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Why Do Limitations Apply to Owners of Life Insurance Contracts, Particularly COLI?

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It is well known that permanent, cash value life insurance contracts can provide significant income tax benefits for their owners and beneficiaries. For example, the "inside buildup" generally grows tax-deferred, meaning interest or earnings credited to the contract's cash value generally are not taxed unless an amount is received during the insured's lifetime. If lifetime distributions occur, they are governed by the income ordering rules in Section 72,[1] which often prescribe basis-first treatment for the amounts received.[2] In addition, death benefits paid to the beneficiary generally are excludable from gross income pursuant to Section 101(a). Thus, if the owner does not receive any distributions during the insured's lifetime, the interest or earnings credited to the cash value are never subjected to federal income tax.

Over the years, Congress has taken action to limit the tax benefits of life insurance, either generally or in particular contexts. In terms of general limitations, actuaries are well aware of the congressional enactments throughout the 1980s that added Sections 7702 and 7702A to the Code.[3] Those rules apply to life insurance contracts generally, rather than to particular uses or purchasers, and are meant to limit the foregoing tax benefits to contracts that strike a prescribed balance between pure insurance protection and investment orientation.[4]

Congress also has targeted limits on particular types of life insurance arrangements—principally those involving business uses of the product. These limits are less actuarial in nature than the definitional rules of Sections 7702 and 7702A. As a result, the members of the Society of Actuaries (SOA) may have had fewer occasions to become familiar with these additional rules or why they exist. This article attempts to remedy this by providing a brief survey of the history and application of some of these provisions.

In particular, the article surveys the limitations under Section 264(a) on business deductions for premiums and interest expense related to life insurance, the similar limitations under Section 264(f) for unrelated interest expense of businesses that own life insurance, the limitations under Section 101(j) on the excludability of death benefits under employer-owned life insurance contracts and the recently enacted rules for life settlement transactions. Finally, the article touches on the importance of knowing the effective dates of these various congressional enactments and the risk of triggering those effective dates by making "material" changes to existing contracts.

SECTION 264(a): BUSINESS DEDUCTIONS FOR PREMIUMS AND INTEREST EXPENSE

Since the dawn of the federal income tax, life insurance death benefits have been excludable from gross income for individual and corporate beneficiaries alike. In February 1913, the states ratified the 16th Amendment to the Constitution, which explicitly empowered Congress to impose income taxes without apportionment among the states. About eight months later, Congress enacted the first federal income tax statute, known as the Revenue Act of 1913, which imposed an income tax on individuals and corporations.[5] The Act's provisions on individuals expressly referenced, for the first time, the tax-free treatment of life insurance death benefits.[6] The Act's provisions on corporations cross-referenced the provisions defining income for individuals, thereby indirectly providing that death benefits were excludable for corporate beneficiaries too.[7]

About a year later, however, the Treasury Department announced that it would interpret the law as *not* extending this exclusion to corporations.[8] Treasury's rationale was that corporations could deduct the premiums paid for the life insurance from their gross incomes as business expenses.[9] In other words, if the death benefits were excludable and the premiums deductible, corporations could fund a tax-exempt asset with tax-deductible money. A few years later Treasury again weighed in on the premium deductibility issue, announcing that corporations could no longer deduct life insurance premiums as business expenses but could recover any non-deducted premiums tax-free from the death proceeds, with the remaining proceeds still being taxable pursuant to Treasury's earlier interpretation.[10] The Supreme Court and Congress overturned Treasury's interpretation of the death benefit exclusion a few years later, restoring it for corporate beneficiaries.[11] However, the concept that premiums should be nondeductible endured and was codified into the tax law, ultimately becoming Section 264(a)(1) of today's Code.

Concern over tax deductions associated with tax-exempt or tax-deferred types of income lies at the heart of the limitations imposed under Section 264, as well as other provisions of the Code dealing with similar situations.[12] With respect to life insurance, when Congress would act to preclude a tax benefit for one type of cost, another would surface and Congress would act again, adding further provisions to Section 264 to address them. As some commentators quipped, “the same basic arbitrage transaction of incurring deductible interest expense to buy nontaxable interest income or other earnings persists to this day, rising from the dead time and again like a phoenix from the ashes, albeit more and more tightly constrained by Congress.”[13] The constraints Congress enacted in Section 264(a) can be summarized as follows.

Section 264(a)(1)

As noted earlier, this provision focuses on premiums paid for life insurance contracts. Specifically, it denies a deduction for “[p]remiums on any life insurance policy, or endowment or annuity contract, if the taxpayer is directly or indirectly a beneficiary under the policy or contract.” Originally, the provision was limited to policies covering officers, employees and persons with financial interests in the taxpayer’s trade or business. In 1997, however, a large lender reportedly planned to acquire policies insuring the lives of its debtors.[14] Given the scope of Section 264(a)(1) at the time, the premiums would have been deductible. Congress reacted by expanding the provision’s scope to deny the deduction regardless of whose life the policy insures.[15] Congress also added Section 264(f) to the Code as part of the same legislation, which is discussed later. Today, the primary interpretive questions involving Section 264(a)(1) relate to when a taxpayer will be “indirectly” a beneficiary under a policy, which (unsurprisingly) courts and the Service have interpreted quite broadly.[16]

Section 264(a)(2)

This provision focuses on interest expense relating to single premium policies. Specifically, it denies a deduction for “[a]ny amount paid or accrued on indebtedness incurred or continued to purchase or carry a single premium life insurance, endowment, or annuity contract.” Whether indebtedness is incurred or continued to purchase or carry a policy is a question of fact. A contract is treated as a single premium contract if (1) substantially all of the premiums are paid within four years of purchase, or (2) an amount is deposited with the insurer for payment of a substantial number of future premiums.[17] This definition presents interpretative questions about what “substantially all” and “substantial number” mean, particularly in the context of flexible premium universal life insurance policies, which did not exist when these rules were enacted.

In that regard, Congress enacted the predecessor of Section 264(a)(2) in 1942 in reaction to transactions occurring at the time in which taxpayers would borrow money to purchase single premium policies and deduct the associated interest expense while also enjoying the tax benefits normally afforded to life insurance.[18] In other words, taxpayers were achieving tax benefits similar to those Congress had previously denied for direct premium payments. If the premiums themselves were nondeductible, taxpayers could achieve a similar tax benefit by borrowing to pay the premiums and deducting the interest. The transactions at the time involved single premium policies, so that is what Congress addressed. However, taxpayers soon moved on to other forms of transactions involving the use of deductible interest to buy life insurance, so the story continued.

Section 264(a)(3)

This provision focuses on interest expense relating to policies, other than single premium policies, involving systematic borrowing to purchase or carry the policies. Specifically, it denies a deduction for interest paid or accrued “to purchase or carry a life insurance … contract (other than a single premium contract …) pursuant to a plan of purchase which contemplates the systematic direct or indirect borrowing of part or all of the increases in the cash value of such contract (either from the insurer or otherwise).” Exceptions to the disallowance rule apply for (1) transactions that do not involve borrowing to

pay premiums for at least four of the first seven annual premiums (the so-called "4 out of 7 test"), (2) certain de minimis borrowing, (3) borrowing due to certain unforeseen circumstances and (4) borrowing in connection with the taxpayer's trade or business (as opposed to borrowing to purchase or carry the policies). Congress enacted these provisions in 1964 in response to so-called minimum deposit plans.[19] The plans were structured to avoid the limitations on single premium policies under Section 264(a)(2) by requiring a series of scheduled premiums funded by borrowing against the policy, either directly or indirectly via collateral assignments. The taxpayer then would deduct the interest expense and thereby achieve the desired tax benefit, at least until Congress acted in 1964.

> Since the dawn of the federal income tax, life insurance death benefits have been excludable from gross income for individual and corporate beneficiaries alike.

Section 264(a)(4)

This provision broadly denies deductions for interest expense "with respect to" life insurance policies, and it was the first to focus on so-called broad-based corporate-owned life insurance (COLI). Specifically, it denies a deduction for interest paid or accrued "with respect to 1 or more life insurance policies owned by the taxpayer covering the life of any individual. …" The reference to interest "with respect to" a policy appears to be directed at policy loans, but this is not made explicit in the statute.

As originally enacted in 1986, the provision applied only to coverage on employees and officers, or individuals with a financial interest in the trade or business.[20] In addition, the disallowance rule applied only to the extent that the aggregate indebtedness with respect to policies covering any such person exceeded $50,000.[21] The 1986 legislative history indicates that Congress enacted these provisions out of concern that when a business owner "borrows against a life insurance policy, the loan reduces the death benefit," with the result that "much of the death benefit promised to an employee is illusory" and the employee ends up "depending upon the credit of his employer to the extent of the indebtedness."[22] Thus, the original enactment was intended to "encourage businesses to provide effective death benefits to employees."[23]

The purpose of the provision evolved, however, with amendments that Congress made in response to the marketplace reaction to the 1986 law. Specifically, the marketplace created broad-based COLI plans in which corporations would purchase life insurance "covering hundreds, thousands, or even hundreds of thousands of employees … in order to maximize the tax arbitrage of deducting [policy loan] interest that is credited, tax-free, to the organization's own insurance contract."[24] The legislative history characterized this practice as "the economic equivalent of a tax-free savings account owned by the company into which it pays itself tax-deductible interest," which Congress viewed as inconsistent with "general principles of accurate income measurement under which … expenses, such as interest, are not deducted from income if they are costs of accretions to wealth that are not included in income."[25]

Congress responded in 1996 by amending Section 264(a)(4) to eliminate interest deductions connected with leveraged COLI plans in most instances, but it continued to "grandfather" from its application contracts purchased on or before June 20, 1986, subject to one change regarding deductible interest rates (described later in this article).[26] The 1996 legislation disallowed all deductions for interest paid on indebtedness related to life insurance contracts purchased after June 20, 1986, while retaining an exception for such contracts if they insured the lives of "key persons." The key person exception, contained in Section 264(e)(1) (formerly Section 264(d)(1)), allowed interest deductions for such contracts only to the extent that the related indebtedness did not exceed $50,000 per key person insured. The 1996 legislation defined a "key person" as an officer or 20-percent owner of the corporate policyholder. This legislation effectively eliminated much of the appeal of leveraged COLI plans. As to the pre–June 20, 1986, contracts otherwise grandfathered from the Section 264(a)(4) change, the 1996 legislation added Section 264(e)(2) (formerly Section 264(d)(2)) to impose a limit on the interest rate that could be used in determining the deductible amount of interest on the borrowing for any month beginning after Dec. 31, 1995. In 1997, Congress further amended Section 264(a)(4) to provide that no deduction is allowed for policy loan interest under a policy covering any individual, whether an employee, officer or financially interested person.[27] The 1996 exception for "key person" coverage survived this legislation and continues to be available.

SECTION 264(f): *PRO RATA* ALLOCATION OF INTEREST TO POLICY CASH VALUES

After the 1986 enactment of Section 264(a)(4) and the subsequent amendments thereto, one might have assumed that Section 264(a) was sufficient to address any tax policy concerns about companies receiving tax deductions for costs to generate tax-preferred income under life insurance contracts. Premiums were wholly nondeductible under Section 264(a). Interest was nondeductible if paid or incurred to purchase or carry single premium life insurance contracts, and it was generally

nondeductible if pursuant to a plan of purchase of life insurance policies that contemplated systematic borrowing, or if incurred "with respect to" life insurance policies. This is not, however, the end of the story.

As noted earlier, in 1996 and 1997 Congress became concerned about a program under which a large, leveraged holder of debt, particularly mortgages, would acquire policies insuring the lives of the debtors. Inside buildup on the policies would not be subject to federal income tax when it was earned. If held to maturity, death benefits on the policies would be wholly excludable from gross income. Even though no borrowing was directly associated with the policies themselves, the financial institution was highly leveraged. In an indirect sense, one might characterize the arrangement as having potential to fund tax-preferred income with tax-deductible interest. For this reason, Congress concluded that additional limitations were needed to prevent "tax arbitrage" in such situations.[28]

The Taxpayer Relief Act of 1997 added Section 264(f) to the Code to address this situation.[29] Under Section 264(f), no deduction is allowed for that portion of a taxpayer's interest expense that is "allocable to unborrowed policy cash values." For this purpose, the allocable portion of a taxpayer's interest expense is determined by applying to the company's interest expense a ratio equal to the average unborrowed cash values of life insurance and annuity contracts, divided by that same amount plus the average adjusted basis of all the company's other assets. The provision includes exceptions for policies that cover the lives of 20-percent owners, officers, directors or employees, a list that is similar to (but in some respects broader than) the list of individuals excepted from the interest expense disallowance rule of Section 264(a)(4). It also carves out policies that already are subject to current income inclusion and policies that are held by a natural person. Finally, the provision applies only to policies issued after June 8, 1997, the date of enactment.

Because Section 264(f) operates as a partial disallowance of interest expense, its impact generally is limited to taxpayers with significant debt. Section 264(f)(8)(B) specifies that the provision does not apply to an insurance company. At the same time Congress added Section 264(f), however, it amended preexisting rules under Sections 807(a) and (b) and Section 832(b)(5) to reduce insurers' tax-deductible reserves by an amount based on policy cash values on policies "to which Section 264(f) applies." As a practical matter, insurance companies thus are subject to a similar disallowance. The relationship between these insurance-specific provisions on the one hand and Section 264(f) on the other was the subject of guidance that the Service issued in 2007.

That year, the Service issued PLR 200738016, concluding that the Section 264(f) exception for 20-percent owners, officers, directors or employees did not apply to life insurance contracts owned by an insurance company (I-COLI contracts), because those exceptions appear only in Section 264(f), which by its terms does not apply to insurance companies. This conclusion could present an obvious problem for insurers, which often insure the lives of their employees for nontax business reasons. The conclusion in the PLR was sufficiently controversial that, concurrent with the public release of the PLR several months after it was first issued, the Service also issued Rev. Proc. 2007-61,[30] addressing the issue differently, and a modification of the PLR (numbered consecutively as PLR 200738017) based on the new revenue procedure. Rev. Proc. 2007-61 was surprising in the sense that, rather than simply apply the same exception for employees that applies under Section 264(f), it excepted only 35 percent of those employees (discussed later in this article). As a practical matter, this was sufficient to provide relief in most cases, though the decision not to simply follow Section 264(f) in the first place created confusion.[31]

The 1997 *pro rata* interest disallowance of Section 264(f) and the subsequent developments on I-COLI represent the most recent activity on deduction limitations on COLI, but they are not the end of the story.

SECTION 101(j): COLI BEST PRACTICES

In the mid-1990s, the Service undertook a campaign to challenge interest deductions by corporations with large blocks of COLI insuring the lives of their employees. Much of that business either predated the limitations of Section 264(a)(4) or complied with Section 264 as in effect when the programs were established. The Service challenged the arrangements based on long-established standards for determining whether an arrangement lacks "economic substance" or otherwise should be treated as a "sham transaction" for federal income tax purposes. The Service expressed concern that on a current basis, the companies claimed a deduction for interest on policy loans, yet included nothing in income as amounts were credited to policy cash values. In the Service's view, the net income tax benefits associated with the arrangements dwarfed any economic returns that the arrangements otherwise would produce.

The Service's efforts resulted in high-profile litigation. In *Winn-Dixie Stores, Inc. v. Commissioner*,[32] *Internal Revenue Service v. CM Holdings, Inc.*,[33] and *American Electric Power, Inc. v. U.S.*,[34] the Service argued that the broad-based COLI arrangements at issue were shams or lacked economic substance. The 11th, third and sixth circuits, respectively, ruled for the Service. In contrast, in *Dow Chemical Company v. U.S.*,[35] the district court reached a different conclusion based on its factual determination that the policies at issue were not "empty

transactions entered into for the sole purpose of generating a deduction." A full discussion of the COLI litigation is beyond the scope of this article; note, however, that tax determinations of sham and economic substance are highly factual and depend on the circumstances in each case.

The COLI cases drew attention to the practice of many large employers to maintain blocks of life insurance on large numbers of employees. Although the business purpose of the strategy was well known among companies and practitioners, in the popular press the practice sometimes was referred to as "janitor insurance"[36] and "dead peasant insurance."[37] In turn, this led to a broader public policy debate about appropriate limitations, or best practices, around COLI. The deduction limitations of Section 264, although effective in preventing tax deductions with regard to tax-preferred income generated by COLI, did not address corporate behavior that one might characterize as "best practices" when insurance was purchased on the lives of employees.

Against this backdrop, Congress enacted Section 101(j) in the Pension Protection Act of 2006.[38] Broadly, that provision imposes a limit on the number and types of employees whose lives may be insured, a requirement that employees be notified that their lives are being insured and a requirement to obtain affirmative employee consent of the coverage. An employer that purchases life insurance on employees without complying with Section 101(j) risks paying tax on death benefits that exceed the premiums and other amounts paid for the contract.

In that regard, pursuant to Section 101(j), the exclusion for death benefits under an employer-owned life insurance contract applies only if the insured was an employee within 12 months of death, was a director or was a highly compensated employee or individual (basically, top 35 percent) as defined when the contract was issued, or if the proceeds are used to pay family members of the insured or to purchase an interest in the employer from the family of the insured. Most important, these exceptions apply only if tax-prescribed notice and consent requirements are met. That is, an employee

- must be notified in writing that the employer intends to insure the employee;
- must be notified of the maximum face amount of the insurance;
- must provide written consent to the insurance; and
- must be notified that the employer will be a beneficiary of any proceeds payable upon death.

A failure to meet these notice and consent requirements can be difficult to cure and may result in a significant portion of the death benefits becoming taxable to the employer. In Notice 2009-48,[39] the Service provided guidance in Q&A format addressing how these requirements may be met and, in limited cases, how a failure may be cured.[40]

LIFE SETTLEMENTS AND TRANSFERS FOR VALUE

As noted earlier, the general income tax exclusion of life insurance death benefits from gross income dates back to the Revenue Act of 1913,[41] which for the first time imposed an income tax on individuals pursuant to the 16th Amendment. A longstanding rule, however, taxes a portion of such death benefits if there was a transfer of the underlying policy for a valuable consideration.

Section 101(a)(2) provides that if there has been a transfer of a life insurance contract for a valuable consideration (a "transfer for value"), the amount excluded from gross income does not exceed the actual value of the consideration paid for the policy plus premiums and other amounts (including interest) that are subsequently paid. Thus, if there has been a transfer for value, the amount of death benefits representing gain, or income, is included in gross income. Importantly, exceptions to the transfer-for-value rule apply in a transferred-basis transaction (basically, a transaction such as a corporate transaction that itself is tax-free), or a transfer to the insured, a partner of the insured, a partnership in which the insured is a partner or a corporation in which the insured is a shareholder or officer. As a practical matter, the exceptions to the transfer-for-value rule accommodated many run-of-the-mill business transactions in which life insurance policies were not a central part of the transaction.

The growth of a secondary market in life insurance policies—life settlements—was viewed as posing unique social and tax policy issues. In 2009, the Service published two revenue rulings addressing tax issues that arise for an individual who sells a life insurance policy to an investor,[42] and for an investor who purchases a life insurance policy and either resells it or holds it until a death benefit is received.[43]

In response to concerns that transactions may be structured to avoid a "transfer" in the first place, in 2017 Congress amended Section 101(a) to make those exceptions inapplicable if there has been a "reportable policy sale." A "reportable policy sale" is defined as the acquisition of an interest in a life insurance contract "directly or indirectly" if the acquirer has no substantial family, business or financial relationship with the insured apart from the acquisition of the contract. The provision goes on to explain that an "indirect" transfer of a policy includes the acquisition of an entity that owns the policy.

On March 22, 2019, the Service filed proposed regulations with the Federal Register to interpret this provision. The proposed regulations define what is a substantial family, business or financial relationship with the insured apart from the acquisition of the contract. The proposed regulations also explain the circumstances under which the transfer of an ownership interest in an entity that, in turn, owns life insurance contracts may be treated as an indirect transfer of those contracts and thus a reportable policy sale. The issue is particularly important in the context of acquisitions of a business.

IMPORTANCE OF EFFECTIVE DATES AND GRANDFATHERED CONTRACTS

Each of the Internal Revenue Code changes discussed in this article came with its own effective date:

- Section 264(a)(3) is effective for contracts purchased after Aug. 6, 1963.
- Section 264(a)(4) is effective for contracts purchased after June 20, 1986, in tax years ending after that date.
- Section 264(f) applies to contracts issued after June 8, 1997, in tax years ending after that date.
- Section 101(j) applies to life insurance contracts issued after Aug. 17, 2006, except for a contract issued after that date in a Section 1035 exchange for a contract issued before that date.
- Section 101(a)(3) applies to "transfers" after Dec. 31, 2017.

Evaluating the treatment of any interest paid, or any death benefits received under contracts that are part of a block of COLI contracts, thus requires an analysis of when the contracts were "issued," "purchased" or "transferred." For example, for an existing block of COLI business, which contracts were issued before and after the relevant dates? For those contracts issued after the relevant dates, did the contracts comply with the provisions and, if not, were interest deductions and death benefits received accounted for properly? Were there tax-free exchanges of the policies and, if so, did the exchanges result in treatment as reissued?

These issues are important to the management of an existing block of COLI business and to the acquisition of a target with a block of existing COLI. An entire supplement to the May 2012 issue of *Taxing Times* is dedicated to a discussion of circumstances under which changes to an existing contract cause the contract to be treated as newly issued or purchased for purposes of Sections 101(f), 7702 and 7702A.[44] Much of that discussion also is relevant to the provisions imposing limitations on COLI.

CONCLUSION

As pointed out earlier, the limitations that apply to COLI are less actuarial in nature than the definitional requirements of Sections 7702 and 7702A and may not be immediately transparent to a product actuary. At the same time, the limitations are important to business purchasers of life insurance because they are part of the environment in which contracts are sold. Though seemingly complex, arbitrary and overlapping, the limitations should be evaluated based on their purpose. Broadly, that purpose is to limit the ability of a company to deduct costs associated with an investment that produces tax-preferred income. Limitations on deductions for premiums, limitations on deductions for interest and even limitations on the population of individuals whose lives may be insured may best be understood as contributing to a regime that is intended to tax life insurance contracts appropriately and to avoid conferring any tax advantage beyond what Congress has considered appropriate. ■

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ENDNOTES

1 References to "Section" are to sections of the Internal Revenue Code of 1986 (the Code), as amended.

2 The basis-first rule applies only to life insurance contracts that are not modified endowment contracts (MECs) as defined in Section 7702A. MECs are subject to an income-first ordering rule for lifetime withdrawals, and policy loans taken under MECs, as well as collateral assignments of MECs, are treated as withdrawals for this purpose. A 10 percent additional tax also applies generally to MEC withdrawals. See Sections 72(e)(2)(B), (e)(5)(C), (e)(10), and (v).

3 *See* Pub. L. No. 98-369 § 221(a) (1984) (adding Section 7702 to the Code) and Pub. L. No. 100-647 § 5012(c)(1) (1988) (adding Section 7702A to the Code).

4 John T. Adney, Why Section 7702 (and 7702A, too)? Some Historical Perspectives, Taxing Times, Vol. 14, Issue 1, at 10 (Feb. 2018).

5 Act of October 3, 1913, ch. 16, 38 Stat. 166.

6 *Id.* at 167.

7 *Id.* at 172.

8 T.D. 2090, 16 Treas. Dec. Int. Rev. 269, 281 (1914).

9 *Id.*

10 T.D. 2519, 19 Treas. Dec. Int. Rev. 150 (1917).

11 *See* Section 265 (disallowing certain expenses and interest relating to tax-exempt income); Supplee-Biddle Hardware Co. v. United States, 265 U.S. 189 (1924), *aff'g* 58 Ct. Cl. 343 (1923); and Revenue Act of 1921, ch. 136, 42 Stat. 227, 238.

12 For example, the Code includes various "proration" rules that apply to banks and insurance companies, which deny deductions for the portion of these corporations' otherwise-allowable deductions that the rules deem allocable to tax-exempt or tax-deferred assets. *See* Section 265(b) (banks), Section 812 (life insurance companies), and Section 832(b)(5)(B) (property and casualty insurance companies). More generally, Section 265(a) denies certain otherwise-allowable deductions relating to the production of tax-exempt income, including "[i]nterest on indebtedness incurred or continued to purchase or carry obligations the interest on which is wholly exempt" from tax. Section 265(a)(2).

13 Kirk Van Brunt and Mark E. Griffin, Income Taxation of Life Insurance and Annuity Contracts, 529 Tax Management Portfolios, at 83 (2019).

14 *See* Staff of the J. Comm. on Tax'n, 105th Cong., General Explanation of Tax Legislation Enacted in 1997, at 271–272 (J. Comm. Print 1997).

15 Pub. L. No. 105-34 § 1084(a) (1997). At the same time, Congress added two exceptions to Section 264(a)(1), one for annuity contracts described in Section 72(s)(5) (regarding qualified plans and IRAs) and one for annuity contracts to which Section 72(u) applies (denying tax deferral for certain nonqualified annuities held by nonnatural persons). *Id.* at § 1084(b).

16 *See, e.g.,* Treas. Reg. Section 1.264-1(b) (partner takes out a policy on his life and irrevocably names his partner as the sole beneficiary to induce his partner to remain as such); Carbine v. Comm'r, 777 F.2d 662 (11th Cir. 1985), *aff'g* 83 TC 356 (1984) (policy used as collateral for bank loan to company in which insured was a shareholder); Brock v. Comm'r, T.C. Memo 1982-332 (premiums for policy on corporate officer where the officer's wife was the named beneficiary but she had a side agreement with the corporation that allowed it to use the proceeds to prevent insolvency if needed); and Omaha Elevator v. Comm'r, 6 B.T.A. 817 (1927) (policy purchased for employee's benefit but could revert to the employer).

17 Section 264(c).

18 Pub. L. No. 77-753 § 129 (1942).

19 Pub. L. No. 88-272 § 215 (1964). *See also* S. Rep. No. 88-830, reprinted in 1964-1 C.B. (pt. 2) 505, at 582 (1964).

20 Pub. L. No. 99-514 § 1003(a) (1986).

21 *Id.*

22 Staff of the J. Comm. on Tax'n, 99th Cong., General Explanation of the Tax Reform Act of 1986, at 578 (J. Comm. Print 1987).

23 *Id.* at 579.

24 Staff of the J. Comm. on Tax'n, 104th Cong., General Explanation of Tax Legislation Enacted in the 104th Congress, at 364 (J. Comm. Print 1996).

25 *Id.*

26 Pub. L. No. 104-191 § 501 (1996).

27 Pub. L. No. 105-34 § 1084(b)(1) (1997).

28 *See generally* S. Rep. No. 105-33, at 186–187 (1997), reprinted in 1997-4 C.B., Vol. 4, pages 1265–1266.

29 Pub. L. No. 105-34 § 1084(c) (1997).

30 2007-2 C.B. 747.

31 For a discussion of the PLRs and Rev. Proc. 2007-61, see John T. Adney, Kirk Van Brunt and Michelle A. Garcia, I-COLI: The Genesis of Revenue Procedure 2007-61 and the Future of Insurer-Owned Life Insurance, Taxing Times, Vol. 4, Issue 1, at 15 (Feb. 2008).

32 113 T.C. 254 (1999), *aff'd* 254 F.3d 133 (11th Cir. 2001), *cert. denied*, April 15, 2002.

33 254 B.R. 578 (D. Del. 2000), *aff'd* 301 F.3d 96 (3d Cir. 2002).

34 136 F.Supp.2d 762 (S.D. Ohio 2001), *aff'd* 326 F.3d 737 (6th Cir. 2003), *reh. denied,* 338 F.3d 534 (6th Cir. 2003).

35 250 F.Supp.2d 748 (E.D. Mich. 2003).

36 Lee Sheppard, "Janitor" Insurance as a Tax Shelter, Tax Notes (Sept. 25, 1995), at 1526.

37 Michael Hiltzik, Feds Say the O.C. Register's Ghoulish Purchase of Life Insurance on its Employees Cost it Millions, Los Angeles Times (Feb. 19, 2019). The article colorfully explains that the reference to "dead peasants" has its roots in Nikolai Gogol's novel *Dead Souls*, in which a con man who crisscrosses czarist Russia buys up dead serfs as collateral for a business deal.

38 Pub. L. No. 109-280 § 863(a) (2006).

39 2009-1 C.B. 1048.

40 *See also* John T. Adney, Bryan W. Keene and Joel Mann, Guidance Released on COLI Best Practice Rules, Taxing Times, Vol. 5, Issue 3, at 37 (Sept. 2009).

41 Revenue Act of 1913, October 3, 1913, ch. 16, 38 Stat. 166, at 167.

42 Rev. Rul. 2009-13, 2009-1 C.B. 1029. The first conclusion of the ruling, concerning the basis of the contract that is sold, subsequently was rendered obsolete by Section 13521 of the Tax Cuts and Jobs Act, which amended Section 1016(a) to clarify no basis adjustment is required for reasonable mortality or other charges under a life insurance or annuity contract.

43 Rev. Rul. 2009-14, 2009-1 C.B. 1031.

44 John T. Adney and Craig R. Springfield, They Go Bump in the Night: Life Insurance Policies and the Law of Material Change, Taxing Times (May 2012, Supplement).