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Harmony Wealth Strategies
BUILDING AND SAFEGUARDING YOUR FINANCIAL WORLD

# Split Dollar Insurance Plans

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Let's say you want to reward a few key executives with low-cost life insurance. Can you do so without providing the same benefit to your other employees? You can with a split dollar life insurance plan. In fact, such an arrangement can provide your business with several benefits. It can help you attract and retain employees, reward key executives, and fund severance packages and certain other benefit plans.

## How does a split dollar life insurance plan work?

Split dollar life insurance is an arrangement between an employer and an employee to share the costs and benefits of a life insurance policy. Specifically, the parties join together to purchase an insurance policy on the life of the employee and agree, in writing, to split the cost of the insurance premiums, as well as the policy's death proceeds, cash value, and other benefits. The actual life insurance policy used can be whole life, universal life, second-to-die (survivorship), or any other cash value policy.

Split dollar arrangements usually take one of two forms. Under the endorsement form, the employer is formally designated as the owner of the life insurance contract and endorses the contract to specify the portion of the death proceeds payable to the employee's beneficiary. Under the collateral assignment form, the employee is formally designated as the owner of the contract, and the employer premium advances are secured by a collateral assignment of the policy.

***Caution:*** *The Sarbanes-Oxley Act of 2002 makes it a criminal offense for a public company to lend money to its executives or directors. This may prohibit the use of the collateral assignment form in these companies.*

## Why use a split dollar life insurance plan?

Split dollar life insurance is widely used in gift and estate planning and can be an important part of the compensation package of many key employees. You don't have to cover all of your employees--the coverage, amounts, and terms of the split dollar arrangement are generally not subject to Employee Retirement Income Security Act (ERISA) nondiscrimination rules. Split dollar plans can be used to:

- Attract, motivate, and retain employees
- Provide low-cost life insurance protection to employees
- Fund severance benefits
- Fund stock purchase agreements
- Fund nonqualified deferred compensation plans

## Advantages of split dollar life insurance plans

Split dollar life insurance offers a number of advantages:

- A split dollar plan allows an executive to obtain life insurance coverage using employer funds.
- The investment by your business in the plan is fully secured. If the insured employee dies or his or her employment is terminated, your business is reimbursed from the policy proceeds for its payment of premiums.
- Split dollar plans can be customized to meet the objectives of both employer and employees.
- The death benefit from a split dollar plan (both the employer's share and the share going to the beneficiary of the employee) is generally free from income tax.

Note: If the death proceeds are paid in installments, any interest element in the installment payments will generally be taxable.

## Disadvantages of split dollar life insurance plans

Split dollar plans have some disadvantages as well, including the following:

- Your business will generally receive no tax deduction for its share of premium payments under the split dollar plan.
- Depending on how the agreement is structured, employees may have to pay income taxes each year on the value of the economic benefits provided to them. Alternatively, if the employer's premium payments are considered a series of loans to the employee, then the employee must pay a reasonable rate of interest to the employer. If the employee does not do so, the employee is considered to have received taxable income up to the amount of interest that should be paid.
- Tax rules regarding split dollar life insurance are complicated.

## Tax issues

Under current regulations, two mutually exclusive sets of rules govern the taxation of split dollar arrangements. Generally, if the employer owns the policy (an endorsement form arrangement), the employer is treated as transferring "economic benefits" to the employee. The employee must include in income the value of the life insurance protection provided by the employer, plus the cash value (if any) to which he or she may have access (to the extent that it has not been taken into account in a prior taxable year). Under the loan regime, the employer is treated as lending premium payments to the employee. The loan regime generally governs the taxation of those arrangements under which the employer's premium advances are secured by a collateral assignment of the policy.

Before entering into a split dollar life insurance arrangement, it's important to ask a financial planning professional to assess how the current regulations might impact your business.

**IMPORTANT DISCLOSURES**

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