

## Benefiting from a split-dollar life insurance plan?



By Marc Singer, CFP

Split-dollar life insurance plans traditionally have been used in employer-employee relationships as an executive benefit, but recent Internal Revenue Service (IRS) rulings have tarnished the shine of these plans. In contrast, private split-dollar plans, which were once believed to be risky, are now becoming increasingly common. Evaluate your split-dollar life insurance plan options to see if such an arrangement can enhance your estate plan.

### Employer-Employee Split-Dollar Plans

In typical split-dollar life insurance plans, the insurance policy is a cash value product such as whole life or universal life. An employer and employee agree to share insurance premium costs, certain policy rights and the death benefit.

The employer generally pays the largest part of the premiums, but may not receive a deduction for these payments. On the insured employee's death or at the arrangement's termination, however, either the death benefit or the cash value of the policy will reimburse the employer for its share of the premiums. In other words, the employer will get back its out-of-pocket costs.

As for the employee, the IRS requires him or her to report a portion of the policy, known as the economic benefit, as income.

### Advantages of Employer-Employee Plans

Both employees and employers benefit from split-dollar plans. The employee has

the advantage of using the employer to help fund policy premiums. The employer can use this highly valued employee benefit to attract or keep good employees.

### Recent Changes to Employee-Employer Plans

A Technical Advice Memorandum (TAM) issued by the IRS last year may diminish the appeal of certain split-dollar plans. The TAM relates to plans in which the employer is entitled to receive back only the premiums that it pays and is not entitled to the increase in values under the policy. In this situation, the TAM says that employees must report as income any cash surrender buildup in the policy exceeding the amount of insurance proceeds that will reimburse the employer. The income tax effect to the employee can be a significantly higher amount than simply taking the policy's economic benefit as income.

### Private Split-Dollar Plans

One increasingly popular alternative to the employer-employee split-dollar plan is a private split-dollar plan. In such a plan, the insured creates an irrevocable life insurance trust (ILIT) that owns a policy, and this trust splits premium costs with a member of the insured's family. (See "How Irrevocable Life Insurance Trusts Work," next page.) The insured makes annual gifts to the trust in the amount equal to the economic benefit, and the family member pays the balance of the premium.

The economic benefit is either the actual cost of the term coverage or the one-year term rate from government table PS 58, whichever is lower. Especially in the early years of the policy, the economic benefit is usually only a small percentage of the annual premium. The economic benefit is also the measure of the transfer for gift tax purposes.

When the insured dies, the family member who has been paying part of the premium costs is entitled to reimbursement for premiums paid, and the trust receives the balance of insurance proceeds. These proceeds are held in accordance with the trust's terms.

### Advantages of Private Plans

Private split-dollar plans offer several advantages. Because the insured can make relatively small gifts to the trust while achieving the same end result as a conventional life insurance policy, a private split-dollar arrangement between the insured and the ILIT effectively can remove insurance proceeds from the insured's estate at minimal or no transfer tax cost. Additionally, without the employee-employer relationship, and since the premium payments are refunded, there is no deemed gift by the family member and there is no income to the insured. Finally, several private IRS rulings suggest that the IRS may be willing to give favorable tax treatment to selected private split-dollar arrangements -- but be aware that you can't use private IRS rulings as precedent.

### Evaluate Split-Dollar Plans Today

As laws surrounding split-dollar plans develop, this insurance arrangement may become a valuable tool in your estate plan. Take some time to evaluate split-dollar plans for your situation.

### How Irrevocable Life Insurance Trusts Work

Traditionally, an insured creates an irrevocable life insurance trust and funds it with a policy on his or her own life, making yearly gifts to the trust to pay premiums. The trust is usually structured so that the gifts qualify for the annual gift tax exclusion, but gift amounts exceeding the exclusion amount are indeed taxable gifts. An irrevocable life insurance trust effectively removes insurance proceeds from the insured's estate while making the proceeds available to his or her family tax-free.

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