Split-Dollar Life Insurance

Life insurance can be an important part of a business owner's financial strategy. It can also be a great benefit to offer to key employees. However, sometimes the cost can be prohibitive. With split-dollar life insurance, the cost of life insurance can be managed by splitting it up.

To be clear, split-dollar life insurance is not an insurance product but rather an arrangement to purchase and fund life insurance between two parties, generally an employee and an employer.

Basically, an agreement is made under which a life insurance policy is purchased on an individual. The employer will pay all or a portion of the premiums on the policy, depending on the arrangement. When the individual dies, the employer receives a portion of the death benefit equal to the amount paid in premiums. The remaining benefit goes to the individual's beneficiaries.

For example, if a $200,000 policy were purchased for an individual who died after the employer had paid $28,000 in premiums, then the employer would get back the money it had paid in premiums and $172,000 would go to the insured individual's beneficiaries.

This agreement is attractive to both parties because the employer recoups its money and the employee receives a life insurance policy at a better rate because the company is picking up all or a portion of the cost. The death benefit is free of income tax for both parties as well.

A split-dollar life insurance arrangement can be used for a variety of reasons.

Split-dollar life insurance can be used to fund a buy-sell agreement.

It can be used as a benefit to recruit and retain quality executives.

Business owners who might not otherwise be able to afford life insurance might benefit from a split-dollar arrangement.

There are different ways to set up split-dollar life insurance. Usually, the individual owns the policy and designates beneficiaries, then by absolute assignment transfers to the employer an amount equal to the premiums paid by the employer. In this case, the individual retains all ownership rights, but when the individual dies, the employer is reimbursed before the individual's named beneficiaries are paid. If the individual leaves the company, any cash value in the policy would be used to repay the company.

In other arrangements, the policy can be purchased by the employee and assigned to the employer as collateral in exchange for the employer paying the premiums. Because the company holds the policy as collateral, it can be confident that it will recoup the money spent on the insurance premiums.

In some cases, the employer can take out a life insurance policy on the employee. The employer names itself as a beneficiary of an amount equal to the cash value and designates that any funds in excess of that amount will be paid to the individual's beneficiaries.

The cost and availability of life insurance depend on factors such as age, health, and the type and amount of insurance purchased. Before implementing a strategy involving life insurance, it would be prudent to make sure that you are insurable.

As with most financial decisions, there are expenses associated with the purchase of life insurance. Policies commonly have contract limitations, fees, and charges, which can include mortality and expense charges.