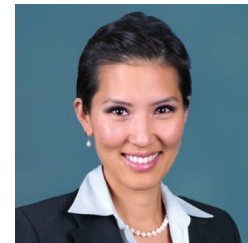




It's Not Gone, It's Just Different

Split Dollar Life Insurance Arrangements in Today's Advanced Planning Market

A number of years ago, a very successful and experienced life insurance producer and I were discussing a case he was working on. A wealthy couple was in need of a substantial amount of life insurance death benefit protection to be owned by an irrevocable trust to provide liquidity to pay estate taxes upon the death of the insured of the policy.¹ The necessary size of the death benefit meant that the premiums for this policy were going to be substantial, and even with the increased gift tax exemption, the clients did not have enough exemption available to gift sufficient amounts to the trust to pay the premiums without incurring gift taxes.² The life insurance producer was considering third-party premium financing but wanted to discuss some alternatives. I immediately brought up the idea of using a private split dollar arrangement. The life insurance producer paused a minute before he said, "Split dollar, I thought that was gone." My reply was, "It's not gone, it's just different."



Monica Rhee,
JD, LL.M.

AVP

Advanced Designs Unit

Before I discuss how split dollar arrangements are used today, I need to provide a little background. For many years, split dollar was the absolute lynchpin for advanced planning with life insurance. In fact, my former-boss would often joke that in the 1980s and 90s there were 30 different advanced concepts, and 28 of them would be some variation of split dollar.

Split dollar in essence is an arrangement that allows multiple parties (usually two) to share in the costs and benefits of a single life insurance policy. For many years, by far the most popular variation of split dollar was known as "equity split dollar." Equity split dollar arrangements were generally between a business and either the business owner or a highly compensated executive. These arrangements were structured in a manner that allowed the business to pay a vast majority of the premiums of a policy owned by the business owner or executive. The business owner or executive would be able to name the beneficiary of the life insurance policy and recognize as taxable income a cost for the death benefit provided by the arrangement known as the reportable economic benefit (REB). The key to the success of equity split dollar was that the business was provided a collateral interest in the policy equal to the

Pacific Life's Advanced Designs Unit consists of a team of highly respected professionals who specialize in advanced life insurance planning.

Bringing You Planning Ideas that Incorporate Life Insurance

¹Life insurance is subject to underwriting and approval of the application and will incur monthly policy charges.

²According to the Tax Cuts and Jobs Act of 2017, the federal estate, gift and generation-skipping transfer (GST) tax exemption amounts are all \$10,000,000 per person (indexed for inflation effective for tax years after 2011); the maximum estate, gift and GST tax rates are 40%. In 2026, the federal estate, gift and generation-skipping transfer (GST) tax exemption amounts are scheduled to revert to \$5,000,000 per person (indexed for inflation for tax years after 2011)."

premiums paid. If the cash value of the life insurance policy grew beyond the premiums paid, that “equity/cash value accumulation” belonged to the policyowner and the tax rules and regulations at the time allowed that equity to pass to the policyowner tax-free.

Most of these rules and regulations that allowed for the tax-free transfer of equity were put in place in the 1960s when the only cash value policies available were participating whole life. Those policies generally were not designed to have significant cash value growth, so for many years equity split dollar did not pose a significant issue for the U.S. Internal Revenue Service (IRS). The advent of more complex life insurance products in the 80s changed the dynamics of these arrangements so that policies in equity split dollar arrangements did have the ability to have a substantial amount of tax-deferred cash value accumulation. Eventually, the IRS and Treasury Department started to chip away at the use of equity split dollar, eventually eliminating it as a viable planning option with the release of the Final Split Dollar Regulations in September of 2003.

Although equity split dollar has gone the way of the Dodo bird, split dollar is still a very viable concept in the right circumstances. Under the Final Split Dollar Regulations, there are two regimes for split dollar arrangements: the economic benefit regime and the loan regime. Both regimes are somewhat similar in that they allow for the sharing of the costs and benefits associated with a life insurance policy. Some of the traditional highlights of these regimes are:

Economic Benefit Regime

- Premium payer/policyowner has all rights to the cash value of the policy (i.e., the only form of collateral assignment split dollar that can now be written is non-equity collateral assignment split dollar).
- Non-owner has the right to name the beneficiary of a portion of the death benefit that is dictated by the split dollar agreement.
- Non-owner either pays or reports REB cost as taxable income (measured by Table 2001).



Loan Regime

- Policyowner borrows premium amounts from another party (e.g. business or trust grantor) known as the lender.
- Policyowner pays interest to the lender based on the appropriate Applicable Federal Rate (AFR).
- Policyowner has rights in the cash value in excess of the loan balance.
- Lender is given a collateral interest in the policy equal to the loan balance.
- Can be structured as either:
 - A demand loan giving the lender the ability to demand repayment at any time.
 - A term loan which will have a fixed date for repayment.



The choice of which regime will be utilized will depend on many different factors, including the need being solved for, age of the client, interest rate environment, and design of the life insurance policy. Each of these designs presents a unique set of issues and requirements that should be addressed by qualified counsel prior to implementing. Although split dollar is used in a variety of ways, the following four plan designs are the most common uses.

Business-provided economic benefit regime:

- A business owns a life insurance policy on a key executive's life and gives that key executive the ability to name the beneficiary of a portion of the death benefit.
- Often used in conjunction with a nonqualified deferred compensation agreement.
- Provides death benefit protection for the key executive at a reasonable cost.

Business-provided loan regime:

- The business lends a key executive the funds necessary to pay all or portion of the premiums for a personally owned life insurance policy.
- At a future date, the key executive will use outside assets, available policy cash value, or both to repay the lender, assuming the arrangement is terminated prior to the key executive's death.
- Often used when there is a long-term need by the executive for death benefit protection provided by his or her employer.

Private economic benefit regime:

- The premiums for a trust-owned policy are paid for by an individual or individuals (usually the trust grantor).
- May provide for estate liquidity planning for a reduced gift tax cost (based on the REB amount).
- Generally used for insureds under age 70 or for survivorship life insurance policies.
- Often used in conjunction with a rollout strategy, such as a grantor retained annuity trust (GRAT) or a sale to an intentionally defective trust (IDIT Sale).

Private loan regime:

- The individual (usually the trust grantor) lends a trust the funds necessary to pay all or a portion of the premiums for a personally owned life insurance policy.
- May provide for estate liquidity planning at a reduced gift tax cost (based on the loan interest cost).
- Generally used for older insureds or when the client is looking to lock in a long-term interest rate particularly during a low interest rate environment.

Although equity split dollar is gone forever, split dollar can still be an effective strategy in many different situations. Any time a business is looking to provide death benefit protection to a key executive, split dollar may be considered. If a client is looking to buy life insurance inside of an irrevocable trust but he or she has gifting limitations, split dollar should be considered. The bottom line is: Although split dollar today is different than it was in the 80s and the 90s, it was never gone and it should not be forgotten by life insurance producers, clients, or financial professionals.³

³In order to sell life insurance, a financial professional must be a properly licensed and appointed life insurance producer.

Split-Dollar arrangements may be affected by the Sarbanes-Oxley Act of 2002 which prohibits personal loans by public companies to their directors and executive officers. Additionally, final split dollar regulations have been adopted by the IRS that may impact the taxation of split dollar arrangements entered into after September 17, 2003 in many circumstances. Please contact your tax and legal advisors for further guidance.

**For more information about life insurance,
please contact our Advanced Designs Unit at
AdvancedDesigns@PacificLife.com or (800) 800-7681, ext. 3690.
PacificLife.com**

Pacific Life, its affiliates, their distributors and respective representatives do not provide tax, accounting or legal advice. Any taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax advisor or attorney.

Pacific Life is a product provider. It is not a fiduciary and therefore does not give advice or make recommendations regarding insurance or investment products.

Pacific Life Insurance Company is licensed to issue insurance products in all states except New York. Product/material availability and features may vary by state.

Insurance products and their guarantees, including optional benefits and any crediting rates, are backed by the financial strength and claims-paying ability of the issuing insurance company. Look to the strength of the life insurance company with regard to such guarantees as these guarantees are not backed by the broker-dealer, insurance agency, or their affiliates from which products are purchased. Neither these entities nor their representatives make any representation or assurance regarding the claims-paying ability of the life insurance company.

The home office for Pacific Life Insurance Company is located in Omaha, Nebraska

This material is intended for financial professional use only. Not for public distribution.

