

Success Strategy Endorsement Split Dollar



PROVIDING FINANCIAL PROTECTION

You may be looking for ways to protect your family from financial hardship in the event of your premature death. Consequently, you may be considering ways in which your employer (or business) may help you to protect your family financially and perhaps to help you to supplement your retirement income.

WHAT IS ENDORSEMENT SPLIT DOLLAR?

An endorsement Split Dollar arrangement is an agreement between you and your company in which you split the cost of a life insurance policy on your life with your company. The plan is a cost-effective way for your company to provide you with a pre-retirement survivor benefit and/or supplemental retirement income. It is often incorporated into a non-qualified deferred compensation plan, or a key person plan in which a company insures itself against your loss.

HOW IT WORKS

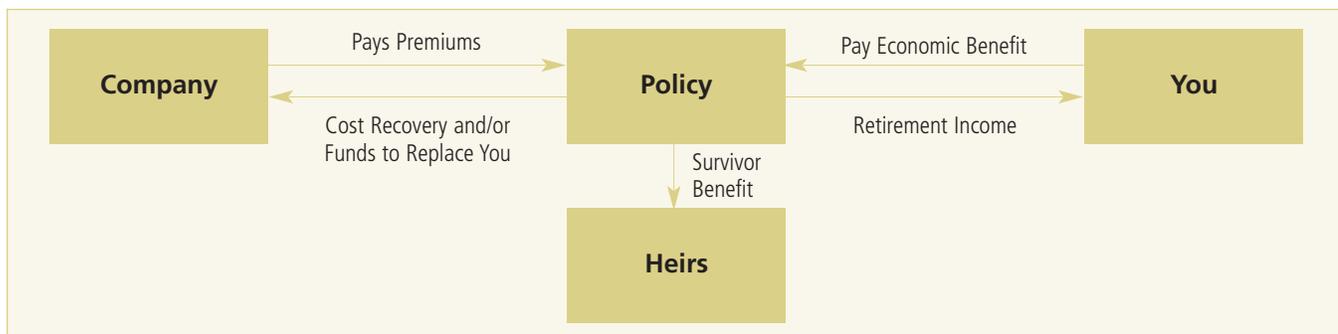
You and your company enter into an endorsement Split Dollar arrangement in which the company owns a policy on your life and pays the majority of the premium. Your company then endorses a portion of the death benefit to you as a pre-retirement survivor benefit payment to benefit your heirs in the event of your premature death. Your company pays the entire premium except for the economic benefit portion, paid by you, which initially

represents only a fraction of the premium. The economic benefit refers to the "term" cost of the death benefit and changes annually based on your age.¹

Alternatively, your company may pay the economic benefit as an income taxable benefit to you.² When you retire, the endorsement terminates and your employer retains ownership of the policy and may use the policy's cash values to pay supplemental retirement income to you. Upon your death, the company receives the death benefit proceeds to recover its costs. (See chart below.)

BENEFITS

- *Simple plan to implement.* The plan can be appealing to an employer because it does not need to meet the requirements of a costly qualified plan.³
- *Cost recovery.* Your company benefits by recovering its plan costs from the death benefit proceeds while providing you with benefits.
- *Plan termination.* There is no cost to you when the endorsement is terminated.
- *Low-cost death benefit coverage.* The plan may provide you low-cost life insurance protection, dependent on your insurability when the policy is underwritten, because the cost to you is the economic benefit and not the full premium.



- *Supplemental retirement income.* The company can access the policy's cash values on a potentially tax-favored basis to provide you with supplemental retirement income.⁴
- *Flexibility.* Your company has the flexibility to decide how to use the policy and what benefits to provide you. Your company may also decide to transfer the policy to you at retirement or before in the form of a bonus.⁵

CONSIDERATIONS

- *Employer-owned policy.* The policy is not a portable benefit since it is owned and controlled by your company. The endorsement can be terminated at anytime.
- *Majority shareholder restriction.* If you are a majority shareholder employee, the endorsement must be "restricted" so that the death benefit is not included in your taxable estate.⁶
- *Income taxes.* If your company pays the economic benefit portion of the premium, you must include its value in your annual taxable income.
- *Trust-ownership of death benefit.* If the endorsement is owned by an Irrevocable Life Insurance Trust (ILIT)⁷ you create, you will make a deemed gift of the economic benefit amount annually.
- *Final Split Dollar Regulations.* The Final Split Dollar Regulations issued in 2003 dictate how a Split Dollar plan can be structured and describe the tax consequences of such plans.⁸ Please see the Comprehensive Split Dollar Client Guide for additional information.

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1. The economic benefit is derived from the Government 2001 rate tables or the insurer's alternative term rates. Please see IRS Notice 2002-8.
2. If the endorsement is owned by an Irrevocable Life Insurance Trust (ILIT), you will be making a deemed gift to the ILIT and the economic benefit amount will be subject to gift tax annually. Providing that the amount of the gift is covered by your annual gift tax exclusions, you will not incur gift taxes. See IRC §2503(b). An annual exclusion gift is the amount of annual gifts that each individual can make to an unlimited number of people without federal gift tax. In 2006, this amount is \$12,000 per individual per year (indexed annually for inflation and subject to specific rules).
3. An endorsement Split Dollar plan is exempt from the participation, funding, and vesting requirements of ERISA. However, notification, in the form of a letter, to the Department of Labor (DOL) may be necessary. See DOL Regs. §2520.104-24.
4. Withdrawals and loans from a life insurance policy that is classified as a Modified Endowment Contract (MEC) may be subject to income and/or penalty taxes at the time the withdrawal or loan is made. If the policy will be used as a supplemental retirement income source, it is important to design the policy so that it is not classified as a MEC.
5. If the company transfers ownership of the policy to you, you will recognize income upon receipt of the policy. However, if the policy is transferred to a "non-grantor" ILIT, the "transfer for value" rule will apply. See IRC §101(a)(2).
6. A "restricted" endorsement refers to an endorsement that does not allow you, as majority shareholder of the corporation, to have access to the policy. This restriction is used to avoid incidents of ownership that may apply for estate tax purposes under IRC §2042.
7. Trusts should be drafted by an attorney familiar with such matters in order to take into account income and estate tax laws (including generation-skipping transfer tax). Failure to do so could result in adverse tax treatment of trust proceeds.
8. The Sarbanes-Oxley Act of 2002 may prohibit (as a personal loan) a Split Dollar arrangement between a public company and one of its executives or directors. Consult your legal and tax advisors before entering into any Split Dollar Plan.



Insurance products are issued by John Hancock Life Insurance Company (U.S.A.), 197 Clarendon Street, Boston, MA 02116.

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