Columbus Life Insurance Company

A member of Western & Southern Financial Group

ADVANCED MARKETS

LIFE INSURANCE PLANNING STRATEGIES

Loan-Based Split Dollar for the Business Owner

How an Indexed Explorer *Plus*® policy with Columbus Life can be funded with business assets in a tax-efficient manner.

Who Can Benefit

- Age: 35 and over.
- Owner of C-Corporation with strong cash flow.
- Would like to reduce current income tax liability and can maintain lifestyle with a temporarily reduced salary.
- In good health.

What is Loan-Based Split Dollar?

In loan-based split dollar, the corporation pays the premiums on a policy owned by the business owner (the "insured"). Generally, this would be treated as a distribution from the corporation and taxable as compensation or a dividend. However, in this case, the premiums payments are structured as individual loans that are collateralized by the cash value and death benefit of the life insurance policy. The principal of the loan is payable at the end of the loan period, with the insured being responsible only for payment of loan interest on an annual basis. If loan interest is not paid, it is treated as taxable distribution to the insured — either as ordinary income or a dividend.

Why Loan-Based Split Dollar Now?

The Tax Cuts and Jobs Act of 2017 made significant alterations to the tax code. Some changes, like those made to individual income tax rates — such as lowering the highest personal income tax bracket to 37 percent — are temporary and will lapse after 2025.

However, the steep reductions to the corporate tax rate (max rate: 21 percent) are permanent. This means that income retained at the corporate level may be taxed at a lower rate than if it distributed as income to the owner. With a maximum personal income tax rate of 37 percent and a maximum corporate tax rate of 21 percent, there may be an opportunity to create positive arbitrage through tax management and a successful loan-based split dollar program.

How Does This Help?

Funds are lent out of current cash flows to the insured that are used to purchase a life insurance policy and are not income taxable to the insured at this point. If a permanent life insurance policy, such as an Indexed Universal Life Policy, is used, there is the possibility to accumulate cash values on a tax deferred basis. At some point in the future, when cash values have accumulated safely beyond the outstanding principal of the loan (generally, premiums paid), funds can be taken out of the life policy to pay back the loan.[1] The resulting policy, along with tax deferred cash value, will be owned free and clear by the insured. The policy cash values can then be borrowed out of the policy generally income tax free (as long as the policy remains in force at death) as needed.

1 Loans accrue interest. Loans and withdrawals may be subject to additional charges and fees. Loans and withdrawals will reduce the Death Benefit and Cash Surrender Value and may cause the policy to lapse.

Benefits of Split Dollar

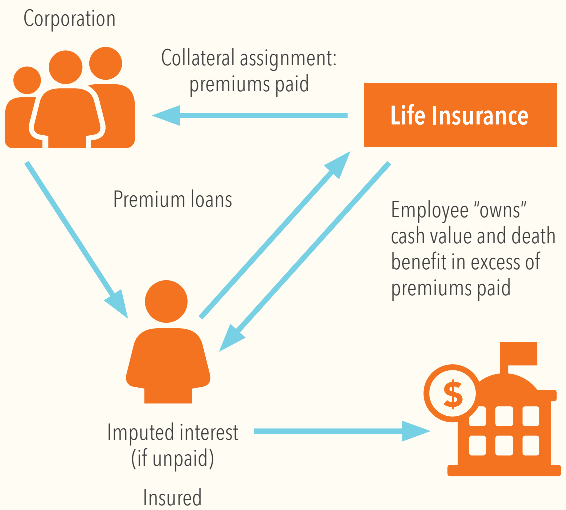
- Premiums are treated as loans and are not income taxable.
- Immediate death benefit protection for beneficiaries.
- Policy cash values accumulate tax deferred.
- Indexed universal life policies provide returns linked to market indices with the added benefit of downside protection from market fluctuation.
- Not a qualified plan (no contribution limits, no need to offer to other employees, etc.).

Be mindful of the following…

- Premium loans are not taxable; however, loan interest must be reconciled annually and must be either paid or recognized as income taxable by the insured.
- Split dollar requires legal documentation and the advice of a qualified attorney.
- Annual administration is necessary.
- If loan exit strategy is predicated on future corporate payments to insured, it must be compliant with IRC Sec. 409A.
- Policy should be carefully designed to avoid modified endowment contract (MEC) status.
- Collateral assignment of a MEC results in loss of tax deferral.
- Issuance of life insurance policy requires insurability and underwriting.
- Policy lapse or full surrender prior to death may result in income tax consequences.

SPLIT DOLLAR STEPS

- Split dollar agreement is entered into.
- Corporation loans premiums.
- Loan principal (premiums paid) collaterally assigned back to corporation.
- Insured recognizes loan interest.
- Policy values above loan principal accrue to insured.
- Insured may "exit" split dollar arrangement via policy cash values.



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