

Gift Tax-Free Split-Dollar (Non-Equity Collateral Assignment) Presentation

We offer you this presentation to help you understand how you can use split-dollar arrangement to help provide funds for estate liquidity. This material contains references to concepts that have legal, accounting and tax implications. It is not intended as legal, accounting or tax advice. Consult your own attorney and/or tax advisor for advice regarding your particular situation.

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Split-Dollar Arrangement

Do you identify with the following?

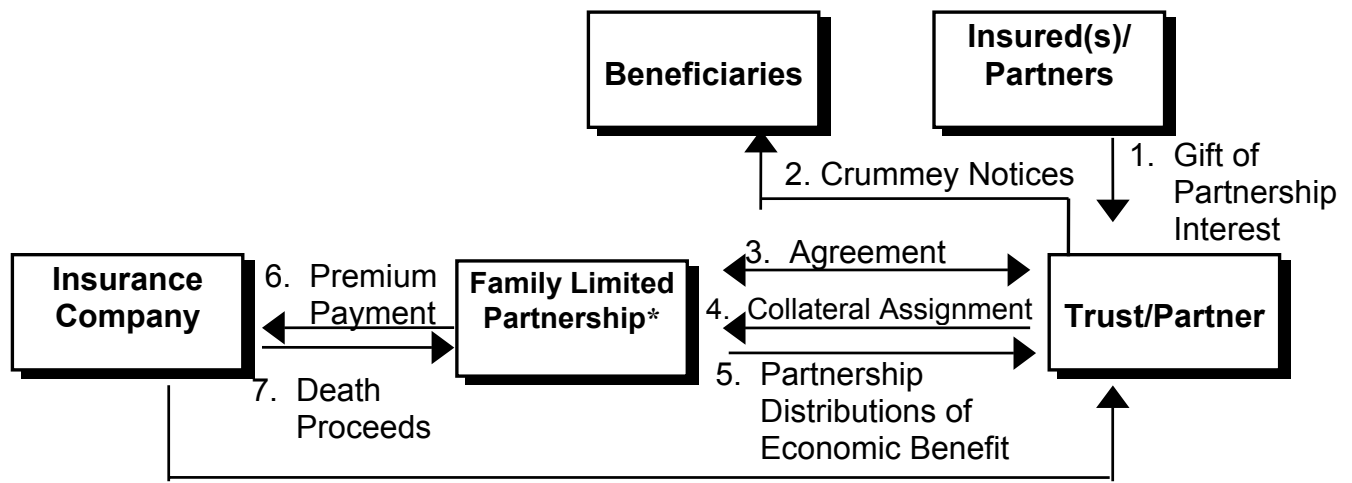
- ◆ You want your family to have cash to help pay estate taxes, liquidate debt or replace assets given to a charity; and
- ◆ You want the life insurance proceeds to pass outside your taxable estate; and
- ◆ You want your family to have the ability to access policy cash values; and
- ◆ You want to minimize the use of your annual gift tax exclusion.

If so, you may want to consider establishing a gift tax-free split-dollar arrangement. The gift tax-free split-dollar arrangement,

- ◆ Is a method of purchasing life insurance; which
- ◆ Enables you to minimize the use of your annual gift tax exclusion.

Split-Dollar Arrangement

Structure of Gift Tax-Free Split-Dollar Arrangement



1. Insured(s) establish an Irrevocable Life Insurance Trust (ILIT) and fund(s) the trust with a gift of existing (or newly created) partnership interest. The ILIT is now a partner in the Family Limited Partnership (FLP)*.
2. Trustee sends "Crummey" notices to the trust beneficiaries giving them a time period to withdraw their proportionate amount of the gift. This qualifies the gift to the trust for annual exclusion gift tax treatment.
3. FLP and ILIT/Partner enter into a non-equity collateral assignment split-dollar agreement where the ILIT/partner owns the policy and pays the economic benefit amount.¹ The FLP pays the balance of the premium.
4. The ILIT/Partner executes a collateral assignment which represents the FLP's interest in the policy cash value and death benefit.
5. The FLP makes distributions to all of the Partners. This provides the cash for the ILIT/Partner to pay its share of the premium.
6. The FLP and ILIT remit the total premium to the insurance company according to the terms of the split-dollar agreement.
7. At the death of the Insured(s), the death proceeds are paid to the ILIT and the FLP according to the terms of the split-dollar agreement.

* A Limited Liability Company (LLC) and its Members may be substituted for a Family Limited Partnership (FLP) and its Partners.

¹ The economic benefit under these facts is the cost of the life insurance protection and is calculated using either the rules in Notice 2002-8 or the rules in other IRS guidance, as applicable.



Split-Dollar Arrangement

Benefits to the Insured:

- ◆ The Insured(s) is able to acquire permanent life insurance protection with little or no federal gift tax cost provided the gift of the partnership interest to the trust falls within the gift tax annual exclusion amount.
- ◆ Enables the Insured(s) to remove a large portion of the death proceed from his/her/their estate.
- ◆ Partners in the FLP are entitled to partnership distributions according to the terms of the FLP agreement. In this manner, the Insured's family has indirect access to the cash value of the policy.²
- ◆ If the split-dollar agreement is terminated during the lifetime of the Insured(s), the income distributed from the FLP to the ILIT can be used by the ILIT to help pay future policy premiums and/or used to pay back the FLP according to the contractual rights under the agreement.
- ◆ At the death of the Insured(s), the trust receives death proceeds that can be used to help meet the cash and income needs of the trust beneficiaries according to the provisions of the trust document.

Tax Considerations:

- ◆ Provided the Insured(s) possesses no incident of ownership in the life insurance policy the portion of the death proceeds paid to the ILIT should not be subject to federal estate tax. The portion of the death proceeds paid to the FLP will be included in the estate of the Insured(s) in proportion to his/her/their FLP ownership interest.
- ◆ Gifts from the Insured(s) to the ILIT, not subject to the terms of the split dollar arrangement, are subject to gift taxation to the extent the transfer does not qualify for the gift tax annual exclusion or gift tax applicable exclusion amounts. Gifts made by the Insured(s) to the trust that are subject to Crummey withdrawal powers should qualify for the gift tax annual exclusion.

² Life insurance policy cash values are accessed through withdrawals and/or policy loans. Loans and/or withdrawals cause a reduction in policy cash values and death benefits, may affect any guarantee against lapse and may cause tax consequences.



Split-Dollar Arrangement

- ◆ The tax treatment of the transfers to the ILIT subject to the terms of the split dollar arrangement (the premium payments) depend on a number of factors including the date the split dollar arrangement is entered into, the type of life insurance policy (individual or survivorship coverage) and the structure of the agreement (collateral assignment or endorsement, equity or non-equity, contributory or non-contributory). The following discussion assumes that the split dollar arrangement is structured as a non-equity collateral assignment between an FLP/LLC and an ILIT funded with either an individual life insurance policy or a survivorship policy as described in the prior page. For all other possible structures, clients should consult their legal and tax advisors.
- ◆ Gift treatment of premium payments while the private split dollar is in effect. 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 benefits” less any amount the trust has contributed. Consequently, if the trust contributes the economic benefit portion of the premiums no part of the payment from the FLP/LLC should be considered a gift. The value of the economic benefit (under these facts, meaning the cost of life insurance protection only) depends on the date the split dollar arrangement is entered into.
- ◆ Contributory arrangements. For arrangements entered into after 9/17/03 the FLP/LLC will be subject to income tax on amounts contributed by the trust.
- ◆ Advisors may want to review Private Letter Rulings 9843024 and 9639053 and Regulations §§ 1.61-22, 1.7872-15.