SPLIT DOLLAR LIFE INSURANCE FOR EXECUTIVES

AMERICAN NATIONAL®

Split dollar life insurance is a contract between a company and their executive to own a policy on the executive where the benefits offered are split between the employer and executive.

Upon the death of the executive, the company receives the total premiums or cash surrender value, whichever is greater.

The IRS has approved two ways to structure the split dollar agreement.

Economic Benefit Method

With the economic benefit method, the company owns the life insurance policy, has full control of the policy, and uses an endorsement on the policy to reflect the interest of the executive or the irrevocable life insurance trust created for the benefit of the executive.

If a corporation or LLC advances the premium, the executive must recognize the economic benefit each year as income. The executive does have the ability to make a premium payment equal to the economic benefit which is the annual term cost and avoid taxable income.

Rates are contained in IRS Table 2001 and go up each year as the executive gets older. This can add up to a lot of money when considering term rates on a large policy when the executive is in their 60's.

Collateral Assignment Method

The more frequently used method is the Collateral Assignment method where the executive owns the policy and has full control of the policy. The executive collaterally assigns the policy to the company to secure the company's interest in the policy.

Under collateral assignment split dollar arrangements, the employer typically will fund the majority or all of the premium payments. The executive may or may not have access to cash value. The executive will receive the net proceeds from the life insurance after the employer receives the greater of the cash value or premiums paid.

The executive can pay or accrue the loan interest which, if accrued, is then deducted from the death benefit. The Applicable Federal Rate under IRC 7872 provides the minimum interest rate that can be used.

With loan based split dollar, interest on the loan is based upon cumulative premiums paid so you avoid an ever-increasing economic benefit as the insured ages.

Keep in Mind

An attorney experienced in creating split dollar agreement should be used when creating the split dollar arrangement. Split dollar plans are terminated at either the executive's death or a future date included in the agreement. The employer can bonus out the cash value when the employee retires as an additional benefit.

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The economic benefit method can get very expensive as the executive gets into their 50's and 60's as the term cost is used to compute the economic benefit. For this reason, the economic benefit method is not looked on as favorably as the collateral assignment method.

Benefits of Split Dollar

- Minimize income and gift taxes when funding large premium payments
- Reduce cash flow to fund large premium payments
- Provide key executives an executive benefit that encourages them to stay with the company as a golden handcuff. They can leave but the employer is protected and receives the cash value in the policy
- Retirement income benefit as well as death benefit that is self-completing
- The cash value of the policy can assist the employer in finding and training a replacement with cash

Risks of Split Dollar

- With life insurance, someone must commit to paying premiums
- If premiums are not paid, the policy could crater and there would be not benefits to split up.
- Life insurance is a long-term commitment for both parties to the agreement

Final Note

Split dollar also works for very high net worth families who need large amounts of insurance and may have other commitments for gifting. By using this "private split dollar method" families who have already utilized their gifting maximums can fund additional insurance as needed in an irrevocable life insurance trust.

For questions and more information, contact the Advanced Sales Department at 888-504-2550 ext. 5767. Neither American National Insurance Company nor its agents offer tax or legal advice. Clients should consult their tax and legal advisors.

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888-501-4043 | img.anicoweb.com