MassMutual

ADVANCED SALES COMMENT

Family Split Dollar Planning

While working with your clients, you find that they need additional life insurance to provide estate liquidity for their family. A life insurance policy owned by an irrevocable trust could keep the proceeds out of your client's taxable estate. However, there are limits to the amount of gifts that can be made by your clients without the imposition of transfer taxes to pay for that coverage. Is there a cost- and tax-effective way to help solve this dilemma?

A family split dollar plan can help provide the life insurance protection that can take care of your client's family estate planning needs without requiring your client to make large taxable gifts to pay the annual insurance premiums. In some cases, the use of this arrangement may also provide your client's family with access to the life insurance policy cash values,[1] while keeping the trust's share of the death proceeds in excess of the policy cash value out of their estate.

[1] Distributions under the policy (including cash dividends and partial/full surrenders) are not subject to taxation up to the amount paid into the policy (cost basis). If the policy is a Modified Endowment Contract, policy loans and/or distributions are taxable to the extent of gain and are subject to a 10% tax penalty. Access to cash values through borrowing or partial surrenders will reduce the policy's cash value and death benefit, increase the chance the policy will lapse, and may result in a tax liability if the policy terminates before the death of the insured.

FOR FINANCIAL PROFESSIONAL AND PROFESSIONAL ADVISOR USE ONLY. NOT FOR USE WITH THE PUBLIC.

NOT A BANK OR CREDIT UNION DEPOSIT OR OBLIGATION • NOT FDIC OR NCUA INSURED • NOT INSURED BY ANY FEDERAL GOVERNMENT AGENCY • NOT GUARANTEED BY ANY BANK OR CREDIT UNION

How Family Split Dollar Works

Generally, the arrangement is structured with an irrevocable trust as the applicant and legal title owner of the life insurance policy. Variations of family split dollar arrangements could also have a child or children of the insured as the policyowner(s). This piece will assume that your client is utilizing the more traditional arrangement with the policy ownership titled in the client's irrevocable trust.

Your client or the client's spouse will pay all or most of the life insurance premiums that come due. These premium payments are not deemed as gifts to the trust, but rather the premium payer is actually deemed to be paying for the ownership of the policy, including all of its cash values. Even though the irrevocable trust will be the legal title owner of the policy, the premium payer is the deemed owner of all of the policy cash value.

The premium payer's interest is secured through a collateral assignment of the life insurance policy from the trust to the premium payer. At the death of the insured, the premium payer (or the estate of the premium payer) receives a portion of the policy death benefit equal to the cash value of the policy at the time of death. The remainder of the death benefit is payable to the trust.

The information provided is not written or intended as specific tax or legal advice. MassMutual, its subsidiaries, employees, and representatives are not authorized to give tax or legal advice. Individuals are encouraged to seek advice from their own tax or legal counsel. Individuals involved in the estate planning process should work with an estate planning team, including their own personal legal or tax counsel.

NOT A BANK OR CREDIT UNION DEPOSIT OR OBLIGATION • NOT FDIC OR NCUA INSURED • NOT INSURED BY ANY FEDERAL GOVERNMENT AGENCY • NOT GUARANTEED BY ANY BANK OR CREDIT UNION

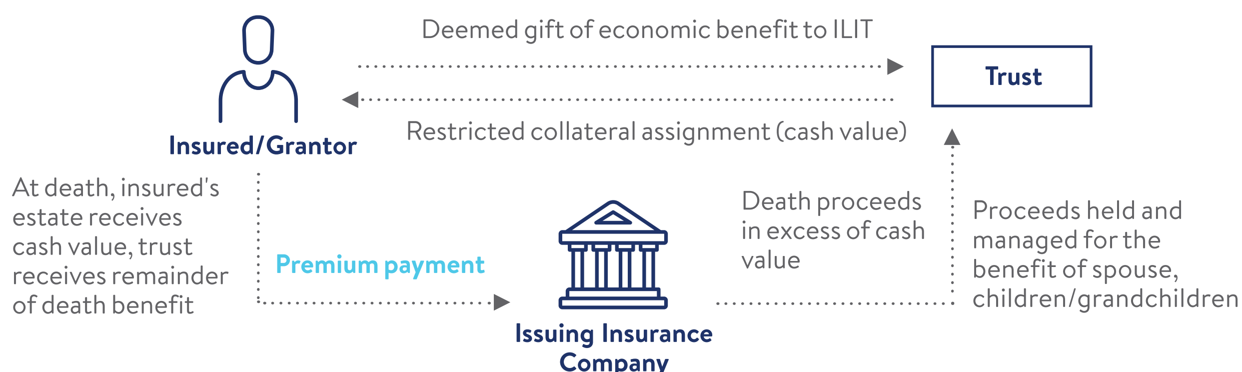
With a married insured purchasing a single life policy, there are two ways that the family split dollar arrangement can be set up with either the insured or the insured's spouse as the premium payer.

Insured as Premium Payer

The insured will pay the entire annual premium. He or she is deemed to be making a gift to the trust each year equal to the term value of the death benefit that would be paid to the trust if the insured dies during that calendar year (based on the amount of the death benefit in excess of the life insurance policy cash value). If the trust provides that trust beneficiaries have a withdrawal right when a gift is made to the trust, the amount of the split dollar gift can qualify for the annual gift tax exclusion.

A regular collateral assignment form issued to the insured would enable him or her to make policy loans or otherwise exercise rights that would cause the death benefit to be includable in the insured's taxable estate (thus negating the benefits of having an irrevocable trust). Therefore, when the insured is the premium payer (or when either or both insureds are the premium payers with a second-to-die policy) a "restricted" collateral assignment form must be used in order to avoid adverse estate tax consequences. This form does not permit the assignee to access policy cash values during his or her lifetime. The insured/premium payer's interest in the policy will be repaid to his or her estate out of the policy death benefit.

FAMILY SPLIT DOLLAR – INSURED PAYS PREMIUM

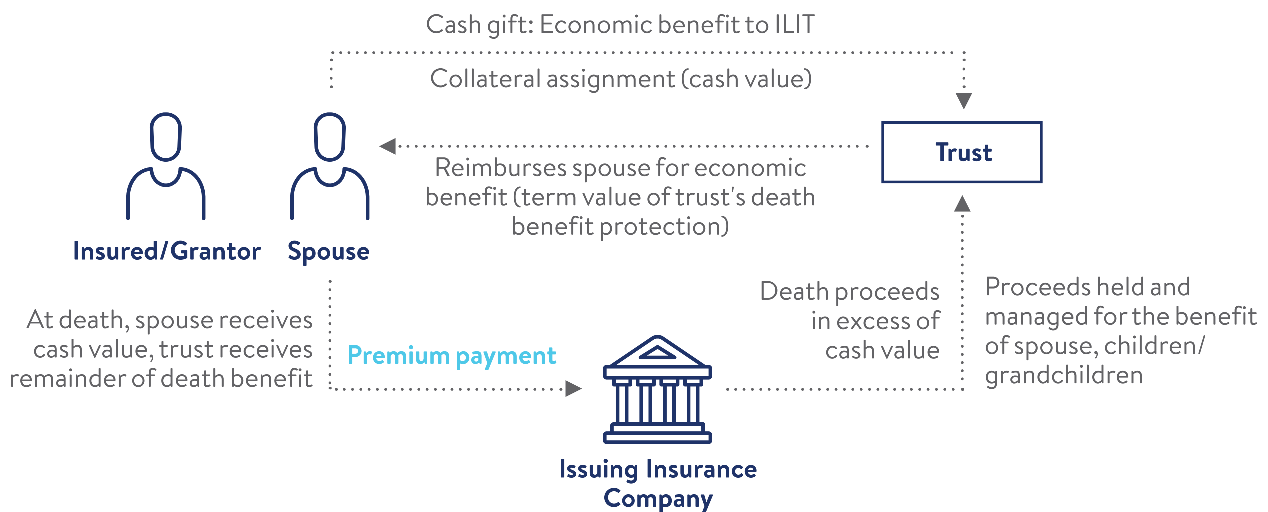


Spouse of the Insured as Premium Payer

Having the spouse of the insured as the premium payer under the split dollar arrangement can be beneficial, but does make the transaction a bit more complicated. When the spouse is the premium payer there is no need to use the special restricted collateral assignment form; therefore, the spouse always has full access to all of the policy cash values. The complication is that the spouse as premium payer cannot be deemed to have made an annual gift to the insured's irrevocable trust, since generally the spouse will be an eligible beneficiary of the trust. There are estate tax consequences when a trust beneficiary makes gifts to the trust.

In order to prevent the spouse from being deemed to have made a gift to the trust, the trustee needs to make an annual contribution to the life insurance premium equal to the term insurance value of the trust's death benefit protection. Note for convenience, it is not necessary to send two checks to the issuing insurance company, one from the primary premium payer and one from the trustee. The premium payer can make the full premium payment and then subsequently receive a reimbursement from the trustee for the trust's share of the annual premium.

FAMILY SPLIT DOLLAR – SPOUSE OF INSURED PAYS PREMIUM



Where does the trustee of the trust get the funds to make this required annual premium contribution? The insured (who created the trust) will need to make cash gifts to the trust each year sufficient to enable the trustee to make its annual premium contribution. If the trust otherwise holds income-producing assets that provide the trustee with cash, then the insured would not have to make an additional gift each year.

Second-to-Die Policy

Now, let's look at a second-to-die policy that is owned by your client's irrevocable trust. Regardless of which insured is treated as the premium payer, a restricted collateral assignment is required to prevent access to the cash values causing "incidents of ownership" and estate taxation.

The premium payer will pay the entire annual premium, resulting in a deemed gift being made to the trust each year in an amount equal to the value of the trust's share of the death benefit protection. Because the risk of both insureds dying in the same calendar year is extremely low, the value of the death benefit protection while both insureds are alive (and thus the value of the deemed annual gift to the trust) is also exceptionally low. At the death of the first spouse, the annual value of the death protection will switch from survivorship rates to the single life rates. (See the chart for a comparison of these rates.)

GIFT VALUES TO PROVIDE $10,000,000 DEATH BENEFIT PROTECTION

Age/Ages	Single Life NCT*	Second-to-Die Table 2001 Rates
45/45	$ 5,000	$ 100
50/50	$ 7,000	$ 100
55/55	$ 9,800	$ 180
60/60	$13,100	$ 430
65/65	$19,200	$ 1,450
70/70	$31,000	$ 4,360
75/75	$49,300	$11,200
80/80	$95,900	$30,510

* MassMutual's current non-convertible, non-renewable term rates.

Summary

Advantages

- Maximize the value of your client's annual gift tax exclusions, lifetime gifting exemption, and generation-skipping transfer tax exemption by maintaining a life insurance policy in excess of what your client would otherwise be able to purchase with gift tax-free transfers. At the death of the insured, death benefit equal to the policy cash value is returned to the premium payer, with the remainder of the death benefit payable to the irrevocable trust (which is out of the insured's taxable estate).
- Maintain access to policy cash values[1] with the use of a single life policy with the insured's spouse as the premium payer. Otherwise, a restricted collateral assignment form is required.
- Additionally, under the Tax Cuts and Jobs Act (TCJA) of 2017, lifetime gift exemptions have doubled to $10 million (inflation adjusted) per person, which will approximately be $11,580,000 in 2020. This increased exemption will sunset on 12/31/2025 and the exemption will revert back to the pre-2018 level ($5 million inflation adjusted). The enactment of the TCJA may allow your clients the opportunity to roll out of (or end) the split dollar arrangement, make large gifts to the ILIT to pay premiums, and leverage the increased gift tax exemption. **Keep in mind that this option is only available until 12/31/2025, when this part of TCJA sunsets.**

Disadvantages

- Access to policy cash value is limited without switching the arrangement to a loan (selling your cash value interest to the trust in exchange for a promissory note).
- The cost of the term portion increases each year as you grow a year older.
- As the cash value of the policy grows in proportion to the overall death benefit, the portion payable to the trust declines.

MassMutual...

Helping you secure what matters most.

Since 1851, MassMutual has been building a reputation for financial strength and integrity. At MassMutual, we operate for the benefit of our customers. Our business decisions are based on a single guiding principle: to help people secure their future and protect the ones they love.

Learn more at **www.MassMutual.com**.

Insurance products issued by Massachusetts Mutual Life Insurance Company (MassMutual) (Springfield, MA 01111) and its subsidiaries, C.M. Life Insurance Co. and MML Bay State Life Insurance Co. (Enfield, CT 06082). C.M. Life Insurance Co. and MML Bay State Life Insurance Co. are non-admitted in New York.

© 2020 Massachusetts Mutual Life Insurance Company (MassMutual®), Springfield, MA 01111-0001.
All rights reserved. www.MassMutual.com.

AS8050k 820

CRN202208-265128