



# WRNewswire

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**TOPIC: Split Dollar Agreement Saves Life Policy from Liquidation in Bankruptcy**

**CITE:** [\*In Re: Racing Services, Inc.\*](#), 2014 WL 747553, No. 13–1086 (8th Cir. Feb. 27, 2014).

**SUMMARY:** In a bankruptcy proceeding concerning Racing Services, Inc., the bankruptcy trustee sought to have Racing Services' interest in a split dollar life insurance policy liquidated to satisfy creditors. The bankruptcy court ordered the surrender of the policy. On appeal, the Eighth Circuit determined that the split dollar agreement did *not* give Racing Services the right to surrender the split dollar agreement or the policy, so the bankruptcy court did not have the right to order surrender of the policy to satisfy Racing Services' creditors either.

**BACKGROUND:** Susan Bala was an employee and the founder of Racing Services, Inc., a simulcast racing and para-mutual gambling company in North Dakota. Pursuant to a collateral assignment split-dollar agreement, she owned a cash-value whole-life insurance policy that Racing Services purchased on her behalf.

The split dollar arrangement was structured with the company having limited ownership rights. That kind of structure is generally employed to prevent the controlling shareholder from having incidents of ownership in the life policy under the regulations to Internal Revenue Code Section 2042 – keeping the death benefit from being included in the insured's taxable estate.

The split dollar agreement in this case provided in its relevant parts:

1. Bala owned and assigned an interest in the policy to Racing Services to the extent of amounts advanced by Racing Services for the payment of premiums.

2. Only the following specific rights were passed to Racing Services:
  - a. The right to obtain, upon surrender of the policy by Bala, an amount of the cash surrender proceeds up to the amount of Racing Services' interest in the policy.
  - b. The right to collect the net proceeds of the policy when it becomes a claim by Bala's death or maturity up to the amount of Racing Services' interest.
3. If the agreement was terminated, Bala would buy out Racing Services' interest in the policy by making a payment equal to Racing Services' collateral interest.

In Racing Services' subsequent bankruptcy proceeding, the trustee claimed an interest in Bala's life policy pursuant to the split dollar agreement.

The bankruptcy court had determined that the third provision described above created a right exercisable by Racing Services to terminate the split dollar agreement and demand repayment of its security interest in the policy. As such, the court decided, Racing Services' right could be assumed by the bankruptcy trustee, and the policy could be surrendered to satisfy Racing Services' creditors.

Bala refused to consent to the surrender of the policy subject to the split dollar agreement. Further, Bala appealed the decision to the bankruptcy appeals panel, which affirmed the decision of the bankruptcy court. Bala then appealed to the Eighth Circuit Court of Appeals which led to this case.

**FACTS:** The appeals court considered the interpretation of the split dollar agreement to be the key to whether the policy could be surrendered to satisfy bankruptcy claims.

In discussing whether Racing Services had the independent right to terminate the split dollar agreement and demand repayment of its security interest by Bala, the court observed about Paragraph 2.a. above:

By specifically providing for rights only in the event of a surrender by Bala, and not for a surrender generally or for some other type of triggering event (such as termination by a court, the DOJ, the insurer, or the Trustee for the employer), the most natural reading . . . makes an act of surrender by Bala a necessary trigger for Racing Services to realize the right assigned . . . .

**RESULT:** The appeals court decided that the split dollar agreement was limited in scope, and that Racing Services had no right, independent of Bala's consent, to terminate the split dollar agreement or the policy. The bankruptcy trustee had no enforceable current claim against the split dollar policy. Thus, the decision of the bankruptcy court was reversed.

**RELEVANCE:** Life policies often work hand-in-hand with legal agreements to achieve a client's objectives. Buy-sell arrangements, deferred compensation agreements and split dollar plans are all examples where life insurance and legal work must be effectively coordinated.

The *Racing Services* decision in favor of the policy's insured hinged on the very precise and clear language of the split dollar agreement. In some ways, the result seems lucky because it doesn't seem reasonable to assume that the insured could have anticipated relying on the assignment language to get a favorable decision in bankruptcy court (or on appeal).

On the other hand, Bala and her company actually had a valid written split dollar assignment, which they apparently administered in a way that was consistent with their agreement. If they hadn't followed the legal niceties of a split dollar plan, it is quite possible that the ultimate decision would have gone the other way.

Which of our clients have life insurance plans that rely on companion legal documents to be effective? Are we working with the other members of our clients' advisory teams to make sure the needed documents are well-thought out, carefully drafted, correct and up-to-date? That time and effort can make all the difference.

***WRNewswire* #14.03.05 was written by Linas Sudzius of [Advanced Underwriting Consultants](#).**

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