



# INSIGHTS



## ESTATE PLANNING

# Family Split Dollar Arrangements: A Way to Help Fund Your Irrevocable Life Insurance Trust

## THE BIG PICTURE

I need a significant amount of life insurance for estate liquidity, but I'm concerned about the estate and gift tax consequences of making large gifts to an irrevocable trust. Is there a solution?

A Family Split Dollar arrangement may be a cost- and tax-effective method of providing life insurance protection that can take care of your family's estate planning needs without requiring large taxable gifts to pay the annual life insurance premiums.

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## How a Family Split Dollar Arrangement Works

**An irrevocable life insurance trust (ILIT) would be the original applicant and owner of the life insurance policy. You would pay all of the life insurance premiums, and own all of the policy cash value.** The premiums are not considered to be gifts to the trust, but are your personal share in the cash value of the permanent life insurance policy. There are annual gifts resulting from the transaction. The gifts are measured not by the amount of the whole premium paid, but by the value of the term insurance portion of the death benefit that would be paid to the trust if your death occurred during the current year.

Your ownership interest in the policy cash value is reflected through a collateral assignment of the policy given to you by the trustee of your ILIT. However, in order to help avoid adverse estate tax consequences, the collateral assignment must restrict your ability to access policy cash values<sup>1</sup> during your lifetime. If a regular collateral assignment form was used which gives you access to policy cash value, the entire policy death benefit would be includible in your taxable estate. Instead, at your death, a portion of the death benefit equal to the cash value immediately prior to death will be paid to your estate. If the policy was surrendered prior to your death, the entire cash surrender proceeds would be paid to you.

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## Is There Ever an Opportunity for You to Have Access to Policy Cash Value?

**While the Split Dollar arrangement is in effect, you own all of the cash value but cannot access it. The trust is the legal title owner of the policy, but it cannot access the cash value, because it does not own any of it.** If you sell your cash value interest to your trust in exchange for a promissory note, the trustee now has access to the cash value because it is owned by the trust. If the policy requires additional premiums, the trust is obligated to make those payments in order to keep it

in force. If the trust does not have sufficient assets to pay the premium, additional loans from you, the grantor, may be needed. The loans call for interest to be paid, accrued, or gifted to the trust by the grantor. The trustee can access that cash value to begin making payments to you on the note payable. If you die before the trust's liability to you is completely repaid, the outstanding note will be included in your taxable estate.

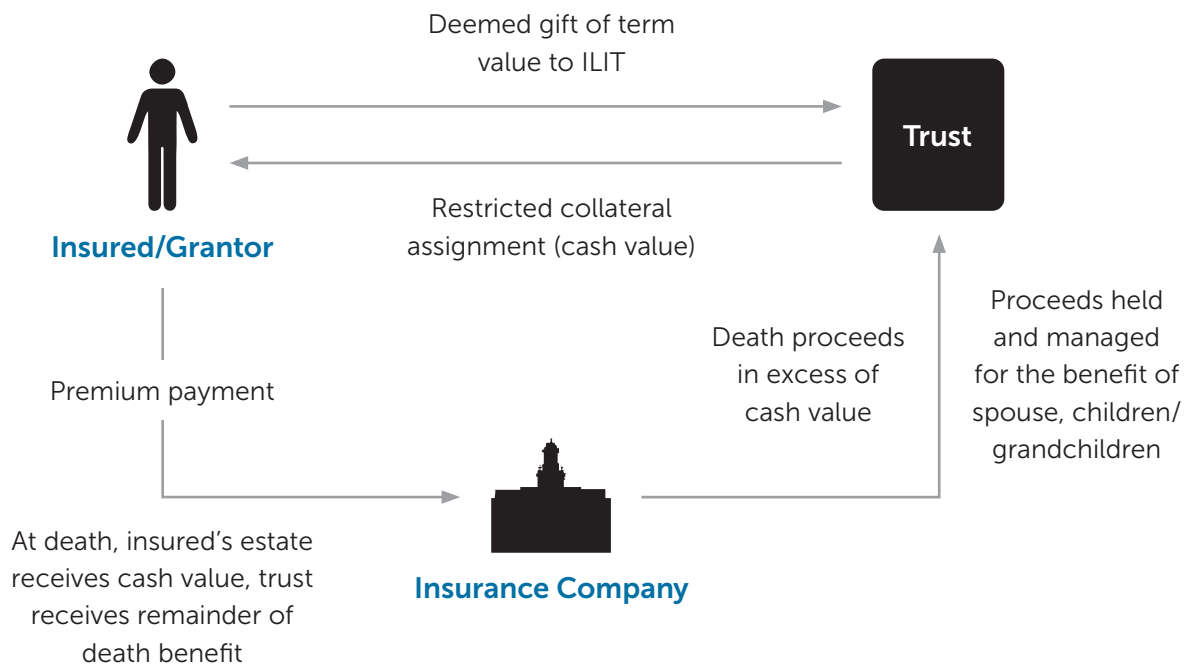
## Advantages

- Help maximize the value of your annual gift tax exclusions, lifetime gifting exemption, and generation-skipping transfer tax exemption by maintaining a life insurance policy far in excess of what you would otherwise be able to purchase with gift tax-free transfers.
- By switching the arrangement from Economic Benefit Split Dollar to Loan Regime Split Dollar when you need access to policy cash value, the trustee now has the right to access policy cash value. The trustee can use policy values to partially or fully pay down the loan obligation to you. This repayment could be secured by the policy cash value, but is not required.

## Disadvantages

- Access to policy cash value is limited without switching the arrangement to a loan (selling your cash value interest to the trust in exchange for a promissory note).
- The cost of the term portion increases each year as you grow a year older.
- As the cash value of the policy grows in proportion to the overall death benefit, the portion payable to the trust declines.

## Family Split Dollar – Insured Pays Premium



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<sup>1</sup>Access to cash values through borrowing or partial surrenders will reduce the policy's cash value and death benefit, increase the chance the policy will lapse, and may result in a tax liability if the policy terminates before the death of the insured.



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