DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF CHIEF COUNSEL

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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR ASSOCIATE AREA COUNSEL, LMSB, AREA 3

FROM: Gary E. Geisler
Assistant to the Branch Chief, Branch 4 CC:FIP:4

SUBJECT:

This Chief Counsel Advice responds to your memorandum dated August 1, 2001. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

LEGEND
Taxpayer

ISSUES

(1) Whether policy loans on secured by life insurance contracts purchased before June 21, 1986 are to be aggregated with policy loans secured by life insurance contracts purchased after that date for purposes of ascertaining whether the $50,000 loan limit contained in former § 264(a)(4) has been exceeded.

(2) If all loans secured by policies insuring the life of a specified individual are aggregated, is the $50,000 limit applied first against the interest that may be disallowed under § 264(a)(4) or first against interest that is not subject to disallowance under that provision.

CONCLUSION

The only indebtedness to be taken into account for purposes of determining whether the $50,000 limit has been exceeded is debt secured by life insurance contracts purchased after June 20, 1986, that insure the same individual.

FACTS

Prior to June 20, 1986, Taxpayer purchased corporate-owned life insurance (COLI) to fund deferred compensation plans for certain employees. After June 20, 1986, Taxpayer purchased additional life insurance contracts insuring the lives of the same employees. Taxpayer typically borrowed against the policies to fund premiums payments as due. In all instances, the loan interest rates are less than Moody's Corporate Bond Yield Average - Monthly Average Corporates and the loans were incurred before January 1, 1996. In both fact patterns below, a portion of the post-effective date interest is already disallowed by the $50,000 limit.

Fact Pattern A

For the fiscal year ended September 30, 1996, employee ABC is a full time employee of Taxpayer. ABC is not a key person within the meaning of section 264(e)(3), as in effect at that time. Taxpayer is the owner and beneficiary of three different COLI policies insuring the life of ABC. Loans have been secured by each of the policies.

The policies, dates of purchase, amounts of indebtedness and interest paid or accrued during Taxpayer's fiscal year are as follows:

Date policy purchased	Loan balance at year-end	Interest paid or accrued
August 1, 1985	$ 60,000	$ 4,800
November 1, 1987	50,000	4,000
October 1, 1993	50,000	4,000

Accordingly, without regard to the loans secured by policies purchased before the effective date of the $50,000 limit, $4,000 of interest is disallowed under § 264(a)(4).

Fact Pattern B

For the fiscal year ended September 30, 1996, employee XYZ is a full time employee of Taxpayer. XYZ is not a key person within the meaning of section 264(e)(3), as in effect at that time. Taxpayer is the owner and beneficiary of three different COLI policies insuring the life of ABC. Loans have been secured by each of the policies.

The policies, dates of purchase, amounts of indebtedness and interest paid or accrued during Taxpayer's fiscal year are as follows:

Date policy purchased	Loan balance at year-end	Interest paid or accrued
August 1, 1985	$ 40,000	$ 3,200
November 1, 1987	40,000	3,300
October 1, 1993	30,000	2,400

Accordingly, without regard to the loans secured by policies purchased before the effective date of the $50,000 limit, a portion of the $5,700 interest accrued with respect to the two $50,000 loans is disallowed under § 264(a)(4).

Summarizing, in both fact patterns, the loans on policies insuring the same individual and purchased after June 20, 1986, are in excess of $50,000. However, in Fact Pattern A, the loans secured by the policy purchased before June 21, 1986, is more than $50,000 while, in Fact Pattern B, the loan secured by the policy purchased before June 21, 1986, is less than $50,000.

LAW AND ANALYSIS

Section 264 limits the ability of the owner of a life insurance contract to deduct real interest on genuine loans secured by the cash value of the contract. For policies purchased after June 20, 1986, § 264(a)4) disallows the deduction of otherwise deductible[1] interest on loans under any COLI contract that exceeded $50,000 cumulatively.

The specific language of § 264(a)(4)'s disallowance rule (as in effect during the taxable year at issue) extends to

> any interest paid or accrued on any indebtedness with respect to 1 or more life insurance policies owned by the taxpayer covering the life of any individual who –
>
> (A) is an officer of employee of, or
>
> (B) is financially interested in,
>
> any trade or business carried on by the taxpayer to the extent that the aggregate amount of such indebtedness with respect to policies covering such individual exceeds $50,000.
>
> Paragraph (4) shall apply with respect to contracts purchased after June 20, 1986.

The transition rule in the implementing legislation states that

> The amendments made by this section shall apply to contracts purchased after June 20, 1986, in taxable years after such date.

This new limit on otherwise allowable interest deductions was added in the Senate. The Conference Report for the 1986 legislation describes the amendment as follows

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[1] For purposes of this memorandum, we assume that all other requirements for deductibility of this interest, whether under § 264 or § 163, are satisfied.

> A deduction for interest on policyholder loans is not allowed to the extent that aggregate loans to any officer, employee, or personal financially interested in any trade or business carried on by the taxpayer exceed $50,000. The provision is effective for interest on loans under policies purchased after June 20, 1986.

The Conference Report follows the Senate amendment. H. Rep. No. 99-841, Vol. II, 99th Cong., 2d. Sess. (September 18, 1986), p. II-340. Although descriptions of the 1986 provisions were included in the legislative history for the subsequent amendments to § 264 in 1996, the description of prior law offer no further assistance, however non-precedential, on the views of Congress as to § 264(a)(4).

Under both fact patterns submitted, the Revenue Agent asks whether the indebtedness secured by policies purchased before the effective date are aggregated with those purchased after June 20, 1986 either for purposes of determining whether the indebtedness with respect to one individual exceeds $50,000 or the extent to which the indebtedness exceeds $50,000. The answer to both questions is no.

The statute specifies that the indebtedness to be aggregated is only that debt that is with respect to policies purchased after June 20, 1986. This effective date disregards all debt secured by policies purchased before June 21, 1986.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

The suggested analysis seems to have little chance of success. Based on past discussions with the Revenue Agent, there may very well be other more fruitful avenues to explore as to the nondeductibility of this interest.

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney client privilege. If disclosure becomes necessary, please contact this office for our views.

Please call Ann H. Logan at (202) 622-4448 if you have any further questions.

Sincerely,
GARY E. GEISLER
Assistant to the Branch Chief, Branch 4
Acting Associate Chief Counsel
(Financial Institutions & Products)