SCHECHTER

Split Dollar in High Interest Rate Environments

What is Split Dollar?

Split dollar is a life insurance *funding* strategy that provides a way for companies or families to share the costs and benefits of life insurance in a more tax-efficient manner.

• In a business setting, we often see it between an employer and an employee as part of a retention plan that that is designed to provide tax-free retirement cashflow.

• In a family setting, it is used to fund life insurance policies that are intended to create estate liquidity and replenish wealth that will be lost to estate taxes without cutting into the lifetime exemption.

Advantages of Split Dollar Life Insurance

- **For Business**: A split dollar program can act as a tax-efficient alternative to a traditional deferred compensation program. Upon retirement, the key employee can borrow from the life insurance policy for tax-free cashflow, or transfer the policy to an irrevocable trust for estate planning purposes.

- **For Families**: A split dollar program can substantially reduce the gift tax cost of funding a life insurance policy that is needed for liquidity and/or wealth preservation purposes.

There Are Two Types Of Split Dollar Life Insurance

Economic Benefit

The employer or grantor pays the premium for a life insurance policy where the cash value is owned (or *deemed to be owned*) by the employer or grantor. The employee or irrevocable trust is entitled to receive the policy death benefit in excess of the cash value. The amount that is deemed to be transferred from the employer or grantor to the employee or trust is the cost of the tax-free life insurance protection they receive, which is considered an "economic benefit". The low cost of this benefit is determined using an IRS Table based on amount of net death benefit that will be paid to the employee or trust.

Loan Regime *(most common)*

Each premium payment is considered an interest-bearing loan to the employee or trust. When the insured dies, or an earlier specified date, the loan is repaid from the policy's cash value or death benefit, and the remaining amount goes to the beneficiaries tax free. The interest rate on the loan is typically determined by using the applicable federal rate (AFR) that is set monthly by the Internal Revenue Service.

Issue

The economic benefit approach is inexpensive at younger ages but can become quite expensive as the insured reaches older ages (generally into their 70s). The loan regime approach can be expensive in a higher interest rate environment and less expensive in a lower interest rate environment. *The solution is* ***Switch Dollar.***

What is Switch Dollar?

- This is the strategy of efficiently transitioning from one form of Split Dollar to another
- Given the current high interest rates, this strategy involves beginning with an economic benefit program and then transitioning to a loan regime approach at some point in the future. This is known as **Switch Dollar.** It takes advantage of the lower economic benefit cost when the insured individuals are younger, and then switches to loan regime when that becomes the less expensive approach.

The **table below** highlights the benefits of Split Dollar and Switch Dollar for a 59-year-old couple. By utilizing an economic benefit Split Dollar plan structure at the outset, with an eye toward switching to a loan regime Split Dollar plan structure in the future, they are projected to reduce the transfer tax cost of providing their family with tax-free death benefit by more than 50%.

Structure	Transfer Tax Cost at age 90	Total Amount Transferred
Loan Regime	$6,875,565	$30,509,621
Switch Dollar	$2,728,714	$34,656,472