

PRESENTED AT

70th Annual The University of Texas Tax Conference

November 30-December 1, 2022
Austin, Texas

**19 Years After the Final Regulations: Where Are We
with Split Dollar Premium Financing?**

Donald O. Jansen, J.D., LL.M., AEP (Distinguished)

Author Contact Information:
Donald O. Jansen
The University of Texas System
Austin, Texas

djansen@utsystem.edu

19 YEARS AFTER THE FINAL REGULATIONS: WHERE ARE WE WITH SPLIT DOLLAR
PREMIUM FINANCING?

TABLE OF CONTENTS

I.	SCOPE AND INTRODUCTION	1
II.	SOME USES OF LEVERAGED PREMIUM FINANCING THROUGH SPLIT DOLLAR	3
A.	Employee Fringe Benefit	3
1.	Mechanism	3
2.	Potential Problems	3
B.	Finance Shareholder Buy Sell Agreements	4
1.	Cross Purchase Agreements	4
2.	Ownership of Policies Problems	4
3.	Split Dollar to the Rescue	4
4.	Multiple Shareholder Problem	5
C.	Life Insurance Informal Funding Non-Qualified Deferred Compensation	6
1.	Role of Life Insurance	6
2.	Role of Split Dollar	6
3.	Income Tax Considerations	6
4.	ERISA Considerations	7
D.	Life Insurance Wealth Transfers	8
1.	ILIT Used for Estate Tax Exclusion	8
2.	Potential Gift Tax Problems	8
3.	Role of Split Dollar	9
4.	Estate Tax Considerations	9
III.	SPLIT DOLLAR ARRANGEMENTS	9
A.	What Is a Split Dollar Arrangement?	9
1.	General Rule Reg. Sec. 1.61-22(b)(1)	9
2.	Special Rule for Compensatory and Shareholder Agreements	9
3.	What About Partnership Split Dollar Arrangements?	10
B.	Two Mutually Exclusive Regimes for Taxing Split Dollar Life Insurance Arrangements	10
1.	Economic Benefit Regime	10
2.	Loan Regime	10
C.	Who Is the Policy Owner in Determining Which Regime to Use?	11
1.	General Rule	11
2.	Joint Ownership Rules	11
3.	Special Exception	11
D.	Remember ILIT Split Dollar Financing is Temporary	11
1.	Split Dollar Premium Financing is Short Term	11
2.	Permanent Financing Techniques to Replace Split Dollar	12
E.	Which Regime Should be Used? It Depends!	12
1.	Loan Regime	12
2.	Economic Benefit Regime	13
IV.	Income and Gift Tax Consequences of Economic Benefit Regime	13
A.	Economic Benefit to Non-Owner	13
B.	Typical Arrangement	14

TABLE OF CONTENTS
(continued)

C.	Basis (Investment in Contract) for Economic Benefit	14
1.	None for Non-Owner	14
2.	Exception for Non-Owner at Roll-Out	14
3.	Owner Investment.....	14
D.	Cost of Current Life Insurance Protection	14
1.	For Single Life Split Dollar Policies—Table 2001.....	14
2.	For Survivor Life Split Dollar Policies – Revised U.S. 38 Cost.....	15
E.	Other Economic Benefits to the Non-Owner	16
1.	Current Access to Policy Cash Value	16
2.	Amounts Received Under the Contract.	17
F.	Tax Consequences to Employer.....	19
G.	Intergenerational Private Split Dollar Arrangements.....	19
1.	Example	19
2.	Split Dollar Contract Restrictions Discount	19
3.	Estate of Levine v. Commissioner, 158 T.C. No.2 (2022)	20
4.	IRC Sections 2036 and 2038.	21
5.	IRC Section 2703.....	23
6.	Valuation of Discount.....	23
7.	Is This a Loan Regime Resulting in an Immediate Gift Instead of Economic Benefit Regime?	24
8.	Present Bottom Line for Intergenerational Split Dollar Economic Benefit Regime.....	25
9.	Does the Loan Regime Avoid These Issues?.....	25
V.	Impact of 409A	26
A.	409A Application to Non-Grandfathered Split Dollar Arrangements.....	26
1.	Economic Benefit Regime	26
2.	Loan Regime.....	28
B.	How Do the Section 409A Grandfathering Rules Apply to Split Dollar Arrangements?	28
1.	Pre-January 1, 2005	28
2.	After 2004.....	28
3.	Equity Split Dollar.....	28
4.	Notice 2007-34	29
5.	Impact of IRC Section 409A on Equity Split Dollar Arrangements Established Before September 18, 2003.	30
6.	Can Grandfathered Equity be Taxed?.....	31
VI.	LOANS TO FINANCE PREMIUMS.....	32
A.	Concept.....	32
1.	Why Use Loans to Finance Premiums?.....	32
2.	Pre-Split Dollar Regulation Equity Split Dollar Arrangements.....	33
3.	Loan Regime Under New Regulations.	33
B.	Secured Loans and Variable Life Insurance.....	33
1.	Bottom Line.....	33
2.	Variable Policies Subject to Margin Rules	34
3.	The Margin Rules of Regulation U.....	34
4.	Reporting Requirement of Regulation U.....	34
C.	Must Be a “Real” Loan.....	34
1.	What Is a Loan?.....	34
2.	Sham Interest Payments.....	34
3.	Sham Principal Payments.	36

TABLE OF CONTENTS
(continued)

D.	Requirements of Loan Regime.	36
1.	General Rules.....	36
2.	Below Market Split Dollar Loans Under IRC Section 7872.	37
3.	Below Market Split Dollar Demand Loans.	38
4.	Below Market Split Dollar Term Loans.	38
5.	Special Rules for Certain Hybrid Split Dollar Term Loans.....	39
6.	Careful of Contingent Payment Split Dollar Loans.....	41
7.	General Observations Concerning Split Dollar Loan Regime Arrangements.....	42
E.	Estate Tax Considerations for Loans from Family Corporation or Partnership to Life Insurance Trust.....	42
1.	Generally, Not a Problem	42
2.	Potential Controlled Corporation Problems.....	43
3.	Partnership Incidents of Ownership Problems.....	43
4.	Bare Bones Collateral Assignment.....	44
F.	Premium Loans By Insured.	45
1.	Concept.....	45
2.	Income Tax Considerations.	46
3.	Gift Tax Considerations.....	53
4.	Estate Tax Considerations.	57
G.	Third-Party Premium Loans.	59
1.	Concept.....	59
2.	Income Tax Considerations.	59
3.	Gift Tax Considerations.....	61
4.	Estate Tax Considerations.	63

19 YEARS AFTER THE FINAL REGULATIONS: WHERE ARE WE WITH SPLIT DOLLAR PREMIUM FINANCING?

By
Donald O. Jansen, J.D., LL.M., AEP (Distinguished)
Associate General Counsel
The University of Texas System
djansen@utsystem.edu
www.donaldjansen.com

I. SCOPE AND INTRODUCTION

A. Split Dollar Is More Popular Than Ever

Nineteen years ago, the Treasury Department issued the final split dollar regulation. This was the first comprehensive guidance concerning this method of life insurance premium financing. Previously, the IRS had issued often changing revenue rulings, private rulings and notices without overall guidance. That changed in 2003. Particularly with regard to income and gift tax consequences, this regulation deviated considerably from its prior ruling positions which were grandfathered for split dollar arrangements entered into before the date of the new final regulation. Many practitioners thought that the regulation would be the death knell for split dollar. However, the contrary has occurred since the regulation finally gave guidance that practitioners had been longing for. Loan regime split dollar blossomed under the regulation. Thus, after nineteen years, split dollar premium financing is still very much used and popular.

B. Background

The first split dollar arrangements appeared in the 1940s. Originally, they were designed to have an employer assist an executive in obtaining life insurance coverage by paying all or part of the insurance premiums. Basically, it was a compensation perk provided by the employer. Sometimes the split dollar arrangement was between a corporation and shareholder, quite often to help the shareholder finance a buy/sell agreement. In more recent years, split dollar arrangements have been used in a wealth transfer context where the insurance policy is owned by an irrevocable life insurance trust (under the loan regime) or the death benefit is owned by such trust (under the economic benefit regime). In this manner, the annual gift to the trust is the applicable Federal interest rate ("AFR") or term premium economic benefit, depending upon whether the loan regime or the economic benefit regime is used, rather than the much larger total premium payment. For wealth transfer purposes, the premium payer may be the employer, a closely held family company or even the insured or family member of the insured.

C. Thus, the Name

The name comes from the non-owner and the owner of the policy splitting the death benefit and quite often (but not always) the premium payment or policy cash value.

D. The 2003 Final Regulations

The split dollar regulations became effective on September 18, 2003. For split dollar arrangements entered into prior to that date, for historical reasons, the IRS had taken the position that the arrangements were not loans but an investment in the policy by the employer. This was true whether the employer owned the policy under an endorsement method or the employee or third party owned the policy under a collateral assignment method. Under the final regulations, most collateral assignment split dollar arrangements will now be treated as loans subject to IRC Section 7872. The endorsement split dollar arrangement may measure economic benefit by the term premium, but the equity will be subject to income/gift taxes unless it is owned by the employer, or other premium payer. The tradeoff under the new rules is clear. Under the loan regime split dollar arrangements, the equity buildup is not subject to income/gift taxes, but the AFR must be charged. Although the economic benefit regime split dollar arrangement may continue to measure current economic benefit by the term premium, the employer (or other premium payer) should own all of the cash value and other rights in the policy to prevent income/gift taxes to the executive. Traditionally, the term premium was lower than the AFR except for older insureds. However, in today's low interest climate, the AFR may be lower than the term premium even at younger ages of the insured. However, recently the AFR has been increasing. Thus, under the final split dollar regulations, almost all premium loans will fall within the loan regime split dollar arrangement. However, economic benefit regime split dollar arrangements will not be treated as premium loans. This outline will discuss developments in planning techniques that involve economic benefit regime split dollar or which apply to all split dollar techniques but which are not peculiar to loans. The premium financing portion of this outline will discuss developments in planning techniques which are particularly applicable to premium loans, although they may also be loan regime split dollar arrangements.

E. Other Premium Financing Techniques.

Before proceeding further, it should be noted that there are many other ways of paying insurance premiums other than through the economic benefit regime split dollar and premium loans. Perhaps the policy can be bought by the insured with existing funds. If for wealth transfer purposes a third-party owner is required, perhaps the policy can be bought by an existing life insurance trust, family partnership or family LLC with sufficient assets to pay the premiums, but with little or no ownership by the insured in the purchasing entity. Again, for wealth transfer purposes, with a policy owned by a life insurance trust, premiums can be paid by outright gifts from the insured grantor, the use of GRATs or sales to defective life insurance trusts or a combination of these techniques.

F. Exit Strategy.

Even if the split dollar or premium loans are involved, it is a temporary premium payment technique and quite often some sort of exit strategy is needed to pay off the policy owner under the economic benefit regime arrangement or the lender under the loan regime. In this situation, gifts, GRATs or sales to defective trusts might be useful exit strategies.

For a more detailed discussion of premium financing, *see* Brody and Jansen, "Leveraging Life Insurance Premium Payments – Using Split-Dollar and Related Party Premium Financing Techniques," American Bar Association Section of Real Estate, Trust & Estate Law (2017).

Find the full text of this and thousands of other resources from leading experts in dozens of legal practice areas in the [UT Law CLE eLibrary \(utcle.org/elibrary\)](https://utcle.org/elibrary)

Title search: 19 Years After the Final Regulations: Where are We with Split-Dollar Life Insurance Financing?

Also available as part of the eCourse

[2022 Taxation eConference: Day 2 - Business Transactions](#)

First appeared as part of the conference materials for the
70th Annual Taxation Conference: Day 2 - Business Transactions session
"19 Years After the Final Regulations: Where are We with Split-Dollar Life Insurance Financing?"