legal & tax trends
Financial Solutions from Advanced Markets
Summer 2011
Issue # 1

Private or Family Split Dollar Arrangements

Inside this issue:

I. INTRODUCTION
II. WHAT IS PRIVATE SPLIT DOLLAR?
III. CASE APPLICATIONS
IV. IMPACT OF THE FINAL REGULATIONS ON PRIVATE SPLIT DOLLAR
V. INCOME TAX IMPLICATIONS OF PRIVATE SPLIT DOLLAR
VI. GIFT TAX IMPLICATIONS OF PRIVATE SPLIT DOLLAR
VII. ESTATE TAX IMPLICATIONS OF PRIVATE SPLIT DOLLAR
VIII. THE IMPORTANCE OF AN EXIT STRATEGY
IX. CONCLUSION

R⁴ Risk & Wealth Solutions™

★ Multi-Generational Wealth Protection ★
★ Retirement Distribution Strategies ★
★ Key Employee Retention Plans ★
★ Business Succession Plans ★
★ Group Employee Benefits ★
★ Financial Assets ★

302 Harper Drive, Suite 103
Moorestown, NJ

856.866.0028 Phone
856.234.4975 Fax
www.R4RWS.com

Peter S. Rosengard, CLU, RHU
Director, R⁴ Strategic Planning

I. Introduction

Private split dollar (sometimes referred to as family split dollar) arrangements can be structured to meet a variety of estate and financial planning needs. In this article, we will first define private split dollar and then describe some of the more typical situations in which the concept may be applied. We will also provide a general description of the income, gift and estate tax ramifications, noting in advance that any legal and tax discussion does not purport to be complete. Parties entering into these complex arrangements will need to consult with and rely on the advice of their own counsel. Lastly, we will discuss the critical need to properly administer the program, as well as the importance of developing a long-term exit strategy.

II. What is Private Split Dollar?

In general, private split dollar is an arrangement between two related parties in a non-employment context where the premiums and benefits of a permanent life insurance policy are shared. Typically, one family member (or trust) provides the bulk of the funds so that another family member (or trust) can insure a family member. In private split dollar any benefit derived by the donee (e.g., irrevocable trust) is potentially taxable as a gift, rather than as income. Private split dollar comes in many variations – endorsement private split dollar (e.g., where the insured owns his or her policy and endorses a portion of the death benefit to a co-owner to fund a cross-purchase buy-sell arrangement) or collateral assignment arrangements where the parties are typically an irrevocable life insurance trust created by the insured(s), and the insured(s) or the insured's spouse. A written split dollar agreement defines the parties' rights in the life insurance policy. The agreement can be structured in many different ways and can be as flexible (or as complex) as the parties desire or as needed to accomplish the planning objectives.

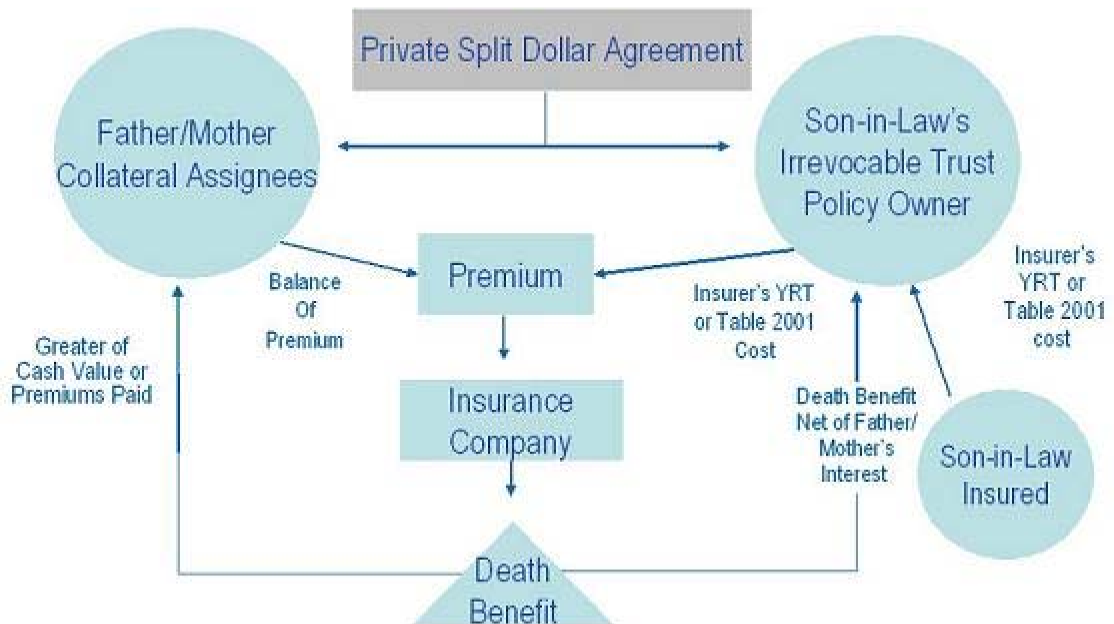
III. Case Applications:

The following are examples of how private split dollar arrangements can be structured to meet a variety of planning needs:

(1) Family Premium Assistance

Father and Mother would like to help provide for their daughter's financial security, but they are reluctant to part with control over their assets. Father and Mother decide to enter into a private split dollar agreement with their son-in-law's irrevocable trust.

The trust is the owner and beneficiary of an insurance policy on the son-in-law's life. Father and Mother pay the full premium on the trust-owned policy and the value of the life insurance protection (i.e., the economic benefit, for individual policies, the Table 2001 rates or the insurance carrier's yearly renewable term insurance rates, if available, and for joint survivorship policies, the so-called revised Table 38 rates) is treated as a gift to the trust beneficiaries. To qualify the gift for the annual exclusion, the trustee gives written notice to the trust beneficiaries of their right to withdraw an amount from the trust equal to the economic benefit. Alternatively, son-in-law could give an amount equal to the economic benefit to the trust and Crummey withdrawal powers are given to the trust beneficiaries so as to qualify this gift for the annual exclusion. The trustee then pays this amount to the insurer and Father and Mother treat this payment as income. Father and Mother pay the balance of the premium and retain a collateral assignee's interest in the policy equal to the greater of the total cash values or the cumulative premiums paid.



At the first to die of Mother and Father, their interest in the policy passes to the survivor. If the survivor's will (or living revocable trust) directs their interest in the policy to the son-in-law's irrevocable trust at the time of the second death the two interests merge and the split dollar agreement can be terminated[1]. The cash values can be used to support the policy in a non-split dollar arrangement.

There are a number of benefits to Father and Mother. First, if the split-dollar agreement and collateral assignment so provide, cash values may be available to them on a tax-favored basis through partial withdrawals up to basis and through policy loans to supplement their retirement income[2]. Second, depending on the terms of the trust, it would appear that the cash values may not be considered a marital asset of the daughter and these policy values will be protected in the event that daughter and son-in-law divorce. Finally, if the trust is properly structured and implemented, upon the son-in-law's death, the death benefit will be received by the trust, estate and income tax free, and can provide the envisioned financial security to the daughter and the grandchildren.

(2) *Retirement Benefit*

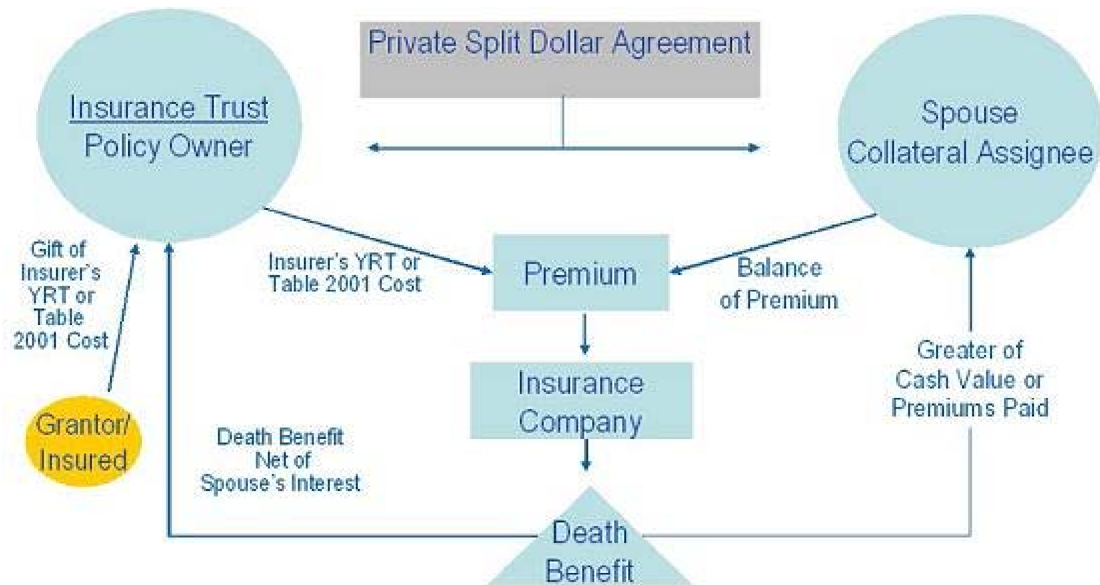
The family split dollar plan, coupled with an irrevocable life insurance trust, can also permit a certain degree of control over the policy in order to access cash values to supplement retirement needs - without adversely affecting the estate and gift tax benefits.

Under a private split dollar arrangement, the insured contributes to the trust from his or her separate property an amount equal to the annual economic benefit. The insured's spouse pays the balance of the insurance premium out of his or her separate property, retaining a collateral assignment interest in the entire cash value of the policy as security for his/her investment. In order to keep the pure death proceeds out of the spouse's estate it will be important for each party to pay its allotted share of each premium.

---

[1] It should be noted that the interest transferred to the Trust at the surviving parent's death could be subject to an estate tax.

[2] Distributions from a life insurance policy through withdrawals of certain policy values (up to cost basis) and loans are generally not taxed as income provided certain premium limits are followed which prevent a policy from becoming a modified endowment contract (MEC). Distributions taken during the first fifteen years may be subject to tax. Loans and withdrawals will generally reduce the cash value available and death benefit payable. If policy loans are taken, there may be income tax consequences if one permits the policy to lapse or if the policy is surrendered or exchanged.

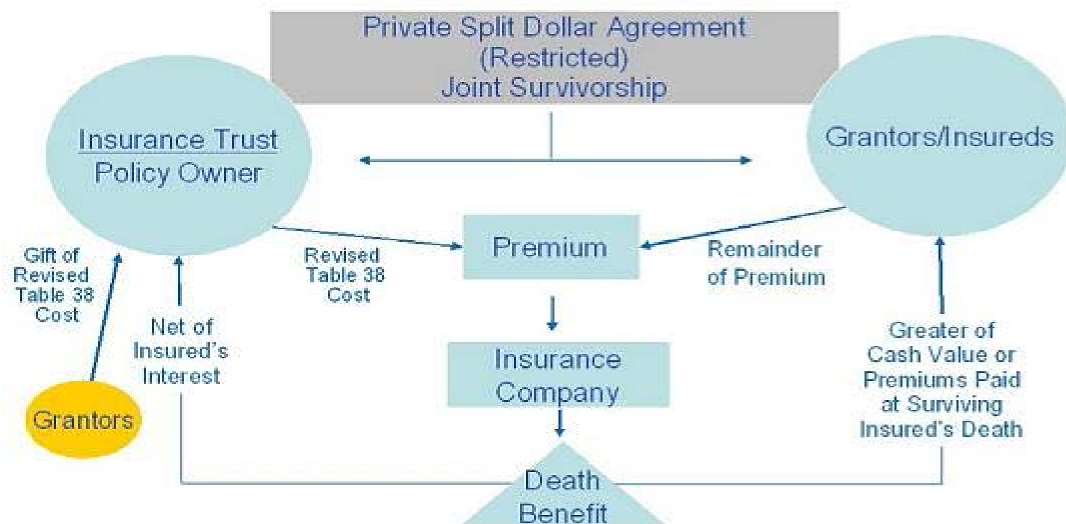


The non-insured spouse has the right under both the split dollar agreement and the collateral assignment to take tax-favored withdrawals (up to his or her basis, which is equal to the total premiums paid reduced by any amounts previously withdrawn from the contract). The balance of the cash value can be accessed through policy loans. The cash value is available to the non-insured spouse for retirement needs or for any other reason. Assuming no incident of ownership in the policy by the insured, the irrevocable trust receives the death proceeds in excess of the spouse's interest free of estate taxes.

(3)   Reduce Taxable Gifts

The insured has established an irrevocable life insurance trust to own a policy on his or her life. However, the annual premium payments on the policy greatly exceed the insured's annual exclusion gifts available through his children's Crummey withdrawal powers. These taxable gifts will reduce the insured's applicable exclusion amount.

A split dollar arrangement would lower the gift to the trust from the full premium to the economic benefit or the "imputed" interest cost if a private split dollar loan is used. Private split dollar is especially attractive when paying the premiums on a joint survivorship insurance policy as these revised Table 38 costs have been lowered to incorporate the lower Table 2001 rates. At the time the first insured dies, the economic benefit cost increases substantially to the Table 2001 cost or the insurer's alternative yearly renewable term rate, if available.



Since the insured has no closely-held corporation or other business with which to enter into a split dollar arrangement, a private split dollar contract is entered into between the trust and the insured's spouse or the insured(s). In this way, private split dollar can minimize the gift tax impact of the insurance program, enabling the insured to acquire the life insurance coverage needed.

(4) Fund a Cross-Purchase Buy-Sell Agreement

In funding for a cross-purchase buy-sell agreement, business owners often express a preference to own their own life insurance policies. Because of concerns over lack of control of the cash values, lack of creditor protection and possible inequities with regard to the payment of substantially different premium amounts, cross ownership of policies may not be an attractive option.

Utilizing private split dollar, each insured business owner would own and control the cash value of his or her own policy and endorse a portion of the death benefit to the non-insured business owner, similar to a standard endorsement split dollar plan. Here, the insured, rather than the business, would own the policy and the co-business owner rather than the insured would have the right to name the beneficiary of a portion of the death proceeds. If the buy-sell agreement involves three or more owners, then a trusteed arrangement (with a trustee or escrow agent having the right to receive the death proceeds on behalf of the business owners) should be considered in order to ease administration and to ensure the agreement is carried out as envisioned.

The business owners would enter into an endorsement split dollar agreement with respect to each policy. The agreement would provide that the business owner would contribute toward the annual premium on each other's policy an amount equal to the term insurance cost (i.e., the economic benefit) for the death benefit he or she is entitled to receive under the agreement. Under the regulations, this amount is taxable income to the recipient. The insured (or the

business through a bonus plan) would be responsible for paying the balance of the premium on his or her respective policy.

Since the business would not be a party to the split dollar arrangement, dollars to pay the premiums would have to be provided through the business owner's personal funds or through a section 162 bonus arrangement. Two amounts could be bonused to each business owner: (i) the economic benefit amount the business owner must pay for the death benefit protection on the other's policy; and (ii) the remaining premium amount the business owner must pay on his or her own policy. [3]

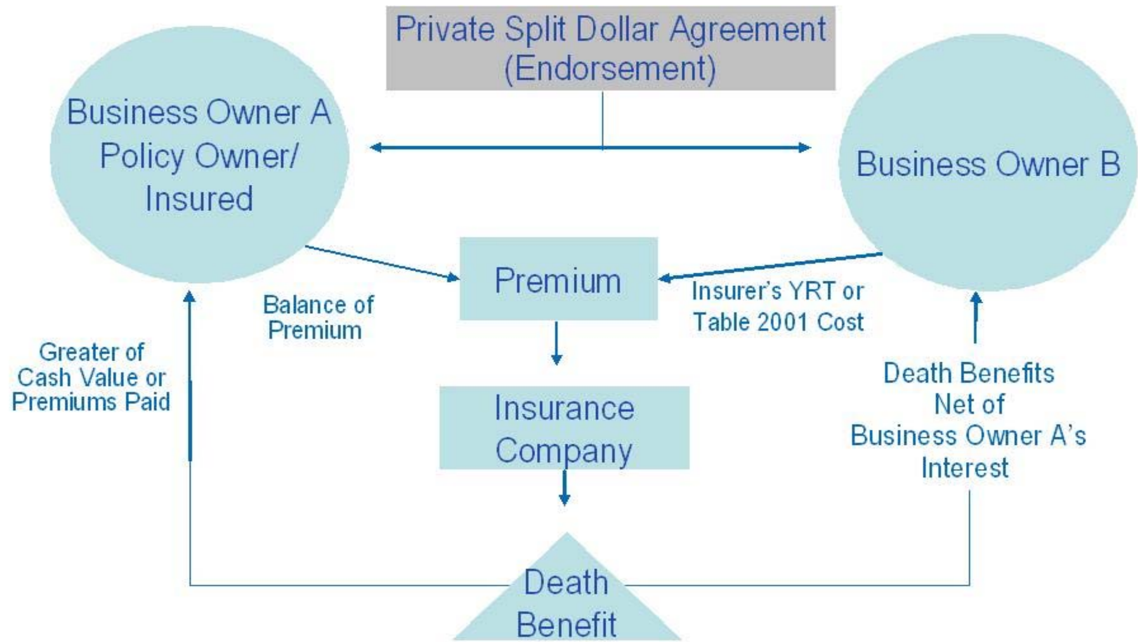
Technically, each business owner would be responsible for actually paying a portion of the premium on each policy. However, rather than send four checks to the insurer, each insured could write a check to the other for the economic benefit amount, which the insured could deposit in his own account. The insured could then write a single check to the insurer for the entire premium payment. Although an alternative approach might be for the business to pay the entire premium on both policies directly to the insurer and then calculate and report as W-2 income the business owner's respective shares, this approach may not establish a sufficiently clear paper trail.

The business owners would enter into a buy-sell agreement under which they would be obligated to use the death proceeds of the policies to purchase the business interest of the first-to-die. Upon the death of the first business owner, the proceeds would be paid in accordance with the split specified in the agreement and the policy. The surviving business owner(s) would use the death proceeds to effect the purchase and the decedent's personal beneficiary would receive the remainder of the proceeds.

The amount of death proceeds payable to the surviving business owner(s) will generally decrease over time if a level death benefit option is selected. This is because the insured's personal beneficiary would typically be entitled to an increasing amount of the death proceeds equal to the premiums paid or the cash value of the policy. If the parties wish to maintain a level death benefit to enable the parties to meet their liquidity needs under the buy-sell agreement, a larger face amount policy could be acquired at the inception or an increasing death benefit option can be selected.

---

[3] For additional information on Section 162 Bonus Plans, please refer to the Fall 2009 issue of Legal & Tax Trends titled 'Section 162 Bonus Plans'.



Benefits of Using Private Split Dollar

There are several benefits in using private split dollar to fund a cross-purchase buy-sell agreement.

- First, purchasing one dual-purpose policy may reduce the overall costs of insurance and may be more cost-efficient than purchasing a permanent policy to build cash values for retirement and a separate term policy to fund the buy-sell agreement.

- Second, the insured controls the policy's investment options and retains an interest in the entire cash value. These cash values can generally be accessed on a tax favored manner through policy loans and/or partial withdrawals up to basis to fund retirement needs.

- A third benefit is that the termination of the split dollar agreement does not trigger a taxable event. Since the insured will own all of the rights in the policy, there is no need to transfer the policies back to the insured. If the policies were cross-owned, the termination of the buy-sell agreement and the subsequent cross transfer of the policies back to the respective insureds will be treated as a sale of the policies, triggering taxable income to the policy owner to the extent there is a gain in the policy.

- Fourth, individual ownership may also provide cash value protection from the claims of both business and personal creditors under many state laws; particularly, if the cash values are payable to a spouse and/or dependent children. This protection is generally not available if the policies are cross-owned.

- Fifth, each insured could elect to make additional after-tax contributions to his or her policy, to the extent the policy permits, to enhance the policy's cash values and/or death benefit or to build cash reserves for a living buy-out.

- Lastly, this type of private split dollar funding for buy-sell agreements is helpful where there is a substantial difference in premiums (or cash value) due to age or underwriting differences. It often appears fairer for the non-insured business owner to pay the term cost for the insurance protection and for each insured to pay the bulk of the insurance premium on his or her policy since the cash values will be owned by the insured.

Concerns

Using private split dollar to fund a cross-purchase buy-sell agreement also raises several concerns.

- First, there is a concern that the private split dollar agreement may violate the transfer for value rule. The reciprocal promise to name each other as beneficiary of the proceeds is the consideration that creates the transfer for value issue.[4] If the transfer for value rule is violated and no exceptions apply, then the death proceeds would be subject to income tax to the extent the proceeds exceed the owner's investment in the policy.

  One exception to the transfer for value rule is if the transfer is made to a partner of the insured. If the owners are not partners (or members of a limited liability company or LLC) the death benefit in excess of the investment in the policy will generally be subject to income taxes. Therefore, this application of private split dollar should only be used where the owners are partners in a bona fide partnership or members in a LLC.[5] The partnership or LLC, however, need not be related to the buy-sell arrangement. For example, if the shareholders in a corporation are also partners in a separate partnership (or can create a bona fide partnership) then the transfer for value exception may apply even if the buy-sell agreement involves a corporation.

- A second concern with private split dollar is that the entire death benefit will be included in the insured's estate including the death benefit payable to the non-insured owner. This raises the double inclusion issue of whether both the insurance and the value of the business interest will be included in the insured's estate for federal estate tax purposes. While the entire death benefit will be included in the insured's estate including the pure death benefit payable to the non-insured owner, authority exists for excluding the value of the business interest where it is clear that the insurance must be used to purchase the stock pursuant to the buy-sell agreement.[6]

[4] See Treas. Reg. Section 1.101-1(b)(4).
[5] The IRS has ruled privately on several occasions members of a LLC are "partners" for purposes of the transfer for value rule. (See PLR 9625013 through 9625019).
[6] *Est. of Ray Tompkins v. Comm., 13TC 1054 (1949) acq.*

In addition, even if the insurance and stock are to be included in the estate, the executor should generally be entitled to an offsetting deduction for the proceeds payable to the business owner by virtue of the contractual obligations created by the split dollar agreement. The rationale for the deduction is that the split dollar agreement was a bona fide arrangement under which the business owner was contractually entitled to the proceeds received.[7] The non-insured owner's interest under the private split dollar plan constitutes a liability against the policy which was contracted bona fide and for adequate and full consideration in money or money's worth. Accordingly, the "at risk" portion represents such a liability and should be deductible from the deceased insured's estate.

- Lastly, there is a concern about the increasing amount of taxable income generated by this technique. For any arrangement entered into after September 17, 2003, the non-owner's contribution of the economic benefit will be taxable to the owner.

(5) Fund a Generation Skipping Trust

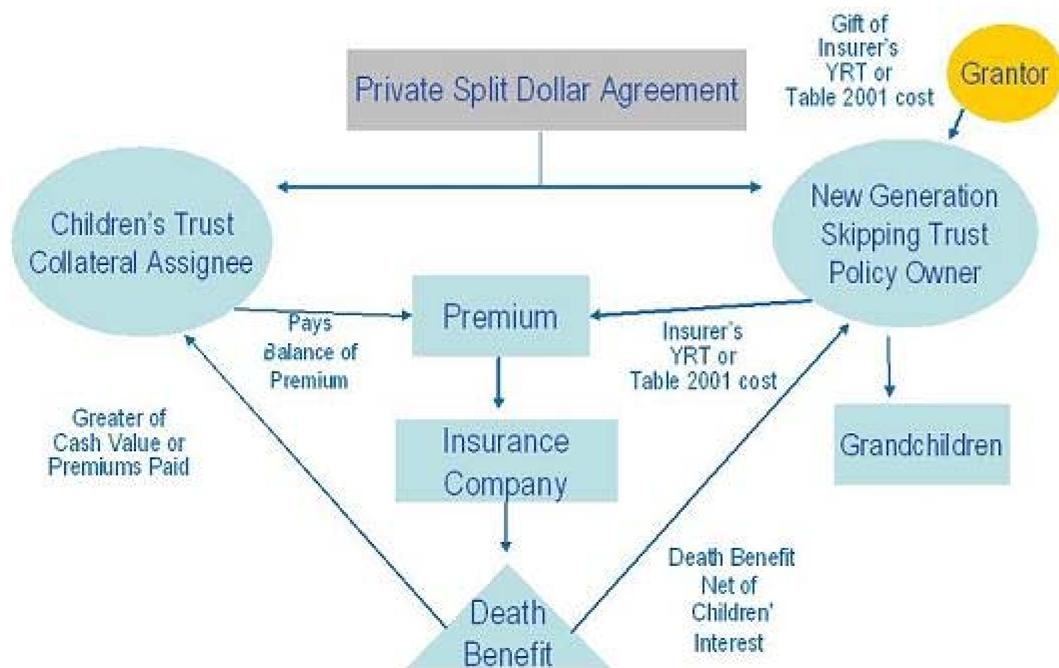
Your clients may have over funded an irrevocable trust for the benefit of their children (i.e., the "Children's Trust") and now would like to use some of those assets in the Children's Trust to provide a benefit for their grandchildren. Your clients are intrigued that the assets in the Children's Trust can be leveraged via private split dollar to provide substantially more benefit to the grandchildren, free of any federal estate tax which might otherwise be due at the time of the children's death.

Under this arrangement, the trustee of the Children's Trust enters into a private split dollar agreement with a newly established generation-skipping transfer trust (the "GST Trust"). The trustee of the GST Trust is the applicant of the newly issued policy. The donor gifts the economic benefit amount to the GST Trust. A gift tax return is filed and the donor utilizes a portion of his or her $5 million (in 2011 and 2012) gift and GST exemption amounts to shelter the entire trust from transfer taxes.

The GST Trust, as owner and beneficiary of the policy, pays the economic benefit cost and the Children's Trust pays the balance of the premium. The interest in the policy held by the Children's Trust is secured by a collateral assignment on the policy. At death the Children's Trust receives the greater of the premiums paid or the cash values and the GST Trust receives the balance of the death proceeds.

---

[7] IRC Section 2053(a)(4) and the regulation promulgated thereunder (Treas. Reg. Section 20.2053-7) allow a deduction for a liability "contracted bona fide and for adequate and full consideration in money or money's worth." Also see PLR 9026041.



The benefit of using private split dollar to fund a GST Trust is that it removes all of the pure death proceeds from the children's estates. It also minimizes the use of the donor's GST exemption amounts since the value of the gift is only the economic benefit amount and not the full premium.

Concerns

There are, however a number of concerns:

- The risk of a "deemed" gift will have more serious impact in those cases in which the policy is owned by and payable to a generation-skipping trust. For example, if the Service were to take the position that the value of the insurance protection provided to the GST Trust is not fairly represented by the insurer's yearly renewable term cost for all standard risks, then this would mean that the allocations of GST exemptions made in prior years for the economic benefit amount would be insufficient to fully shelter the trust from generation skipping transfer tax. It would be necessary to allocate additional exemption on a late filed gift tax return. To avoid the risk of not having a fully sheltered GST Trust, clients may wish to gift to the GST Trust an amount equal to the Table 2001 cost each year and have the trustee pay this larger amount toward the premium.

- Another concern is whether the trustee of the Children's Trust has the authority to utilize trust property to pay premiums on such a split dollar program. In most situations, the trustee will not be given express authority to enter into such an arrangement. The trustee will need to determine whether the split dollar arrangement might violate the trustee's fiduciary duty to act on behalf of the trust beneficiaries; namely, the

children. It may be prudent to obtain the permission of all of the trust beneficiaries (i.e., the children) before proceeding.

IV. Impact of the Final Regulations on Private Split Dollar

On September 17, 2003 the Internal Revenue Service published the final regulations governing the taxation of split dollar arrangements, giving clarity to an area of the law that had been in flux.[8] The final regulations also sanctioned for the first time the concept of a private split dollar deal by stipulating that the final regulations apply to all types of split dollar arrangements including private split dollar arrangements.[9] These regulations, however, only apply to split dollar arrangements entered into after the date of publication of the final regulations and arrangements entered into before the date of the final regulations that are "materially modified" after that date.

Two Mutually Exclusive Taxing Regimes

Similar to business split dollar, the final regulations treat private split dollar arrangements entered into after the date of publication under one of two mutually exclusive taxing regimes. Generally, donor owned arrangements (i.e., endorsement) will be governed by the economic benefit regime and donee owned arrangements (i.e., collateral assignment) would be taxed as a loan under Section 7872 of the Code.

One of the more important factors to consider in choosing between the two regimes is the relative tax efficiency of each method. That is, the parties will need to compare the projected costs of the life insurance protection under the economic benefit regime with the projected interest costs incurred with the loan regime. The loan regime generally works best with older insureds and with single life secondary guaranteed universal life policies. It is especially attractive in today's low interest rate environment. The economic benefit regime is typically more attractive with younger insureds and with survivorship split dollar when the lower revised Table 38 costs can be used. In other situations, as discussed below, it may be more favorable to begin the arrangement under the economic benefit regime and later switch to the loan regime.

(1) Loan Regime

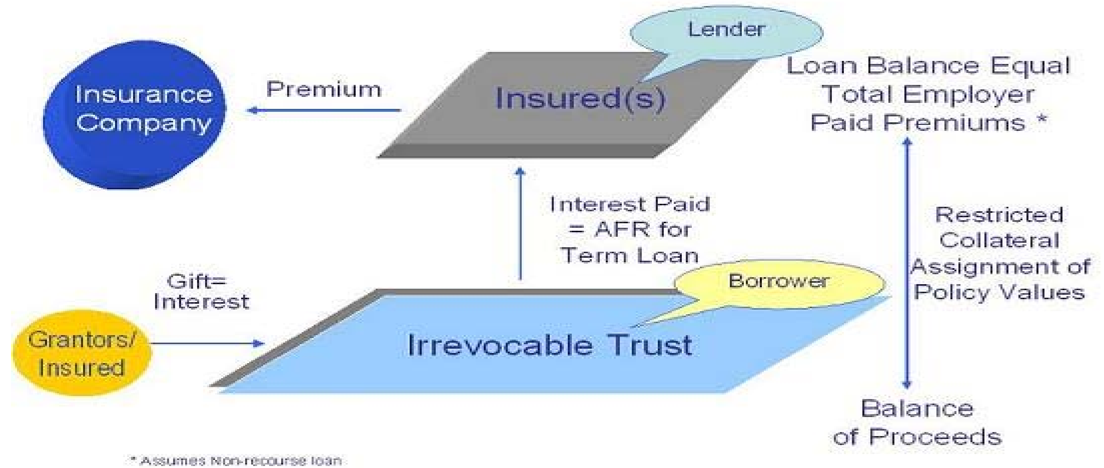
Background

Under the loan regime, the donor (e.g., insured) pays the policy's premium, treating the premium payments as a series of loans to the donee (e.g., irrevocable trust). If the donee is not charged at least the government established interest rate for the type of loan, i.e., the applicable federal rate (AFR), then the difference between the AFR and the rate the donor is charged is an imputed gift from the donor to the donee. Upon termination of the loan arrangement, if the

---

[8] The most important of these regulations are Treas. Regs. 1.161-22 and 1.7872-15. Also, see Rev. Rul. 2003-105, 2003-2 CB 696.
[9] Preamble Section of the Final Regulations titled "Background and Explanation of Provisions."

donee does not repay the outstanding loan balance, the donor is generally deemed to have made a gift of the amount of the loan balance forgiven.



Under the loan regime, the donee or third party owns the policy and collaterally assigns the cash value (not to exceed the outstanding loan balance) of the policy to the donor. The donee retains the cash values over and above the outstanding loan balance. The owner is treated as the borrower and the non-owner is treated as the lender of a private split dollar loan. The parties can structure the arrangement as a term or demand loan.

Demand Loan

A split dollar demand loan is any split dollar loan that is callable in full at any time on the demand of the lender. If a split dollar demand loan is a below market loan (i.e., the interest on the loan is less than the short-term blended rate), the foregone interest is deemed to be transferred annually from the lender to the borrower.

A demand loan is attractive because it is easy to administer. The blended short-term rate (an average of the January and July short term rates) is simply multiplied times the outstanding loan balance to determine the amount of foregone interest. With private split dollar, this amount is treated as an imputed gift to the borrower annually. The demand loan may also be appealing because the interest rate (at least in the short-run) is often much lower than the mid-term or long-term AFRs that are used with term loans. One of the primary disadvantages of the demand loan is the inability to lock-in the interest rate and the resulting uncertainty of future interest costs. Another disadvantage in using the demand loan with private split dollar is the inability to avoid inclusion of the death benefit in the insured's/lender's estate.

Term Loan

A split dollar term loan is any split dollar loan other than a split dollar demand loan. For example, a loan due at the end of a certain term of years or upon

the death of an individual is a term loan. The split dollar term loan is tested on the day the loan is made to determine if it has adequate stated interest. The applicable federal rate applied to determine if the split dollar term loan is a below market loan is the rate appropriate for the fixed term: short-term (not over 3 years), mid-term (over 3 years but not over 9 years), or long-term (over 9 years). A loan's term is the period from the date the loan is made to its stated maturity date. For a private split dollar term loan where the term will end at the date of the donor's death, the regulations permit the parties to use the AFR appropriate for a term equal to the life expectancy of the donor.

If a split dollar term loan is considered a below market loan, the entire amount of the foregone interest over the term of the loan is generally considered transferred in the year the loan is made for both income and gift tax purposes. Split dollar loans payable on the death of an individual, loans that are conditioned on the performance of future services, as well as private split dollar term loans are recognized exceptions to this general rule for income tax purposes. These types of loans are treated as split dollar term loans for purposes of determining the appropriate AFR, but as demand loans for determining when the interest is taxed for income tax purposes. That is, if an adequate rate of interest is not provided for, then the foregone interest for these special types of term loans is determined on the loan annually (i.e., the income recognition is not accelerated). Unfortunately, it does not appear that these exceptions will apply for gift tax purposes. That is, the gift which is equal to the foregone interest over the term of the loan would be considered a gift in the year that the loan was made.

Best to Use a Term Loan with Stated Interest Rate at Least Equal to the AFR

Term loans are generally desired where the insured is a party to a private split dollar arrangement. Where it is important to keep the proceeds out of the insured's estate, care must be exercised not to give the insured any incident of ownership. The right to demand payment (as evidenced by a demand note) could be considered an incident of ownership and such an incident of ownership held by the insured(s) would cause the inclusion of the proceeds in the insured's estate.

Term loans are also attractive in a low interest rate environment where you want to lock in the interest rate for a set period of time. Unfortunately, it will not be possible to lock in today's AFR for future premium payments by using a term loan. The donor can, however, loan a sufficiently large amount to the trust so that future premiums can be paid with the loan proceeds. In this way, the interest rate on the lump sum amount can be locked in at today's rate. Term loans, however, can be cumbersome to administer since each premium payment is considered a new term loan with a new interest rate.

Generally, if term loans are desired, it may be best to enter into a loan arrangement with a stated interest rate at least equal to the applicable federal rate. In this way, the parties can avoid the complexities of section 7872 of the Code including the possible acceleration of the foregone interest over the term of the loan into the year that the loan is made for gift tax purposes.

(2) <u>Economic Benefit Regime</u>

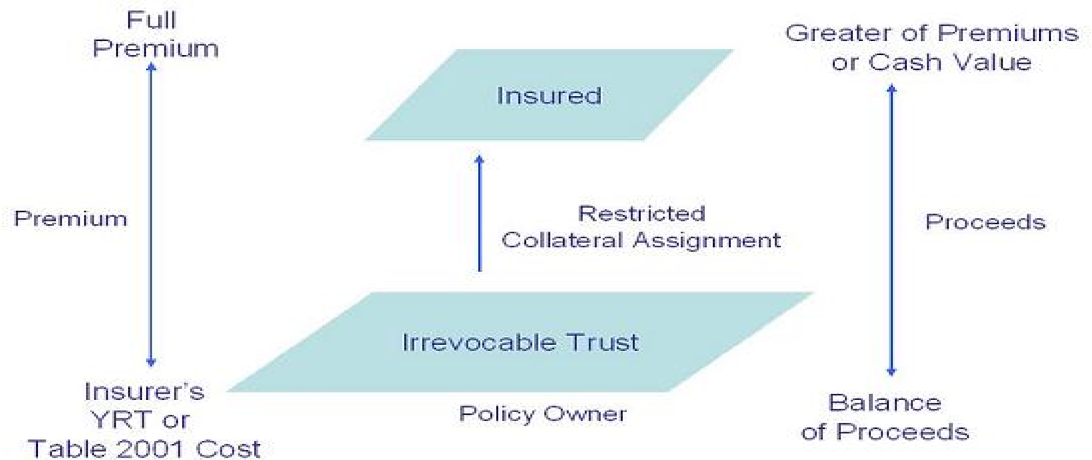
The economic benefit regime can be structured in either of two ways: a non-equity endorsement or a non-equity collateral assignment. Under the non-equity endorsement method, the premium payer owns the life insurance policy and rents the coverage to the non-owner. Since this creates concerns for estate inclusion if the insured is the premium payer, this arrangement is typically not used when an irrevocable trust is to receive the pure death proceeds.

The final regulations provide that the non-equity collateral assignment forms of private split dollar will be treated under the economic benefit regime and not the loan regime. If the only economic benefit to the donee (e.g., the irrevocable trust) is the pure life insurance protection and all of the cash values are assigned to the donor, the plan can be treated under the economic benefit regime. Thus, it will be possible after the final regulations to obtain the low cost economic benefit treatment and the estate tax savings associated with removing the proceeds from the insured's estate.

A non-equity arrangement might provide for the donor (e.g., the insured) to have a restricted right in all of the cash value during the donor/insured's life but reduce the donor's interest to only the sum of the premiums paid if the arrangement is terminated by death. The question becomes whether this type of arrangement will be considered a non-equity arrangement so as to be treated under the economic benefit regime. If it can be treated under the economic benefit regime, will there be any adverse estate tax consequences at death?

The final regulations do not specifically address this situation. It could be argued that an arrangement under which the donor is only entitled to receive premiums paid when death proceeds are paid is a non-equity arrangement because the irrevocable trust only has the right to the death benefit and has no direct interest in the cash value during the insured's life. The unknown is whether the IRS would disagree with this position and attempt to include the full cash value (assuming it was greater than the premiums paid) in the insured's estate for federal estate tax purposes. We note that in virtually all of the IRS rulings dealing with family split-dollar, the estate of the premium payer was entitled to receive the greater of policy cash value or premiums paid while the irrevocable trust was entitled to the balance of the death benefit.

Under the non-equity collateral assignment method, the donee (e.g., irrevocable trust) owns the policy and collaterally assigns all of the cash value of the contract to the donor (e.g., insured) as security for the donor's premium payments. In the event of the termination of the agreement, the donor is entitled to receive the greater of the policy's cash value or premiums paid.



This method is often used when the policy is owned by a third party such as the insured's irrevocable life insurance trust. The advantage of this approach is that upon termination of the split dollar arrangement, the release of the collateral assignment is not considered a transfer for purposes of the transfer for value rule. Another benefit is that it is possible through use of a restricted collateral assignment to remove the pure death proceeds from the insured's estate for federal estate tax purposes assuming the insured possesses no incident of ownership with respect to the policy.

(3) <u>Switch Dollar</u>

The parties under a private split dollar should be able to use the "switch" technique. Under this planning technique the parties would initially elect the economic benefit regime by entering into a non-equity collateral assignment arrangement with the donee paying the economic benefit amount (or alternatively, the donor treating the economic benefit amount as a gift) until the switch year. A switch will generally be warranted:

(i) in the first year in which the economic benefit cost exceeds the annual interest cost;

(ii) the year in which the first insured dies under a survivorship split dollar arrangement; or

(iii) the first year in which the total cash values exceed the cumulative premiums paid by the donor.

At the time of the switch, the parties terminate the economic benefit arrangement and enter into a split dollar loan arrangement, treating all prior premium payments by the donor as a loan. This approach could permit the parties to take advantage of the low economic benefit cost during the initial years of the arrangement. Any cash value transferred to the donee at the time of the switch would be considered a taxable gift.

As previously discussed, the switch to a loan may be appropriate if the annual interest cost under the loan regime is less than the economic benefit amount. This would likely be the case at the death of the first insured to die under a survivorship split dollar arrangement. The death of the first insured to die will cause the arrangement to be taxed using the much higher Table 2001 rates (or the insurer's alternative term rates, if available) rather than the much lower revised Table 38 rates, the rates the parties had been previously enjoying.

If the arrangement is treated as a loan then there will be no additional income charged for the term insurance protection and if a third party (e.g., an irrevocable trust) owns the policy, then any growth in the policy equity in excess of the loan balance will not be considered a taxable gift from the donor to the trust. This equity may help facilitate a tax-free rollout.

Furthermore, under the economic benefit regime the term insurance costs increase with age. Even if the premiums are paid with policy values (i.e., premium offset) or contractually cease, the donor will still be deemed to make escalating economic benefit gifts under the economic benefit regime. On the other hand, under the loan regime when premiums are offset or cease, the amount of the loan balance remains constant and the imputed interest is effectively capped (although the interest itself may fluctuate with changes in the interest rate).

V. <u>Income Tax Implications of Private Split Dollar</u>

Under the final regulations, the payment of the economic benefit by the non-owner (e.g., the donee or trust) will result in taxable income to the owner (e.g., the donor or the insured(s)). The final regulations treat the payment by the non-owner as effectively a taxable rent payment to the owner. This lends a kind of symmetry to the regulations since the entire basis accrues in the hands of the owner. To avoid taxable income, parties to a private split dollar arrangement should consider using a non-contributory split dollar arrangement in lieu of a contributory arrangement whenever possible. Alternatively, the trust could be structured as an intentionally defective grantor trust. In this way, any income tax consequences between the trust and the grantor/insured will be ignored for federal income tax purposes.

Similarly, the payment of interest by the borrower (e.g., the trust) will generally result in taxable income to the lender (e.g., the insured). As before, to avoid income tax consequences the trust should be structured as an intentionally defective grantor trust with respect to the insured/grantor.

VI. <u>Gift Tax implications of Private Split Dollar</u>

Each year the non-equity collateral assignment split dollar arrangement is in effect the insured(s) is deemed to have made a gift in the amount equal to the economic benefit less any amount the donee (e.g., trust) has contributed toward the premium. Consequently, if the donee contributes the economic

benefit portion of the premium, as prescribed by the relevant rulings, then no part of the payment from the insured(s) should be considered a gift.

The Service has ruled favorably when dealing with both pre-regulation and post-regulation private split dollar arrangements. In PLR 200848002 the Service ruled that a married couple's payment of premiums on two life insurance policies under a non-equity grandfathered private split dollar life insurance agreement would not result in a gift to the irrevocable trust which held the policy for either gift or generation skipping tax purposes.[10]

In PLR 200910002 the fact that the split dollar arrangement was entered into after the effective date of the final regulations did not change the favorable results. The donors'/insureds' annual payment (which was equal to the excess of the premium over the economic value of the current insurance protection) would not be a taxable gift to the trust or its beneficiaries.[11]

The value of the economic benefit (i.e. the cost of the life insurance protection) depends upon the date the split dollar arrangement was entered into or materially modified, the type of life insurance policy used (individual or survivorship) and whether the insurance company has alternative term rates that meet the applicable IRS standard.

Cost of the life Insurance Protection - Individual

The final regulations clarified the standards for valuing current life insurance protection. First, the final regulations make it clear that the P.S. 58 costs can no longer be used in private, non-compensatory arrangements including existing reverse split dollar arrangements. Second, the final regulations introduced the "premium rate factor" which was to be used to value the current life insurance protection and presumably replace both the Table 2001 rates and the insurer's One Year Term (OYT) rates for all split dollar arrangements. These premium rate factors have never been issued.

Until such time as the Service issues the premium rate factors, the parties to the private split dollar arrangement can use the Table 2001 rates to measure the annual cost of the current life insurance protection on the life of the insured. If the insurer has published yearly renewable term rates available to all standard risks, as set forth in IRS Notice 2001-10 and these rates meet the Service's higher standard, then these lower rates may be used instead of the Table 2001 rates. The Notice provides that the insurer's OYT rates would have to be made "generally available" and be "regularly sold" by the insurer after December 31, 2003.

Cost of the Life Insurance Protection - Survivorship

[10] Also, see PLR 200822003 in which the Service ruled favorably on the gift tax consequences involving a pre-regulation private split dollar arrangement.
[11] Also, see PLR 200825011 in which the IRS again ruled favorably on the gift tax consequences of a post-regulation private split dollar arrangement.

The calculation of the economic benefit cost of life insurance protection for a survivorship life insurance policy has historically been based upon an unofficial informational letter from the Actuarial Branch of the U.S. Department of the Treasury. This letter permitted the use of joint mortality rates (typically called Table 38 rates) which were based on the government's P.S. 58 rates. While IRS Notice 2002-8 replaced the P.S. 58 rates with Table 2001 rates, it did not provide a similar table with respect to survivorship rates. The only description in the Notice on how to calculate the cost of the insurance protection for a survivorship life policy was that "appropriate adjustments" could be made to the Table 2001 rates. The revised Table 38 rates are therefore based on the government's Table 2001 rates, assuming the methodology permitted by the informational letter can be used. While there is no assurance that these rates will be accepted by the Service, they are commonly used in the industry.

When a private split dollar plan is entered into using a second-to-die insurance policy, the parties have two choices:

(i) the trustee can pay the insureds/donors the economic benefit amount based upon these low revised Table 38 rates, thereby eliminating any gift or generation skipping tax consequences; or alternatively,

(ii) the donors can elect to treat the economic benefit amount as a gift for gift tax (and possibly GST) purposes. If the trust is properly drafted, the trustee can send Crummey withdrawal notices to the beneficiaries in order to qualify this gift for the annual gift tax exclusion.

The parties are able to enjoy these very low joint rates while both insureds are alive. However, at the time of the first insured to die, the economic benefit rates going forward will be based on the individual economic benefit rates using the age of the surviving insured. This can result in a substantial increase in the amount of the gift (and if the trust is a GST trust, a corresponding increase in the generation skipping transfer amount). As discussed in Section VIII, an appropriate long-term exit strategy should be developed in order to successfully manage the risks and avoid unpleasant tax consequences at that time.

VII. Estate Tax Implications of Private Split Dollar

A. Private Split Dollar between Non-Insured Participant and Trust

One of the principal features of the private split dollar plan is the ability to exclude the pure death proceeds of the life insurance policy from the estates of both the client and his or her spouse. The private split dollar must be structured in such a way as to avoid giving the parties any rights that would subject the policy proceeds to estate taxation. This section will review three estate tax issues that might arise with a private split dollar plan between a non-insured participant and an irrevocable trust.

(1) Inclusion in the Estate of the Insured - I.R.C. Sec. 2042

Life insurance proceeds will be included in the estate of the insured if (i) the proceeds are payable to or for the benefit of the estate of the insured, or (ii) the insured possessed any "incidents of ownership" in the policy at the time of his or her death.[12]

Payable to the Estate

Under the private split dollar plan no portion of the death proceeds is payable to or for the benefit of the insured's estate. The spouse's share of the death proceeds is paid directly to the spouse and the spouse is under no obligation to pay any portion of the proceeds to the insured's estate. The balance of the proceeds are payable to an irrevocable trust created by the insured. If properly drafted, the trustee may be authorized to lend monies to the insured's estate or to purchase assets from the estate. This power permits the proceeds to be used to indirectly meet the insured's estate obligations without causing any portion of the proceeds to be includable in the insured's estate.

Incidents of Ownership

The second issue relates to the insured's retention of "incidents of ownership" in the life insurance policy at the time of his or her death. The private split dollar arrangement must be structured to avoid this possibility. Ownership rights in the policy are split between two parties – typically the insured's irrevocable trust and the insured's spouse. Assuming a properly drafted irrevocable trust, the insured has no power or other "incident of ownership" over assets that have been transferred to the trust.

PLR 9636033 dealt with just this type of division of ownership interests in a life insurance policy. The trustee of the insured's irrevocable trust owned the pure death benefit and the insured's spouse owned the cash value. Under these circumstances, the IRS ruled that:

> "… the decedent has retained no incidents of ownership in the life insurance policy on his life. He has no powers over either the policy or the irrevocable trust that holds the policy."

(2) Inclusion in the Estate of the Insured – I.R.C. Sec. 2038

Section 2038 of the Code provides that in the case of any transfer where the decedent has retained the power to alter, amend, revoke or terminate the transfer, the value of the transferred property will be includable in the decedent's estate for federal estate tax purposes. The relevant transfer here occurs when the insured makes a gift to the spouse so that he or she can pay the balance of

[12] IRC § 2042

the premiums. This transfer can be avoided if the spouse has independent funds from which to make such premium payments.

The private split dollar plan usually envisions that the spouse will access policy values on a tax-favored basis at retirement. Since the spouse may use these funds to supplement the couple's retirement income, query whether this represents a power to revoke the transfer which will cause inclusion in the insured's taxable estate. There is also an issue as to whether this constitutes an incident of ownership in the policy by the insured.

The spouse, however, is completely independent of the insured and after the gift is made, the donor has no power to control how the gift will be utilized. The insured has no power other than that of persuasion over the transferred property. Although it cannot be cited as precedent, PLR 9636033 would lend support to this position. The Service ruled that even though the insured's spouse had all the rights to the policy cash values, the insured had no power over the policy and had retained no incidents of ownership.

However, even if the Service were successful in asserting that the insurance proceeds were includable under Section 2038 (revocable transfers) or Section 2042 (incidents of ownership), the insured's estate may be entitled to a corresponding deduction for the portion of the proceeds payable to the irrevocable trust. The Code allows an estate deduction for any "indebtedness" with respect to property that is includable in the decedent's estate.[13] Under the terms of the split dollar agreement the trust has an enforceable claim with respect to the policy and therefore, the estate is entitled to a corresponding deduction for the portion of the death proceeds payable to the trust in satisfaction of that claim.

As the foregoing discussion indicated, the tax issues are complex and will depend on individual facts and circumstances.

(3) Inclusion in the Estate of the Spouse – Section 2036

Not only is it necessary to be concerned with the estate tax consequences for the insured, it is also critical to minimize the estate tax impact on the spouse who is participating in the program.

Spouse's Interest in the Cash Value

If the spouse predeceases the insured, the cash surrender value of the policy will be subject to the terms of the deceased spouse's estate plan. In order to keep the proceeds out of the insured's estate, the spouse's will (or revocable trust) should make sure that any incidents of ownership in the policy are not given to the insured either directly or to a trust for the insured's benefit or a trust in which the insured is a trustee.

Giving the insured the right to the income as a trust beneficiary or the right to control the policy, even in a fiduciary capacity, is generally considered to be an

[13] IRC § 2053 (a)(4)

incident of ownership, resulting in inclusion of the death proceeds in the insured's estate.[14] To avoid this result, the spouse's interest must pass to someone other than the insured. Perhaps, sending it to the trust that owns the death benefit would make the most sense. In this way, the two interests would merge and the split dollar arrangement could be terminated with the cash value used to support the policy in a non-split dollar basis.

If the spouse's interest in the cash value of the split dollar policy is left to the children (or to a trust for their benefit), there will be a federal estate tax due if the amount of the cash value exceeds the spouse's remaining applicable exclusion amount. This estate tax liability may be minor compared to the estate tax savings resulting from excluding the balance of the death proceeds from both spouses' estates.

The spouse's death will also mean that the spouse will no longer be a source of premium payments for the policy under the split dollar arrangement. The successor in interest will be responsible for the premium payments but may not have the ability to make them. As later discussed in Section VIII, it will be critical for the parties to develop an exit strategy early in the planning process.

Spouse's Interest in the Net Death Benefit

In the private split dollar plan, the objective is to ensure that all of the net death benefit is excluded from the estates of both the insured and his or her spouse. However, failure to properly administer the program could result in the inclusion of all or a substantial portion of the trust assets in the estate of the spouse regardless of whether the spouse dies before or after the insured.

If the spouse makes a gift to the trust that has been established for his or her benefit (even if the spouse is not the person who created the trust) all or a portion of the assets in that trust will be included in the spouse's estate.[15] Typically, it is not contemplated that the spouse will make transfers to the trust; such transfers are generally made inadvertently.

If the insured contributes sufficient assets to the irrevocable trust, and the trust pays a portion of the premium equal to the economic benefit in each and every year until the death of the insured, then, in general, it appears that no portion of its value would be includable in the spouse's estate for federal estate tax purposes. Since the trust's only interest in the policy is the net death benefit and as the trust has always paid the full value for that insurance protection, the spouse's payment of the balance of the premium has not resulted in any transfer to the trust. Since the spouse has not transferred any interest to the trust, no portion of its value should be includable in the spouse's estate for federal estate tax purposes.

At the other extreme is a situation where the insured creates the trust, but never contributes any assets to it. As a result, the trustee never pays any portion of the premium, and the spouse in effect, makes all premium payments. In this case the

[14] Treas. Reg. §20.2042-1(c)
[15] IRC §2036

spouse would be treated as the grantor of all of the trust's assets and the entire value of the trust will be includable in the spouse's estate.

What happens in a more typical example, where the trust pays its share of the premiums in some years, but through oversight fails to do so in other years? Assume for example, that during the first five years of the trust, the insured makes annual exclusion gifts to the trust and the trustee then contributes a portion of the premium equal to its imputed economic benefit, a total of $5,000. Assume further that the insured makes no further contributions after that point and the imputed income to the trust over the next ten years totals $15,000. Finally, assume that the insured dies at that point, that $1 million of insurance proceeds are paid to the trust and that the spouse dies ten years later when the trust assets have grown to $1.6 million. What amount is includible in the estate of the spouse and how is it determined?

Section 2036 of the Code includes property in the spouse's estate only "to the extent" that the spouse has made a transfer of assets to the trust. Since the spouse made the transfers and retained an interest in the trust, it is necessary to determine the value of the trust at the time of the spouse's death ($1.6 million) and not the value of the trust at the insured's death ($1 million). Next, that value is includable in the spouse's estate only "to the extent" that the spouse has made a "transfer" to the trust. Here, the total transfers to the trust are $20,000 (the insured's contribution of $5,000 and the spouse's imputed gifts of $15,000). Thus, the spouse is treated as the grantor of 75% of the value of the trust, so $1.2 million (75% of $1.6 million) will be includable in the spouse's estate. In addition, the spouse received an amount equal to the cash value when the client died ten years earlier. To the extent that those proceeds have not been consumed or given away, they will also be includable in the spouse's estate for federal estate tax purposes.

Avoiding Inclusion

This problem of inclusion can be avoided in a couple of ways. The first way has already been discussed – taking steps to ensure that the trust always pays an amount equal to the economic benefit and thereby avoid any imputed "transfer" from the spouse to the trust. This requires careful attention to proper administration during the entire term of the trust arrangement.

A second alternative is to design the trust to provide no benefit at all for the spouse. For example, the grantor/insured could establish a trust for the sole benefit of his or her children. In this case, no portion of the trust assets would be includable in the spouse's estate since the spouse has no right to either the "enjoyment" or the "income" from the trust property. This option, however, may be unacceptable, especially for less affluent individuals.

B. Private Split Dollar between Insured and Trust

Private split dollar with an insured(s) is useful when the insured is primarily interested in reducing the amount of the gift to the trust from the full premium to the economic benefit amount or the "imputed" interest. This form of private split

dollar is not used if the insured is interested in having direct access to the cash value. If a policy is transferred to an irrevocable trust and the insured retained the right to borrow against the cash values, the entire proceeds would be included in the insured's estate since the insured would have possessed at his or her death an incident of ownership in the policy.[16]

In PLR 9745019, the insureds proposed to secure their interest in the policy by using a limited or restricted collateral assignment. The trustee would assign to the insureds the right to receive the cash value of the policy (less the first year policy's cash value) in the event that the agreement terminated prior to the death of the surviving insured or in the event of the death of the surviving insured. All other rights with respect to the policy were reserved to the trustee and were exercisable solely by the trustee subject only to the insureds' security interest.

The Service ruled that because the insureds retained no incidents of ownership in the policy on their lives, the policy proceeds would not be includible in the gross estate of the survivor of the insureds. The key to the holding was the Service's finding that the insureds could not force cancellation of the policy. The split dollar agreement was carefully worded so that it could be terminated by the insureds only if the value of all trust assets equaled or exceeded the amount payable to the insureds, counting only the loan value of the policy as an asset of the trust.

The IRS has not found an incident of ownership in the controlled corporation (which could be attributable to a majority shareholder) where its rights under the split dollar agreement were limited to getting repaid its investment in the contract and all other rights in the policy are owned by the trustee (or third party).[17]

In PLR 9745019 the IRS extended the restricted collateral assignment reasoning to private split dollar arrangements where the restricted collateral assignment is directly with the insured(s) and not a controlled corporation. More recently, the Service has ruled favorably when dealing with both pre-regulation and post-regulation private split dollar arrangements. In PLR 200848002 the Service found that neither insured held any incident of ownership in the two pre-regulation private split dollar arrangements and ruled that the proceeds payable to the trust were not included in the gross estate of either the husband or the wife.[18]

In PLR 200910002 the fact that the split dollar arrangement was entered into after the effective date of the final regulations did not change the favorable estate tax results. Again, the key to the ruling was the finding that the settlors retained no incidents of ownership in the policy which would cause inclusion of the proceeds paid to the trustee.[19] The terms of the trust specifically preclude either settlor from acting as trustee. Further, the settlors retained no powers or authority over the trust, trust property, or the administration of the trust.

---

[16] Treas. Reg. §20.2042-1 (c)(2); Estate of McCoy v Comm., TC Memo 1961-40.
[17] PLRs 9348009 and 9511046.
[18] The Service issued a similar ruling in PLR 200822003 which also involved a pre-regulation private split dollar arrangement.
[19] Also, see PLR 200825011 in which the IRS again ruled favorably on the estate tax consequences of a post-regulation private split dollar arrangement.

The trust collaterally assigned the following rights: (1) if the split-dollar agreement terminated on the death of the survivor of the two insureds then upon the death of the survivor, the right of the survivor's estate to receive the greater of the cash surrender value of the policy or the cumulative premiums paid by the settlors; and (2) if the agreement terminated during the lifetime of the two settlors, or the lifetime of the survivor, then within 60 days of termination, the right to receive from trust an amount equal to the greater of the cash surrender value of the policy, or the premiums paid, to the extent trust has other assets.
Under the agreement, all incidents of ownership over the policy (including the sole right to surrender or cancel the policy, and the sole right to borrow or withdraw against the policy) were vested in the Trustee of the Trust.

The IRS therefore concluded as follows:

> "In the present case, under the Agreement and the collateral assignment, neither Settlor A nor B will hold any incidents of ownership in Policy. As noted above, all incidents of ownership in the policies, including the power to change the beneficiary, the power to surrender or cancel the policy, the power to assign the policy or to revoke an assignment, and the power to pledge the policy for a loan or to obtain from the insurer are vested in the Trustee of the Trust. Accordingly, we conclude that the proceeds of the policy payable to the Trust will not be included in the gross estate of the second to die of A and B under §2042(2). The portion of the proceeds payable to the estate of the survivor of A and B will be includible under § 2042(1). See, e.g., § Rev. Rul. 79-129, 1979-1 C.B. 306. "

To obtain such favorable estate tax results, it is critical that neither insured retain any incident of ownership and that the insureds' only interest in the private split dollar arrangement is to receive nothing more than the greater of cash value or premiums paid .The agreement must limit the insureds' ability to force action with respect to the policy. If the insureds have the ability to trigger the trustee's obligation to repay advances (e.g., by terminating the agreement), the Service could argue that such a right, in the case of a trust without other funds, is equivalent to the ability to force the trustee to exercise policy loan privileges or other policy rights.

VIII. The Importance of an Exit Strategy

In determining the use of private split dollar as a viable estate planning tool, it is important to analyze the current gifting program employed by the client. If the client is not fully utilizing his annual exclusion gifting capacity, then private split dollar may not provide any gift or generation skipping transfer tax benefit. On the other hand, if the client is maximizing his gifting capacity, then private split dollar combined with an appropriate exit strategy may provide significant transfer tax benefits.

Non-equity private split dollar may not be financially attractive in the long term. Since the equity owner (e.g., the spouse if using an individual policy or the insureds if using a survivorship policy) would be entitled to the greater of the

premiums paid or the cash value, only the difference between the death benefit and this equity interest would be removed from the insured's estate. Unless a secondary guaranteed universal life policy with a limited pay plan is utilized, the amount which is removed from the estate decreases significantly over time.

Furthermore, the economic benefit cost increases as the insured ages. In fact, these economic benefit costs will continue to increase so long as the private split dollar arrangement remains in force, even if premiums are no longer needed to be paid in cash to sustain the policy. With increased longevity, this problem will only become more acute. The cost of the insurance protection may eventually exceed the premium for the underlying policy, often making the private split dollar plan uneconomical.

Where the policy is owned by a third party, e.g., children or an irrevocable life insurance trust (ILIT), the economic benefit may also exceed the donor/insured's available annual exclusion amounts, resulting in a taxable gift and the use of a portion or all of the insured's applicable exclusion amount. Only by terminating the private split dollar agreement and repaying the donor's interest can the escalating tax costs be stopped.

In a non-equity arrangement where the trust does not own any interest in the cash value, it may not be possible to terminate the split dollar arrangement without incurring adverse gift tax (and possibly GST) consequences. Since the amount required to repay the donor will equal the greater of the premiums paid or total cash value of the policy, it will be difficult to accumulate sufficient assets in the trust to repay the split dollar obligation. For these types of non-equity split dollar arrangements, it will be important to design an exit strategy in order to avoid any unpleasant tax consequences at rollout. That is, it will be critical to create a tax efficient gifting strategy so that the irrevocable trust holding the life insurance policy has sufficient funds to repay the split dollar obligation from sources other than the policy itself.

Exiting the split dollar agreement for a survivorship life policy at the time of the first death will be important since at the first insured's death, the economic benefit or "imputed gift," increases quite dramatically. For example, assume a private survivorship split dollar arrangement provides a $10 million death benefit to an irrevocable trust for a couple, both age 75. If one of the insureds dies, the economic benefit cost for that year increases from $11,196 as calculated under the revised Table 38 rates to a whopping $330,500 utilizing the Table 2001 rates. In addition, the death of a spouse will cut in half the amount available for annual exclusion gifts. Thus, the surviving spouse may quickly discover that the private split dollar plan may no longer insulate him or her from actual or imputed taxable gifts.

Based upon the above, an exit strategy involving a survivorship policy should consider one of the following:

(i) convert the arrangement to a split dollar loan at the death of the first insured since the annual interest cost will generally be less than the economic benefit calculated at the age of the surviving insured;

(ii) suggest each insured include a provision in their will or revocable trust to pass an amount equal to the split dollar obligation (and possibly, an additional amount to pay future premiums) to the irrevocable trust to enable the trustee to repay the split dollar obligation and exit from the arrangement;

(iii) efficiently transfer (as early as possible) assets into the trust by making discounted gifts of minority interests in real estate or a family-controlled business; or

(iv) implement a tax efficient planning technique such as a grantor retained annuity trust or a sale to a defective trust in order to move assets into the trust and repay the split dollar obligation.

Of course, the best course of action will be based upon the particular facts and circumstances.

Non-equity collateral assignment private split dollar typically provides the most transfer tax benefits when (i) it is designed as an interim financing tool, (ii) a limited pay secondary guaranteed universal life policy is used, and (iii) an appropriate exit strategy is developed. A thorough examination of the strategies available to terminate the split dollar arrangement, repay the donor and provide alternative funding should be undertaken as early in the process as possible. By developing this type of long-range plan, the risks associated with private split dollar can be managed successfully.

IX. Conclusion

Private split dollar continues to be an important tool in helping to solve complex financial and estate planning problems. This article provides a sampling of the many possible applications of private split dollar. It also discusses the income, gift and estate tax consequences of private split dollar.

The split dollar regulations along with the private letter rulings provide guidance. Proper ownership and documentation, however, are not sufficient. To fully realize the substantial tax benefits of private split dollar, it is critical that the program be administered properly from inception and throughout its duration. Lastly, the importance of having a well-thought-out exit strategy for private split dollar cannot be overly emphasized.

* * * * *

Legal & Tax Trends is provided to you by a coordinated effort among the advanced markets consultants. The following individuals from the Advanced Markets Organization contribute to this publication: Thomas Barrett, Michele B. Collins, Kenneth Cymbal, John Donlon, Lori Epstein, Jeffrey Hollander, Jeffrey Jenei, Lillie Nkenchor and Barry Rabinovich. All comments or suggestions should be directed to Thomas Barrett at tbarret@metlife.com or John Donlon at jdonlon@metlife.com.

Pursuant to IRS Circular 230, MetLife is providing you with the following notification: The information contained in this document is not intended to (and cannot) be used by anyone to avoid IRS penalties. This document supports the promotion and marketing of insurance products. You should seek advice based on your particular circumstances from an independent tax advisor.

MetLife, its agents, and representatives may not give legal or tax advice. Any discussion of taxes herein or related to this document is for general information purposes only and does not purport to be complete or cover every situation. Tax law is subject to interpretation and legislative change. Tax results and the appropriateness of any product for any specific taxpayer may vary depending on the facts and circumstances. You should consult with and rely on your own independent legal and tax advisers regarding your particular set of facts and circumstances.

Metropolitan Life Insurance Company
1095 Avenue of the Americas
New York, NY 10036

New England Life Insurance Company
501 Boylston Street
Boston, MA 02116

#L0711194294[exp0212][CA,DE,FL,MD,NY,NJ,PA]