APPLIED KNOWLEDGE | SPLIT DOLLAR PLANS

Accounting guidelines for Endorsement Split Dollar plans

Under a typical endorsement split dollar plan, the employer is the owner of a life insurance policy on the key employee. The agreement gives the key employee the right to name a beneficiary for a specified amount of the policy's death benefit, with any remainder payable to the employer. Since there are no future promises of retirement benefits, the accounting focuses on current premium payments and benefits.

Journal transaction example

The employer has a written endorsement split dollar agreement with a key employee, to pay $20,000 annual premiums on a $1 million life insurance policy owned by the employer. The employer obtained the key employee's notice and consent before acquiring the policy to comply with IRC Section 101(j). The employer endorses $400,000 of the death benefit to the key employee (this is approximately equal to 4x the key employee's annual salary). The balance of the death benefit is retained by the employer for key person insurance purposes. The employer must meet the notice and consent requirements of IRC Section 101(j). Each year the company must file a completed IRS form 8925 and include its employer-owned life insurance policies.

This hypothetical example is for illustrative purposes only.

1. The employer pays $20,000 in life insurance premium out of company cash flow.
2. The cash surrender value (CSV) is accounted for as an asset and offsets the life insurance premium expense.
3. The key employee (assumed to be age 40) is deemed to receive an annual economic benefit based on the $400,000 of endorsed life insurance death benefit. This economic benefit is reportable as income to the key employee, annually. The employer books journal entries if the employer bonuses the key employee cash to cover the taxes for the annual economic benefits costs.
4. The key employee unexpectedly passes away, and the employer collects a death benefit. The employer records journal entries for the $600,000 of key person coverage it receives. The employer does not book journal entries for the $400,000 of death benefit payable directly to the key employee's named beneficiaries.

	Balance Sheet		Income Statement	
	Debit	Credit	Debit	Credit
1. Paying the annual premiums				
Life insurance expense			$20,000	
Cash		$20,000		
2. Booking the life insurance as an asset				
Life insurance CSV	$18,850			
Life insurance expense				$18,850
3. Optional - Bonus for the annual economic benefit costs			$86	

Bonus wage expense*				
Cash		$86		
4. Death benefit received by company				
Cash	$600,000			
Life insurance CSV		$18,850		
Life insurance proceeds				$581,150

*Assumes the annual economic benefit cost for $400,000 of endorsed death benefits on a 40-year-old is $200. This is reported as income to the key employee. This economic benefit cost increases annually based on age. The employer could choose to help the key employee with the taxes on the economic benefit costs. Following is a sample calculation: $200 x 30% (example key employee tax rate) = $60 of taxes. If the employer wants to “double bonus” the key employee an amount to cover the $60 plus the taxes on this bonus (gross it up for taxes), the calculation is $60 / (1 – key employee tax rate) or $60 / (1 – 30%) = $86.