Allianz Life Insurance Company of North America

Split-dollar life insurance

A business life insurance arrangement that splits the proceeds

Invest in your most important asset – your key employees.

Over the years you've invested your time, talents, and money into reaching your goals and growing your business. One of the most important assets you've invested in may be the key employees who have supported that growth. Those employees often expect to receive special benefits designed to help them meet their financial goals and provide protection for their families.

Life insurance is one of the special benefits you can offer key employees. The death benefit[1] protection can assist a family when it needs it most – after one of the primary breadwinners passes away. One of the ways your business can provide this valuable life insurance protection to a key employee (or to you) is through a split-dollar arrangement.

Split-dollar life insurance, like anything else, isn't for everybody. But split-dollar life insurance may work well in certain situations. For example, split-dollar life insurance could be appropriate for:

- A key employee who wishes to have additional life insurance for his or her family in the event something happened to him or her, but doesn't want to pay the entire premium. With split-dollar, the business pays the premium for the employee.
- The owner of a family-owned business who wishes to provide a life insurance death benefit to his or her surviving family but would like to use his or her business to pay the premium on his or her behalf. The owner may also wish to ensure that the family has enough life insurance coverage on the owner to pay taxes or other expenses after the owner's death.
- A key employee or business owner who is age 40 or 55 (or younger) and anticipates staying with the business in the years ahead – so there is time to ensure that the life insurance stays in force and the cash value potentially grows.

For all that's ahead.®

Allianz

[1] The death benefit is generally income-tax-free when passed on the beneficiaries.

Must be accompanied by the "Understanding fixed index universal life insurance" brochure (M-3959) or the appropriate product brochure.

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M-5776

Choose the split-dollar endorsement or collateral assignment method.

Split-dollar life insurance is a life insurance benefit your business provides. The insured on the policy is the key employee, and your business pays all or some of the policy premiums. At the employee's death, the life insurance proceeds are split according to a previously executed agreement by the business and the key employee. Split-dollar arrangements are usually structured in one of two ways – the endorsement method or the collateral assignment method.

Under the **endorsement method**, your business provides a life insurance benefit and pays the policy premiums on an insured key employee (who could be the business owner).

The business owns the policy. Upon the key employee's death, the death benefit is split according to the agreement, with the employer receiving its portion for repayment of the policy premiums, and the employee's beneficiaries receiving their agreed-upon portion. In some cases, the employee repays the premiums while still living, and the employer transfers ownership of the policy to the employee. Typically, business owners choose the endorsement method if the key employee has a need for survivor income but has no estate-tax concerns, the employer paying the premium is a C corporation, and the business is not a publicly traded corporation.

The business must comply with the notice and consent requirements for employer-owned life insurance that all parties will need to review and sign, plus provide ongoing reporting to the IRS regarding policy ownership.[1]

With the **collateral assignment method**, your business provides a life insurance benefit and may pay the policy premiums, but the policy is owned by the insured or the insured's irrevocable life insurance trust (ILIT). The policy owner collaterally assigns an interest in the policy to the business.

Typically, business owners choose the collateral assignment method if the key employee or business owner has a need for life insurance, especially if there is an estate-tax concern. In that case, the insured would use a trust to own the policy. Publicly traded corporations cannot use split-dollar life insurance because they are not allowed to issue loans to key employees.

[1] An employer-owned life insurance policy is subject to the requirements of Internal Revenue Code 101(j) in order to obtain an income-tax-free death benefit. In general, those rules require that before the policy is issued, the employer must provide the insured with a written notice of the life insurance, obtain a written consent from the insured, and provide the IRS with ongoing annual reporting regarding policy ownership. Consult with an attorney for application of those rules to a specific situation.

ENDORSEMENT METHOD

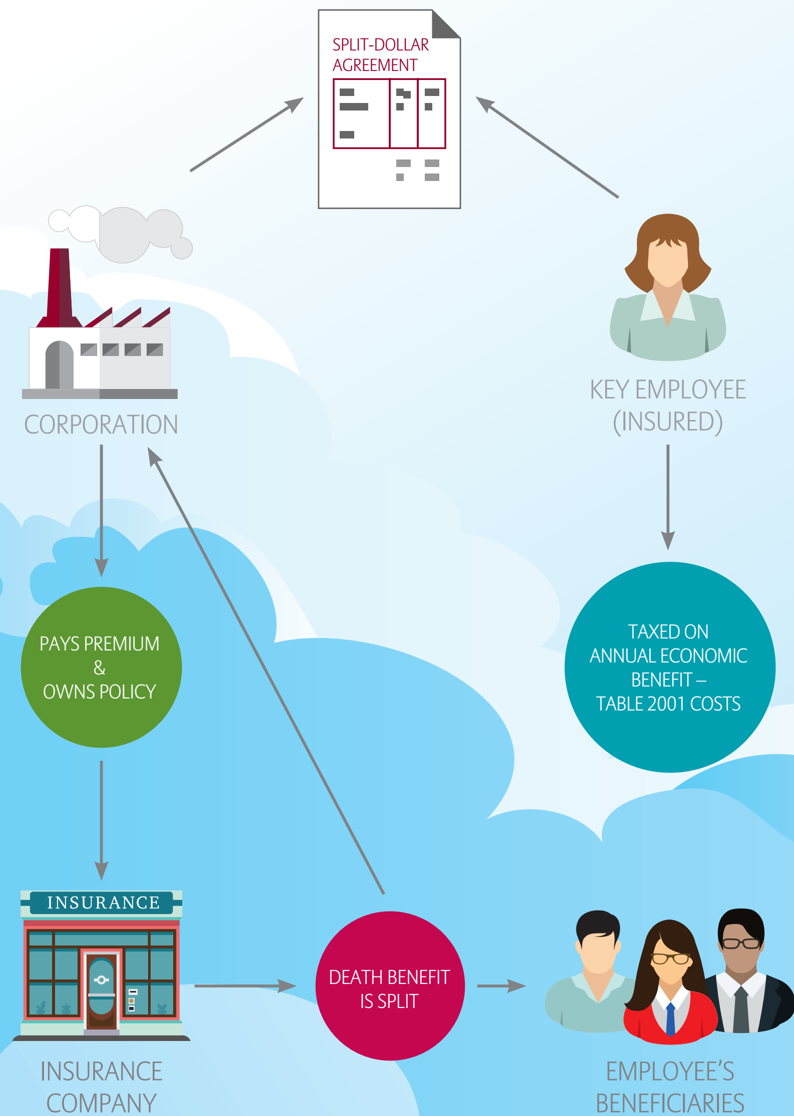
1 BEFORE THE **ENDORSEMENT METHOD OR COLLATERAL ASSIGNMENT METHOD** SPLIT-DOLLAR POLICY CAN BE ISSUED, YOUR BUSINESS HAS TO COMPLY WITH EMPLOYER-OWNED LIFE INSURANCE (EOLI) RULES. EOLI RULES REQUIRE THE BUSINESS TO GET A SIGNED NOTICE OF CONSENT FROM THE INSURED.

2 YOUR BUSINESS WORKS WITH AN ATTORNEY TO DRAFT AND CREATE THE SPLIT-DOLLAR AGREEMENT.[1]

3 YOUR BUSINESS AND KEY EMPLOYEE ENTER INTO AN **ENDORSEMENT METHOD** SPLIT-DOLLAR AGREEMENT.

4 YOUR BUSINESS PURCHASES LIFE INSURANCE ON YOUR KEY EMPLOYEE. YOUR BUSINESS OWNS THE POLICY AND PAYS ALL OF THE PREMIUM.

5 THE BENEFICIARY OF THE POLICY IS SPLIT. THE GREATER OF THE CASH SURRENDER VALUE OR PREMIUM IS PAID TO THE BUSINESS AND THE BALANCE OF THE DEATH BENEFIT GOES TO THE EMPLOYEE'S CHOSEN BENEFICIARIES INCOME-TAX-FREE.



These hypothetical examples are provided for illustrative purposes only.

[1] Some potential issues to consider before adapting a split-dollar arrangement: **Under-collateralization** may expose the employer to the business risk of not receiving repayment for the premium loans. **Insufficient cash value** could result in the inability to finance policy loans and withdrawals the executive is relying on to help supplement retirement income.

You should consult your attorney and/or tax advisor to address these and other potential concerns regarding your unique situation.

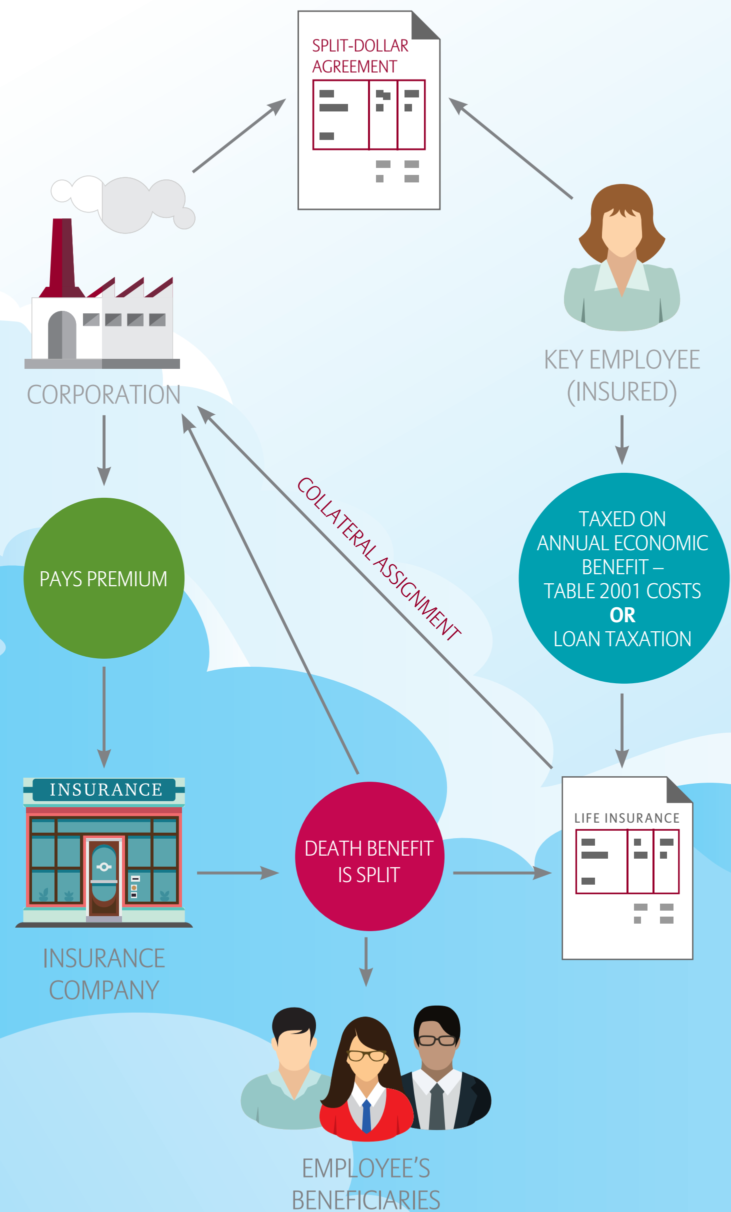
SPLIT-DOLLAR LIFE INSURANCE – HOW IT WORKS | Examples of both methods of **split-dollar life insurance**

COLLATERAL ASSIGNMENT METHOD

1 BEFORE THE **ENDORSEMENT METHOD OR COLLATERAL ASSIGNMENT METHOD** SPLIT-DOLLAR POLICY CAN BE ISSUED, YOUR BUSINESS HAS TO COMPLY WITH EMPLOYER-OWNED LIFE INSURANCE (EOLI) RULES. EOLI RULES REQUIRE THE BUSINESS TO GET A SIGNED NOTICE OF CONSENT FROM THE INSURED.

2 YOUR BUSINESS WORKS WITH AN ATTORNEY TO DRAFT AND CREATE THE SPLIT-DOLLAR AGREEMENT.[1]

3 YOUR BUSINESS AND KEY EMPLOYEE ENTER INTO A **COLLATERAL ASSIGNMENT METHOD** SPLIT-DOLLAR AGREEMENT.



4 THE EMPLOYEE OR EMPLOYEE'S ILIT PURCHASES AND OWNS THE LIFE INSURANCE ON THE EMPLOYEE. THE BUSINESS PAYS ALL OF THE PREMIUM.

5 THE EMPLOYEE OR EMPLOYEE'S ILIT COLLATERALLY ASSIGNS AN INTEREST IN THE POLICY TO THE EMPLOYER.

6 UPON THE INSURED'S DEATH, THE EMPLOYER RECEIVES ITS SHARE OF THE DEATH BENEFIT AS SPECIFIED IN THE COLLATERAL ASSIGNMENT, AND THE BALANCE OF THE DEATH BENEFIT IS PAID TO THE EMPLOYEE'S CHOSEN BENEFICIARIES.

These hypothetical examples are provided for illustrative purposes only.

[1] Some potential issues to consider before adapting a split-dollar arrangement: **Under-collateralization** may expose the employer to the business risk of not receiving repayment for the premium loans. **Insufficient cash value** could result in the inability to finance policy loans and withdrawals the executive is relying on to help supplement retirement income.

You should consult your attorney and/or tax advisor to address these and other potential concerns regarding your unique situation.

Tax considerations

The tax results depend on which method of split-dollar is used – the endorsement method or the collateral assignment method.

With the **endorsement split-dollar**, the tax results are as follows:	
Tax results to the employee: The employee is taxed annually on the Table 2001 costs (based on age and amount of death benefit provided) OR on the life insurance company's one-year term costs if the company regularly sells that one-year term policy, and if the life insurance company must generally make those term rates known to clients purchasing their term coverage. Because Allianz Life Insurance Company of North America (Allianz) does not sell a one-year term product, the employee would be taxed annually on the Table 2001 costs. The death benefit to the personal beneficiary is income-tax-free.	**Tax results to the employer:** The employer cannot income-tax-deduct the premium and cannot income-tax-deduct the Table 2001 costs, if that table is used. If the employer meets the IRS employer-owned life insurance rules which require advance notice and consent from the employee, the death benefit paid to the employer should be income-tax-free.
With the collateral assignment split-dollar method, there are two possible ways to treat the taxation – either the economic benefit regime or the loan regime can be chosen.	
With the **economic benefit regime**, the tax results are as follows:	
Tax results to the employee: The employee is taxed annually on the Table 2001 costs (based on age and amount of death benefit provided) OR on the life insurance company's one-year term costs if the company regularly sells that one-year term policy, and if the life insurance company must generally make those term rates known to clients purchasing their term coverage. Because Allianz does not sell a one-year term product, the employee would be taxed annually on the Table 2001 costs. The death benefit to the personal beneficiary is income-tax-free.	**Tax results to the employer:** The employer cannot income-tax-deduct the premium and cannot income-tax-deduct the Table 2001 costs, if that table is used. If the employer meets the IRS employer-owned life insurance rules which require advance notice and consent from the employee, the death benefit paid to the employer should be income-tax-free.
With the **loan regime**, the tax results are as follows:	
Tax results to the employee: The premiums paid by the business are considered a loan to the employee. IRS interest rates and interest-free loan rules apply. If the employee pays the interest to the business each year, there is no annual taxation to the employee. If the interest rate on the loan to employee is less than the market interest rate the IRS requires, then the employee is taxed annually on the difference between the market rate interest and the actual interest rate applied. The death benefit paid to the personal beneficiary is income-tax-free.	**Tax results to the employer:** The premiums that the employer lends the employee are not income-tax-deductible to the employer. If the insured employee pays interest to the employer each year, that amount of interest is income-taxable to the employer. If the employer meets the IRS employer-owned life insurance rules which require advance notice and consent from the employee, any death benefit paid to the employer should be income-tax-free.

You may want to offer a **split-dollar** (either endorsement or collateral assignment) life insurance policy as a special benefit to select key employees. **Talk to your financial professional** about how split-dollar could work for your business and your key employees.