship between the borrower or lender and some third person (the indirect participant), the effect of a below-market split-dollar loan is to transfer value from the lender to the indirect participant and from the indirect participant to the borrower, then the below-market split-dollar loan is restructured as two or more successive below-market loans (the deemed loans) as provided in this paragraph (e)(2). The transfers of value described in the preceding sentence include (but are not limited to) a gift, compensation, a capital contribution, and a distribution under section 301 (or, in the case of an S corporation, under section 1368). The deemed loans are—

(A) A deemed below-market split-dollar loan made by the lender to the indirect participant; and

(B) A deemed below-market split-dollar loan made by the indirect participant to the borrower.

(ii) *Application*. Each deemed loan is treated as having the same provisions as the original loan between the lender and borrower, and section 7872 is applied to each deemed loan. Thus, for example, if, under a split-dollar life insurance arrangement, an employer (lender) makes an interest-free split-dollar loan to an employee's child (borrower), the loan is generally restructured as a deemed compensation-related below-market split-dollar loan from the lender to the employee (the indirect participant) and a second deemed gift below-market split-dollar loan from the employee to the employee's child. In appropriate circumstances, section 7872(d)(1) may limit the interest that accrues on a deemed loan for Federal income tax purposes. For loan arrangements between husband and wife, see section 7872(f)(7).

(iii) *Limitations on investment interest for purposes of section 163(d)*. For purposes of section 163(d), the imputed interest from the indirect participant to the lender that is taken into account by the indirect participant under this paragraph (e)(2) is not investment interest to the extent of the excess, if any, of—

(A) The imputed interest from the indirect participant to the lender that is taken into account by the indirect participant; over

(B) The imputed interest to the indirect participant from the borrower that is recognized by the indirect participant.

(iv) *Example*. The provisions of this paragraph (e)(2) are illustrated by the following example:

Example. (i) On January 1, 2009, Employer *X* and Individual *A* enter into a split-dollar life insurance arrangement under which *A* is named as the policy owner. *A* is the child of *B*, an employee of *X*. On January 1, 2009, *X* makes a $30,000 premium payment, repayable upon demand without interest. Repayment of the premium payment is fully recourse to *A*. The payment is a below-market split-dollar demand loan. *A*'s net investment income for 2009 is $1,100, and there are no other outstanding loans between *A* and *B*. Assume that the blended annual rate for 2009 is 5 percent, compounded annually.

(ii) Based on the relationships among the parties, the effect of the below-market split-dollar loan from *X* to *A* is to transfer value from *X* to *B* and then to transfer value from *B* to *A*. Under paragraph (e)(2) of this section, the below-market split-dollar loan from *X* to *A* is restructured as two deemed below-market split-dollar demand loans: a compensation-related below-market split-dollar loan between *X* and *B* and a gift below-market split-dollar loan between *B* and *A*. Each of the deemed loans has the same terms and conditions as the original loan.

(iii) Under paragraph (e)(3) of this section, the amount of forgone interest deemed paid to *B* by *A* in 2009 is $1,500 ([$30,000 x 0.05] – 0). Under section 7872(d)(1), however, the amount of forgone interest deemed paid to *B* by *A* is limited to $1,100 (*A*'s net investment income for the year). Under paragraph (e)(2)(iii) of this section, *B*'s deduction under section 163(d) in 2009 for interest deemed paid on *B*'s deemed loan from *X* is limited to $1,100 (the interest deemed received from *A*).

(3) *Split-dollar demand loans*—(i) *In general*. This paragraph (e)(3) provides rules for testing split-dollar demand loans for sufficient interest, and, if the loans do not provide for sufficient interest, rules for the calculation and treatment of forgone interest on these loans. See paragraph (g) of this section for additional rules that apply to a split-dollar loan providing for certain variable rates of interest.

(ii) *Testing for sufficient interest*. Each calendar year that a split-dollar demand loan is outstanding, the loan is tested to determine if the loan provides for sufficient interest. A split-dollar demand loan provides for sufficient interest for the calendar year if the rate (based on annual compounding) at which interest accrues on the loan's adjusted issue price during the year is no lower than the blended annual rate for the year. (The Internal Revenue Service publishes the blended annual rate in the Internal Revenue Bulletin in July of each year (see § 601.601(d)(2)(ii) of this chapter).) If the loan does not provide for sufficient interest, the loan is a below-market split-dollar demand loan for that calendar year. See paragraph (e)(3)(iii) of this section to determine the amount and treatment of forgone interest for each calendar year the loan is below-market.

(iii) *Imputations*—(A) *Amount of forgone interest*. For each calendar year, the amount of forgone interest on a split-dollar demand loan is treated as transferred by the lender to the borrower and as retransferred as interest by the borrower to the lender. This amount is the excess of—

(*1*) The amount of interest that would have been payable on the loan for the calendar year if interest accrued on the loan's adjusted issue price at the AFR (determined in paragraph (e)(3)(ii) of this section) and were payable annually on the day referred to in paragraph (e)(3)(iii)(B) of this section; over

(*2*) Any interest that accrues on the loan during the year.

(B) *Timing of transfers of forgone interest*—(*1*) *In general*. Except as provided in paragraphs (e)(3)(iii)(B)(*2*) and (*3*) of this section, the forgone interest (as determined under paragraph (e)(3)(iii)(A) of this section) that is attributable to a calendar year is treated as transferred by the lender to the borrower (and retransferred as interest by the borrower to the lender) on the last day of the calendar year and is accounted for by each party to the split-dollar loan in a manner consistent with that party's method of accounting.

(2) *Exception for death, liquidation, or termination of the borrower*. In the taxable year in which the borrower dies (in the case of borrower who is a natural person) or is liquidated or otherwise terminated (in the case of a borrower other than a natural person), any forgone interest is treated, for both the lender and the borrower, as transferred and retransferred on the last day of the borrower's final taxable year.

(3) *Exception for repayment of below-market split-dollar loan*. Any forgone interest is treated, for both the lender and the borrower, as transferred and retransferred on the day the split-dollar loan is repaid in full.

(4) *Split-dollar term loans*—(i) *In general*. Except as provided in paragraph (e)(5) of this section, this paragraph (e)(4) provides rules for testing split-dollar term loans for sufficient interest and, if the loans do not provide for sufficient interest, rules for imputing payments on these loans. See paragraph (g) of this section for additional rules that apply to a split-dollar loan providing for certain variable rates of interest.

(ii) *Testing a split-dollar term loan for sufficient interest*. A split-dollar term loan is tested on the day the loan is made to determine if the loan provides for sufficient interest. A split-dollar term loan provides for sufficient interest if the imputed loan amount equals or exceeds the amount loaned. The imputed loan amount is the present value of all payments due under the loan, determined as of the date the loan is made, using a discount rate equal to the AFR in effect on that date. The AFR used for purposes of the preceding sentence must be appropriate for the loan's term (short-term, mid-term, or long-term) and for the compounding period used in computing the present value. See section 1274(d)(1). If the split-dollar loan does not provide for sufficient interest, the loan is a below-market split-dollar term loan subject to paragraph (e)(4)(iv) of this section.

(iii) *Determining loan term*. This paragraph (e)(4)(iii) provides rules to determine the term of a split-dollar term loan for purposes of paragraph (e)(4)(ii) of this section. The term of the loan determined under this paragraph (e)(4)(iii) (other than paragraph (e)(4)(iii)(C) of this section) applies to determine the split-dollar loan's term, payment schedule, and yield for all purposes of this section.

(A) *In general*. Except as provided in paragraph (e)(4)(iii)(B), (C), (D) or (E) of this section, the term of a split-dollar term loan is based on the period from the date the loan is made until the loan's stated maturity date.

(B) *Special rules for certain options*—(*1*) *Payment schedule that minimizes yield*. If a split-dollar term loan is subject to unconditional options that are exercisable at one or more times during the term of the loan and that, if exercised, would require full payment of the loan on a date other than the stated maturity date, then the rules of this paragraph (e)(4)(iii)(B)(*1*) determine the term of the loan. For purposes of determining a split-dollar loan's term, the borrower is projected to exercise or not exercise an option or combination of options in a manner that minimizes the loan's overall yield. Similarly, the lender is projected to exercise or not exercise an option or combination of options in a manner that minimizes the loan's overall yield. If different projected patterns of exercise or non-exercise produce the same minimum yield, the parties are projected to exercise or not exercise an option or combination of options in a manner that produces the longest term.

(*2*) *Change in circumstances*. If the borrower (or lender) does or does not exercise the option as projected under paragraph (e)(4)(iii)(B)(*1*) of this section, the split-dollar loan is treated as retired and reissued on the date the option is or is not exercised. The amount for which the loan is deemed to be retired and reissued is the loan's adjusted issue price on that date. The reissued loan must be retested using the appropriate AFR in effect on the date of reissuance to determine whether it is a below-market loan.

(3) *Examples*. The following examples illustrate the rules of this paragraph (e)(4)(iii)(B):

Example 1. Employee *B* issues a 10-year split-dollar term loan to Employer *Y*. *B* has the right to prepay the loan at the end of year 5. Interest is payable on the split-dollar loan at 1 percent for the first 5 years and at 10 percent for the remaining 5 years. Under paragraph (e)(4)(iii)(B)(*1*) of this section, this arrangement is treated as a 5-year split-dollar term loan from *Y* to *B*, with interest payable at 1 percent.

Example 2. The facts are the same as the facts in *Example 1*, except that *B* does not in fact prepay the split-dollar loan at the end of year 5. Under paragraph (e)(4)(iii)(B)(*2*) of this section, the first loan is treated as retired at the end of year 5 and a new 5-year split-dollar term loan is issued at that time, with interest payable at 10 percent.

Example 3. Employee *A* issues a 10-year split-dollar term loan on which the lender, Employer *X*, has the right to demand payment at the end of year 2. Interest is payable on the split-dollar loan at 7 percent each year that the loan is outstanding. Under paragraph (e)(4)(iii)(B)(*1*) of this section, this arrangement is treated as a 10-year split-dollar term loan because the exercise of *X*'s put option would not reduce the yield of the loan (the yield of the loan is 7 percent, compounded annually, whether or not *X* demands payment).

(C) *Split-dollar term loans providing for certain variable rates of interest*. If a split-dollar term loan is subject to paragraph (g) of this section (a split-dollar loan that provides for certain variable rates of interest), the term of the loan for purposes of paragraph (e)(4)(ii) of this section is determined under paragraph (g)(3)(ii) of this section.

(D) *Split-dollar loans payable upon the death of an individual*. If a split-dollar term loan is described in paragraph (e)(5)(ii)(A) or (v)(A) of this section, the term of the loan for purposes of paragraph (e)(4)(ii) of this section is determined under paragraph (e)(5)(ii)(C) or (v)(B)(*2*) of this section, whichever is applicable.

(E) *Split-dollar loans conditioned on the future performance of substantial services by an individual*. If a split-dollar term loan is described in paragraph (e)(5)(iii)(A)(*1*) or (v)(A) of this section, the term of the loan for purposes of paragraph (e)(4)(ii) of this section is determined under paragraph (e)(5)(iii)(C) or (v)(B)(*2*) of this section, whichever is applicable.

(iv) *Timing and amount of imputed transfer in connection with below-market split-dollar term loans*. If a split-dollar term loan is a below-market loan, then the rules applicable to below-market term loans under section 7872 apply. In general, the loan is recharacterized as consisting of two portions: an imputed loan amount (as defined in paragraph (e)(4)(ii) of this section) and an imputed transfer from the lender to the borrower. The imputed transfer occurs at the time the loan is made (for example, when the lender makes a premium payment on a life insurance policy) and is equal to the excess described in paragraph (e)(4)(ii) of this section.

(v) *Amount treated as OID*. In the case of any below-market split-dollar term loan described in this paragraph (e)(4), for purposes of applying sections 1271 through 1275 and the regulations thereunder, the issue price of the loan is the amount determined under § 1.1273–2, reduced by the amount of the imputed transfer described in paragraph (e)(4)(iv) of this section. Thus, the loan is generally treated as having OID in an amount equal to the amount of the imputed transfer described in paragraph (e)(4)(iv) of this section, in addition to any other OID on the loan (determined without regard to section 7872(b)(2)(A) or this paragraph (e)(4)).

(vi) *Example*. The provisions of this paragraph (e)(4) are illustrated by the following example:

Example. (i) On July 1, 2009, Corporation *Z* and Shareholder *A* enter into a split-dollar life insurance arrangement under which *A* is named as the policy owner. On July 1, 2009, *Z* makes a $100,000 premium payment, repayable without interest in 15 years. Repayment of the premium payment is fully recourse to *A*. The premium payment is a split-dollar term loan. Assume the long-term AFR (based on annual compounding) at the time the loan is made is 7 percent.

(ii) Based on a 15-year term and a discount rate of 7 percent, compounded annually (the long-term AFR), the present value of the payments under the loan is $36,244.60, determined as follows: $\$100{,}000/[1+(0.07/1)]^{15}$. This loan is a below-market split-dollar term loan because the imputed loan amount of $36,244.60 (the present value of the amount required to be repaid to *Z*) is less than the amount loaned ($100,000).

(iii) In accordance with section 7872(b)(1) and paragraph (e)(4)(iv) of this section, on the date that the loan is made, *Z* is treated as transferring to *A* $63,755.40 (the excess of $100,000 (amount loaned) over $36,244.60 (imputed loan amount)). Under section 7872 and paragraph (e)(1)(i) of this section, *Z* is treated as making a section 301 distribution to *A* on July 1, 2009, of $63,755.40. *Z* must take into account as OID an amount equal to the imputed transfer. See § 1.1272–1 for the treatment of OID.

(5) *Special rules for certain split-dollar term loans*—(i) *In general*. This paragraph (e)(5) provides rules for split-dollar loans payable on the death of an individual, split-dollar loans conditioned on the future performance of substantial services by an individual, and gift term loans. These split-dollar loans are split-dollar term loans for purposes of determining whether the loan provides for sufficient interest. If, however, the loan is a

below-market split-dollar loan, then, except as provided in paragraph (e)(5)(v) of this section, forgone interest is determined annually, similar to a demand loan, but using an AFR that is appropriate for the loan's term and that is determined when the loan is issued.

(ii) *Split-dollar loans payable not later than the death of an individual*—(A) *Applicability*. This paragraph (e)(5)(ii) applies to a split-dollar term loan payable not later than the death of an individual.

(B) *Treatment of loan*. A split-dollar loan described in paragraph (e)(5)(ii)(A) of this section is tested under paragraph (e)(4)(ii) of this section to determine if the loan provides for sufficient interest. If the loan provides for sufficient interest, then section 7872 does not apply to the loan, and the interest on the loan is taken into account under paragraph (f) of this section. If the loan does not provide for sufficient interest, then section 7872 applies to the loan, and the loan is treated as a below-market demand loan subject to paragraph (e)(3)(iii) of this section. For each year that the loan is outstanding, however, the AFR used in the determination of forgone interest under paragraph (e)(3)(iii) of this section is not the blended annual rate but rather is the AFR (based on annual compounding) appropriate for the loan's term for the month in which the loan is made. See paragraph (e)(5)(ii)(C) of this section to determine the loan's term.

(C) *Term of loan*. For purposes of paragraph (e)(5)(ii)(B) of this section, the term of a split-dollar loan payable on the death of an individual (including the death of the last survivor of a group of individuals) is the life expectancy as determined under the appropriate table in § 1.72–9 on the day the loan is made. If a split-dollar loan is payable on the earlier of the individual's death or another term determined under paragraph (e)(4)(iii) of this section, the term of the loan is whichever term is shorter.

(D) *Retirement and reissuance of loan*. If a split-dollar loan described in paragraph (e)(5)(ii)(A) of this section remains outstanding longer than the term determined under paragraph (e)(5)(ii)(C) of this section because the individual outlived his or her life expectancy, the split-dollar loan is treated as retired and reissued as a split-dollar demand loan at that time for the loan's adjusted issue price on that date. However, the loan is not retested at that time to determine whether the loan provides for sufficient interest. For purposes of determining forgone interest under paragraph (e)(5)(ii)(B) of this section, the appropriate AFR for the reissued loan is the AFR determined under (e)(5)(ii)(B) of this section on the day the loan was originally made.

(iii) *Split-dollar loans conditioned on the future performance of substantial services by an individual*—(A) *Applicability*—(*1*) *In general*. This paragraph (e)(5)(iii) applies to a split-dollar term loan if the benefits of the interest arrangements of the loan are not transferable and are conditioned on the future performance of substantial services (within the meaning of section 83) by an individual.

(*2*) *Exception*. Notwithstanding paragraph (e)(5)(iii)(A)(*1*) of this section, this paragraph (e)(5)(iii) does not apply to a split-dollar loan described in paragraph (e)(5)(v)(A) of this section (regarding a split-dollar loan that is payable on the later of a term certain and the date on which the condition to perform substantial future services by an individual ends).

(B) *Treatment of loan*. A split-dollar loan described in paragraph (e)(5)(iii)(A)(*1*) of this section is tested under paragraph (e)(4)(ii) of this section to determine if the loan provides for sufficient interest. Except as provided in paragraph (e)(5)(iii)(D) of this section, if the loan provides for sufficient interest, then section 7872 does not apply to the loan and the interest on the loan is taken into account under paragraph (f) of this section. If the loan does not provide for sufficient interest, then section 7872 applies to the loan and the loan is treated as a below-market demand loan subject to paragraph (e)(3)(iii) of this section. For each year that the loan is outstanding, however, the AFR used in the determination of forgone interest under paragraph (e)(3)(iii) of this section is not the blended annual rate but rather is the AFR (based on annual compounding) appropriate for the loan's term for the month in which the loan is made. See paragraph (e)(5)(iii)(C) of this section to determine the loan's term.

(C) *Term of loan*. The term of a split-dollar loan described in paragraph (e)(5)(iii)(A)(*1*) of this section is based on the period from the date the loan is made until the loan's stated maturity date. However, if a split-dollar loan described in paragraph (e)(5)(iii)(A)(*1*) of this section does not have a stated maturity date, the term of the loan is presumed to be seven years.

(D) *Retirement and reissuance of loan*. If a split-dollar loan described in paragraph (e)(5)(iii)(A)(*1*) of this section remains outstanding longer than the term determined under paragraph (e)(5)(iii)(C) of this section because of the continued performance of substantial services, the split-dollar loan is treated as retired and reissued as a split-dollar demand loan at that time for the loan's adjusted issue price on that date. The loan is retested at that time to determine whether the loan provides for sufficient interest.

(iv) *Gift split-dollar term loans*—(A) *Applicability*. This paragraph (e)(5)(iv) applies to gift split-dollar term loans.

(B) *Treatment of loan*. A split-dollar loan described in paragraph (e)(5)(iv)(A) of this section is tested under paragraph (e)(4)(ii) of this section to determine if the loan provides for sufficient interest. If the loan provides for sufficient interest, then section 7872 does not apply to the loan and the interest on the loan is taken into account under paragraph (f) of this section. If the loan does not provide for sufficient interest, then section 7872 applies to the loan and the loan is treated as a below-market demand loan subject to paragraph (e)(3)(iii) of this section. For each year that the loan is outstanding, however, the AFR used in the determination of forgone interest under paragraph (e)(3)(iii) of this section is not the blended annual rate but rather is the AFR (based on annual compounding) appropriate for the loan's term for the month in which the loan is made. See paragraph (e)(5)(iv)(C) of this section to determine the loan's term.

(C) *Term of loan*. For purposes of paragraph (e)(5)(iv)(B) of this section, the term of a gift split-dollar term loan is the term determined under paragraph (e)(4)(iii) of this section.

(D) *Limited application for gift split-dollar term loans*. The rules of paragraph (e)(5)(iv)(B) of this section apply to a gift split-dollar term loan only for Federal income tax purposes. For purposes of Chapter 12 of the Internal Revenue Code (relating to the gift tax), gift below-market split-dollar term loans are treated as term loans under section 7872(b) and paragraph (e)(4) of this section. See section 7872(d)(2).

(v) *Split-dollar loans payable on the later of a term certain and another specified date*—(A) *Applicability*. This paragraph (e)(5)(v) applies to any split-dollar term loan payable upon the later of a term certain or—

(*1*) The death of an individual; or

(*2*) For a loan described in paragraph (e)(5)(iii)(A)(*1*) of this section, the date on which the condition to perform substantial future services by an individual ends.

(B) *Treatment of loan*—(*1*) *In general*. A split-dollar loan described in paragraph (e)(5)(v)(A) of this section is a split-dollar term loan, subject to paragraph (e)(4) of this section.

(*2*) *Term of the loan*. The term of a split-dollar loan described in paragraph (e)(5)(v)(A) of this section is the term certain.

(*3*) *Appropriate AFR*. The appropriate AFR for a split-dollar loan described in paragraph (e)(5)(v)(A) of this section is based on a term of the longer of the term certain or the loan's expected term as determined under either paragraph (e)(5)(ii) or (iii) of this section, whichever is applicable.

(C) *Retirement and reissuance*. If a split-dollar loan described in paragraph (e)(5)(v)(A) of this section remains outstanding longer than the term certain, the split-dollar loan is treated as retired and reissued at the end of the term certain for the loan's adjusted issue price on that date. The reissued loan is subject to paragraph (e)(5)(ii) or (iii) of this section, whichever is applicable. However, the loan is not retested at that time to determine whether the loan provides for sufficient interest. For purposes of paragraph (e)(3)(iii) of this section, the appropriate AFR for the reissued loan is the AFR determined under paragraph (e)(5)(v)(B)(3) of this section on the day the loan was originally made.

(vi) *Example*. The provisions of this paragraph (e)(5) are illustrated by the following example:

Example. (i) On January 1, 2009, Corporation *Y* and Shareholder *B*, a 65 year-old male, enter into a split-dollar life insurance arrangement under which *B* is named as the policy owner. On January 1, 2009, *Y* makes a $100,000 premium payment, repayable, without interest, from the death benefits of the underlying contract upon *B*'s death. The premium payment is a split-dollar term loan. Repayment of the premium payment is fully recourse to *B*. Assume the long-term AFR (based on annual compounding) at the time of the loan is 7 percent. Both *Y* and *B* use the calendar year as their taxable years.

(ii) Based on Table 1 in §1.72–9, the expected term of the loan is 15 years. Under paragraph (e)(5)(ii)(C) of this section, the long-term AFR (based on annual compounding) is the appropriate test rate. Based on a 15-year term and a discount rate of 7 percent, compounded annually (the long-term AFR), the present value of the payments under the loan is $36,244.60, determined as follows: $100,000/[1+(0.07/1)]15. Under paragraph (e)(5)(ii)(B) of this section, this loan is a below-market split-dollar term loan because the imputed loan amount of $36,244.60 (the present value of the amount required to be repaid to *Y*) is less than the amount loaned ($100,000).

(iii) Under paragraph (e)(5)(ii)(B) of this section, the amount of forgone interest for 2009 (and each subsequent full calendar year that the loan remains outstanding) is $7,000, which is the amount of interest that would have been payable on the loan for the calendar year if interest accrued on the loan's adjusted issue price ($100,000) at the long-term AFR (7 percent, compounded annually). Under section 7872 and paragraph (e)(1)(i) of this section, on December 31, 2009, *Y* is treated as making a section 301 distribution to *B* of $7,000. In addition, *Y* has $7,000 of imputed interest income for 2009.

(f) *Treatment of stated interest and OID for split-dollar loans*—(1) *In general*. If a split-dollar loan provides for stated interest or OID, the loan is subject to this paragraph (f), regardless of whether the split-dollar loan has sufficient interest. Except as provided in paragraphs (f)(2), (g), and (j) of this section, split-dollar loans are subject to the same Internal Revenue Code and regulatory provisions for stated interest and OID as other loans. For example, the lender of a split-dollar loan that provides for stated interest must account for any qualified stated interest (as defined in § 1.1273–1(c)) under its regular method of accounting (for example, an accrual method or the cash receipts and disbursements method). See § 1.446–2 to determine the amount of qualified stated interest that accrues during an accrual period. In addition, the lender must account under § 1.1272–1 for any OID on a split-dollar loan. See paragraph (h) of this section for a subsequent waiver, cancellation, or forgiveness of stated interest on a split-dollar loan.

(2) *Term, payment schedule, and yield*. The term of a split-dollar term loan determined under paragraph (e)(4)(iii) of this section (other than paragraph (e)(4)(iii)(C) of this section) applies to determine the split-dollar loan's term, payment schedule, and yield for all purposes of this section.

(g) *Certain variable rates of interest*—(1) *In general*. This paragraph (g) provides rules for a split-dollar loan that provides for certain variable rates of interest. If this paragraph (g) does not apply to a variable rate split-dollar loan, the loan is subject to the rules for split-dollar loans providing for one or more contingent payments in paragraph (j) of this section.

(2) *Applicability*—(i) *In general*. Except as provided in paragraph (g)(2)(ii) of this section, this paragraph (g) applies to a split-dollar loan that is a variable rate debt instrument (within the meaning of § 1.1275–5) and that provides for stated interest at a qualified floating rate (or rates).

(ii) *Interest rate restrictions*. This paragraph (g) does not apply to a split-dollar loan if, as a result of interest rate restrictions (such as an interest rate cap), the expected yield of the loan taking the restrictions into account is significantly less than the expected yield of the loan without regard to the restrictions. Conversely, if reasonably symmetric interest rate caps and floors or reasonably symmetric governors are fixed throughout the term of the loan, these restrictions generally do not prevent this paragraph (g) from applying to the loan.

(3) *Testing for sufficient interest*—(i) *Demand loan*. For purposes of paragraph (e)(3)(ii) of this section (regarding testing a split-dollar demand loan for sufficient interest), a split-dollar demand loan is treated as if it provided for a fixed rate of interest for each accrual period to which a qualified floating rate applies. The projected fixed rate for each accrual period is the value of the qualified floating rate as of the beginning of the calendar year that contains the last day of the accrual period.

(ii) *Term loan*. For purposes of paragraph (e)(4)(ii) of this section (regarding testing a split-dollar term loan for sufficient interest), a split-dollar term loan subject to this paragraph (g) is treated as if it provided for a fixed rate of interest for each accrual period to which a qualified floating rate applies. The projected fixed rate for each accrual period is the value of the qualified floating rate on the date the split-dollar term loan is made. The term of a split-dollar loan that is subject to this paragraph (g)(3)(ii) is determined using the rules in § 1.1274–4(c)(2). For example, if the loan provides for interest at a qualified floating rate that adjusts at varying intervals, the term of the loan is determined by reference to the longest interval between interest adjustment dates. See paragraph (e)(5) of this section for special rules relating to certain split-dollar term loans, such as a split-dollar term loan payable not later than the death of an individual.

(4) *Interest accruals and imputed transfers*. For purposes of paragraphs (e) and (f) of this section, the projected fixed rate or rates determined under paragraph (g)(3) of this section are used for purposes of determining the accrual of interest each period and the amount of any imputed transfers. Appropriate adjustments are made to the interest accruals and any imputed transfers to take into account any difference between the projected fixed rate and the actual rate.

(5) *Example*. The provisions of this paragraph (g) are illustrated by the following example:

Example. (i) On January 1, 2010, Employer *V* and Employee *F* enter into a split-dollar life insurance arrangement under which *F* is named as the policy owner. On January 1, 2010, *V* makes a $100,000 premium payment, repayable in 15 years. The premium payment is a split-dollar term loan. Under the arrangement between the parties, interest is payable on the split-dollar loan each year on January 1, starting January 1, 2011, at a rate equal to the value of 1-year LIBOR as of the payment date. The short-term AFR (based on annual compounding) at the time of the loan is 7 percent. Repayment of both the premium payment and the interest due thereon is nonrecourse to *F*. However, the parties made a representation under paragraph (d)(2) of this section. Assume that the value of 1-year LIBOR on January 1, 2010, is 8 percent, compounded annually.

(ii) The loan is subject to this paragraph (g) because the loan is a variable rate debt instrument that bears interest at a qualified floating rate. Because the interest rate is reset each year, under paragraph (g)(3)(ii) of this section, the short-term AFR (based on annual compounding) is the appropriate test rate used to determine whether the loan provides for sufficient interest. Moreover, under paragraph (g)(3)(ii) of this section, to determine whether the loan provides for sufficient interest, the loan is treated as if it provided for a fixed rate of interest equal to 8 percent, compounded annually. Based on a discount rate of 7 percent, compounded annually (the short-term AFR), the present value of the payments under the loan is $109,107.91. The loan provides for sufficient interest because the loan's imputed loan amount of $109,107.91 (the present value of the payments) is more than the amount loaned of $100,000. Therefore, the loan is not a below-market split-dollar term loan, and interest on the loan is taken into account under paragraph (f) of this section.

(h) *Adjustments for interest paid at less than the stated rate*—(1) *In general*. To the extent required by this paragraph (h), if accrued but unpaid interest on a split-dollar loan is subsequently waived, cancelled, or forgiven by the lender, the waiver, cancellation, or forgiveness is treated as if, on that date, the interest had in fact been paid to the lender and then retransferred by the lender to the borrower. To determine the characterization of any retransferred amount, see paragraph (e)(1)(i) of this section. For purposes of this paragraph (h), the amount of interest deemed transferred and retransferred pursuant to this paragraph (h) is determined under paragraph (h)(2) or (3) of this section. See § 1.61–22(b)(6) for the treatment of amounts other than interest on a split-dollar loan that are waived, cancelled, or forgiven by the lender. For purposes of this paragraph (h), a split-dollar term loan described in paragraph (e)(5) of this section (for example, a split-dollar term loan payable not later than the death of an individual) is subject to the rules of paragraph (h)(3) of this section.

(2) *Split-dollar term loans*. In the case of a split-dollar term loan, the amount of interest deemed transferred and retransferred for purposes of paragraph (h)(1) of this section is determined as follows:

(i) If the loan's stated rate is less than or equal to the appropriate AFR (the AFR used to test the loan for sufficient interest under paragraph (e) of this section), the amount of interest deemed transferred and retransferred pursuant to this paragraph (h) is the excess of the amount of interest payable at the stated rate over the interest actually paid.

(ii) If the loan's stated rate is greater than the appropriate AFR (the AFR used to test the loan for sufficient interest under paragraph (e) of this section), the amount of interest deemed transferred and retransferred pursuant to this paragraph (h) is the excess, if any, of the amount of interest payable at the AFR over the interest actually paid.

(3) *Split-dollar demand loans*. In the case of a split-dollar demand loan, the amount of interest deemed transferred and retransferred for purposes of paragraph (h)(1) of this section is equal to the aggregate of—

(i) For each year that the split-dollar demand loan was outstanding in which the loan was a below-market split-dollar demand loan, the excess of the amount of interest payable at the stated rate over the interest actually paid allocable to that year; plus

(ii) For each year that the split-dollar demand loan was outstanding in which the loan was not a below-market split-dollar demand loan, the excess, if any, of the amount of interest payable at the appropriate AFR used for purposes of imputation for that year over the interest actually paid allocable to that year.

(4) *Examples*. The provisions of this paragraph (h) are illustrated by the following examples:

Example 1. (i) On January 1, 2009, Employer *Y* and Employee *B* entered into a split-dollar life insurance arrangement under which *B* is named as the policy owner. On January 1, 2009, *Y* made a $100,000 premium payment, repayable on December 31, 2011, with interest of 5 percent, compounded annually. The premium payment is a split-dollar term loan. Assume the short-term AFR (based on annual compounding) at the time the loan was made was 5 percent. Repayment of both the premium payment and the interest due thereon was fully recourse to *B*. On December 31, 2011, *Y* is repaid $100,000 but *Y* waives the remainder due on the loan ($15,762.50). Both *Y* and *B* use the calendar year as their taxable years.

(ii) When the split-dollar loan was made, the loan was not a below-market loan under paragraph (e)(4)(ii) of this section. Under paragraph (f) of this section, *Y* was required to accrue compound interest of 5 percent each year the loan remained outstanding. *B*, however, was not entitled to any deduction for this interest under paragraph (c) of this section.

(iii) Under paragraph (h)(2) of this section, the waived amount is treated as if, on December 31, 2011, it had in fact been paid to *Y* and was then retransferred by *Y* to *B*. The amount deemed transferred to *Y* and retransferred to *B* equals the excess of the amount of interest payable at the stated rate ($15,762.50) over the interest actually paid ($0), or $15,762.50. Because of the employment relationship between *Y* and *B*, this retransferred amount is treated as compensation paid by *Y* to *B*.

Example 2. (i) On January 1, 2009, Employer *Y* and Employee *B* entered into a split-dollar life insurance arrangement under which *B* is named as the policy owner. On January 1, 2009, *Y* made a $100,000 premium payment, repayable on the demand of *Y*, with interest of 7 percent, compounded annually. The premium payment is a split-dollar demand loan. Assume the blended annual rate (based on annual compounding) in 2009 was 5 percent and in 2010 was 6 percent. Repayment of both the premium payment and the interest due thereon was fully recourse to *B*. On December 31, 2010, *Y* demands repayment and is repaid its $100,000 premium payment in full; however, *Y* waives all interest due on the loan. Both *Y* and *B* use the calendar year as their taxable years.

(ii) For each year that the split-dollar demand loan was outstanding, the loan was not a below-market loan under paragraph (e)(3)(ii) of this section. Under paragraph (f) of this section, *Y* was required to accrue compound interest of 7 percent each year the loan remained outstanding. *B*, however, was not entitled to any deduction for this interest under paragraph (c) of this section.

(iii) Under paragraph (h)(1)(i) of this section, a portion of the waived interest may be treated as if, on December 31, 2010, it had in fact been paid to *Y* and was then retransferred by *Y* to *B*. The amount of interest deemed transferred to *Y* and retransferred to *B* equals the excess, if any, of the amount of interest payable at the blended annual rate for each year the loan is outstanding over the interest actually paid with respect to that year. For 2009, the interest payable at the blended annual rate is $5,000 ($100,000 x 0.05). For 2010, the interest payable at the blended annual rate is $6,000 ($100,000 x 0.06). Therefore, the amount of interest deemed transferred to *Y* and retransferred to *B* equals $11,000. Because of the employment relationship between *Y* and *B*, this retransferred amount is treated as compensation paid by *Y* to *B*.

(i) [Reserved]

(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 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 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 date the loan is made, *T* is treated as transferring to *G* $23,710.48 (the imputed transfer) as compensation. In addition, *T* must take into account as OID an amount equal to the imputed transfer. See § 1.1272–1 for the treatment of OID.

Example 2. (i) Assume, in addition to the facts in *Example 1*, that on December 31, 2013, *T* receives $115,000 (its premium payment of $100,000 plus $15,000).

(ii) Under the contingent split-dollar method, when the loan is repaid, there is a $15,000 positive adjustment ($15,000 actual payment minus $0 projected payment). Under paragraph (j)(4) of this section, because *T* accrued imputed interest under section 7872 on this split-dollar loan to *G* and this interest would not have accrued in the absence of section 7872, *T* is not required to include the positive adjustment in income, and *G* is not treated as having interest expense for the positive adjustment. To the same extent, *T* must include in income, and *G* is entitled to deduct, $15,000 to reverse their respective prior tax consequences imposed under paragraph (e) of this section (*T* 's prior deduction for imputed compensation deemed paid to *G* and *G*'s prior inclusion of this amount). *G* takes the reversal into account in determining adjusted gross income. That is, the $15,000 is an "above-the-line" deduction, whether or not *G* itemizes deductions.

Example 3. (i) Assume the same facts as in *Example 2*, except that on December 31, 2013, *T* receives $127,000 (its premium payment of $100,000 plus $27,000).

(ii) Under the contingent split-dollar method, when the loan is repaid, there is a $27,000 positive adjustment ($27,000 actual payment minus $0 projected payment). Under paragraph (j)(4) of this section, because *T* accrued imputed interest of $23,710.48 under section 7872 on this split-dollar loan to *G* and this interest would not have accrued in the absence of section 7872, *T* is not required to include $23,710.48 of the positive adjustment in income, and *G* is not treated as having interest expense for the positive adjustment. To the same extent, in 2013, *T* must include in income, and *G* is entitled to deduct, $23,710.48 to reverse their respective prior tax consequences imposed under paragraph (e) of this section (*T* 's prior deduction for imputed compensation deemed paid to *G* and *G*'s prior inclusion of this amount). *G* and *T* take these reversals into account in determining adjusted gross income. Under the contingent split-dollar method, *T* must include in income $3,289.52 upon resolution of the contingency ($27,000 positive adjustment minus $23,710.48).

(k) *Payment ordering rule*. For purposes of this section, a payment made by the borrower pursuant to a split-dollar life insurance arrangement is applied to all direct and indirect split-dollar loans in the following order—

(1) A payment of interest to the extent of accrued but unpaid interest (including any OID) on all outstanding split-dollar loans in the order the interest accrued;

(2) A payment of principal on the outstanding split-dollar loans in the order in which the loans were made;

(3) A payment of amounts previously paid by a non-owner pursuant to a split-dollar life insurance arrangement that were not reasonably expected to be repaid by the owner; and

(4) Any other payment with respect to a split-dollar life insurance arrangement, other than a payment taken into account under paragraphs (k)(1), (2), and (3) of this section.

(l) [Reserved]

(m) *Repayments received by a lender*. Any amount received by a lender under a life insurance contract that is part of a split-dollar life insurance arrangement is treated as though the amount had been paid to the borrower and then paid by the borrower to the lender. Any amount treated as received by the borrower under this paragraph (m) is subject to other provisions of the Internal Revenue Code as applicable (for example, sections 72 and 101(a)). The lender must take the amount into account as a payment received with respect to a split-dollar loan, in accordance with paragraph (k) of this section. No amount received by a lender with respect to a split-dollar loan is treated as an amount received by reason of the death of the insured.

(n) *Effective date*—(1) *General rule*. This section applies to any split-dollar life insurance arrangement entered into after the date the final regulations are published in the **Federal Register**.

(2) *Early reliance*. Taxpayers may rely on this section for the treatment of any split-dollar life insurance arrangement entered into on or before the date described in paragraph (n)(1) of this section, provided that all taxpayers who are parties to a split-dollar loan described in paragraph (b)(1) of this section treat the arrangement consistently under this section.

(3) *Modified arrangements treated as new arrangements*. An arrangement entered into on or before the date set forth in paragraph (n)(1) of this section that is materially modified after the date set forth in paragraph (n)(1) of this section is treated as a new arrangement entered into on the date of the modification.

PART 31—EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX AT SOURCE

Par. 10. The authority citation for part 31 continues to read in part as follows:

Authority: 26 U.S.C. 7805. * * *

Par. 11. In § 31.3121(a)–1, paragraph (k) is added to read as follows:

§ 31.3121(a)–1 Wages.

* * * * *

(k) *Split-dollar life insurance arrangements*. Except as otherwise provided under section 3121(v), see § 1.61–22 of this chapter for rules relating to the treatment of split-dollar life insurance arrangements.

Par. 12. In § 31.3231(e)–1, paragraph (a)(6) is added to read as follows:

§ 31.3231(e)–1 Compensation.

(a) * * *

(6) *Split-dollar life insurance arrangements*. See § 1.61–22 of this chapter for rules relating to the treatment of split-dollar life insurance arrangements.

* * * * *

Par. 13. In § 31.3306(b)–1, paragraph (l) is added to read as follows:

§ 31.3306(b)–1 Wages.

* * * * *

(l) *Split-dollar life insurance arrangements*. Except as otherwise provided under section 3306(r), see § 1.61–22 of this chapter for rules relating to the treatment of split-dollar life insurance arrangements.

Par. 14. In § 31.3401(a)–1, paragraph (b)(15) is added to read as follows:

§ 31.3401(a)–1 Wages.

* * * * *

(b) * * *

(15) *Split-dollar life insurance arrangements*. See § 1.61–22 of this chapter for rules relating to the treatment of split-dollar life insurance arrangements.

* * * * *

David A. Mader,
Acting Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on July 3, 2002, 9:53 a.m., and published in the issue of the Federal Register for July 9, 2002, 67 F.R. 45414)

Miscellaneous Federal Tax Matters; Hearings

Announcement 2002–67

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Proposed Rulemaking; changes of dates and/or locations of public hearings.

SUMMARY: This document changes some of the dates and/or locations of public hearings for several proposed regulations. The proposed regulations that are affected are identified in the table set out in this document. (REG–103823–99, 2002–27 I.R.B. 44), (REG–105885–99, 2002–23 I.R.B. 1103), (REG–105369–00, 2002–18 I.R.B. 828), (REG–118861–00, 2002–12 I.R.B. 651), (REG–136193–01, 2002–21 I.R.B. 995), (REG–161424–01, 2002–21 I.R.B. 1010), (REG–165706–01, 2002–16 I.R.B. 787), and (REG–102740–02, 2002–13 I.R.B. 701).

FOR FURTHER INFORMATION CONTACT: Guy R. Traynor, Regulations Unit, Associate Chief Counsel (Income Tax & Accounting), (202) 622–7180 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On various dates from March of 2002 through May of 2002, a number of notices of public hearings were published in the **Federal Register** announcing the scheduling of public hearings. This document changes the dates and/or locations of some of those public hearings.

Many of the public hearings are being held at the Internal Revenue Service, National Office, 1111 Constitution Avenue NW, Washington, DC. For these hearings, use the Constitution Avenue entrance.

One hearing is being held in the Internal Revenue Service Auditorium, New Carrollton, 5000 Ellin Road, Lanham, MD.

The new hearing dates and locations are listed as follows:

Project Number	Title of Regulation	Date Published FR cite	New Hearing Date	New Location of Hearing
REG–102740–02	Loss Limitation Rules	March 12, 2002 (67 FR 11070)	July 19, 2002	Room 2615
REG–165706–01	Obligations of States & Political Subdivisions	April 10, 2002 (67 FR 17309)	August 7, 2002	Room 2615
REG–136193–01	Notice of Significant Reduction in the Rate of Future Benefit Accrual	April 23, 2002 (67 FR 19713)	No change	Room 4718
REG–105885–99	Compensation Deferred Under Eligible Deferred Compensation Plans	May 8, 2002 (67 FR 30826)	August 29, 2002	Room 2615

Project Number	Title of Regulation	Date Published FR cite	New Hearing Date	New Location of Hearing
REG–118861–00	Application of Section 338 to Insurance Companies	March 8, 2002 (67 FR 10640)	No change	Room 6718
REG–105369–00 REG–113526–98	Arbitrage & Private Activity Restrictions Applicable to Tax-exempt Bonds Issued by State and Local Governments	April 17, 2002 (67 FR 18835)	September 25, 2002	Room 2615
REG–105316–98 REG–161424–01	Information Reporting for Payments of Qualified Tuition and Payments of Interest on Qualified Education Loans	April 29, 2002 (67 FR 20923)	No change	Room 4718
REG–103823–99	Guidance on Cost Recovery Under the Income Forecast Method	May 31, 2002 (67 FR 38025)	No change	Internal Revenue Service Auditorium, New Carrollton Building, 5000 Ellin Road, Lanham, MD 20706

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Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as"rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified,* below).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified,* above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign Corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Intemal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statements of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z—Corporation.

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