

Private split dollar financing

The concept

Private split dollar financing is often used in situations when there is a need for efficient planning for gift and estate taxes in moving assets from one generation to future generations. The typical case involves creation of a loan from an affluent family member to a trust in order to purchase a life insurance policy for the benefit of the trust beneficiaries. Because the transaction is structured as a loan, the potential for moving assets from one generation to the next in a tax-efficient manner may be enhanced.

Benefits

- The arrangement provides gift tax leverage because the gift that creates the death benefit is measured by the economic benefit of the death benefit protection rather than the premiums paid
- The death proceeds are received by the ILIT both income and estate tax free
- The death proceeds (net of the loan repayment) are available to provide estate liquidity or to meet other family objectives
- The ability to terminate the arrangement gives the family member providing the funding the ability to recover policy cash values if personal circumstances or objectives change

Tax considerations

IRS Notice 2002-8 and the associated final regulations permit the use of Table 2001 to calculate economic benefit values or alternatively the insurer's term rates if certain conditions are met.

Steps

- A trust is established to hold a life insurance policy to benefit future generations
- The trustee applies for a policy on the grantor's life (or potentially another's life) and enters into a private nonequity collateral assignment split dollar agreement with the family member providing the funding

- The trustee executes a collateral assignment in favor of the funding family member for the greater of the cash value of the policy or total premiums advanced
- The family member advances premium amounts to the insurance company and the economic benefit of the death benefit protection is treated as a gift to the trust
- Under the terms of the split dollar agreement and collateral assignment, the funding family member controls the access to the policy cash value
- If the agreement remains in place until the insured's death, the insurance company pays the death benefit to the trust, and the funding family member is reimbursed according to the terms of the split dollar agreement and the collateral assignment

How it works

