

Executive Benefits: Why Split Dollar Still Matters

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Tyler Talbot, Regional Vice President



A DIVISION OF
Gallagher Benefit Services, Inc.

Highlights

- History
- Types of Split Dollar
- Tax Implications
- Regulatory Considerations
- Collateral Assignment Split Dollar
- Q&A



History - Then

- Mid-20th century
- Employer and employee “split” the “dollars” from cash value life insurance
- Originally death proceeds and employer retains right to cash value

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History - Now

- Plans are more creative
- Portion of cash value to employee
 - In force after termination
 - Supplemental compensation

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Types of Split Dollar Plans

Three types depending upon policy ownership

1. Employer-owned = Endorsement
2. Employee-owned = Collateral
3. Jointly-owned = Joint ownership arrangement

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Tax Implications

- IRS struggled to determine proper taxation
- 2003 – Treasury Reg § 1.61-22 Taxation of split dollar life insurance arrangements

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Who Owns the Policy?

1. Employer-owned = **Endorsement**
 - Economic benefit regime (EBR)
2. Employee-owned = **Collateral**
 - Collateral assignment regime (CBR)
3. Jointly-owned = **Joint ownership arrangement**
 - If first listed owner is employer, then EBR. If employee, then CAR.

The logo for BFB, consisting of the letters 'BFB' in white on a dark blue rectangular background.

Annual Taxation: Non-equity and EBR

- Value of death benefit is taxable to employee based on carrier or IRS tables
- Employee can
 - Pay taxable value to employer**OR**
 - Report value as taxable income

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Annual Taxation: Collateral Assignment

- Employer premium payment is deemed as loan to employee
 - Interest on “loans” must be
 - Paid by employee
- OR
- Imputed as income to the employee
- OR
- Paid from death proceeds

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Regulatory Considerations

Safety and Soundness

- Portion of assets in policy – concentration
- Financial strength of carrier
- Recovery of assets
- Financial penalties for withdrawals
- Expected rate of return

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Collateral Assignment Split Dollar



Plan Overview

Credit union pays premium on life insurance policy with two components:

1. Creates fund for Executive – tax-free retirement income
2. Death proceeds:
 - Repays premium + interest; key person coverage
 - Tax-free death benefit to beneficiary

Plan Details

- Executive owns policy; IRS treats premium as loan
- Non-recourse loan but recovery secured by collateral assignment of cash values and death proceeds
- Interest rate locked in at long-term AFR
- Plan conforms to Treasury Regs and NCUA Guidance



Shortfall Analysis

COMPENSATION		EXISTING BENEFIT PLANS				RETIREMENT GOAL			SHORTFALL		
Current Salary (\$)	Final Salary (\$)	Employer Social Security (\$)	Employer 401(k) (\$)	Total Existing Benefits (\$)	Total %	Years of Service	Goal %	Total Annual Benefit (\$)	Shortfall %	Split Dollar Annual Shortfall Amount (\$)	457(f) Alternative Lump Sum Distribution (\$)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
Sample Executive, Male Age 50; 11/1/1995 Hire Date, Current Age 50, Retirement Age 65, 20 Retirement Benefit Years											
100,000	197,993	24,924	36,024	60,948	30.78%	35	50.00%	98,997	19.22%	\$38,049	\$486,919
							60.00%	118,796	29.22%	\$57,848	\$740,295
							70.00%	138,595	39.22%	\$77,647	\$993,671



Compensation

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Sample Executive, Male Age 50



Existing Benefit Plans

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Retirement Goal

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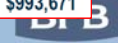
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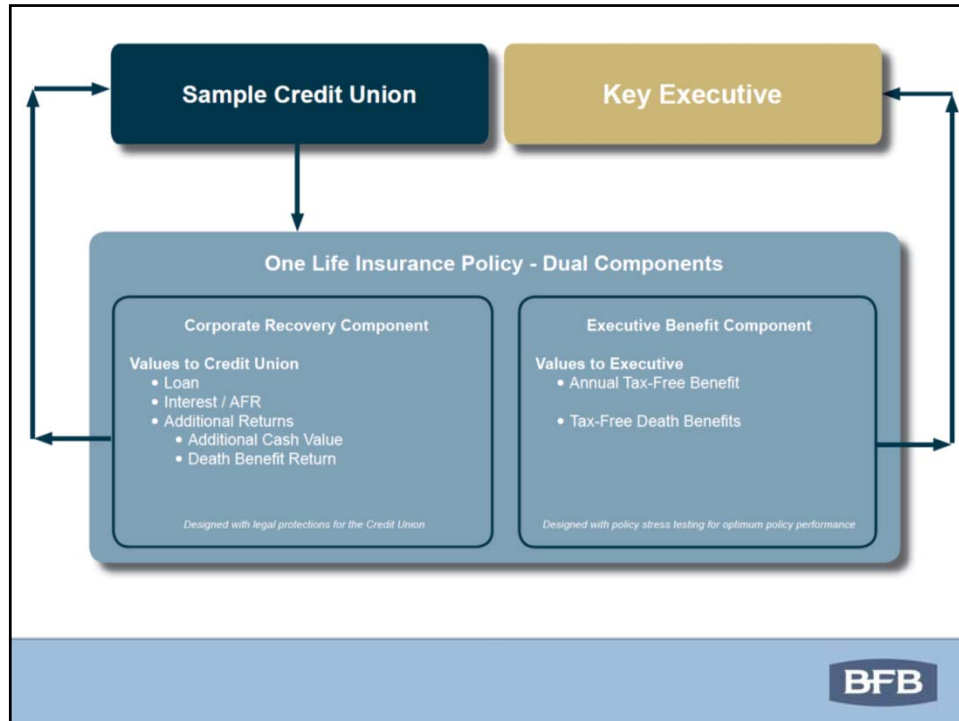


Shortfall

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Key Plan Decisions

- Vesting?
- Capped or uncapped?
- Recourse or non-recourse?
- Excess death benefit?

Vesting?

When will the executive be granted rights to the benefit under voluntary termination?

OPTIONS

1. Immediate
2. Level annual
3. Cliff vesting events
4. Custom schedule
5. 100% cliff vesting

Capped or Uncapped?

Does the executive participate in the upside if the policy outperforms target projections?

OPTIONS

1. Benefit limited to target payments
2. Benefit unlimited
3. Benefit can be increased above target up to a specified amount

Recourse or Non-recourse?

Are the executive's assets (other than the split dollar policy) subject to loan repayment claims?

OPTIONS

1. Non-recourse
2. Partial recourse
3. Full recourse
4. Temporary recourse agreement

Excess Death Benefit?

How will the death benefit above and beyond the loan repayment and executive benefit payments be divided?

OPTIONS

1. 100% of excess to executive
2. 100% of excess to credit union
3. Custom split

Is Split Dollar Still Relevant?



Yes!

- Balance sheet
- Mitigate excess tax risks and implications
- Efficiencies
 - Tax-free income
 - Asset vs liability
- Low interest rate environment

Thank you!



Tyler Talbot, Regional Vice President
801-232-9305
Tyler_Talbot@ajg.com

Save the Date - March 29, 2018
ICYMI: What's New in Executive Benefits



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