M Financial Group™

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M Intelligence

Enhancing understanding of sophisticated planning strategies and their applications.

Economic Benefit Regime Private Split Dollar

What is Private Split Dollar?

Private Split Dollar is an advanced life insurance strategy that combines an Irrevocable Life Insurance Trust (ILIT), a life insurance policy, and a split dollar agreement to reduce gift taxes and potentially increase an inheritance.

How Does the Strategy Work?

In an Economic Benefit Private Split Dollar arrangement, a life insurance policy is owned by an ILIT. The Grantor of the trust provides funds to pay the premiums on the policy, but reserves the right to be repaid the greater of the premiums paid or the policy cash values.

Advantages Over a Traditional ILIT

In a typical ILIT, gifts are made by the Grantor to the trust to fund life insurance premiums. These gifts may be subject to gift tax to the extent that they exceed the annual exclusions available to the Grantor. With an Economic Benefit Private Split Dollar arrangement, gift taxes may be reduced or completely eliminated, depending on the arrangement's structure.

Planning Steps

1. An ILIT is drafted with an attorney's assistance.
2. The Trustee of the ILIT purchases a life insurance policy insuring the Grantor's life.
3. The Grantor and the Trustee enter into a Split Dollar agreement in which the Grantor provides the trust with funds necessary to pay the policy premiums. The trust commits to repaying the Grantor the greater of premiums paid or policy cash values at a later date.
4. The trust collaterally assigns the policy and its cash value to the Grantor as security for the premiums advanced. The Grantor's estate will receive the greater of premiums paid or policy cash value upon death, with the trust as beneficiary of the residual death benefit.

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**The economic benefit provided can be calculated as:
[The Total Death Benefit] - [The Non-Owner's Interest] / 1,000
X [The Age Appropriate Rate Established in IRS Table 2001-10
or the insurer's qualifying alternative term rates][1]**

Economic Benefit

The IRS has determined that in the Split Dollar transaction arrangement described above, the non-owner of the policy is providing the policy's owner an economic benefit.

Non-Contributory vs. Contributory Plans

There are two typical premium payment structures.

1. The Grantor will pay the entire premium. The gift he or she is deemed to make to the trust is equal to the economic benefit value of the trust's insurance protection, or
2. The trust will pay that portion of the premium equal to the economic benefit value, and the Grantor will pay the balance of the premium.

What Happens at Death?

At death, the estate of the Grantor receives a portion of the policy death benefits equal to the greater of the total premiums paid or the cash value. The balance is paid to the trust for distribution to the trust's beneficiaries.

Lifetime Exit Strategy ("Rollout")

Private Split Dollar arrangements can also end at a designated time during the Grantor's life. In a rollout, the Grantor gives up his or her interest for full consideration. The trust then takes full control of the policy.

In order to fund the rollout, the trust must have assets other than the life insurance policy from which to buy out the Grantor's interest. If the trust lacks sufficient assets for this purpose, the Grantor may make additional gifts to the trust.

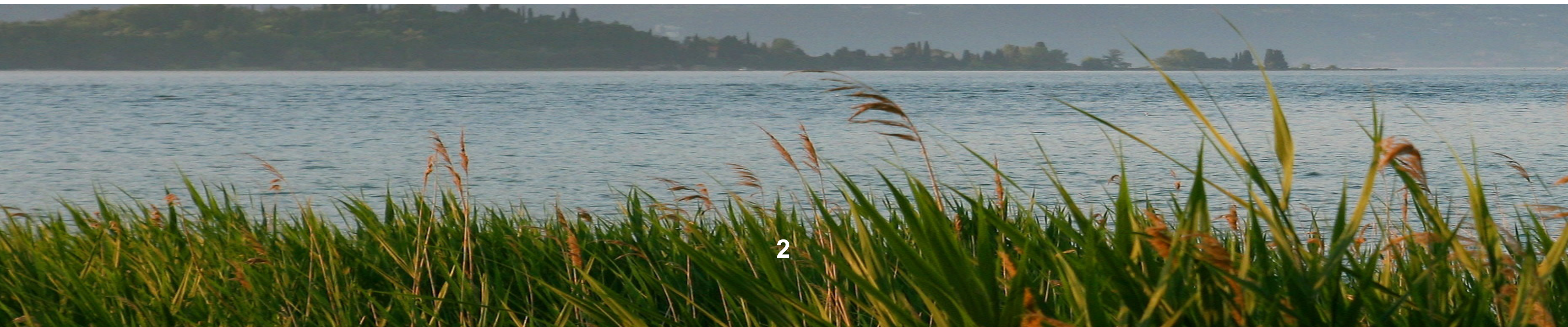
Estate Planning Benefits

- Gift taxes, if any, are limited at the economic benefit value rather than subjecting the full premiums to gift taxation.
- The Grantor retains control of his or her funds by being able to modify or discontinue future premiums in the event of changing circumstances and by the recovery of policy cash values personally or for his or her estate.
- The policyowner trust receives cash proceeds at death that are income and estate tax-free to fund the Grantor's estate planning objectives and legacies.

Considerations

- If the Grantor is repaid at death from the policy death benefit, the proceeds are includible in the Grantor's estate for estate tax purposes.
- The economic benefit rates are age based and increase annually.
- It is important for tax purposes that Split Dollar arrangements be well documented and administered.

1. IRS Notice 200-8 permits taxpayers to determine the value of current life insurance protection by using the insurer's lower published premium rates that are available to all standard risks for initial issue one-year term insurance. The IRS will consider these rate valid only if 1) the insurer generally makes those rates known to persons who apply to the insurer for term insurance coverage; 2) the insurer regularly sells term insurance at such rates through its normal distribution channels; and 3) the insurer does not more commonly sell term insurance at higher premium rates to standard risk individuals.



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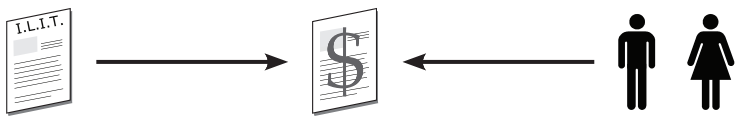
1. Grantor creates an Irrevocable Life Insurance Trust (ILIT).

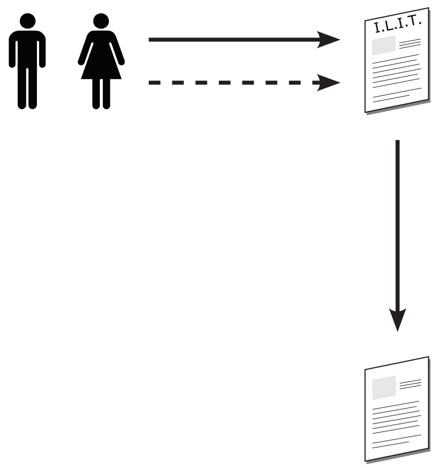
2. The Trustee of the ILIT purchases a life insurance policy on the life of the Grantor

3. The Grantor and the Trustee enter into a Split Dollar agreement that promises to repay the Grantor either the policy's cash value or the total premiums paid.



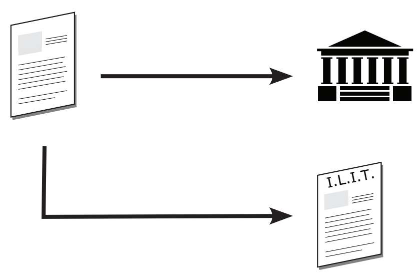
During Life

The Grantor provides funds to the ILIT, which the ILIT uses to pay its share of the premiums. If the Grantor pays the entire premium, he is deemed to be making gifts to the trust in amounts equivalent to the value of the insurance protection provided.



At Death

4. A portion of the death benefit equivalent to the greater of policy's cash value or the total premiums paid is paid the Grantor's estate. The balance of the death benefit is paid to the trust.



5. Trust assets are passed to the heirs.

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Contact Information

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