Split-Dollar Life Insurance Arrangement: Endorsement Method

Program Highlights & Fact Finder

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A Valuable Benefit for Employers and Key Executives

The endorsement method for a split-dollar life insurance arrangement is a strategy that can serve a dual purpose. It can provide employees with a valuable fringe benefit that will appeal to talented executives. If set up correctly, this benefit will also help the company retain key employees.

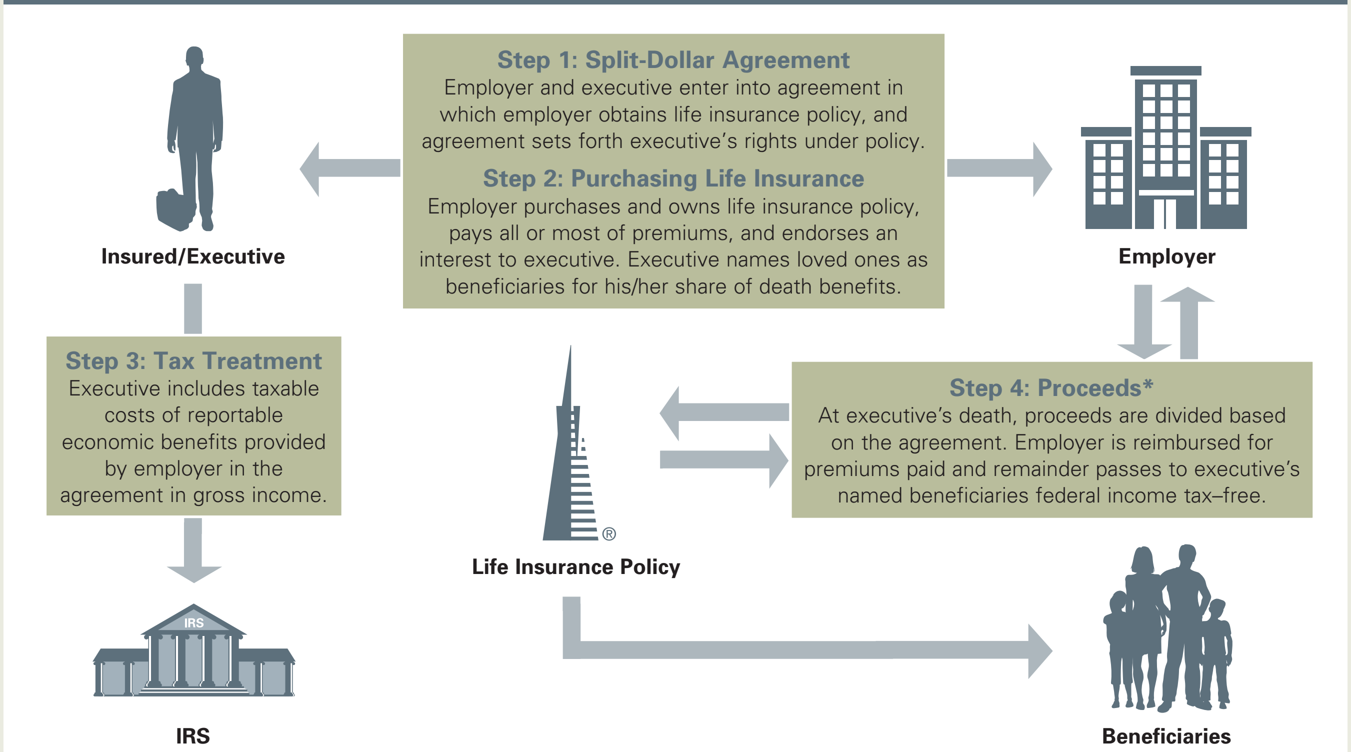
The benefit provided via the split-dollar endorsement method is attractive to executives because the life insurance offered can provide security and liquidity for their family members in the event of the executive's death. Many executives delay purchasing adequate insurance due to a need to use cash for other purposes. When the employer purchases the insurance, the cost to the executive is much lower.

A split-dollar endorsement arrangement also acts as a retention tool for key executives, as the executive must stay with the employer to keep the insurance coverage.

The split-dollar arrangement is an agreement between two parties—usually an employer and executive—to "split" the costs and benefits of a life insurance contract. Using the endorsement method, the employer would purchase the policy and hold ownership of the policy. The employer would also make the premium payments due on the policy.

Typically, the split-dollar agreement would provide the executive with current life insurance protection; however, the exact division of the policy would be split between the parties as established in their agreement.

Split-Dollar Nonequity Endorsement Method



*If the split-dollar arrangement will terminate at some point during the executive's life and the policy will be rolled out to him/her, this arrangement would likely be subject to IRC § 409A tax treatment as a form of deferred compensation.

Here's How it Works

Step 1. Entering Into the Split-Dollar Agreement

- The employer and executive enter into a contractual agreement in which the employer agrees to pay all or most of the premiums and obtains a life insurance policy insuring the executive's life while the employer retains ownership of the policy.
- The agreement provides that, at the executive's death, the proceeds are split. There are several ways in which the proceeds can be split, including, for the employer, a return of premiums paid only, return of cash value only, or a return of the greater of the premiums paid or the cash value. If cash value exceeding the premiums paid is credited to the executive, then this type of agreement is called "equity split dollar." When the executive has an interest only in the death benefit and no interest in the cash value of the policy, then the arrangement is referred to as "nonequity split dollar."
- By reserving ownership of the policy, the employer is able to retain control of the policy and access to its cash value. The employer endorses a benefit under the policy over to the executive. Typically, the agreement would give the executive the right to name a personal beneficiary for the employee's share of the death benefits.
- In order to prevent the death benefits from being included in the employer's gross income for tax purposes, there are certain exceptions for which the agreement must qualify. It must also satisfy pre-issue notice and consent requirements, and the employer must follow additional annual recordkeeping and reporting obligations under IRC §§ 101(j) and 6039I.

Step 2. Premiums and Taxes

- The owner of the policy is deemed to provide a taxable economic benefit to the other party. The economic benefit may be the value of the life insurance protection (nonequity split dollar) or may include other benefits such as all or part of the cash value built up in the policy (equity split dollar).
- The executive reports the value of the economic benefits received as gross income, reduced by any amounts paid by the employee as reimbursement of economic benefit costs. The economic benefit of the value of the life insurance protection is usually determined based upon IRS Table 2001, or an insurer's alternative term rates may be used if they meet the requirements of split-dollar regulations.
- Economic benefit costs paid by the executive to the employer are gross income to the employer.
- Premium payments made by the employer are generally not deductible by the employer.

Step 3. Accessing the Benefits

- If the arrangement is terminated due to the executive's death, then the policy proceeds are divided as specified in the agreement.
- If the employee is still alive and the employer wishes to terminate the arrangement, the employer can remove the endorsement on the policy and either continue with the policy or surrender it for its cash value.
- Alternatively, the employer may wish to distribute the policy to the executive—such as in the form of a bonus retirement benefit. In this case, the employer would roll out the policy to the executive. The executive can either purchase the policy from the employer or pay income tax on the fair market value of the policy, with the employer likely receiving an income tax deduction. Once the policy has been rolled out to the executive, he or she no longer needs to pay income tax on economic benefit amounts, but future premiums if any are the executive's responsibility.

What Are the Advantages?

With the Split-Dollar Life Insurance Endorsement Method, both employer and key executive benefit. Here's how:

The Employer…

- Enhances its compensation package to attract and retain key talent
- Provides selected employees with attractive benefits
- Retains control over the policy including all policy rights, access to cash value, and nonforfeiture privileges and creates a balance sheet asset
- May be repaid for premiums loaned to pay for the policy at the termination of the agreement
- Is not subject to burdensome approval, testing, and discrimination requirements since the split-dollar plan is not a qualified retirement plan

The Executive…

- May be able to obtain the policy at the time the agreement is terminated by purchasing it at a fair market value, or through a transfer of ownership via a bonus or similar compensation
- May benefit from accumulated cash value, which can be accessed later for retirement needs
- Is able to obtain death benefit protection for his or her named beneficiaries
- Can use cash that would have been used to pay premiums for other needs
- Can likely obtain life insurance protection at a lower current out-of-pocket cost than for a personally purchased policy

Employers can help prevent a loss of talent, executives are able to prepare for retirement and estate planning in a cost-efficient manner, and beneficiaries obtain a federal income tax–free death benefit.

Who Can Benefit from the Split-Dollar Endorsement Method?

- Employers who want to retain key executives
- Employers who want to offer benefits in excess of those offered by their qualified retirement plans while maintaining full control over the benefit assets and minimizing balance sheet impact
- Executives who want to provide financial security for their families without tying up current assets

Individually Designed Proposal

By completing the attached Fact Finder, a Transamerica life insurance professional can develop a customized proposal illustrating a split-dollar arrangement using the endorsement method.

Split-Dollar Arrangement: Endorsement Method Fact Finder

Executive

Executive Name ______________________ Date of Birth ______________ Gender: ☐ M ☐ F

Address ______________________ State ______________

Spouse Name ______________________ Date of Birth ______________ Gender: ☐ M ☐ F

Retirement Age ________ Annual Retirement Income Goal ______________________ Payable to Age ________

Risk Status: Insured ☐ S ☐ NS Risk Classification: ☐ Select ☐ Preferred ☐ Standard

Table Rating ______________ Flat Extra/Amount ______________

Risk Status: Spouse ☐ S ☐ NS Risk Classification: ☐ Select ☐ Preferred ☐ Standard

Table Rating ______________ Flat Extra/Amount ______________

Officer of Corporation? ☐ Y ☐ N Shareholder of Corporation? ☐ Y ☐ N Percentage of Corporate Ownership ________ %

Executive Premium Share: ☐ PS58 ☐ ART Other ______________

Bonus: ☐ Y ☐ N ☐ Single ☐ Double

Employer

Employer Name ______________________ Status: ☐ C Corp ☐ S Corp ☐ Partnership, LLC

Address ______________________ State ________ Number of Employees ________

Federal Tax Bracket ______________ % State Tax Bracket ______________ %

Premium Payment Mode ______________________ Solve? __________ or Amount? ______________

Years of Out-of-Pocket Premium Payments ______________________ Rollout Year ______________

Illustration

Type of Illustration: ☐ Fixed Universal Life

Product to Illustrate ____

Policy Assumptions: Current ______________ Guaranteed ______________

Desired: Death Benefit $ ______________ or minimum so as not to create a MEC ______________

Death Benefit Option: ☐ Level ☐ Increasing with cash value ☐ Increasing switching to Level

Plus-Premium ______________________________

Annual Insurance Premium $ ______________________________

Years to pay premium ______________ or to age ______________

Maximize income from policy at insured's age ______________ for ______________ number of years

If premium is not known, indicate desired cash flow from policy beginning in year __________, and ending in year __________.

Policy cash value at 100 equal to:

Endowment at initial face ______________ or keep in force until age 100 ______________

or cash value equal to $ ______________

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