

qualified personal services that could result if the non-accrual experience method were eliminated with regard to amounts to be received for such services.

EXPLANATION OF PROVISION

The provision provides that the non-accrual experience method will be available only for amounts to be received for the performance of qualified personal services. Amounts to be received for the performance of all other services will be subject to the general rule regarding inclusion in income. Qualified personal services are personal services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts or consulting. As under present law, the availability of the method is conditioned on the taxpayer not charging interest or a penalty for failure to timely pay the amount.

EFFECTIVE DATE

The provision is effective for taxable years ending after the date of enactment. Any change in the taxpayer's method of accounting necessitated as a result of the proposal will be treated as a voluntary change initiated by the taxpayer with the consent of the Secretary of the Treasury. Any required section 481(a) adjustment will be taken into account over a period not to exceed four years under principles consistent with those in Rev. Proc. 98-60.²⁴

L. DENIAL OF CHARITABLE CONTRIBUTION DEDUCTION FOR TRANSFERS ASSOCIATED WITH SPLIT-DOLLAR INSURANCE ARRANGEMENTS (SEC. 212 OF THE BILL AND NEW SEC. 501(C)(28) OF THE CODE)

PRESENT LAW

Under present law, in computing taxable income, a taxpayer who itemizes deductions generally is allowed to deduct charitable contributions paid during the taxable year. The amount of the deduction allowable for a taxable year with respect to any charitable contribution depends on the type of property contributed, the type of organization to which the property is contributed, and the income of the taxpayer (secs. 170(b) and 170(e)). A charitable contribution is defined to mean a contribution or gift to or for the use of a charitable organization or certain other entities (sec. 170(c)). The term "contribution or gift" is not defined by statute, but generally is interpreted to mean a voluntary transfer of money or other property without receipt of adequate consideration and with donative intent. If a taxpayer receives or expects to receive a quid pro quo in exchange for a transfer to charity, the taxpayer may be able to deduct the excess of the amount transferred over the fair market value of any benefit received in return, provided the excess payment is made with the intention of making a gift.²⁵

In general, no charitable contribution deduction is allowed for a transfer to charity of less than the taxpayer's entire interest (i.e., a partial interest) in any property (sec. 170(f)(3)). In addition, no

²⁴ 1998-51 I.R.B. 16.

²⁵ *United States v. American Bar Endowment*, 477 U.S. 105 (1986). Treas. Reg. sec. 1.170A-1(h).

deduction is allowed for any contribution of \$250 or more unless the taxpayer obtains a contemporaneous written acknowledgment from the donee organization that includes a description and good faith estimate of the value of any goods or services provided by the donee organization to the taxpayer in consideration, whole or part, for the taxpayer's contribution (sec. 170(f)(8)).

REASONS FOR CHANGE

The Committee is concerned about an abusive scheme²⁶ referred to as charitable split-dollar life insurance, and the provision is designed to stop the spread of this scheme. Under this scheme, taxpayers typically transfer money to a charity, which the charity then uses to pay premiums for cash value life insurance on the transferor or another person. The beneficiaries under the life insurance contract typically include members of the transferor's family (either directly or through a family trust or family partnership). Having passed the money through a charity, the transferor claims a charitable contribution deduction for money that is actually being used to benefit the transferor and his or her family. If the transferor or the transferor's family paid the premium directly, the payment would not be deductible. Although the charity eventually may get some of the benefit under the life insurance contract, it does not have unfettered use of the transferred funds.

The Committee is concerned that this type of transaction represents an abuse of the charitable contribution deduction. The Committee is also concerned that the charity often gets relatively little benefit from this type of scheme, and serves merely as a conduit or accommodation party, which the Committee does not view as appropriate for an organization with tax-exempt status. In substance, the charity receives a transfer of a partial interest in an insurance policy, for which no charitable contribution deduction is allowed. While there is no basis under present law for allowing a charitable contribution deduction in these circumstances, the Committee intends that the provision stop the marketing of these transactions immediately.

Therefore, the provision clarifies present law by specifically denying a charitable contribution deduction for a transfer to a charity if the charity directly or indirectly pays or paid any premium on a life insurance, annuity or endowment contract in connection with the transfer, and any direct or indirect beneficiary under the contract is the transferor, any member of the transferor's family, or any other noncharitable person chosen by the transferor. In addition, the provision clarifies present law by specifically denying the deduction for a charitable contribution if, in connection with a transfer to the charity, there is an understanding or expectation that any person with directly or indirectly pay any premium on any such contract.

The provision provides that certain persons are not treated as indirect beneficiaries, in certain cases in which a charitable organiza-

²⁶"A Popular Tax Shelter for 'Angry Affluent' Prompts Ire of Others," *Wall Street Journal*, Jan. 22, 1999, p. A1; "U.S. Treasury Officials Investigating Charitable Split-Dollar Insurance Plan," *Wall Street Journal*, Jan. 29, 1999, p. B5; "Brilliant Deduction?," *The Chronicle of Philanthropy*, Aug. 13, 1998, p. 24; "Charitable Reverse Split-Dollar: Bonanza or Booby Trap," *Journal of Gift Planning*, 2nd quarter 1998.

tion purchases an annuity contract to fund an obligation to pay a charitable gift annuity. The provision also provides that a person is not treated as an indirect beneficiary solely by reason of being a noncharitable recipient of an annuity or unitrust amount paid by a charitable remainder trust that holds a life insurance, annuity or endowment contract. The rationale for these rules is that the amount of the charitable contribution deduction is limited under present law to the value of the charitable organization's interest. Congress has previously enacted rules designed to prevent a charitable contribution deduction for the value of any personal benefit to the donor in these circumstances, and the Committee expects that the personal benefit to the donor is appropriately valued.

Further, the provision imposes an excise tax on the charity, equal to the amount of the premiums paid by the charity. Finally, the provision requires a charity to report annually to the Internal Revenue Service the amount of premiums subject to this excise tax and information about the beneficiaries under the contract.

EXPLANATION OF PROVISION

Deduction denial

The provision²⁷ restates present law to provide that no charitable contribution deduction is allowed for purposes of Federal tax, for a transfer to or for the use of an organization described in section 170(c) of the Internal Revenue Code, if in connection with the transfer (1) the organization directly or indirectly pays, or has previously paid, any premium on any "personal benefit contract" with respect to the transferor, or (2) there is an understanding or expectation that any person will directly or indirectly pay any premium on any "personal benefit contract" with respect to the transferor. It is intended that an organization be considered as indirectly paying premiums if, for example, another person pays premiums on its behalf.

A personal benefit contract with respect to the transferor is any life insurance, annuity, or endowment contract, if any direct or indirect beneficiary under the contract is the transferor, any member of the transferor's family, or any other person (other than a section 170(c) organization) designated by the transferor. For example, such a beneficiary would include a trust having a direct or indirect beneficiary who is the transferor or any member of the transferor's family, and would include an entity that is controlled by the transferor or any member of the transferor's family. It is intended that a beneficiary under the contract include any beneficiary under any side agreement relating to the contract. If a transferor contributes a life insurance contract to a section 170(c) organization and designates one or more section 170(c) organizations as the sole beneficiaries under the contract, generally, it is not intended that the deduction denial rule under the provision apply. If, however, there is an outstanding loan under the contract upon the transfer of the contract, then the transferor is considered as a beneficiary. The fact that a contract also has other direct or indirect beneficiaries (persons who are not the transferor or a family member, or des-

²⁷ The provision is similar to H.R. 630, introduced by Mr. Archer and Mr. Rangel (106th Cong., 1st Sess.).

ignated by the transferor) does not prevent it from being a personal benefit contract. The provision is not intended to affect situations in which an organization pays premiums under a legitimate fringe benefit plan for employees.

It is intended that a person be considered as an indirect beneficiary under a contract if, for example, the person receives or will receive any economic benefit as a result of amounts paid under or with respect to the contract. For this purpose, as described below, an indirect beneficiary is not intended to include a person that benefits exclusively under a bona fide charitable gift annuity (within the meaning of sec. 501(m)).

In the case of a charitable gift annuity, if the charitable organization purchases an annuity contract issued by an insurance company to fund its obligation to pay the charitable gift annuity, a person receiving payments under the charitable gift annuity is not treated as an indirect beneficiary, provided certain requirements are met. The requirements are that (1) the charitable organization possess all of the incidents of ownership (within the meaning of Treas. Reg. sec. 20.2042-1(c)) under the annuity contract purchased by the charitable organization; (2) the charitable organization be entitled to all the payments under the contract; and (3) the timing and amount of payments under the contract be substantially the same as the timing and amount of payments to each person under the organization's obligation under the charitable gift annuity (as in effect at the time of the transfer to the charitable organization).

Under the provision, an individual's family consists of the individual's grandparents, the grandparents of the individual's spouse, the lineal descendants of such grandparents, and any spouse of such a lineal descendant.

In the case of a charitable gift annuity obligation that is issued under the laws of a State that requires, in order for the charitable gift annuity to be exempt from insurance regulation by that State, that each beneficiary under the charitable gift annuity be named as a beneficiary under an annuity contract issued by an insurance company authorized to transact business in that State, then the foregoing requirements (1) and (2) are treated as if they are met, provided that certain additional requirements are met. The additional requirements are that the State law requirement was in effect on February 8, 1999, each beneficiary under the charitable gift annuity is a bona fide resident of the State at the time the charitable gift annuity was issued, the only persons entitled to payments under the annuity contract issued by the insurance company are persons entitled to payments under the charitable gift annuity when it was issued, and (as required by clause (iii) of subparagraph (D) of the provision) the timing and amount of payments under the annuity contract to each person are substantially the same as the timing and amount of payments to the person under the charitable organization's obligation under the charitable gift annuity (as in effect at the time of the transfer to the charitable organization).

In the case of a charitable remainder annuity trust or charitable remainder unitrust (as defined in section 664(d) that holds a life insurance, endowment or annuity contract issued by an insurance company, a person is not treated as an indirect beneficiary under

the contract held by the trust, solely by reason of being a recipient of an annuity or unitrust amount paid by the trust, provided that the trust possesses all of the incidents of ownership under the contract and is entitled to all the payments under such contract. No inference is intended as to the applicability of other provisions of the Code with respect to the acquisition by the trust of a life insurance, endowment or annuity contract, or the appropriateness of such an investment by a charitable remainder trust.

Nothing in the provision is intended to suggest that a life insurance, endowment, or annuity contract would be a personal benefit contract, solely because an individual who is a recipient of an annuity or unitrust amount paid by a charitable remainder annuity trust or charitable remainder unitrust uses such a payment to purchase a life insurance, endowment or annuity contract, and a beneficiary under the contract is the recipient, a member of his or her family, or another person he or she designates.

Excise tax

The provision imposes on any organization described in section 170(c) of the Code an excise tax, equal to the amount of the premiums paid by the organization on any life insurance, annuity, or endowment contract, if the premiums are paid in connection with a transfer for which a deduction is not allowable under the deduction denial rule of the provision (without regard to when the transfer to the charitable organization was made). The excise tax does not apply if all of the direct and indirect beneficiaries under the contract (including any related side agreement) are organizations described in section 170(c). Under the provision, payments are treated as made by the organization, if they are made by any other person pursuant to an understanding or expectation of payment. The excise tax is to be applied taking into account rules ordinarily applicable to excise taxes in chapter 41 or 42 of the Code (e.g., statute of limitation rules).

Reporting

The provision requires that the charitable organization annually report the amount of premiums that is paid during the year and that is subject to the excise tax imposed under the provision, and the name and taxpayer identification number of each beneficiary under the life insurance, annuity or endowment contract to which the premiums relate, as well as other information required by the Secretary of the Treasury. For this purpose, it is intended that a beneficiary include any beneficiary under any side agreement to which the section 170(c) organization is a party (or of which it is otherwise aware). Penalties applicable to returns required under Code section 6033 apply to returns under this reporting requirement. Returns required under this provision are to be furnished at such time and in such manner as the Secretary shall by forms or regulations require.

Regulations

The provision provides for the promulgation of regulations necessary or appropriate to carry out the purposes of the provisions, including regulations to prevent the avoidance of the purposes of

the provision. For example, it is intended that regulations prevent avoidance of the purposes of the provision by inappropriate or improper reliance on the limited exceptions provided for certain beneficiaries under bona fide charitable gift annuities and for certain noncharitable recipients of an annuity or unitrust amount paid by a charitable remainder trust.

EFFECTIVE DATE

The deduction denial provision applies to transfers after February 8, 1999 (as provided in H.R. 630). The excise tax provision applies to premiums paid after the date of enactment. The reporting provision applies to premiums paid after February 8, 1999 (determined as if the excise tax imposed under the provision applied to premiums paid after that date).

No inference is intended that a charitable contribution deduction is allowed under present law with respect to a charitable split-dollar insurance arrangement. The provision does not change the rules with respect to fraud or criminal or civil penalties under present law; thus, actions constituting fraud or that are subject to penalties under present law would still constitute fraud or be subject to the penalties after enactment of the provision.

M. PREVENT DUPLICATION OR ACCELERATION OF LOSS THROUGH ASSUMPTION OF CERTAIN LIABILITIES (SEC. 213 OF THE BILL AND SEC. 358 OF THE CODE)

PRESENT LAW

Generally, no gain or loss is recognized when one or more persons contribute property in exchange for stock and immediately after the exchange such person or persons control the corporation. However, the person may recognize gain to the extent it receives money or other property ("boot") as part of the exchange (sec. 351).

The assumption of liabilities by the controlled corporation generally is not treated as boot received by the transferor. One exception to this rule is when, "taking into consideration the nature of the liability and the circumstances in the light of which the arrangement for the assumption or acquisition was made, it appears that the principal purpose of the taxpayer * * * was a purpose to avoid Federal income tax on the exchange, or * * * if not such purpose, was not a bona fide business purpose" (sec. 357(b)). Another exception applies to the extent that the liabilities assumed exceed the total of the adjusted basis of the property transferred to the controlled corporation pursuant to the exchange (sec. 357(c)).

In general, the transferor's basis in the stock of the controlled corporation is the same as the basis of the property contributed to the controlled corporation, increased in the amount of any gain recognized by the transferor on the exchange, and reduced by the amount of any money or property received (sec. 358). For this purpose, the assumption of a liability is treated as money received by the transferor.

Special rules apply in connection with the assumption of a liability that would give rise to a deduction. These liabilities are not taken into account in determining whether the transferor has gain on the exchange, and the transferor's basis in the stock of the con-