



Greetings and Happy New Year!

During the past year, we have periodically communicated with you regarding Notice 2001-10 issued by the Treasury Department and Internal Revenue Service on January 29, 2001, to provide interim guidance regarding split-dollar life insurance arrangements.

On January 3rd, Notice 2002-8 was issued giving further clarification to this situation. While there are many questions that remain unanswered, this Notice provide much more clarification as to what the future guidelines and rules for split dollar arrangements will be and what type of treatment existing arrangements might receive.

As you know, for the past year I have served on the board of directors of AALU which is the organization that was charged with representing our industry in negotiations with Treasury and the Service on this and other legislative matters that affect us. While the time commitment has been high, the effort has been worth it as I have been able to watch the process from close-up and contribute to it.

As mentioned above, there are many questions still to be answered and already there is a swirl of speculation as to what the Notice does or does not say or mean. The purposes of this communication are to:

1. Provide you with a copy of the Notice as published and distributed by Treasury and the Service.
2. Provide you with a copy of the Washington Report analysis of the Notice. Please note that the authors of this report were integral parts of the team that represented us in these discussions and sat in on all of the meetings with Treasury and the Service.
3. Share with you notes I developed in conversations with the authors of the above report and others who were involved first-hand in the negotiations.

I hope they shed a bit more light on the Notice 2002-8 posted here and serve as a guide to identify some of the more important points, as follows.

Note the second to last paragraph in Section II. We have been advised that Private Split Dollar should be covered under the guidelines outlined in this Notice due to the language in this paragraph, although Private Split Dollar is not specifically identified.

We are advised that during the commentary period between now and the issuance of final regulations, this should be clarified.

The last paragraph in Section II is especially key in that it seems to offer “grandfathering” to split dollar “arrangements” that exist prior to the date of publication of final regulations. It seems there is no intent to actually grandfather any arrangements since that would protect existing plans that are improperly designed. Hence, the Treasury and Service are suggesting that the new regulations as outlined in the Notice will be “prospective” and affect plans created after the date of final regulations. The word “arrangements” is also key in that it seems to imply that the protection prospective treatment will offer applies to the split dollar plan itself and is not policy specific. This can be very important for future planning as it might allow for Section 1035 exchanges, additional policies, etc.

If, as we are advised, the above two paragraphs provide what I have outlined above, then the rest of the Notice outlines what the guidelines will be for plans issued after the date of final regulations.

Section III provides interim guidance on the valuation of the life insurance protection. Please note the important date mentioned of January 28<sup>th</sup>, 2002, in sub-section 1. This date is again mentioned in sub-section 3 and suggests that for plans in existence prior to that date, taxpayers ‘may continue to determine the value of current life insurance protection by using the insurer’s lower published premium rates.....’ This is a very important advantage that current plans would enjoy over future plans. Generally, the economic benefit costs will be 2 or 3 times the current alternative term rates.

Section IV provides interim guidance on how section 83 and section 7872 would come into play for future plans. This section also outlines four safe harbors that will be offered to taxpayers for plans originated at various dates before the date of final regulations.

It is important to note that a few of our advisors in their reading of Section IV have speculated that the language in Paragraph 4, subsection 4, seems to be inconsistent with the last paragraph in Section II which seems to offer “grandfather” protection to existing split dollar arrangements before the date of the publication of the final regulations. We here at SML will continue to monitor the ambiguity between these two important sections in the Notice.

Section V indicates a willingness to discuss the need for additional premium rate tables to valuing the life insurance protection. We are advised that there will be substantial discussion concerning the validity of Table 2001 rates as well as the need to specifically identify the appropriate valuation table for joint life policies.

Section VI is a bit confusing to understand but let me try to clarify it as it has been explained to me. This Notice revokes Notice 2001-10 which revoked Rev. Rul. 55-

747 which set up the PS 58 table rates to begin with. So, by revoking 2001-10, they would also be reversing the revocation of 55-747, which they did not want to do. Hence, they are stating that 55-747 remains revoked. Got it? Having fun yet? Phew!

The last paragraph in this section beginning on page 5 is also very important and provides the fifth safe harbor. It is also a bit confusing to understand. Our negotiating team fought hard for this language that includes “no inference” language. If you want additional clarification as to its importance or meaning, feel free to give me a call and I will be happy to go over it with you.

That is about it for now. Again, the above information is only intended to provide you with a summary of my understanding of what the Notice says or implies based on discussions with those who handled the negotiations. As further discussions are held during the commentary period and when the final regulations are published, things will become a bit clearer. For now, it appears that properly executed arrangement already in force will fall outside the scope the Notice. For arrangements created after the various dates listed in the Notice, or after the date of the final regulations, it appears that new split dollar arrangements will be taxed under one of two mutually exclusive regimes: (1) the economic benefits of split dollar life insurance arrangements will be treated as a transfer (subject to income tax/gift tax); or (2) payments by the sponsor will be treated as a series of loans to the benefited party.

Finally, during the discussions I participated in over the past 48 hours of when the notice was published, various strategies have emerged as to what strategies can be implemented by those who do not currently have implemented split dollar arrangements to increase their possibility of having a “grand fathered” structure. I would be happy to go over those with you also, so please give me a call.

We are posting additional analysis on our website as more information is becoming available.

Best regards,

A handwritten signature in black ink, appearing to read "Gary R. Sitzmann". The signature is fluid and cursive, with a large, sweeping initial letter.

Gary R. Sitzmann, CLU