



Demand Loans (Split Dollar Loan Regime)

For over forty years, many professionals were involved in promoting or recommending split-dollar arrangements designed to minimize or eliminate tax liability associated with purchasing, gifting and funding life insurance premiums. There are three types of split-dollar loans: (1) demand loans; (2) term loans and (3) certain term loans treated as demand loans (“hybrid loans”). A demand loan is any loan that is payable in full at any time on the demand of the lender. A term loan is any split-dollar loan that is not a demand loan. Finally, a hybrid loan is a split-dollar loan (1) payable at the death of an individual; (2) conditioned on the future performance of substantial services by an individual or (3) a gift term loan. Hybrid loans are treated as split-dollar term loans to determine whether the loan provides sufficient interest, but then the forgone interest, if any, is determined annually. This type of loan is similar to a demand loan in that it is calculated annually but uses the applicable federal rate (“AFR”) appropriate for the loan’s term when the loan was advanced

Demand Loans

Employer loans sufficient funds to Executive (or Executive’s ILIT) to pay the required premium

Employer can demand repayment of loaned funds at any time (Demand Loan)

Executive (or ILIT) must annually pay an adequate rate of interest to Employer—rate is declared each July (Annual Blended Rate)

If Executive (or ILIT) does not annually pay an adequate rate of interest, IRC 7872 will apply

If IRC 7872 applies, two deemed transfers occur:

“the forgone interest for the calendar year is treated as transferred from the Employer (lender) to the Executive (borrower) and then

retransferred as interest by the Executive (borrower) to the Employer (lender”

The transfers are deemed to have occurred on the last day of the calendar year and are classified as compensation, dividend or gift depending upon the parties’ relationship and as interest income to the lender.

If the life insurance policy is owned by the Executive’s ILIT, the deemed interest is also considered as transferred as a gift from the Executive to the ILIT

Provides a “golden handcuff” – if the Executive leaves employment, the Employer can demand repayment – the loan is secured by the policy

A proper demand loan arrangement must include a termination strategy (repaying Employer) other than death. Strategies can include utilizing grantor retaining annuity trusts (GRATs), installment sales to intentionally defective grantor trusts (IDIT), etc.

A Split-Dollar Demand Loan is a Welfare Benefit Plan for ERISA purposes and requirements.

Demand Loans are not appropriate for Public Company executives due to Sarbanes-Oxley implications