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Financial Planning Strategies

A Financial Planning Update

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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

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Shielding Your Insurance from Estate Taxes

Life insurance, which can help to provide for your heirs in the event of your death, can be an important estate planning tool. It can provide funds to loved ones when they need it most and help meet your family's financial obligations. One issue overlooked by many people, however, is that life insurance can add significant wealth to an overall estate, potentially causing assets to exceed the 2014 **applicable exclusion amount** of $5.34 million, the amount that can be sheltered from estate taxes. Fortunately, with proper guidance, it is possible to keep your life insurance policy proceeds out of your estate and to also provide immediate funding for short-term financial needs.

You may already know that the inclusion of life insurance policy benefits in your taxable estate is contingent partly on **incidents of ownership**. Policy

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An Introduction to Split-Dollar Life Insurance

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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.

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:

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.

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. $

Charitable Giving Forecast to Grow in 2014

According to a report on charitable giving released in May 2014 by a leading forecast organization, Atlas of Giving, the U.S. is likely to see more than a 7% growth in charitable donations in 2014 compared to 2013. Atlas of Giving provides a monthly estimate of charitable giving by sector, source, and state.

In 2013, Americans set a record. Fueled largely by significant gains in stock prices, charitable giving in the U.S. increased 13% in 2013, hitting a record $416.7 billion, according to an end-of-year report released by the Atlas of Giving.

The 2013 analysis showed that while all of the measured sectors grew significantly, the biggest increases in gift revenue

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Charitable Giving Forecast to Grow in 2014

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were among human services organizations, environmental charities, donor-advised funds, and educational institutions. Meanwhile, giving to churches and health organizations failed to keep pace with the revenue growth seen in other charitable sectors.

Researchers observed that several key factors came together to create a favorable atmosphere for philanthropy in 2013, including a 12% nationwide rise in housing prices and big jumps in stock market values. However, the lingering effects of unemployment continued to hurt churches and other organizations that rely on small gifts from a large number of donors.

The 2013 report projected that giving in 2014 would rise by 4%. However, the current data predicts more robust growth, according to Rob Mitchell, CEO of the Atlas of Giving: "Driven primarily by strong sustained stock market gains and continuing low interest rates, charitable giving is exceeding expectations in 2014," said Mitchell. "The current revised forecast suggests that giving will increase more than 7%. Several sectors should expect double-digit growth, including the environment and human services. However, church and religious giving is expected to grow only 4.6%, and the health sector forecast has improved to just 6.1%." $

Shielding Your Insurance from Estate Taxes

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proceeds cannot be excluded from estate taxation if you have held any incidents of ownership on the policy during the three-year period preceding your death.

In general terms, an incident of ownership is the right to exercise control over the policy or to receive an economic benefit from the policy, including any powers to *surrender* the policy, to *pledge* the policy as collateral, or to *assign* the policy and any reversionary interest equal to 5% or more of the value of the policy before death. An incident of ownership also exists on a policy if you have any power to act as a fiduciary of a trust that holds insurance on your life if you established the trust, if you transferred the policy or consideration for the policy to the trust, or if you could have exercised any fiduciary power over the trust for your own benefit. However, your estate may not include your life insurance proceeds merely because you planned to purchase the insurance or gifted money used to pay premiums within three years prior to your death.

Again, entire policy benefits may be included in your estate unless all incidents of ownership are transferred more than three years before your death. In practice, the application of this rule is not always clear. Therefore, it is important to consult with your tax and legal advisors to ensure that your actions are consistent with your desired objectives.

A Plan of Action

Here is some additional information that you may want to discuss in detail with your advisors: For new life insurance policies, insurance proceeds are not included in the estate of the insured when another person (often an adult child or an **irrevocable trust** created by the insured) is the initial applicant on, and owner of, the policy, or when the insured never possessed an incident of ownership on the policy.

If you want to keep life insurance proceeds on existing policies out of your estate, you need to transfer any incidents of ownership on the policy to another person at least three years before your death. In addition, make sure that your estate is not the beneficiary of the policy *and* that the policy beneficiary is not required to use policy proceeds to pay estate claims and expenses.

Keep the above in mind as you develop a plan for keeping your life insurance proceeds out of your estate. Remember, before you take any action that might affect your policies, consider carefully all of the alternatives and seek professional counsel on how to best achieve your specific objectives. $

Credit Card Debt after the Death of a Loved One

After a loved one dies, who is responsible for his or her remaining credit card debt? This is a question you are unlikely to be thinking about in the days and weeks after the death, but it is one you will ultimately need to face.

In many cases, family members are not responsible for the debt, but there are a few exceptions. Luckily, while you and other family members sort out the financial impact of the death, you are protected by the Federal Fair Debt Collection Practices Act (FDCPA), which prevents debt collectors from using abusive or deceptive practices to collect a debt. According to the FDCPA, a debt collector might be a collection agency, a lawyer who regularly collects debts, or a company that buys debts and later attempts to collect payment.

When a spouse or other individual is a joint owner of a credit card account, that person is obligated to pay the debt after the death of the other co-owner. Most often, the co-owner is a spouse, but adult children will sometimes become authorized to use a parent's credit card account, to help the aging parent with financial matters. They then become liable for unpaid credit debt after the death of the parent.

If the widowed spouse lives in a "community property" state, such as California and a handful of other states, he or she may be liable for the credit card debt, even if the account was not co-owned. In such states, debts incurred after the marriage may qualify as community property, which means that, regardless of the credit card agreement, the surviving spouse is responsible for the debt. Also, some states may require that particular kinds of debt, such as debts related to health care, be paid by the spouse. Particularly given the differing state laws, it's a good idea to speak to an attorney to better understand your obligation.

When a relative or other person is not responsible for the uncollected debt, the responsibility falls to the deceased person's estate. The executor of the estate (or an administrator appointed by the court if there is no executor) is responsible for using the estate assets to pay the debt. If the assets do not cover all or any of the debt, the debt is wiped out. This means that the deceased person's heirs will not inherit the debt. $