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December 5, 2008

The Honorable Eric Solomon
Assistant Secretary (Tax Policy)
Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, DC 20220

The Honorable Douglas Shulman
Commissioner
Internal Revenue Service
Room 3000 IR
1111 Constitution Avenue, N.W.
Washington, DC 20024

Re: Report on Investor-Owned Life Insurance

Dear Sirs:

We write to comment on the federal income tax issues that arise when a life insurance policy is purchased by an investor with no insurable interest in the insured. We refer to these policies as "investor-owned life insurance."

More specifically, we address three broad federal income tax issues raised by investor-owned life insurance. The first issue is the character of gains or losses on the sale of life insurance policies for both the original policy owner and the purchaser. The second issue is the adjusted basis of investor-owned life insurance for purposes of determining gain or loss. The third issue is the operation of Section 264(f) with respect to investor-owned life insurance. We

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recommend that the Treasury Department (the “Treasury”) and the Internal Revenue Service (the “IRS”) issue guidance that addresses these issues. More specifically:

- We recommend that the IRS and Treasury clarify that Section 1234A does not apply to amounts received under a life insurance policy from the insurance company when the policy matures upon the death of the insured, or is surrendered or cancelled. Absent an actual sale or exchange, amounts received under an investor-owned life insurance policy upon surrender or cancellation should be taxable as ordinary income.
- We recommend that the IRS and Treasury adopt a bifurcated approach as to the character of income realized on the sale of a life insurance policy in the secondary market. Under this approach, the amount of gain realized on the sale would be ordinary income to the extent of the policy’s cash surrender value and any additional amounts would be treated as capital gains.
- We recommend that the IRS and Treasury confirm that a secondary market investor in life insurance acquires a basis in the policy equal to the sum of the purchase price and the aggregate premiums paid on the policy (without reduction for amounts allocated to the “cost of insurance”).
- We recommend the IRS and Treasury confirm that the phrase “loan in respect of such policy or contract” under Section 264(f) includes indebtedness in respect of the policy for which interest expense is denied under Section 264(a). This clarification would ensure that taxpayers do not suffer double disallowances of interest expenses.

We recognize that there are non-tax policy issues that arise when investors purchase life insurance from insureds and we do not address these issues. We also limit our discussion to the current law treatment of investor-owned life insurance; we do not attempt to harmonize the tax treatment of investor-owned life insurance with the tax rules that apply to similar investments in financial instruments, and we do not address the application of the split dollar regulations to investor-owned life insurance.

We appreciate your consideration of our report. Please let us know if you would like to discuss these matters further or if we can assist you in any other way.

Respectfully,

A handwritten signature in black ink, appearing to read "D. Miller". The signature is fluid and cursive, with a large initial "D" and a stylized "Miller".

David S. Miller

cc: Honorable Donald L. Korb
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