

# SAMPLE DOCUMENT

## SPLIT DOLLAR INSURANCE AGREEMENT (REVERSE SPLIT DOLLAR ENDORSEMENT METHOD)

*Employee-owned policy; endorsing death benefit to employer*

— For Use by Legal Counsel Only. Not for use by Financial Representatives with the public. —

### **Background Information:**

- *This sample split dollar agreement is between an employer and an employee, where the employee owns the policy and endorses to the employer 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 employee to the employer under this Agreement is current life insurance protection). Typically, the employer will name itself, the business entity, as the split dollar beneficiary.*
- *Because this endorsement arrangement reverses the roles normally held by the employer and employee (i.e., in common endorsement split dollar plans, the employer is the policy owner and endorses death benefit to the employee), this type of plan is generally called a "reverse" split dollar arrangement.*
- *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.*
- *To best ensure that the portion of the policy's death benefit that's endorsed to the employer is received income tax free by the employer under Internal Revenue Code (I.R.C.) § 101, the employer and employee generally should:*
  - *"account" for the cost of insurance that the employee is providing to the employer. This is usually done by having the employer pay the cost of insurance amount (often called the VEB – value of the economic benefit – amount). No matter which rate tables the parties use to measure the cost of insurance, the amount the employer pays to the employee to "rent" the insurance coverage that's endorsed to the employer is generally: (i) income taxable to the employee (the policyowner), and (ii) not deductible for the employer (the VEB payor).*
  - *satisfy the "notice and consent" requirements of I.R.C. § 101(j) before the policy is issued. This is true even though some practitioners might question whether the statute applies, as the employer is not the underlying policyowner.*

*Split-dollar arrangements between employers and employees are generally considered to be "welfare benefit" plans under ERISA. At least that's true when the employer is providing benefits to the employee. Here, however, the employee is the policyowner and is providing benefits (i.e., death benefit) to the employer, so some practitioners might question whether ERISA applies at all.*

---

This sample document is intended only as guidance for the client's own legal counsel. The document is general in nature and does not reflect the specific circumstances of any individual or situation. The document does not constitute tax or legal advice and cannot be used to avoid any penalties that may be imposed on a taxpayer. It is intended that the client's legal counsel will modify the document where necessary to satisfy the client's objectives and the requirements of any applicable federal, state or local law. Northwestern Mutual does not guarantee the effectiveness of this document and is not responsible for any tax or legal consequences resulting from use.

## SAMPLE DOCUMENT

*Nonetheless, this sample document contains “ERISA provisions” as if the law did apply. The drafter is free to remove those provisions but might want to keep them in just in case ERISA were found to apply, and there seems no harm in including them.*

THIS is an Agreement between [Name of Employer], a [Name of State] corporation (the “Employer”) and [Name of Employee] (the “Employee”). Today’s date is \_\_\_\_\_, 20\_\_\_\_\_.

**Comment:** *Regulations have not yet been promulgated to address split dollar arrangements involving partnerships – though Treas. Reg. § 1.61-22(c)(1)(iv) does appear to have a “Reserved” space for such regulations. Moreover, PLR 9639053 approved the notion of a partnership being a party to a split dollar arrangement in which a general partner (a revocable trust) was the owner of the policy and the grantor/trustee of the general partner was the insured. However, such treatment would not seem automatically to follow with respect to “limited partners”—or, for that matter, to the members of limited liability companies (LLCs), whose treatment may depend on how active the member is in management (similar to the concepts under Section 1402(a)(13)).*

### RECITALS

- A. The Employee owns a life insurance policy on his life.
- B. The Employer wants to obtain death benefit insurance protection on the life of the Employee by purchasing from the Employee a portion of the death benefit as described below.
- C. This Agreement is intended to qualify as a split dollar life insurance arrangement under the tax rules established under Section 61 of the Internal Revenue Code and the corresponding regulations, particularly Treasury Regulation § 1.61-22 and successor provisions.

### AGREEMENT

Now Therefore, Employer and Employee 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. Employee 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 Employer’s endorsed right to name a beneficiary of a portion of the Policy’s death benefit as described in paragraph 2(b) below.

- b. Employer shall have the right to designate the beneficiary of that portion of the Policy's death benefit *that exceeds* the greater of: (i) Employee's cumulative premiums paid, or (ii) the policy cash value as of Employee's death. The Employee'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 policy total death benefit controlled by Employee.

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 Employer (the endorsed portion is sometimes referred to as the "at risk" portion). But any amount of death benefit can be endorsed. For example, the Employer's interest could alternatively be expressed as an exact dollar amount, or as a percentage of the death benefit in any given year. The Employee should be careful, however, to not endorse an amount that is greater than the actual death benefit remaining when the Employee dies. This could happen if the Employee 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 Employer.*

*Also, some parties might want to add a provision explicitly addressing the effect of a premium paid by Employee 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 Employee's portion by virtue of being an Employee-paid premium, but decreases the Employee'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.*

*In a reverse split dollar arrangement, the death benefit proceeds received by the Employer are not taxable for regular income tax purposes. However, if the Employer is a C Corporation, such proceeds would go into the calculation of the Employer's liability for alternative minimum tax (AMT) purposes. This potential for increased corporate AMT may warrant the allocation of more death benefit proceeds to the Employer to make up for such income tax exposure.*

- 3. Premium Payment.** Each premium of the Policy shall be paid as it becomes due. At the time each premium payment is made, the Employer shall contribute to the payment of each premium. The Employer shall contribute each year an amount equal to the value of the economic benefit ("VEB") attributable to the life insurance protection provided to the Employer under this split dollar Agreement. The "value of the economic benefit" will be computed by multiplying the portion of the death benefit controlled by the Employer, by the life insurance premium factor designated or

permitted in guidance published by the Internal Revenue Service. Any premium for any waiver of premium benefit shall be paid by the Employee.

**Comment:** *As of this sample Agreement's creation, the term rate table to use to measure the value of the life insurance protection (i.e., the life insurance premium factor) 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 20028; Notice 2002-59; and Rev. Rul. 2003-105.*

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 any 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 Employer shall be the value of the current life insurance protection attributable to naming the beneficiary under the Policy. Employer shall not have any current access to the Policy's cash values within the meaning of the split dollar treasury regulations (or otherwise) or any other economic benefit other than the value of current life insurance protection.
6. **Purchase of Insurance Upon Termination.** Employee shall not surrender the Policy while this Agreement is in effect without first giving written notice to Employer of his or her intention to surrender. Employer shall have 60 days from the date of such written notice to purchase the Policy from Employee. 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), less any Policy indebtedness to the Insurer that was incurred by policyowner Employee. This restriction shall not impair the right of the Employee to terminate this Agreement pursuant to paragraph 7 hereof. The exercise by the Employee of the right to surrender the Policy will terminate the rights of the Employer.

**Comment:** *In many instances the parties might want to exclude the Employer's right to purchase the policy found in the above paragraph 6. This is particularly true if the parties intend the Employee to maintain ownership of the policy for personal needs after the agreement ends.*

*If Employer'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." Valuation of life insurance contracts when transferred from employers to employees – going in the opposite direction of what would occur here – 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." It appears reasonable to use the same approach here. 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.*

7. **Termination of Agreement.** This Agreement shall not be terminated before the \_\_\_ day of \_\_\_\_\_, 20\_\_ unless the Employer and Employee mutually agree to terminate in writing prior to this specified date. This Agreement may be terminated after such date 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. In the event of termination of the Agreement, Employer shall transfer its right to name the beneficiary of the "at risk" amount of death benefit to the Employee.

**Comment:** *If the parties want this Agreement to be terminable by either party from inception, rather than only after a certain date, they would exclude the first sentence of paragraph 7, above.*

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. **Employer Right to Death Benefit Constitutes Indebtedness.** The Employer's right to receive the death benefit under this Agreement shall constitute an indebtedness in respect of the Policy for which the Employer and Employee agree has been contracted for full and adequate consideration within the meaning of and for purposes of I.R.C. section 2053(a)(4) and the regulations promulgated thereunder.

**Comment:** *The purpose of the above paragraph is to make it more likely that insured/Employee's estate will be able to obtain an estate tax deduction under I.R.C. § 2053(a)(4) – property subject to mortgage or other indebtedness – for the portion of the death benefit payable to the Employer.*

*In Private Letter Ruling 9026041 (March 30, 1990), an insured owned a policy subject to a reverse split dollar endorsement in favor of a business. The ruling held that the policy's proceeds were in the insured/decedent's estate due to the "incident of ownership" rules of I.R.C. § 2042, but ruled that the insured's estate was permitted a deduction for the amount of the death benefit endorsed to the business – as indebtedness under § 2053(a)(4) – assuming that the business/endorsee paid adequate consideration for the death benefit it controlled. That is also why, in paragraph 3 above, this Agreement calls for the Employer to pay the insured/Employee for the cost of insurance death benefit.*

10. **Employee's Right to Employment.** Nothing contained in this Agreement shall be construed to give Employee any rights to employment or to continued employment with Employer.

- 11. 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].
- 12. 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.
- 13. 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.
- 14. 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.
- 15. 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.
- 16. Notice.** Any notice, consent or demand required or permitted to be given under the provisions of this Agreement shall be in writing and shall be signed by the party giving or making the same. If such notice, consent or demand is mailed to a party hereto, it shall be sent by United States certified mail, postage prepaid, addressed to such party's last known address as shown on the records of the Employer. If mailed, such notice, consent or demand shall be deemed to have been given on the next business day after such notice, consent or demand is mailed.
- 17. 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:
- a. The Named Fiduciary and Claims Manager: [an independent individual designated by the insured/policyowner who has experience overseeing benefit arrangements or, if appropriate, 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: \_\_\_\_\_

— For Use by Legal Counsel Only. Not for use by Financial Representatives with the public. —