Accounting guidelines for Loan Split Dollar plans

With this type of split dollar plan, the life insurance policy is owned by the key employee, and collaterally assigned to the employer. Amounts advanced by the employer to pay premiums are treated as loans. If these loans are forgiven, they're also generally treated as additional compensation in the employer's financial statements.

Journal transaction example

The employer has a written split dollar loan agreement with a key employee, to pay $50,000 in annual premiums on a life insurance policy owned by the key employee. Assume the loans are demand loans and that the blended annual rate is 3%, meaning that the imputed interest amount is $1,500 ($50,000 x .03) for the first year.

The employer reports $1,500 income to the key employee as imputed interest. If the employer reports $1,500 imputed interest to the key employee, then the key employee will owe income tax of $525 (assuming the key employee's tax rate is 35%) on that imputed interest income.

The employer also makes an additional bonus to the key employee to cover the income tax liability on the $1,500 imputed interest amount. If the tax on the imputed interest is 35%, the bonus amount calculation is: $525 tax on imputed interest divided by (1 - .35 employee tax rate) = $808 bonus. This means a bonus of $808 would cover both the $525 tax on the imputed interest and the $283 tax ($808 X .35 = $283) on the bonus itself. This limits the out-of-pocket tax costs to the key employee.

Assume the split dollar agreement is terminated after the fourth year.

1. Loaned amounts from the employer to pay annual premiums on the life policy owned by the key employee.
2. Loan triggers taxable imputed interest to the key employee.
3. The employer pays a bonus to the key employee to cover the tax on the imputed interest.
4. In year four, the collateral assignment is released, the key employee reimburses the employer, and the split dollar agreement is terminated.
5. Alternatively, in year four, the employer forgives the loan repayment obligation, releases the collateral assignment, and the split dollar agreement is terminated. The amount forgiven is considered compensation to the key employee.

This hypothetical example is for illustrative purposes only.

	Balance Sheet		Income Statement	
	Debit	**Credit**	**Debit**	**Credit**
1. Employer loaned premium amount Loan receivable	$50,000			
cash		$50,000		
2. Imputed interest Compensation expense			$1,500	
Miscellaneous income				$1,500
3. Income tax cost of bonus to key employee Compensation expense			$808	
Cash		$808		
4. Termination of split dollar agreement (if paid in cash) Cash	$200,000			
Loan receivable		$200,000		
5. Termination of split dollar agreement (if loan is forgiven) Compensation expense			$200,000	
Loan receivable		$200,000		

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