**advanced markets**

# private split dollar economic benefit approach

case study

## Help Family Business Owners Address Estate Equalization Needs Using Private Split Dollar

do you have clients like these?

Business owners:

- Age 45 and older
- Married
- Steady cash flow

### Problem

Estate planning for business owners can create some interesting opportunities as well as challenges. It is fairly common to come across planning situations in which some, but not all, of the children are involved in running the family business, but all expect to inherit some of the business value. The issues boil down to business succession planning combined with "equalizing inheritances." One way to address this is to have the children in the business purchase the business at the parents deaths. This leaves a liquid estate that can be equally divided among all the children.

Life insurance frequently plays a vital role in maintaining the future of family harmony. A Private Split Dollar strategy may allow this with reduced gift taxes.

### Situation

Bill and Martha are the sole owners of the business, and one of their four children, Jeremy, has worked in the business for the last 20 years.

The business is worth $3,000,000 and their other assets total $2,000,000. The couple realize that Jeremy is responsible for a substantial portion of the business value and want him to benefit from it. Yet they are hard-pressed to suggest they could leave $3,000,000 represented by the business value to Jeremy and leave only $2,000,000 to be shared by their three other children.

## Strategy

Their financial professional suggests they enter into a buy-sell agreement with their son Jeremy for the full business value, $3,000,000. The liquidity it provides allows all their children to share equally in their estate, currently valued at $5,000,000. If the estate grows in value, everything would still be split equally.

The premium on a $3,000,000 Athena Survivorship Universal Life℠ III (Athena SUL℠ III) policy on their lives is $32,398[1] a year. That is more than Jeremy can afford at this time. To address this, they can enter into an Economic Benefit Model funding arrangement.

## Bill and Martha can enter into a Private Split Dollar Agreement with Jeremy

Under the agreement, Jeremy could apply for a $3,000,000 Athena SULSM III policy on the lives of Bill and Martha.

Bill and Martha can make premium payments to AXA Equitable, with Jeremy contributing an amount equal to the "Economic Benefit" (i.e., the value of the pure life insurance coverage being provided to Jeremy under the agreement determined using term insurance rates). This avoids gift tax implications for Bill and Martha, though they will be subject to income tax on the amount of the Economic Benefit paid by Jeremy.

Economic Benefit Private Split Dollar is perfect in this scenario because the rates for married couples can be low. In this case, the premium is $32,398. Sample Economic Benefit amounts for this married couple are:

- Year 1 is $129
- Year 10 is $959
- Year 20 is $5,487[1]

For their premium payments, Bill and Martha would receive a collateral interest in the policy for the greater of cash value or premiums they pay on the policy.

- On the first Insured's death, the Economic Benefit calculation jumps from a joint life value to a single life value. The Economic Benefit costs will rise significantly. One possibility is to consider a switch to a Loan Regime Split Dollar plan.

## Benefit

Bill and Martha have assured that their estate maintains liquidity. All their children can expect to receive equal shares from Bill and Martha's estate. In recognition of his years of work, Jeremy ends up as sole owner of the business, assisted by Bill and Martha. Private Split Dollar played an important role in the couple's estate planning!

1 This is a supplemental illustration and must be read in conjunction with the basic illustration. The basic illustration contains values using the same underwriting assumptions as this supplemental and contains other important information. The values represented here are for a $3,000,000 Athena SUL℠ III policy on a 60-year-old male with Preferred Tobacco User status and 60-year-old-female with Preferred Tobacco User status. The values reflect the cost of 40 years of premiums. If guaranteed rates and charges are used, the policy would fail in year 23.

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G22562
IU-50433 (7/09)
Cat. #143873 (7/09)

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