



WASHINGTON REPORT

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Subject: **IRS Releases Final 409A Regulations Along With IRS Notice 2007-34, Which Specifically Addresses Split-Dollar Life Insurance Arrangements**

Major References: [*Final Treasury Regulations Under Code Section 409A; IRS Notice 2007-34.*](#)

Prior AALU Washington Reports: 07-34; 06-131; 06-118; 06-114; 06-96; 06-70; 06-44; 06-16; 06-06; 06-02; 04-173

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The Internal Revenue Service today issued the long-awaited final regulations under Revenue Code section 409A along with IRS Notice 2007-34, which provides specific guidance regarding the application of that Code section to split-dollar life insurance arrangements. The combined package, which is more than 400 pages in length, will be the subject of an AALU teleseminar on Monday, April 23rd. Based on a cursory review of the final regulations, it appears that they follow the general structure of the previously issued proposed regulations (see our Bulletin Nos. 05-106; 05-102; 05-99; 05-97), but include substantial modifications and clarifications. After a more thorough review, AALU will provide a detailed analysis of the guidance in a future Washington Report.

The following is a brief overview of some of the more significant provisions in the final regulations and IRS Notice 2007-34:

1. Effective Date Rules: The final regulations are effective April 17, 2007 (the date on which they are scheduled to be published in the Federal Register) and are generally applicable for taxable years beginning on or after January 1, 2008. The final regulations do not extend the existing transition rules or period beyond December 31, 2007; therefore, all plans subject to the new rules will have to be fully compliant, in both operation and documentation, by the end of 2007.

2. Documentation Requirements: Under the new rules, all plans subject to section 409A must be in writing. The final regulations provide that a plan must specify the following items in order to satisfy the written plan requirement:

(a) the amount which the service provider has a right to be paid (or, in the case of an amount determinable under an objective, nondiscretionary formula, the terms of such formula);

(b) the schedule or triggering events that will result in a payment of the amount;

(c) the six-month delay requirement for payments to specified employees of publicly-traded companies upon separation from service (no later than the time such provision may be applicable); and

(d) the conditions under which a deferral election may be made.

The final regulations provide that the written plan does not need to specify the conditions under which an accelerated payment will be made, provided that the taxpayer must be able to demonstrate that the acceleration of a payment complies with the requirements of section 409A and the final regulations. The final regulations also confirm that the terms of a plan document may be contained in more than one document.

The documentation requirements must be satisfied no later than December 31, 2007. However, the preamble to the final regulations states that any amendments are required only to bring the document into compliance effective January 1, 2008.

3. Split-Dollar Life Insurance Arrangements: As expected, the IRS released IRS Notice 2007-34 along with the final regulations to specifically address the application of section 409A to split-dollar life insurance arrangements. In addition, as expected, the IRS has taken the position that certain types of split-dollar life insurance arrangements provide for deferred compensation and are subject to the requirements of section 409A. Specifically, the IRS indicated in Notice 2007-34 that:

(a) split dollar life insurance arrangements that provide only death payments to or for the benefit of the service provider may be excluded from section 409A under the exception for death benefit plans;

(b) split dollar life insurance arrangements that are treated as loan arrangements under Regulations section 1.7872-15 (i.e., generally collateral assignment method split dollar) generally will not give rise to deferrals of compensation, provided that there is no agreement under which the service recipient will forgive the related indebtedness and no obligation on the part of the service recipient to continue to make premium payments without charging the service provider a market interest rate on the funds advanced; and

(c) split dollar life insurance arrangements structured under the endorsement method, where the service recipient is the owner of the policy but where the service provider obtains a legally binding right to compensation includible in income in a taxable year after the year in which a substantial risk of forfeiture (if any) lapses, generally provides for the deferral of compensation.

Notice 2007-34 also addressed the extent to which grandfathered split-dollar arrangements (i.e., those entered into before September 18, 2003) could be modified to comply with 409A and not lose their grandfathered status under the split-dollar rules (i.e., IRS Regulations section 1.61-22(j)). Specifically, the notice provides that a modification of a split-dollar life insurance arrangement necessary to bring such arrangement into compliance with section 409A, or to avoid application of the section, will not be treated as a material modification for purposes of the split-dollar grandfather rules if each of the following requirements is met:

(i) there is a reasonable determination that section 409A is applicable to the arrangement, and that the arrangement does not comply with the requirements of section 409A;

(ii) there is a reasonable determination that the modification causes the arrangement to comply with section 409A or results in section 409A no longer being applicable to the arrangement, or that the modification is a necessary part of a number of actions that together cause the arrangement to come into compliance with section 409A or result in section 409A no longer being applicable to the arrangement;

(iii) the modification to the arrangement consists solely of changes to the applicable definitions or changes to the payment timing requirements, including election provisions related to the time and form of payment, or changes to the conditions under which all or part of the benefit under the arrangement will be forfeited, reasonably intended to conform the arrangement to the requirements of, or to qualify for an exclusion from, section 409A;

(iv) the modification establishes a time and form of payment, or establishes potential times and forms of payment that are consistent with times and forms of payment under which the benefits could have been paid under the terms of the arrangement before the modification; and

(v) the modification does not materially enhance the value of the benefits to the service provider under the arrangement.

(4) Commissions and Timing of Deferral Elections:

The final regulations include modifications to the proposed regulation provisions addressing the timing of deferral elections with respect to commissions. The proposed regulations generally treated the services related to a commission payment as performed in the year in which the customer remits payment to the service recipient. This rule was retained and the IRS also included a new rule under which the taxable year in which the transaction is consummated can be substituted for the year in which the customer remits payment. The regulations also include a new rule for investment commissions. Under this new rule, the services with respect to investment commission compensation are deemed to be performed over the 12 months immediately preceding the date as of which the overall value of the assets or asset accounts is determined for purposes of the calculation of the investment commission compensation.

(5) Actuarially Equivalent Annuities:

The final regulations clarify the circumstances under which two actuarially equivalent life annuities may be treated as one form of payment and thereby allow elections among such annuity forms at any time before the initial annuity payment without regard to the rules on subsequent deferral elections.

(6) Plan Aggregation Rules - New Category for Split-Dollar Arrangements:

The proposed regulations generally provided that all amounts deferred with respect to a service provider under all plans of a service recipient falling within a particular category would be treated as deferred under a single plan (i.e., account balance plans, nonaccount balance plans, separation pay plans, and all other plans). These plan aggregation rules are important if one or more plans within a category of plans does not satisfy the 409A requirements. If so, all of the other plans in the same category are deemed not to satisfy the 409A requirements as well. The final regulations provide additional categories of plans for purposes of the aggregation rules, including new categories for split-dollar life insurance arrangements, reimbursement plans, stock right plans subject to 409A and foreign plans. The final regulations also subdivide account balance plans between elective and nonelective plans.

(7) Future Guidance:

As expected, the final regulations do not address the calculation and timing of amounts required to be included in income under section 409A or provide any further guidance regarding the reporting and withholding requirements imposed by the section. The preamble to the final regulations indicates that the IRS and Treasury intend to issue further guidance with respect to these issues, including additional transition guidance "as may be appropriate" with respect to the reporting and withholding requirements.

A more extensive analysis of the final regulations and Notice 2007-34 will be provided in one or more Washington Reports to be issued in the near future.

Any AALU member who wishes to obtain a copy of the final 409A regulations or IRS Notice 2007-34 may do so through the following means: (1) use hyperlink above next to "Major References," (2) log onto the AALU website at www.aalu.org and enter the *Member Portal* with your social security number and select *Current Washington Report* for linkage to source material or (3) email Angela Street at street@aalu.org and include a reference to this *Washington Report*.

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