

SAMPLE DOCUMENT

SAMPLE SPLIT DOLLAR PLAN AGREEMENT (ENDORSEMENT METHOD)

Employer-owned life insurance policy; endorsing death benefit to employee to name their split dollar beneficiary; taxed under the “economic benefit” regime

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Background Information:

- A. *This sample split dollar plan agreement is between an employer and an employee, where the employer owns the policy and endorses to the employee the right to name a beneficiary of a certain portion of the policy’s death proceeds (and at all times the only benefit provided by the employer to the employee under this Agreement is current life insurance death benefit protection).*
- B. *This Agreement is intended to meet the definition of a “split-dollar life insurance arrangement” under the split dollar treasury regulations (see Treas. Reg. § 1.61-22(b)), and to be taxed under the “economic benefit regime” of those regulations.*
- C. *To avoid income taxation of the death benefit, the employer and employee generally should satisfy the “notice and consent” requirements of I.R.C. § 101(j) before the policy is issued. This is an employer requirement to provide notice and obtain employee consent under I.R.C. § 101(j).*
- D. *Split-dollar arrangements between employers and employees are generally considered to be “welfare benefit” plans under the federal ERISA statute. Among other things, this generally requires that the plan be put forth in writing, and that the plan agreement contain certain “fiduciary” and “claims procedure” provisions (that are included here).*

This is an Agreement between [Name of Employer], a [Name of State] [Form of Entity], (the “Employer”), and [Name of Employee], (the “Employee”). Today’s date is _____, 20____.

RECITALS

- A. Employee is a valued employee of Employer and Employer wants to retain him in its employ.

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- B. Employer, as an inducement to continue this employment, wants to assist Employee with [his or her] personal life insurance program.

AGREEMENT

Now Therefore, Employer and Employee hereby agree as follows:

1. **Life Insurance.** The life insurance Policy with which this Agreement relates to is Policy Number [] issued by The Northwestern Mutual Life Insurance Company, of Milwaukee, Wisconsin (the Insurer), on the life of Employee (the "Policy").
2. **Rights of the Parties.**
 - a. Employer shall be the sole and exclusive owner of the Policy. This includes all the rights of "owner" under the Policy, including the right to name the beneficiary of the Policy's death benefit, subject to Employee's endorsed right to name a beneficiary of a portion of the Policy's death benefit as described in paragraph 2(b) below.
 - b. Employee shall have the right to designate the beneficiary of that portion of the Policy's death benefit *that exceeds* the greater of: (i) Employer's cumulative premiums paid, or (ii) the policy cash value as of Employee's death. The Employer's portion of the death benefit, defined in the prior sentence as the greater of sub point (i) or (ii), is identified as the "indebtedness" in this paragraph 2(b). Any indebtedness on the Policy and any indebtedness secured by the cash value of the Policy will first be deducted from the proceeds controlled by Employer.

Employee's rights and economic benefits, either in this Agreement or documented on the Insurer's records are limited exclusively to the value of death benefit protection stipulated in this paragraph 2(b).

Comment: *The above is just one example of how much death benefit can be endorsed/provided to the Employee (the endorsed portion is sometimes referred to as the "at risk" portion). But any amount agreed to by the parties can be endorsed. For example, the Employee's interest could alternatively be expressed as an exact dollar amount, or as a percentage of the death benefit in any given year. The Employer should be careful, however, to not endorse an amount that is greater than the actual death benefit remaining when the Insured dies. This could happen if the Employer endorsed, say, a flat dollar amount, but then borrowed from the policy so much that the Policy's net death benefit was even smaller than the flat dollar amount endorsed to the Employee.*

Also, some parties might want to add a provision explicitly addressing the effect of a premium paid by Employer through borrowing against the policy (e.g., by using an “automatic premium loan” option). Normally this will have an offset effect, at least initially, in that it increases the Employer’s portion by virtue of being an Employer-paid premium, but decreases the Employer’s portion by virtue of being an indebtedness against the policy. As time passes, however, the indebtedness can easily become the larger amount as loan interest is added to the loan.

3. **Premium Payment.** The entire premium on the policy shall be paid by Employer as it becomes due.

Comment: *If Employer pays the entire premium as paragraph 3 provides (i.e., a “non-contributory plan”), then Employee must report the value of the current life insurance protection – often labeled “value of economic benefit” or VEB – as taxable income so that the death proceeds payable to Employee’s beneficiaries are income tax-free.*

As of this sample agreement’s creation, the term rate table to use to measure the value of the life insurance protection is the federal government’s Table 2001 or, if lower, the Insurer’s lower rate table (provided it meets certain requirements). See Treas. Reg. § 1.61-22(d)(3) and (f)(3)(i); Notice 2002-8; Notice 2002-59; and Rev. Rul. 2003-105.

Another way to preserve income tax-free death benefit is to have Employee pay the Employer for the value of the death benefit that Employee controls (i.e., pay the cost of insurance under a “contributory plan”), and in that instance Employer would be income taxed on the amount contributed by Employee.

4. **Policy Dividends.** Policy dividends shall be applied to purchase additional paid-up life insurance.
5. **Economic Benefit Tax Treatment.** This Agreement shall be interpreted and enforced to comply with the final split dollar Treasury Regulations issued in 2003, and successor provisions, so that it is treated as an economic benefit transaction for tax purposes in which, at all times, the only economic benefit to Employee shall be the value of the current life insurance protection attributable to naming the split dollar beneficiary under the Policy. Employee shall not have any current access to the Policy’s cash values within the meaning of the split dollar regulations (or otherwise) or any other economic benefit other than the value of current life insurance death benefit protection.
6. **Right to Purchase Policy.** Employer shall not surrender or transfer ownership of the Policy while this Agreement is in effect without first giving Employee the option to purchase the Policy during a period of 60 days from written notice to Employee of such intention. The purchase price of the Policy shall be an amount equal to the Policy’s fair market value as determined under Treas. Regs. §§ 1.61-22(g)(2) and 1.83-3(e), less any Policy indebtedness to the Insurer that was incurred by Employer. This restriction shall not impair the right of Employer to terminate this Agreement pursuant to paragraph 7 hereof. The exercise by Employer of the power to surrender the policy

will terminate the rights of Employee, subject to his right to purchase the policy pursuant to this paragraph. However, the exercise by Employer of the power to transfer ownership of the Policy will not terminate the rights of Employee.

Comment: *The above paragraph 6, and the final sentence of the next paragraph – regarding Employee’s right to purchase the policy – are optional. If Employee’s right to purchase the policy is included in this Agreement, there is the question of how to determine the policy’s “fair market value.” (Employee must pay at least this amount to avoid being subject to income tax). Valuation of life insurance contracts transferred from employers to employees are generally governed by Treas. Regs. §§ 1.61-22(g)(2) and 1.83-3(e), which articulate fair market value as “the policy cash value and all other rights under such contract (including any supplemental agreements thereto and whether or not guaranteed), other than current life insurance protection.” In Rev. Proc. 2005-25, the IRS expanded on this by providing a safe harbor valuation formula, and many parties might want to state in the Agreement that a policy valuation provided by the Insurer that purports to follow the Rev. Proc. 2005-25 safe harbor shall be the purchase price. With traditionally-valued permanent policies with no surrender charges, the fair market value will often be close to the net cash value.*

Comment: *In some instances the parties might want to exclude the Employee’s right to purchase the policy (found in the above paragraph 6 and the final sentence of the next paragraph). Employee’s right to purchase the policy raises some issues.*

First, Employer might want to retain ownership of the policy for reasons unrelated to this split dollar plan, such as to informally fund a separate and independently operating nonqualified deferred compensation / supplemental employee retirement plan. In that case, Employer might not want Employee to have the right to buy the policy.

Second, there is some legal authority suggesting that Employee’s right to buy a policy insuring himself (even if never exercised) could amount to an incident of ownership, putting into his gross estate the death benefit that remains with Employer. See, e.g., Rev. Ruls. 75-70 and 79-46. Those fearing this result would generally exclude these “right to buy policy” provisions. On the other hand, other legal authorities have found no incident of ownership in similar situations. See, e.g., Morrow, 19 T.C. 1068 (1953); Infante, T.C. Memo 1970-206 (1970); and Smith, 73 T.C. 307 (1979). Further, the parties might find that the additional amount potential included in Employee’s estate – the death benefit retained by Employer – to be too small to cause a concern.

- 7. Termination of Agreement; Right to Purchase Insurance Upon Termination.** This Agreement may be terminated by either party hereto, with or without the consent of the other, by giving notice of termination in writing to the other party. This Agreement shall terminate automatically upon termination of Employee’s employment with Employer for any reason whatsoever other than the Employee’s death. If this Split Dollar Plan Agreement is terminated, Employee shall have the right

to purchase the Policy from Employer on the same terms and conditions as specified in paragraph 6 hereof.

Comment: *Keeping in mind that the Insurer generally is not aware of the provisions of the parties' split dollar agreement (this document), but instead is aware only of the provisions of its policy and accompanying endorsements (see below), the parties – particularly Employer – might want to request that the Insurer draft the endorsement to provide that Employee's rights in the policy terminate automatically upon Employer notifying the Insurer that Employee's employment has terminated. Among other things, this generally eliminates the need to seek a release of the endorsement from a hard-to-find former employee.*

8. **Insurance Company Not Liable.** The Insurer shall be bound only by the provisions of and endorsements to the Policy, and any payments made or action taken by it in accordance therewith shall fully discharge it from any and all claims, suits and demands of all persons whatsoever. It shall in no way be bound by or be deemed to have notice of the provisions of this Agreement.
9. **Employee's Right to Transfer.** Employee shall have the right to transfer (sometimes called the right to assign) any part or all of Employee's interest in the Policy and this Agreement to any person, entity, or trust by execution of a written document evidencing such transfer and by delivering it to Employer and the Insurer.

Comment: *An employee might exercise his right in paragraph 9, above, to transfer his interest in the Policy and in this Agreement (i.e., the right to name a beneficiary of a portion of the proceeds) to an irrevocable trust, in order to get the endorsed death benefit out of his estate. This may have gift tax consequences to the employee.*

10. **Governing Law.** This Agreement is being delivered and is intended to be performed in [Name of State] and shall be construed and enforced in accordance with the laws of [Name of State].
11. **Integration.** This Agreement embodies the entire understanding and agreement among the parties concerning the subject matter hereof and supersedes any and all prior written or oral negotiations, understandings, or agreements in regard thereto.
12. **Amendment.** This Agreement may not be amended except by an instrument in writing signed by all of the parties hereto. Any such amendment shall be effective when so signed, or as of such other effective date as is designated therein.
13. **Counterparts.** This Agreement may be executed in two (2) or more counterparts, each of which shall be deemed an original and all of which together shall constitute one and the same instrument, or with multiple signature pages which may be delivered electronically.
14. **Binding Effect.** This Agreement shall bind Employer and its successors and assigns, Employee and his or her heirs, executors, administrators and assigns, and any Policy beneficiary.

15. ERISA Requirements. The following provisions are part of this Agreement and are intended to meet the requirements of the Employee Retirement Income Security Act of 1974 (ERISA):

- a. The Named Fiduciary and Claims Manager: [a representative of the Employer, e.g., The Secretary of the Employer].
- b. The funding policy under this Plan is that all premiums on the Policy be remitted to the Insurer when due.
- c. Direct payment by the Insurer is the basis of payment of benefits under this Plan, with those benefits in turn being based on the payment of premiums as provided in the Plan.
- d. Claims procedure— for a claim other than a death benefit:
 - i. If for any reason a claim for benefits (other than a death benefit) under this Plan is denied by the Employer, the Claims Manager shall deliver to the Claimant a written explanation setting forth the specific reasons for the adverse benefit determination; specific references to the Plan section on which the adverse benefit determination is based; a description of any additional material or information necessary for the Claimant to perfect the claim and an explanation of why such material or information is necessary; and a description of the Plan’s review procedure including a statement of the Claimant’s rights to bring a civil action under Section 502 of ERISA following an adverse determination on review, all written in a manner calculated to be understood by the Claimant. For this purpose:
 - (A) The Claimant’s claim shall be deemed filed when presented orally or in writing to the Claims Manager.
 - (B) The Claims Manager’s explanation shall be in writing and delivered to the Claimant within 90 days of the date the claim is filed unless the Claims Manager determines that special circumstances require an extension of time for processing the claim. If such an extension of time for processing is required, written notice of the extension shall be furnished to the Claimant prior to the termination of the initial 90 day period. In no event shall such extension exceed a period of 90 days from the end of such initial period. The extension notice shall indicate the special circumstances requiring an extension of time and the date by which the Claims Manager expects to render the benefit determination. If the period of time is extended because the Claimant has failed to provide necessary information to decide the claim, the period for making the benefit determination shall be tolled from the date on which the notification of the extension is sent to the Claimant, until the date on which the Claimant provides the information. Failure to provide notice of decision in the time specified is the same as denial of the claim and the Claimant is entitled to require a review of the denial under the review procedures.

- ii. The Claimant (or his or her duly authorized representative) shall have 60 days following the receipt of the denial of the claim to file with the Claims Manager a written request for review of the denial. For such review, Claimant shall have the opportunity to submit written comments, documents, records, and other information relating to the claim for benefits. Claimant shall be provided, upon request and free of charge, reasonable access to, and copies of, all documents, records, and other information relevant to the claim for benefits. The review of the claim shall take into account all comments, documents, records, and other information submitted by the Claimant relating to the claim, without regard to whether such information was submitted or considered in the initial benefit determination.
- iii. In the case of a request for review of an adverse benefit determination, the Claims Manager is designated as the appropriately Named Fiduciary for a full and fair review. On review, the Claims Manager shall notify the Claimant not later than 60 days after the Company's receipt of the request for review, unless the Claims Manager determines that special circumstances require an extension of time for processing the claim, in which case a decision shall be rendered as soon as possible, but not later than 120 days after receipt of the request for review. If such an extension of time for review is required because of special circumstances, written notice of the extension shall be furnished to the Claimant prior to the termination of the initial 60 day period. In no event shall any such extension exceed a period of 60 days from the end of the initial period. The extension notice shall indicate the special circumstances requiring an extension of time and the date by which the Plan expects to render the determination on review. If the period of time is extended because the Claimant has failed to provide necessary information to decide the claim, the period for making the benefit determination shall be tolled from the date on which the notification of the extension is sent to the Claimant, until the date on which the Claimant provides the information. The decision on review shall be in writing and in the case of an adverse benefit determination shall include: (i) the specific reason or reasons for the decision; (ii) references to the specific Plan provisions on which the benefit determination is based; (iii) a statement that the Claimant is entitled to receive, upon request and free of charge, reasonable access to, and copies of, all documents, records and other information relevant to the Claimant's claim for benefits; and (iv) a statement of the Claimant's right to bring an action under Section 502(a) of ERISA, all written in a manner calculated to be understood by the Claimant. If the decision on review is not furnished within such time, the claim shall be deemed denied on review.

e. Claims procedure – for a claim for a death benefit:

A claim for a death benefit must follow the procedures established by the Insurer which may include time deadlines. If a participant's beneficiary makes a written request to the Claims Manager, the Claims Manager will either provide copies of forms or instructions required by Insurer to make a claim or tell the participant's beneficiary how to obtain them. Insurer will notify the beneficiary if the claim is denied and will explain the procedures it has for reviewing any claims

which it denies. The time and manner of such review, and the time for a final decision shall correspond to the time and manner of review for claims denied by the Claims Manager. The beneficiary must act in making any claim for a death benefit.

IN WITNESS WHEREOF, the Parties have executed this Agreement this _____ day of _____, 20__.

[NAME OF EMPLOYER]

By: _____

Its: _____

Attest: _____

Its: _____

[NAME OF EMPLOYEE]

SSN: _____

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