



# Split Dollar Arrangements

Strategies for Competitive Business



## TABLE OF CONTENTS

- 1 Key to a Successful Business
- 3 Split Dollar is Advantageous for Employers and Employees
- 4 Flexibility and Versatility – for a Variety of Business and Personal Insurance Needs
- 6 Establishing a Split Dollar Arrangement
- 8 What Does it Cost?
- 9 Split Dollar Activity Checklist

NOT A BANK OR CREDIT UNION DEPOSIT OR OBLIGATION • NOT FDIC OR NCUA INSURED •  
NOT INSURED BY ANY FEDERAL GOVERNMENT AGENCY • NOT GUARANTEED BY ANY BANK OR CREDIT UNION

# Key to a Successful Business

## Retention of Key Employees

If you own a closely held business or are a senior executive at a major corporation, you know the importance of rewarding, retaining and recruiting key employees. Key employees are as important to the success of your business as the product or service you provide.

Split Dollar arrangements can be an advantageous alternative to adding new fringe benefits, increasing compensation or enhancing current incentive programs – all of which increase company overhead. Balancing the impact to the bottom line with the need to retain experienced employees is challenging in today's market.

## What is Split Dollar?

Split Dollar life insurance is not a type of insurance policy; it is a cost- and tax-effective way to split the premiums and benefits of a permanent life insurance policy between two or more parties. A Split Dollar arrangement can be used by an employer to provide valuable life insurance death benefit protection for select key employees. The employer can be a C or S corporation, partnership, LLC or even a sole proprietor. The insured may be the employee or anyone in whom the employee has an insurable interest (such as a spouse, parent, child or business associate). Family or private Split Dollar Plans may also be structured between family members (parents and children) or between insureds and their irrevocable life insurance trusts (ILITs).

## How Does Split Dollar Work?

There are two types of Split Dollar arrangements: Endorsement (or Economic Benefit) and Loan Regime.

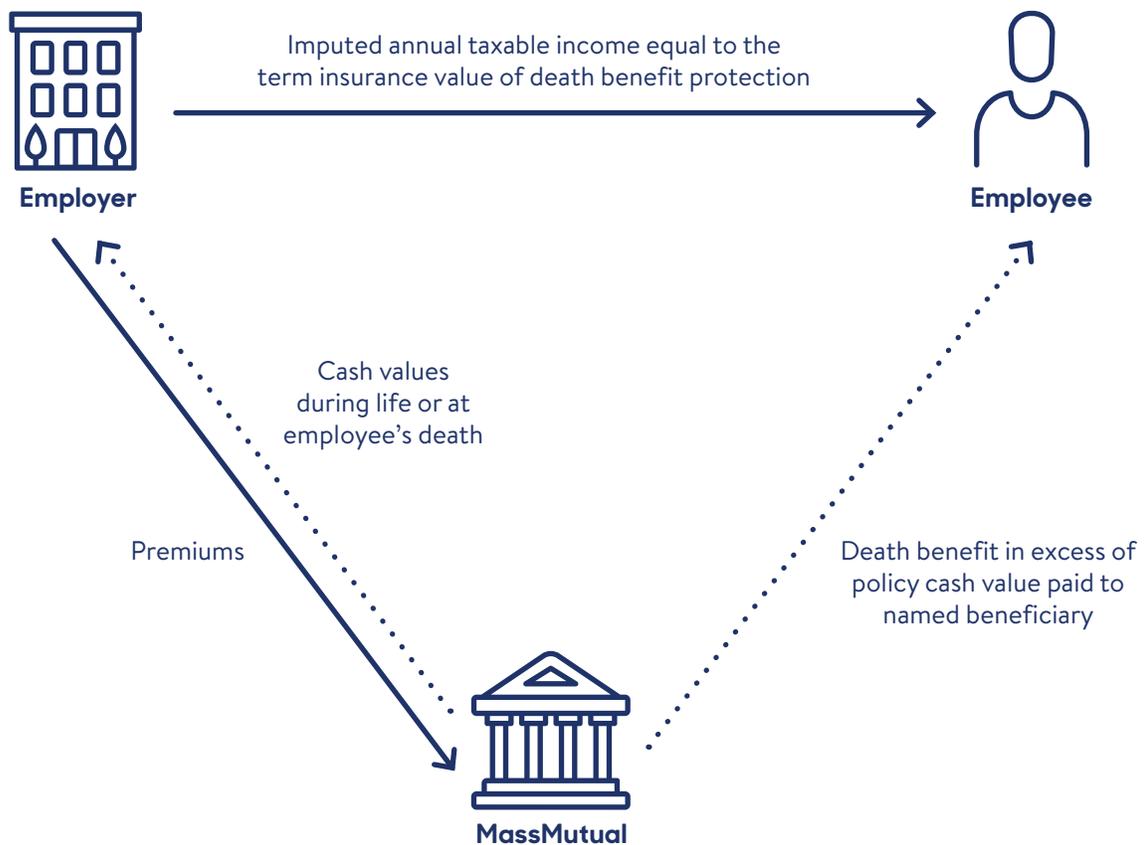
### Endorsement Arrangement

The employer pays all of the premiums and owns all of the policy cash value. The death benefit is split between the employer and the employee's named beneficiaries, with the employer being entitled to an amount at least equal to its cash value interest.

### Split Dollar Loan Arrangement

The employer pays all or a portion of the employee's life insurance policy premiums as a loan. The employer has a collateral assignment against the policy to ensure recovery of the loan.

## ENDORSEMENT SPLIT DOLLAR ARRANGEMENT



# Split Dollar is Advantageous for Employers and Employees

## Employer Advantages

- **Selectivity** – You decide who participates and the benefit levels for each employee. Split Dollar gives you the flexibility to choose a group of executives or just one key employee with the versatility to have a different benefit for each.
- **Easy to establish and administer** – IRS approval is not required, and administration is minimal.
- **Split Dollar is an asset** – Policy cash values are an asset on the business' balance sheet, and the cash value grows on a tax-deferred basis.
- **Cost-effective** – Unlike other fringe benefits, the business normally recoups the cost, and the death benefit proceeds are normally received income tax free.
- **Leverage** – A Split Dollar arrangement may cost less than the after-tax compensation dollars required to provide an equivalent benefit.
- **Employee productivity and loyalty** – Key employees will feel valued and will be more productive. “Golden handcuff” provisions can be included by promising a future deferred compensation benefit informally funded with policy cash values, giving key employees incentive to remain loyal to the business.
- **Versatility** – Split Dollar arrangements can be used in a variety of ways to meet an executive's or a business owner's estate planning and business needs.

## Employee Advantages

- **More meaningful** – The employee enjoys insurance protection when he or she needs the coverage the most.
- **Cost- and tax-effective** – The employer generally pays the entire premium, the employee is taxed based on his or her share of the death benefit at a very attractive “term” rate.
- **Tax-free death benefit** – Death benefit proceeds are generally received income tax free by the employee's beneficiary.
- **Versatility** – In addition to the financial protection life insurance in a Split Dollar arrangement provides, it can also be designed to help supplement retirement or estate planning needs.

# Flexibility and Versatility

## For a Variety of Business and Personal Life Insurance Needs

### Employee Retention

A Split Dollar arrangement can be an excellent fringe benefit that provides protection and estate planning advantages above and beyond other benefits for a key employee.

### Estate Planning

Split Dollar arrangements can be structured to provide the executive and/or the business owner with estate liquidity at a low out-of-pocket cost (the income tax on the term value). Combining the arrangement with an irrevocable trust may also keep the death benefit out of the executive/owner's estate. Use of business funds for the premium frees up personal cash for other needs.

### More Efficient than Group Term Insurance Benefits

Higher-paid employees are subject to income tax on the value of group term benefits in excess of \$50,000, using the IRS-provided Table I term rates, making the excess benefits potentially quite costly to the employee. The Split Dollar rules permit the employer to use either the IRS Table rates or the insurance company's lower qualifying term rates. Permanent life insurance under a Split Dollar arrangement can be a very attractive replacement for an executive group term arrangement.

### Fund Cross Purchase Buy-Sell Agreement

Split Dollar arrangements can be a great way to reduce the out-of-pocket costs for the parties to a buy-sell agreement.

### Supplemental Retirement Benefit

The employer can decide at any time up to an employee's actual retirement to transfer ownership of the permanent life insurance policy to the employee as a taxable bonus. Alternatively, the employer may use the policy itself or a portion of the policy values to fulfill a deferred compensation promise to the key employee. Any promise to provide compensation in the future must be detailed in a written Deferred Compensation Agreement compliant with the rules of the Internal Revenue Code (Section 409A). The employer receives a tax deduction based on the value provided to the employee at the time of the transfer. The transfer of the policy to the employee enables the employee to maintain permanent death benefit protection for the benefit of the employee's family. The policy cash values can be used to fund the employee's tax liability on the receipt of the policy. It can also be used by the employee to supplement retirement income.

## Split Dollar and Deferred Compensation

The combination of Split Dollar and Deferred Compensation permits the employer to control the life insurance policy cash values during the employee's working life. Split Dollar allows the employee to receive life insurance death benefit protection at a very low tax cost that will be paid to his or her named beneficiary income tax free. All benefits paid as Deferred Compensation, including a promised pre-retirement death benefit, are taxable as ordinary income to the recipient beneficiary. Adding a Split Dollar arrangement means that any death benefits paid to the employee's named beneficiary in excess of the amount received by the employer (usually the life insurance policy's cash value) are generally received income tax free by the employee's beneficiary.



# Establishing a Split Dollar Arrangement

Split Dollar arrangements are easy to set up and administer. Your financial professional<sup>1</sup> will work with you through the process to minimize your efforts while maximizing the efficiency of your Split Dollar arrangement. At Massachusetts Mutual Life Insurance Company (MassMutual), we are committed to helping you address your business needs.

## How Permanent Life Insurance Works in a Split Dollar Arrangement

- **Premiums:** The employer pays the premiums. The employee is taxed on the economic value of his or her share of the death benefit. The taxable value is based on an IRS table or the insurance company's applicable one-year term rates.
- **Cash values:** The employer is entitled to all of the policy cash values if the arrangement is terminated before the insured's death. The cash values are reflected on the employer's balance sheet. The employee has no interest in the cash value.
- **Death benefits:** The employer is usually entitled to the greater of the policy premiums or the cash value. The employee's beneficiary is entitled to the balance. The written Split Dollar agreement could provide that the employer is entitled to receive a greater share of the policy death proceeds.
- **Ownership of the policy:** While the employer is generally the owner of the policy, IRS Split Dollar Regulations permit the policy to be owned by the employee, a trust created by the employee or any third party with an insurable interest on the employee's life. Third-party ownership is sometimes used in order to meet the employee's estate planning goals. When the employer is not the owner of the policy, the employer's share of policy cash values and death benefits are protected through the documentation of the Split Dollar arrangement, including a collateral assignment form.

<sup>1</sup> There are many alternatives and variations associated with Split Dollar arrangements. Given the possibilities, you can gain great advantage by putting the MassMutual team of advanced sales experts to work for you. Your financial professional will coordinate with your advisors and a team of MassMutual Home Office professionals to help assure that you implement the right solution to your fringe benefit and estate planning needs.

## Implementation of a Split Dollar Arrangement is Simple

- **Identify** and discuss with your key employees.
- **Apply** for the insurance.
- **Design a Split Dollar arrangement:** Taking into account your company's needs and those of the key people you wish to cover, your financial professional can help design the appropriate Split Dollar arrangement for your review. This may involve tailoring benefits to each key employee or a group of key employees or executives.
- **Execute the Split Dollar agreement:** In certain arrangements, you may also need to execute a collateral assignment. To facilitate implementation, MassMutual can provide specimen agreements for use by your advisors. For legal reasons, MassMutual cannot prepare the actual agreements for your Split Dollar arrangements.
- **Termination of the Split Dollar arrangements:** The Split Dollar agreement addresses treatment of the policy if the arrangement is terminated for any reason other than death; e.g., termination of employment or retirement.

## Alternative Split Dollar Loan Arrangement

- Instead of utilizing a traditional Endorsement Split Dollar arrangement where the employer owns all of the policy cash values and the employee is taxed on the term insurance values of the annual death benefit protection, the arrangement could be established as a Split Dollar loan. Under the loan arrangement, the employee (or a trust or other third party) owns the life insurance policy, and the employer provides a loan each year to pay all or a portion of the annual life insurance premium.
- The loan can bear interest at the Applicable Federal Rate (AFR), which can be paid or accrued. Alternatively, the loan can be structured as a below-market rate or no-interest loan. Under the below-market rate loan rules, the employee is taxed each year on the calculated value of interest that the employee was not required to pay using the IRS Demand Loan AFR as the benchmark interest rate. The employer receives a tax deduction for the below-market interest rate value treated as compensation to the employee; the employer is then treated as receiving such amount from the employee as a taxable interest payment.
- All other aspects of the Split Dollar loan arrangement are similar, except that the employer's interest is equal to the outstanding loan rather than the entire cash value. The employer's interest is secured by a collateral assignment rather than through direct policy ownership. Instead of the employee being taxed annually on the term value, the tax consequences with a Split Dollar loan arrangement are based on the below-market rate tax rules.

# What Does it Cost?

The cost of a Split Dollar arrangement to the employer (the premiums paid) rests on many variables:

- The number of employees covered;
- The desired benefit levels;
- The ages, health, and in some instances, the employee's occupation; and
- The type of product selected and its long-term performance.

While it is true that the premiums must be paid, and the business usually bears most or all of this cost, the **true cost** of Split Dollar is not measured in terms of insurance premiums alone. The employer's share of the policy cash value is an asset on the business' balance sheet. Eventually, this asset may be equal to or greater than the premiums paid by the employer. Moreover, upon the death of the employee, the employer recovers its cost from the policy's death proceeds. Likewise, if the Split Dollar arrangement is terminated, the employer usually recovers his or her costs from the policy cash value.

As for the employee, his or her cost is the income tax on the taxable economic benefit. Therefore, the employee receives an insurance benefit at a low cost.

The bottom line is that permanent life insurance in a Split Dollar arrangement uses recoverable business dollars to meet important key employee needs while greatly benefiting the business – which makes Split Dollar a win-win for the employer **and** the employee.

# Split Dollar Activity Checklist

## Endorsement Split Dollar Arrangement

### Policy owned by employer

- 1 | Review MassMutual Split Dollar illustration and basic policy illustration;
- 2 | Consult with personal legal counsel; execute Split Dollar agreement;
- 3 | Complete MassMutual life insurance application, endorsement Split Dollar beneficiary designation, and related MassMutual Split Dollar forms;
- 4 | Before the end of each calendar year in which the Split Dollar arrangement remains in effect, employer should provide to its payroll service the value of employee's death benefit protection using either MassMutual's non-convertible term (NCT) rates or the IRS Table 2001 rates; and
- 5 | Employers are required to submit IRS Form 8925, Report of Employer-Owned Life Insurance Contracts, annually with their federal tax returns.

## Collateral Assignment Economic Benefit Split Dollar Arrangement

### Policy owned by employee, trust or other third-party owner

- 1 | Review MassMutual Split Dollar illustration and basic policy illustration;
- 2 | Consult with personal legal counsel; execute Split Dollar agreement;
- 3 | Complete a MassMutual life insurance application, Split Dollar collateral assignment form, and related MassMutual Split Dollar forms;
- 4 | Before the end of each calendar year in which the Split Dollar arrangement remains in effect, the employer should provide to his or her payroll service the value of the employee's death benefit protection using either MassMutual's NCT rates or the IRS Table 2001 rates; and
- 5 | Employers are required to submit IRS Form 8925, Report of Employer-owned Life Insurance Contracts, annually with their federal tax returns. (The employee or other third party may be the legal title owner of the policy, but under the Split Dollar rules, the employer is still treated as the owner of the policy cash value).

## Split Dollar Loan Arrangement

### Policy owned by employee, trust or other third-party owner

- 1 | Review MassMutual Split Dollar Loan illustration and basic policy illustration;
- 2 | Consult with personal legal counsel; execute Split Dollar Loan agreement (specimen agreements can be provided by MassMutual to your legal advisor);
  - a | Agreement should specify whether arrangement will be structured as a Demand Loan or as a Term Loan
  - b | Agreement should specify how interest will be determined and whether it will be paid or accrued
- 3 | Complete a MassMutual life insurance application, Split Dollar collateral assignment form, and related MassMutual Split Dollar forms; and
- 4 | At the policy anniversary date, or before the end of each calendar year in which the Split Dollar Loan arrangement remains in effect, the amount of interest on the loan should be determined. If loan interest is being taxed to the employee, the employer should provide the value of the employee's taxable interest income to his or her payroll service. If the life insurance policy is owned by an irrevocable trust, and loan interest is to be treated as a gift, the trustee should be notified of the amount of the deemed gift.



Life insurance products issued by Massachusetts Mutual Life Insurance Company (MassMutual) (Springfield, MA 01111-0001) and its subsidiaries, C.M. Life Insurance Co. and MML Bay State Life Insurance Co. (Enfield, CT 06082). C.M. Life Insurance Co. and MML Bay State Life Insurance Co. are non-admitted in New York.

**The information provided is not written or intended as specific tax or legal advice. MassMutual, its subsidiaries, employees and representatives are not authorized to give tax or legal advice. Individuals are encouraged to seek advice from their own tax or legal counsel. Individuals involved in the estate planning process should work with an estate planning team, including their own personal legal or tax counsel.**

© 2017 Massachusetts Mutual Life Insurance Company (MassMutual), Springfield, MA 01111-0001.  
All rights reserved. [www.massmutual.com](http://www.massmutual.com).

AS2007 1117

CRN201910-219631