Congress of the United States
Washington, DC 20515

November 16, 2007

The Honorable Henry M. Paulson
Secretary, United States Department of Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Dear Mr. Secretary:

We are writing to request your assistance with a serious tax issue impacting unsuspecting elderly Americans. The issue relates to a life insurance product known as Stranger-Originated, or Stranger-Owned, Life Insurance ("STOLI"). STOLI transactions take advantage of the secondary market in life insurance settlements at the expense of elderly Americans who are left with an unexpected tax liability. *Business Week* recently devoted its cover story to the legal and public policy concerns raised by products that wager on the life expectancy of elderly Americans.

From the information we have received, there are currently several variations of the product being marketed. For example, some arrangements use a life insurance trust to procure the policy. However, in each case the key to the transaction is an elderly individual, often with a high net worth. In a typical STOLI transaction, an elderly individual, on average 80 years old, is marketed a policy that claims to provide millions of dollars of "free" insurance coverage on his or her life. We understand that these policies are aggressively marketed, and, in certain cases, the individual receives an expensive dinner voucher or cruise as part of the promotion.

In a typical transaction, the individual "purchases" the policy with a non-recourse premium loan, secured only by the policy's value on the secondary market. The loan is generally financed by the promoter or a lender obtained by the promoter. The terms of the non-recourse loan vary, but in most cases the loan term is two to three years. In certain transactions the individual also receives an upfront cash payment. In almost all cases, the insured is unable to pay off the loan and interest on maturity and is therefore economically compelled to sell the policy. Before such sale, if the insured dies during the term of the policy, the death benefit is paid to their heirs after the loan and interest are repaid.

If the proceeds of the sale of the policy exceed the remaining loan premium and interest, the insured receives the excess proceeds. At this point, the policies are sold on a secondary market. The investor becomes the owner of the policy and receives the proceeds on death of the insured. It is clear from the outset that the terms and pricing of the policies all but guarantee that the insured will be economically compelled to settle the policy, and the investor will receive the proceeds on the death of the individual. As reported by *Business Week*, promoters have also begun to create a third market in "death bonds" based on the investor insurance pools.

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State legislators, regulators, and industry groups have questioned whether STOLI transactions satisfy the fundamental requirement that the owner of the policy have an insurable interest consistent with state law and public policy. From the outset, the parties to the transaction contemplate that the policy will be settled at the end of the term, with the investor receiving the death benefit. After the policy is settled, the investor's interest is enhanced on death of the individual, rather than on the insured's continued life. Thus, STOLI policies are similar to the wager policies considered against public policy and rejected by the Supreme Court in Warnock v. Davis, 104 U.S. 775 (1882).

While we acknowledge that the state law treatment of a STOLI policy is not within the jurisdiction of the Department of Treasury, the federal tax consequences to the insured on the settlement of a STOLI transaction have been the subject of increasing commentary and concern. Depending upon the structure, the transaction can be classified as a "split-dollar life insurance" arrangement as defined in Treas. Reg. §1.7872-15. The rules concerning cancellation of indebtedness income may also come into play on settlement of the policy. In certain cases, the terms for the initial arrangement may not qualify as true indebtedness, thus exposing the insured to income inclusion. Also, depending upon the value of the promotional incentive or cash payment, the insured could be taxed on the value of the promotion received. Depending upon the structure of the product promoters may also be liable for information reporting.

Our concern with STOLI policies is not intended to inhibit the ability of individuals to legitimately settle life insurance policies. Rather, we seek Treasury's assistance in notifying elderly taxpayers of the adverse tax consequences of investing in a product that is in fact "too good to be true." We recommend that Treasury issue a Notice or other form of public guidance outlining the potential tax consequences of participating in a STOLI transaction. While we recognize that STOLI products can take various forms that potentially alter the tax treatment, we believe that guidance could be crafted to address these variations.

We appreciate your attention to this important matter and look forward to working with you to resolve this issue of importance to the American taxpayer.

Sincerely,

Richard E. Neal, Chairman
Select Revenue Measures Subcommittee
House Committee on Ways and Means

Phil English, Ranking Member
Select Revenue Measures Subcommittee
House Committee on Ways and Means