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Treasury Proposes Rules to End Executives' Insurance Tax Breaks

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WASHINGTON -- The Treasury Department proposed rules that would tax executives for life-insurance policies widely used in compensation packages for top managers.

The regulations would end the tax benefit for so-called split-dollar arrangements, in which companies pay most premiums on life-insurance policies that benefit executives or their families.

The Internal Revenue Service plan sets two rules for taxation of split-dollar arrangements based on whether the company or the executive owns the policy. Premiums paid by a company would be included in gross income "to the extent that the employee's rights to the life insurance contract are substantially vested," according to the proposal released Wednesday.

If the company owns the policy, the premiums are treated as an economic benefit to the employee. That means the employer wouldn't get a deduction for part of the premium paid because it has a right to get money from the policy.

"Every benefit that you get out of a split-dollar arrangement has to be taxed under some bucket," said Laurie Lewis, chief counsel for federal tax at the American Council of Life Insurers.

The approach generally tracks a Clinton administration proposal that sought to tax the split-dollar arrangements either as loans or as income. But unlike the Clinton plan, the Bush administration proposal wouldn't affect existing arrangements or those put into effect until at least Oct. 23, when the IRS holds a hearing on the matter. Treasury officials said they didn't think it was appropriate to impose tax restrictions retroactively, when the government had allowed split-dollar packages to flourish for decades.

The insurance industry cheered the decision to grandfather those policies.

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