I. Split-Dollar

a. Equity: (See Leimberg & Zaritsky, “Final Split Dollar Regulations Create New Problems,” 15 Prob. Pract. Rptr. 1 (Oct. 2003); Ratner and Leimberg, “A Planner’s Guide To Split Dollar After the Final Regulations”, Estate Planning, Jan 2004 ; Leimberg and DeRitter, “The Final Split-Dollar Regs: What They Say and What They Mean”, Tax Notes, Doc 2003-24709 or TNT 223-49; Leimberg and DeRitter, “Final Split-Dollar Regs: Planning Considerations and Strategies”, Tax Analysts Document Number: Doc 2003-25228 (21 original pages) and Tax Analysts Electronic Citation: 2003 TNT 227-8. Leimberg and Simmons, "Using Life Insurance in Qualified Retirement Plans", Estate Planning, March 2004, Vol. 31, No. 3, Pg. 107.

b. Non-Equity Split Dollar

c. Survivorship Split Dollar

d. Exit Strategy

e. Pros/Cons – Viable Alternatives

II. 7 (Plus) ALTERNATIVES TO SPLIT-DOLLAR

1. Outright Gifts

2. Section 162 Plans

2A. Dividends

3. GRATs

4. FLPs/LLCs

5. 3rd Party Financing

6. Qualified Pension/P.S. Plans

7. Death Benefit Only (D.B.O.) Plans

III. OUTRIGHT GIFTS TO FUND PREMIUMS

1. Client Transfers Cash, Property, or Both To Trust

2. Trusteee Uses Cash, Property, or Both to Purchase Life Insurance

3. Annual Exclusion Will Enable Many to Exclude Total Premium

4. For UltraWealthy: Create "Perpetual Internal Funding Engine"

    a. Client and Spouse Each Contribute $1,000,000 (NOTE: $1,000,000 Gift Tax Exemption DOES NOT increase – even for Inflation)

    b. If Trust has $2,000,000, at 5% Net, Trust Can Pay $100,000 Annually in Premiums (Can Enhance With Annual Exclusion Gifts) (Note: Grantor Trust: Client Pays Tax at Client's Bracket: Essentially Gift Tax Free Gift).

    c. Allows Use of Highly Efficient Contract: Low Premiums

    d. Does not have risks of financed insurance/uncertain law

    e. Relatively Simple to Explain/Easy for Client to Understand/Implement/Buy Into

    f. Insulates Massive Amounts of Wealth From Client's Creditors/Can Use as Dynasty Trust

    g. Assures Heirs of financial security

    h. Frees Client to Invest More Aggressively

    i. Gives Client "Permission" to Spend Down Capital

    j. Focus on Use of Discountable Income Producing Assets

    k. Consider Fractional Interests in Appreciating Real Estate

5. Downsides: Client Must Give Up Cash/property/income

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IV. SECTION 162 (Executive Bonus) PLANS

In general: See Christensen, "Several Methods Have Been Devised Which Allow Companies to Provide Life Insurance Benefits as an Executive Perquisite", 127 Tr. & Est. 83 (Feb. 1988); "Life Insurance Bonus Makes Good Dollars and Sense," Life Insurance Ideas 1, April 1991; Leimberg and Doyle, **Tools and Techniques of Life Insurance Planning** (800 543 0874); Kraus, "The Private Pension Plan Revisited", 4 Pers. Fin. Plan. 41 (Sept/Oct 1992); Kaltenbach, "Life Insurance Still Makes a Good Pension,", Best's Rev. 64 (Jan. 1995); Clolery, "Dangers of Insurance as a Private Pension Plan," Prac. Acct. 9 (Sept. 1994). R. Landsberg, "Executive Bonus – Parts 1 and 2: Restrictive Bonus Arrangement, Journal of Financial Service Professionals, March 2005, Vol. 59, No. 2.

1. ER selects one or more EEs
2. ER pays premiums
3. EE reports bonus income
4. Policy Owned by Tee or 3rd Party
5. Tax Implications if 3rd Party Purchased and Owned
    a. Income to EE (Reportable on IRS Form W-2); Reg. Sec. 1.162-9; Rev. Rul. 58-90, 1958-1 CB 88; Brown Agency, Inc. v. Comm'r, 21 BTA 1111 (1931), acq. 1931 CB 10; Reg. 1.264-1(b).
    b. Gift to 3rd Party
    c. F.E. T. Excludible
    d. ER - Current Deduction (IRC Sec. 264(a)). Rev. Rul. 55-714, 1955-2 CB 51; Goedel v. Comm'r, 39 BTA 1 (1939) to extent reasonable.
    e. Payments to EE subject to FICA/FUTA
    f. EE's basis – Sum of Premiums
    g. 3rd Party Owner – All Rights

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h. Corporation – No Rights
i. Corp Deducts Premium as Bonus Under Sec. 162
j. EE Reports Bonus as Income
k. Withdrawals or loans made by EE subject to income as if EE had purchased policy

6. Corp Pays Premiums to Insurer

7. EE Can Increase D.B. by Paying Additional Premium

8. Proceeds Income Tax Free

9. Cash Values Grow Income Tax Free

10. Setup:
    i. Corporate Resolution (For sample: **Tax Planning With Life Insurance** – 800 950 1216)
    ii. Employment Agreement with EE and
    iii. Restrictive Endorsement
    iv. ER retains right to terminate
    v. Lists D.B., Terms, Conditions, Eligibility

11. D.O.L (ERISA) Issues

    vi. None if Cover Only Owner-EEs, Highly Compensated
    vii. Minimal Reporting, Disclosure, Claims Procedure if Common – Law EEs covered (Plan must be in writing. Corporate Resolution Adopting Plan Sufficient, must be SPD (Summary Plan Description), Plan Documents Furnished To Participants on request, Employer must name itself or other as

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plan fiduciary and specify duties, Plan Documents Must Specify How Plan is to be financed, Contain Provisions for Amendment, and Specify Terms of Payment and Claims Procedure. See DOL Reg. Sec. 2520.104-24(a)-2520.104(c))

12. Downsides – Costs:

    a. ER has No Access to C.V.s

    b. EE Can't Recover Outlays

    c. EE has All Ownership – Control

13. Restrictive Endorsement Solution

    a. No EE rights W/O ER Consent

    b. Can Be Temporary or Permanent

    c. Policy endorsement executed by ER and filed with insurer. Temporarily restricts some of EE's rights (e.g. surrender, take loans, pledge) without ER permission.

    d. EE retains unilateral right to name/change Beneficiary.

    e. Expires at specified future date (e.g. attained age, retirement date, date EE fully vested in ER's stock rights) May also expire on ER's bankruptcy or dissolution prior to otherwise stated date.

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f. Employment Agreement not tied to life insurance nor does ER get any rights to policy's cash values or death benefit

g. Employment Agreement should address vesting, changes in control, insolvency

14. ERISA Issues With Restricted Access Bonus Life Insurance Arrangements: (Welfare Benefit Plan: Sec. 3(4).

If a "top hat" plan (select group of management or highly compensated Ees: Must provide copies of the plan to Sec. Of Labor upon request – Exempt from other ERISA reporting and disclosure

Subject to Part 4 of Title 1: Must have written plan document and must appoint "named fiduciary". (Corporate Resolution should serve as written instrument. Officer of ER can be named fiduciary).

Sec. 503: Must have claims procedure which provides plain language written notice to Ees and/or beneficiaries if claims denied. Must give beneficiary reasonable opportunity for full and fair review.

See the five possible approaches the Service and DOL may take in Chapter 6 of Zaritsky and Leimberg, **Tax Planning With Life Insurance** (800 950 1216).

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DIVIDENDS:

1. Until December 31, 2008, Dividends Taxed at 15% under Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA). This is a lower rate than would be paid if Shareholder-Employees took salary and/or bonuses.

2. Corporation can distribute dividend in cash. SH-EE can then purchase needed life insurance.

3. Alternatively, corporation can buy a policy, "incubate it", and 3 to 6 years later, distribute it as a dividend in kind (i.e., non-cash dividend) under a "delayed dividend" strategy.

4. Advantages:

   i. Helps avoid, reduce Accumulated Earnings Tax

   ii. Can be used to fund cross-purchase

   iii. May Use fewer Corp $ Than Bonus

   Example: To pay a $100,000 annual premium, a corporation would have to pay a shareholder – employee in a 33% bracket a $149,250 bonus to net $100,000 after taxes. But if the money was paid in the form of a bonus, it would take only $117,650 since the tax is only 15% for the shareholder-employee to net $100,000. The annual savings would exceed $31,000!

   iv. The documents involved, administration costs, and therefore the cost of the arrangement would be lower than alternatives such as split-dollar or 3rd party financed insurance.

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v. Unlike split dollar or a third party loan, here there would be no annually reportable income tax costs (other than the dividend itself).

vi. Only a corporate resolution is needed.

5. DOWNSIDES:

i. Expires in 5 Years – if not sooner because of deficits

ii. State Dividend Laws must be checked and met.

iii. No discrimination allowed either between classes of stock or between officer shareholders and other shareholders.

iv. May be state income tax implications.

v. No deduction at corporate level.

vi. As corporation's bracket goes up, the tax utility goes down. See Peter McCarthy, "Double Taxation Goes on a Diet", Life Insurance Selling, November 2003, Pg. 24.

vii. As shareholder's bracket goes down, the tax utility goes down. So most appealing for clients in personal income tax brackets between 15% and 35% when the corporation is in up to a 15% federal bracket.

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V. GRATS

General information on GRATs can be found in Leimberg, Kasner, et. Al, **Tools and Techniques of Estate Planning** (800 543 0874) and in Zaritsky, Tax Planning for Family Wealth Transfers (800 950 1216). GRAT computations can be done on **NumberCruncher Estate and Financial Planning Software** (610 924 0515).

1. Income producing property placed in GRAT
2. Asset (hopefully) also appreciates inside GRAT
3. At end of term, asset in GRAT paid to ILIT (or IDGT)
4. Technique funds ILIT at minimal possible gift tax cost
5. Creates Perpetual Internal Premium Paying Engine (PIPPE)
6. Additional Initial Gifts "Seen installment purchases of additional income producing premium paying funding assets
7. No liability to outsider
8. No increasing D.B. needed
9. Lower C.V. / Lower Premium
10. Relatively easy to unwind
11. Irrevocable loss of property and income and "leaky freeze"

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VI. FLPs/LLCs

General information about FLPs/LLCs can be obtained in **THE CUTTING EDGE** (610 924 0515); **Tools and Techniques of Estate Planning** (800 543 0874); Eber, **A CPA's Guide to Today's Hottest Device in Estate Planning: The Family Limited Partnership** (888 777 7077); Mezzullo, **An Estate Planner's Guide To Family Business Entities** (312 988 5522)

1. Income producing assets placed inside pass-through entity
2. Distributions from entity used to purchase/support policy
3. Trust set up as Grantor Trust
4. No need to repay 3rd party for loans
5. Trust Income taxed to Client at client's bracket
6. Reduces or eliminates need for client to make ongoing gifts
7. No Crummey letters needed
8. No need for increasing D.B.
9. Can combine with GRAT/IDGT

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VII. 3rd PARTY FINANCING

See S. Leimberg and A. Gibbons, "Premium Financing, The Last Choice - Not the First Choice", Estate Planning, January 2001, Vol. 28, No. 1, Pg. 35. D. Moore, "Planning For Third-Party Life Insurance Financing", Estate Planning, Aug. 2004, Vol. 31/No. 8, Pg. 383. Advanced Markets Quarterly Call, "Private Financing with Larry Brody and Randy Zipse, May 4, 2004.)

1. For Clients who can afford to pay but want or need to leverage assets
2. For wealthy clients with reduced income
3. Sources: AI Credit – Client's Own Bank
4. Rates currently still low
5. Can use to terminate or roll-out split-dollar as well as pay ongoing premiums
6. Meet large temporary need with no out of pocket outlay
7. How it works:
   i. ILIT borrows premiums from 3rd Party (Trust must allow borrowing)
   ii. Client gives or loans ILIT sufficient $ each year to pay interest – or pre-seeds trust with sufficient income producing property to pay interest
   iii. ILIT assigns collateral to lender
   iv. Client may have to personally guarantee loan
   v. Agreement may require client to pay – or may allow client to accrue interest

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vi. Loan can be interest only with balloon

vii. Current rates:

viii. Typically loan term:

ix. Trust could borrow principal and interest

x. No outlay, need to sell appreciated assets, no tax on gain

xi. Principal: Repaid on or before Death of Insured

b. A Twist on normal procedure:

i. ILIT borrows large lump sum – buys single premium immediate annuity
ii. ILIT uses annuity payments (after tax) to pay life insurance premiums
iii. Two different insurers used – one annuity – one life
iv. To annuity company: Client in Poor Health
v. To life insurance company: Client in Great Health!
vi. Client pays tax on annuity income because Grantor Trust
vii. Because most annuity income tax free as recovery of cost, easier to pay premiums
viii. Because client paid tax, trust has all of annuity income to pay premiums

c. ILIT pays interest to lender

d. ILIT owns policy – subject to collateral assignment of policy

e. No Section 61 income

f. No 7872 income

g. Compare to 3rd Party Premium Costs

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h. Is this split Dollar – and what if it is?

i. Downsides/Costs

  i. Each interest payment by client is gift to trust
  ii. High powered legal/accounting advice needed
  iii. Impractical with smaller policies
  iv. Policy must outperform cost of loan
  v. If borrowing rates higher than investment return, trouble
  vi. If insured outlives basis in annuity, not as appealing
  vii. Client pays O.I. on annuity payments
  viii. Loan must be repaid – out of pocket or out of death proceeds
  ix. Works best for older clients
  x. Can be substantial increase in rates
  xi. More collateral demanded if client's wealth/income drop
  xii. Loan grows exponentially if interest also borrowed
  xiii. Accruing interest not viable if client much younger than 70's
  xiv. Reduced reinsurance capacity may make adequate coverage unattainable
  xv. Lender usually demands more collateral than policy
  xvi. Typically lender wants marketable securities as collateral
  xvii. Lender may "release" collateral as C.V. in policy grows
  xviii. Consider impact on client if lender forecloses on collateral
  xix. If lender calls loan, may force surrender of policies
  xx. If client substantially outlives expectancy, deemed to be making gifts of interest for life
  xxi. Death benefit could be exceeded by loan
  xxii. If loan to be paid at death, policy must contain increasing D.B. rider – increasing cost significantly
  xxiii. Is guarantee of loan a gift? If so, how measured?

j. Exit strategies:

  1. Side funds with discounted or appreciated assets

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2. GRATs
3. Installment Sales to Defective Trusts
4. CLTs

k. Client who borrows should be ready, able to pay premiums
l. Checklist:
   i. Borrow minimum possible
   ii. Keep duration of loan as short as possible
   iii. Do Best, Worst, Moderate Case Illustrations
   iv. Constantly monitor performance
   v. Insist on reasonable exit strategy
   vi. Consider pros/cons of viable alternatives

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VIII. USE OF PENSION/ PROFIT-SHARING PLANS

General: See Leimberg and Simmons, "Using Life Insurance in Qualified Retirement Plans", Estate Planning, March 2004, Vol. 31, No. 3, Pg. 107; Leimberg and McFadden, **Tools and Techniques of Employee Benefit and Retirement Planning** (800 543 0874); Fair, "The Rules, Risks, and Rewards of Insurance in Qualified Plans," 128 Tr. & Est. 37 (May 1989); Budin, 111-6th Tax Management., Life Insurance; Larson and Norquist, "Life Insurance as a Qualified Plan Investment", Taking on the Qualified Plan Rules, " 51 J. Am. Soc'y CLU & ChFC 66 (Nov. 1996).

A. Survivorship Life in Profit Sharing Plan:

1. Profit-Sharing Trust Can use assets to purchase and pay premiums: Reg. Sec. 1.104-1.

2. Profit-Sharing plan participant may allocate a portion of account toward purchase of policy on any person in respect to whom he/she has insurable interest (e.g. spouse or child). PLR 8445095 and PLR 8711075.

3. Participant reports as current income the economic benefit of the coverage. If survivorship contract used, participant must use U.S. table 38 to compute cost while both insureds are alive and table 2001 when one spouse dies.

4. Plan document language must clearly provide for purchase of insurance. Otherwise, purchase is violation of fiduciary responsibility.

5. To exclude proceeds:

    a. Participant directs that trustee(s) of plan through a beneficiary designation) distribute policy to ILIT if participant dies before spouse. (Must get written consent of spouse).

    b. No transfer for value since no value given for transfer.

    c. No 3 year inclusion in estate of second spouse to die because the transfer occurred with respect to first spouse.

6. If Plan Participant Dies First:

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a. ILIT incurs income tax on the value of policy. (Money can be obtained from trust itself or from gifts to trust)

b. Value of policy includible in decedent's estate.

7. If Spouse of Participant Dies First:

a. No immediate tax consequences on death of non-participant spouse.

b. Survivorship policy stays in account of participant in P.S. plan as a single life contract on participant's life.

c. Must remove contract to avoid estate tax inclusion.

d. To avoid estate tax inclusion:

i. Distribution in kind

ii. Purchase by ILIT

iii. In-Service distributions permissible (subject to income/penalty tax) with limitations: Can't distribute amounts or assets attributable to employer if made within prior two years.

iv. Participant may purchase policy for its value. Must meet PTE 92-6 exemption requirements.

A. Advantages:

1. May make coverage available even if otherwise uninsurable or highly rated

2. If client rated, reportable term costs standard

3. Insurance can increase deductible contribution limits

4. Plan may be only feasible source of premium dollars

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5. Tax Deducible dollars

6. "Someone else's dollars"

7. Locks in favorable annuity rates

8. Pure insurance income tax free

B. Downsides/Costs

1. Currently reportable income

2. Decreased retirement income

3. Proceeds estate tax includable (unless repeal or exclusion covers)

4. Beware valuation games! (New Regs) (See Employee Benefit and Retirement Planning Newsletters 224, 225, 226, 227 at http://www.leimbergservices.com ; Simmons and Leimberg, "Prop. Regs. Address Abusive Transactions Involving Life Insurance in Qualified Plans", Estate Planning, April 2004, Vol. 31, No. 4, Pg.

5. Beware ERISA Issues with valuation games.

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IX DEATH BENEFIT ONLY (SURVIVOR INCOME BENEFIT) PLANS

General Information: **See Tools and Techniques of Estate Planning and Tools** and **Techniques of Employee Benefit Planning** (800 543 0874) and **Tax Planning With Life Insurance** (800 950 1216).

1. The Employer's Promise:

2. Employer is Owner, Premium Payor, Beneficiary

3. EE Never Taxable

    a. No Constructive Receipt

    b. No Economic Benefit

4. ER – Premiums Not Deductible – Deduction allowed when payments made – and includible in recipient's income - to extent ordinary, necessary, reasonable. Rev. Rul. 55-212, 1955-1 CB 299. Lundy Packing Co. v. U.S., 302 F. Supp. 182 (1969), aff'd per curium, 421 F.2nd 850 (4th Cir. 1970). See Morse Signal Devices, Inc. v. U.S. 434 F.Supp. 85 (D. Ohio 1978). Must be valid business purpose.

5. Proceeds Paid (income tax free) to ER at EE's Death

6. At EE's Death, ER pays compensation to ER selected class of beneficiary and Deducts Payments

7. Beneficiary Pays Income Tax (O.I.) as Deferred Salary Received (I.R.D). Each dollar received is treated as salary and taxed at O.I. rates. Essenfeld v. Comm'r, 311 F. 2nd 208 (2nd Cir. 1962).

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8. Amounts Received Exempt from FICA/FUTA Rev. Rul. 71-456, 1971-2 CB 354. IRC Secs. 3121(a)(14).

9. No F.E.T. If covered insured EE owns 50% or Less. Estate of Barr v. Comm'r, 40 T.C. 227 (1963), acq. 1964-1 CB 4, acq. In result only, 1978-1 CB 1. See Worthen v. U.S. , 192 F. Supp. 727 (D. Mass. 1961).

10. Increased Corporate Liability Reduces F.E.T. Value of Business

11. Minimal ERISA Requirements: See Belka v. Rowe Furniture Corp., 571 F. Supp. 1249 (D. Md. 1983); Dependahl v. Falstaff Brewing Corp., 491 F. Supp. 1188 (D. Mo. 1980), aff'd 653 F.2nd 1208 (8th Cir. 1981), cert. Denied, 454 U.S. 968 (1981); ERISA Sec. 3(1), 4021(b)(6); DOL Reg. Sec. 2520.104-23; DOL Advisory Opinion 81-11A (Jan. 15, 1981); Sec. 401, 501-503. In Adams v. Intralinks, Inc., __F.Supp. 2d. __ (S.D.N.Y. July 20, 2004), a U.S. District Court ruled that a stock option plan is not an ERISA-covered plan, but instead is a non-ERISA "bonus plan." The court reasoned that a stock option plan generally provides incentives for employee performance, not retirement income. The D.B. O. might fall under this classification.

    a. Summary Plan Description

    b. Letter to DOL Informing of Basic Terms

    c. Claims Proceedure

12. ER free to chose Who, Terms, Amounts

13. AMT: Eliminated for Small Corporations. If an issue, multiply target amount of life insurance by 118 percent to find proper level of insurance in worst case scenario.

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