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An Introduction to SPLIT-DOLLAR LIFE INSURANCE

Contrary to what you may think, split-dollar life insurance is not an insurance policy, at least not in the classic sense. It is a type of arrangement that allows two parties, typically an employer and an employee, to split life insurance protection costs and benefits. The premium payments, rights of ownership, and proceeds payable on the death of the insured are often split between the company and a key employee. In many situations, however, the employer pays all or a greater part of the premiums in exchange for an interest in the policy's **cash value** and **death benefit**. Cash values accumulate, providing repayment security for the employer, who is paying the majority of the premium. In this scenario, business owners have the opportunity to provide an executive with life insurance benefits at a low cost. Another option for companies to consider is to use split-dollar policies in place of insurance-funded **nonqualified deferred compensation plans**.

The split-dollar arrangement is attractive to employers because it provides a way to recruit and retain top performers. In turn, employees have the opportunity to acquire future protection with a flexible policy that meets their needs. In addition, this type of policy can be used as a viable strategy for transferring wealth between a parent and child and for estate planning.

There are two basic types of split-dollar life insurance policies: **endorsement,** in which the employer owns the policy and reaps the benefits, but the employee chooses the beneficiary or beneficiaries and how the death benefit is paid out; and **collateral**, in which the employee owns the policy.
In this situation, the employer's premium payments are treated the same as interest-free loans. The employee assigns the policy to the employer as collateral for these loans. On the employee's death, the loans are paid from the face value of the policy. Any proceeds that remain are paid to the beneficiary or beneficiaries.

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Easing into RETIREMENT

For many people, crossing the bridge into retirement is a big step. If you're approaching retirement, it's time to develop a strategy to facilitate a smooth transition from the more structured world of work to one of leisure.

After spending years building your professional career, you've accumulated assets along the way. While retirement planning usually focuses on preparing for your financial future, *nonfinancial* matters may also need to be addressed. When retirees feel dissatisfied, it's often the lifestyle changes that accompany retirement living that tend to create difficulties with self-esteem and identity associated with ending one's profession.

Staying Active

One possible solution for managing these challenges may be to ease into retirement. Some individuals may welcome the opportunity to continue some form of work, such as consulting, job-sharing, mentoring, or back-up management. Mentoring, in particular, enables you to transfer a lifetime of learning and experience to a friend, relative, or younger colleague. Phased-in retirement provides an "anchor," allowing new retirees to explore other activities while also maintaining their role at work.

Since some people may have more of an emotional reaction to the separation and disengagement from working than they expected, taking between two to five years to "decompress" may be an appropriate option.

Maintaining a Healthy Perspective

While "retirement" suggests the end of your working life, a more positive perspective to take could be that it's the beginning of a new phase of life—when you can do all the things you never seemed able to find the time for while you were working. For example, volunteer work can allow you to make a valuable contribution to a charitable cause and meet new people. Taking courses in subjects that interest you can sharpen your intellect and help maintain your cognitive abilities. If chosen thoughtfully, these activities can be enjoyable and fulfilling.

Obviously, it's a lot easier for a retiree to consider other pursuits if financial considerations are secondary. People may think that it costs less to live in retirement. However, it's actually common for retirees to increase, rather than decrease, their expenditures, especially in the first few years of transition. Without working full-time, retirees may have more energy and time to enjoy entertainment, dining out, travel, and recreation.

On Spending and Inflation

During the working years, it's common to take a certain lifestyle for granted. In retirement, however, you may need to change your priorities or consider budgeting depending on your circumstances. On the other hand, you may find that you no longer need or want to do some of the things that seemed so important when you were working.

Additionally, be sure to keep an eye on the effects of inflation after retirement. For example, an item costing $100 when you are age 65 will cost $180 at age 80, assuming a 4% inflation rate compounded annually. Therefore, it's important that your retirement plan be not only a plan "at" retirement, but also a plan continuing "through" retirement, which may require revision on a regular basis.

If you view retirement as your opportunity for growth and exploration, you can make this transition exciting and enjoyable. Your horizons are limited only by your imagination. After all of your hard work, you've earned this opportunity—enjoy the freedom! **20/20**

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AN INTRODUCTION TO SPLIT DOLLAR LIFE INSURANCE

The Way It Was

Split-dollar arrangements date back to the 1930s. Over time, the Internal Revenue Service (IRS) came to view any gain or equity from a split-dollar policy, known as **equity collateral assignment split dollar**, as an interest-free loan and therefore taxable. The IRS regarded equity benefits as being profitable mainly for the party paying the lowest amount of the premium cost, and it introduced new regulations, to seek more overall transparency.

In 2003, the IRS finalized the new regulations on split-dollar policies, which are still in effect today. While validating the use of split-dollar policies in estate planning between donors and donees, the changes have curbed the use of equity collateral assignment split dollar for funding nonqualified executive compensation.

Variations on a Theme

The following two tax regimes emerged from the 2003 IRS regulations; they affect the structure of a split-dollar policy for business owners and estate plans and depend on who owns the policy:

1. An **economic benefit (**or **equity) regime** allows the business owner/employer or the donor to pay the annual premium as the owner of the insurance policy. Alternatively, an **irrevocable life insurance trust (ILIT)** can be the policy owner, in which case the gift of an economic benefit is made annually to the trust.

   If an employer owns the policy, the employer's premium payments would provide equity or economic benefits that are taxable each year. The employee is responsible for the taxes. Benefits could include, among others, an interest in the policy cash value or the cost of life insurance protection.

2. In a **loan regime** business arrangement, if the employee owns the policy, the employer's premium payments are considered loans to the employee. In this case, the employee would be taxed on the difference between the actual interest amount and the amount that would have accrued at the market interest rate.

Look Before You Leap

It is important to note that a split-dollar life insurance arrangement requires specific adherence to complex tax rules and regulations. Before establishing the policy, be sure to consult with your team of qualified insurance, legal, and tax professionals to determine how split-dollar life insurance may benefit you, your company, and your key employees. **20/20**

Planning Your Estate

BEFORE REMARRIAGE

Despite the best intentions, marriages may not last forever. If you are divorced or widowed, and planning to remarry, you may want to take the opportunity to review and revise your estate conservation strategies. This is especially important if you and your future spouse have children from previous marriages.

Consider the following points:

1. Regardless of the details of your situation, it is important to be aware of the potentially sensitive aspects of estate planning. When multiple families are involved, objective professional counsel may help you achieve your desired results.

2. Familiarize yourself with the advantages and disadvantages of different types of asset ownership. If you would like your assets to pass entirely to your children, you may want to put them in your own name. It is important to know that new assets acquired in **joint tenancy** with your spouse will automatically be passed on to the surviving spouse.

3. Consider a pre-marital agreement to legally detail your property arrangements. While you may feel ambivalent about broaching this subject, a formalized agreement can help facilitate your wishes.

4. Review your **will** and update the beneficiary arrangements of your **life insurance policy** to ensure that your property is distributed according to your wishes upon your death.

As you prepare for and experience a major life change, such as remarriage, be sure to consult with an estate planning team comprised of qualified tax, legal, and financial professionals to help ensure that you meet your overall objectives. **20/20**

Some Things to Consider When MAKING REGULAR CHARITABLE GIFTS

Sometimes, our desire to give can lead us into making commitments that are difficult to fulfill. Any endeavor worth undertaking, especially one that can benefit others, deserves our careful consideration *before* we take action. Therefore, when contemplating charitable giving, you may want to consider the following points:

- **Choose your causes.** Worthy causes abound and often demand our immediate attention. Choose a limited number of organizations that concentrate on areas that are important to *you*, and then research what kind of help is needed.
- **Budget your gifts.** Include charitable gifts when planning your annual budget. Distributing your donations throughout the year may lessen the impact on your finances and increase the total you may be able to give.
- **Plan your volunteer activities.** Volunteering can be a rewarding experience, especially when you're able to see the fruits of your labor. Carefully determine the time you have available to ensure your best efforts for the cause, and avoid taking on too much.
- **Review your plans.** Just as you review your annual financial budget, look at your annual time/value budget. Revise your volunteer commitments to include those where the rewards have been the greatest for both you and your cause.
- **Consider a testamentary gift.** If you are fortunate enough to be in a position to increase the amount you donate, or if you are concerned about the future of the organizations you support, consider making a testamentary gift.

Testamentary Gifts

Generally, a testamentary gift is a promise of funds to be given from your estate upon your death. However, using your estate in this way may cause complications. Your intended gift could be reduced if any of the following apply:

- The fair-market value of your assets decreases before your death.
- Unforeseen estate expenses must be met from your assets.
- Your will is contested.

You may be able to protect your gift from estate problems through the establishment of a **trust**. However, the associated legal and administrative costs may have an adverse impact on your gift.

Protection for Your Charitable Gift

Your intentions—and your gift—can be protected from the complications above through the use of **life insurance**. The potential of life insurance may even result in a larger gift than you had originally intended.

The policy can be owned by the charity and removed from your estate, generally protecting your gift from taxation, creditors, and legal contest. It can be purchased and maintained with funds that you contribute to the charity, and as such, your contributions are tax deductible as a charitable gift. As owner of the policy, the charity can decide whether to use your gift to pay the premiums or let the policy lapse.

As **beneficiary**, the charity will receive the proceeds of the policy at your death. Depending on the type of policy purchased and the charity's willingness to use your contributions to maintain the policy, these proceeds may be guaranteed and may increase over time. In addition, the proceeds may exceed the amount you would have otherwise given outright during your lifetime or upon your death, depending on the policy type and other factors.

The satisfaction that can come from preparing your charitable gifts ahead of time can be extremely rewarding. When protected with life insurance, your gift could result in the ability to yield more than you ever imagined possible. It may help provide essential funding for your chosen organization, enabling the continuation of its good work.

Be sure to consult a qualified insurance professional to determine the appropriate strategy for your unique circumstances. **20/20**

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