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TAX ISSUES SUMMARY

February 28, 2005

HIGHLIGHTS:

I.R.C. §§ 6111 and 6112 — IRS Issues Guidance for Material Advisors and Extends Reporting Deadline to April

On February 24th, the IRS released Notice 2005-22, 2005-12 I.R.B. ____, which provides that if a person becomes a material advisor on or after October 22, 2004 (the effective date of new I.R.C. § 6111, enacted by the Jobs Act of 2004) and on or before March 31, 2005, the time for that material advisor to file a return under the new tax law is extended to April 30, 2005. The Notice also provides additional guidance for material advisors, as defined under I.R.C. §§ 6111 and 6112 and in the interim guidance of Notice 2004-80, 2004-50 I.R.B. 963. See Company Issues.

Administration Releases 2006 Budget Proposal

On February 7th, the Administration released its fiscal year 2006 budget proposal. The proposal includes extensions of the capital gain and dividend rates reductions, and several proposals to curb tax avoidance and close loopholes in the tax code, including an excise tax on amounts received under certain life insurance investment arrangements. See Legislation.

LEGISLATION

1. Administration Releases 2006 Budget Proposal

On February 7th, the Administration released its fiscal year 2006 budget proposal. The proposal seeks to make permanent several tax cuts enacted in 2001 and 2003, including the capital gain and dividend rates reductions that are expected to expire in 2008. The budget proposal also includes several provisions to curb tax avoidance and close loopholes in the tax code. Of interest to the insurance industry is a provision that proposes to apply an excise tax to amounts received under certain life insurance investment arrangements (sometimes referred to as “stranger-owned life insurance” or “SOLI”). Under the provision, a 25% excise tax would be imposed upon any person who receives death benefits, dividends, withdrawals, loans or surrenders under a life insurance contract if (i) a charity has ever had a direct or an indirect ownership interest in the contract, and (ii) a person other than a charity has ever had

a direct or an indirect interest in the same contract. The excise tax would not be deductible for federal income tax purposes nor includible in determining the policyholder's investment in the contract. The excise tax would not apply if the non-charity involved in the arrangement has an insurable interest in the insured independent of the charity or if the non-charity's only interest in the life insurance contract is as a named beneficiary, or if the transaction is exempt under regulations prescribed by Treasury.

2. Bipartisan Congressional Group Reintroduces Retirement Annuity Legislation

Bipartisan groups in both the House and Senate, on February 15th, reintroduced the Retirement Security for Life Act, which would provide favorable tax treatment for retirement annuity income. The legislation is designed to encourage all retirees to invest in life annuities (i.e., to annuitize for life) to receive "paychecks for life." Under the proposed legislation, half the income portion of the annuity payments received under a retirement annuity, up to \$20,000 annually, would not be subject to federal income taxes.

POLICYHOLDER ISSUE

I.R.C. § 170 — Supreme Court Denies Cert on Charitable Split-Dollar Cases

On February 22nd, the Supreme Court denied certiorari in Addis v. Commissioner, No. 04-843, and Weiner v. Commissioner, No. 04-838, letting stand two Ninth Circuit decisions denying deductions for charitable contributions made to a nonprofit organization with the expectation that the contributions would be used to pay premiums for charitable split-dollar life insurance contracts. The two appeals court decisions, both affirming Tax Court decisions, held that the taxpayers were not entitled to such deductions because the receipts substantiating the contributions failed to satisfy the disclosure requirements.

COMPANY ISSUES

1. I.R.C. § 809 — Differential Earnings Rates Released by IRS

In Notice 2005-18, 2005-9 I.R.B. 634, the IRS set the tentative 2004 differential earnings rate and the recomputed 2003 differential earnings rate for mutual life insurance companies at zero. Although I.R.C. § 809 has been repealed, it is still applicable for 2004.

2. I.R.C. §§ 6111 and 6112 — IRS Issues Guidance for Material Advisors and Extends Reporting Deadline to April

On February 24th, the IRS released Notice 2005-22, 2005-12 I.R.B. ____, providing additional guidance for material advisors as defined under I.R.C. §§ 6111 and 6112 and in Notice 2004-80, 2004-50 I.R.B. 963, and granting an extension of time for such material advisors to comply with the new filing requirements under I.R.C. § 6111. Notice 2005-22 provides that if a person becomes a material advisor between October 22, 2004 (the effective date of new I.R.C. § 6111, enacted by the Jobs Act of 2004)

and March 31, 2005, the time for that material advisor to file the information return newly required under I.R.C. § 6111 is extended to April 30, 2005.

Notice 2005-22 also addresses questions raised by taxpayers regarding the interim guidance issued in Notice 2004-80. For example, Notice 2005-22 clarifies that material advisors should not physically modify Form 8264, but simply complete the form as if Parts I, IV and V had been modified in accordance with Notice 2004-80. The Notice also clarifies that a material advisor will be treated as a material advisor when all of the following have occurred: (1) the material advisor makes a tax statement; (2) the material advisor receives (or expects to receive) a minimum fee; and (3) the transaction is entered into. Material advisors, including those who cease to provide services prior to the time the transaction is entered into, must make reasonable efforts to determine whether the taxpayers entered into the transaction.

In addition, Notice 2005-22 clarifies that the tolling provisions of Treas. Reg. § 1.6011-4(f) would apply to suspend the reporting requirements of a potential material advisor that requests a ruling prior to the due date of the return and fully discloses all relevant facts related to the transaction. The IRS cautioned that this action would not suspend the reporting requirements of participants under I.R.C. § 6011. Finally, Notice 2005-22 provides that Notice 2004-80 is effective for transactions with respect to which material aid, assistance or advice is provided after October 22, 2004 regardless of whether any portion of the fee was received before October 22, 2004 or whether the transaction was entered into before October 22, 2004.

3. More Taxpayers May Be Required to File Schedule M-3

In the February 8th Tax Talk Today webcast, an IRS spokesman stated that the IRS may extend the Form 1120 Schedule M-3, Net Income (Loss) Reconciliation for Corporations With Assets of \$10 Million or More, filing requirements to include taxpayers that file:

- Form 1120F (U.S. Income Tax Return of a Foreign Corporation);
- Form 1120L (U.S. Life Insurance Company Income Tax Return);
- Form 1120PC (U.S. Property and Casualty Insurance Company Income Tax Return);
- and
- Form 1120S (U.S. Income Tax Return for an S Corporation).

Such changes could be effective for tax years beginning on or after December 31, 2005.

**For comments or questions, or if you would like to receive the Tax Issues Summary via electronic mail, please contact Joseph A. Sergi at (202) 434-9172 or jsergi@scribnerhall.com
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