

## TAX

### IRS TAXES EQUITY SPLIT-DOLLAR LIFE INSURANCE

By [Robert C. Kautz, Esq.](#)

**Introduction.** In a recently released Technical Advice memorandum - TAM 9604001- the Internal Revenue Service (IRS) surprised legal and accounting experts by holding that an employee was subject to tax on the annual increase in the cash surrender value of a split-dollar life insurance policy to the extent that the value of the policy exceeded the premium paid by the employee's company.

**Background.** In a typical split-dollar life insurance arrangement, the employer pays the entire premium on an insurance policy on the life of an employee, permits the employee (or his or her assignee, such as an irrevocable life insurance trust) to receive the annual term insurance protection, and "splits" the ownership of the cash surrender value with the employee.

The employer retains, either through a split endorsement or a collateral assignment, an interest in the policy equal to the lesser of the cash surrender value of the policy or the aggregate amount of premiums it has paid, with no increase for the time value of money. Any excess value attributable to the earnings credited to the policy by the employer belongs to the employee (or his or her assignee).

Although the IRS has ruled in the past that an employee who benefits from such an arrangement would be taxed annually on the annual value of the term insurance coverage, the extent to which the employee would be taxed on the incremental build-up of the policy's cash surrender value was unclear. Accordingly, many tax advisors took comfort in the IRS's silence on this issue and advised their clients that the annual build-up would accrue tax free.

**Holding.** TAM 9604001 holds that once the cash surrender value exceeds the amount to which the employer is entitled (the return of all premiums paid), the employee is taxed currently on the remaining build-up in the cash surrender value of the policy.

Furthermore, on the facts of TAM 9604001, the life insurance policy at issue had been transferred to an irrevocable life insurance trust. Thus, the TAM held that the employee made a gift to the trust each year equal to the amount by which the cash surrender value exceeded the premiums paid by the employee.

**Recommendation.** Based upon the release of this TAM, we recommend that all employers and employees undertake a review of their split-dollar arrangements. This review should include a determination of the potential taxation of each employee (and the employer's corresponding tax obligation, if any), including the year in which each employee may be subject to taxation.

After this review, employers should consider whether to restructure such arrangements to reduce or eliminate prospective taxation of their employees. We would be pleased to assist you both in the review of your current structure as well as the restructuring of any insurance arrangements which may be necessary.

---

### [Back to Publications](#)

[Home](#) | [What's New](#) | [Corporate Services](#) | [Individual Services](#) | [Attorney Biographies](#) | [Publications](#)  
[Employment Opportunities](#) | [Directions](#) | [Search](#) | [Guest Book](#) | [Disclaimer](#)

---

Send e-mail to [webmaster@wilentz.com](mailto:webmaster@wilentz.com) with questions or comments about this web site.  
Copyright © 1998-99 Wilentz, Goldman, & Spitzer, P.C., All rights reserved.