



Split Dollar Life Insurance Programs

for Nonprofit Organizations

Nonprofits, e.g. Hospitals, are besieged by Split Dollar proposals – Why?

Catalyst - Section 4960:

- 21% excise tax on “excessive compensation” introduced in the 2017 Tax Cuts and Jobs Act

Underlying Issue - Prevalence of Section 457(f) as a solution:

- “Substantial Risk of Forfeiture” requirement
- Incentive and deferred compensation benefits are fully taxable upon vesting regardless of the timing of the actual benefit payments

Example 457(f) Plan

			PROJECTED 457(f) SERP				EXCISE TAX		
			(2)	(3)	(4)	(5)	(6)	(7)	(8)
Year	Cal Yr	Age	SERP Contrib	SERP Interest Credit @ 6.0%	Acct Balance	Vested Acct Balance	21% Excise Tax on Cash Comp	21% Excise Tax on 457(f) Distrib	Cum Excise Tax
1	2020	55	150,000	9,000	159,000	0	0	0	0
2	2021	56	150,000	18,540	327,540	0	0	0	0
3	2022	57	150,000	28,652	506,192	0	0	0	0
4	2023	58	150,000	39,372	695,564	0	0	0	0
5	2024	59	150,000	50,734	896,298	0	0	0	0
6	2025	60	150,000	62,778	1,109,076	0	0	0	0
7	2026	61	150,000	75,545	1,334,620	0	3,138	0	3,138
8	2027	62	150,000	89,077	1,573,697	0	9,532	0	12,671
9	2028	63	150,000	103,422	1,827,119	0	16,118	0	28,789
10	2029	64	150,000	118,627	2,095,746	2,095,746	22,902	440,107	491,798

At Risk

Excise Tax



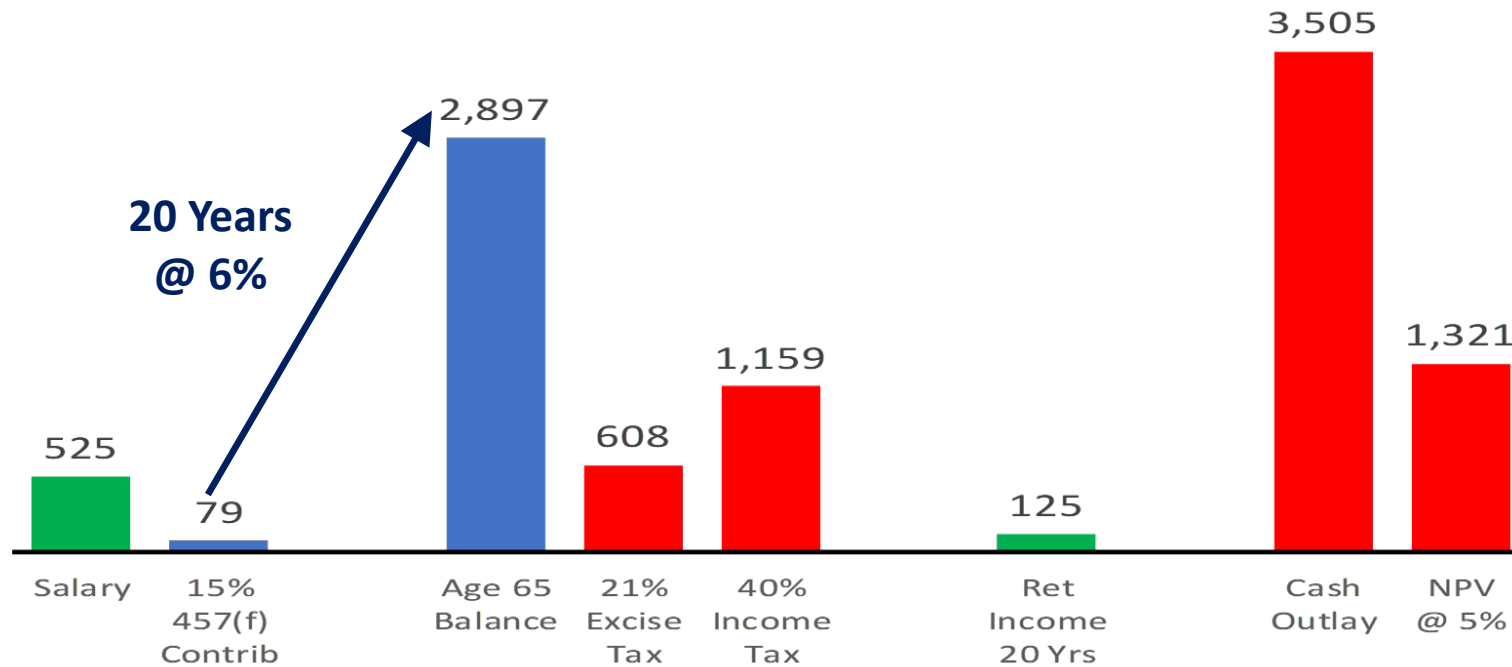
Hypothetical Case Study

Large Hospital

Trigger: Compensation Consultant's Report

- Report Findings:
 - Salaries are 3% above median, but below 75th percentile
 - Total cash compensation levels 8% below median
 - Benefit expenditures positioned below the 10th percentile
- Recommendations
 - Implement a defined contribution SERP
 - 15% of salary for the CEO
 - 10% of salary for the EVPs
- Initial design was a 457(f) SERP

15% Contribution to CEO's 457(f) SERP



Issues with Proposed SERP

- 457(f) plans are rarely satisfactory to either the participant or the organization:
 - The perceived value to **Participant** is reduced from the nominal value because of the ***Risk of Forfeiture***
 - From **Organization's** standpoint, the 457(f) is neither a performance-based incentive, nor a retention plan for the most senior execs that the organization wants to retain (successful execs will negotiate a replacement with next employer)
- Excise Tax
- Double reporting of comp for Form 990 (once as accrued; again when paid)
- Creditor risk

Split Dollar Alternative

- Concept
 - Life insurance contract owned by the Participant
 - Employer pays the annual premium, which is treated as a loan:
 - Typically non-recourse (but could be recourse)
 - Repaid out of cash value at termination, or from death benefit
 - Employer retains a security interest until repayment
- Taxation to the Participant
 - No tax impact if interest on loans accrued
 - Annual imputed interest at the “Applicable Federal Rate,” if not accrued (1.98% in Apr 2021)

Split Dollar Alternative

			457(f)	Loans to Executive		Insurance Policy Illustrated at 6.00%					
			(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Year	Cal Yr	BOY Age	BOY After Tax Withdrawals	BOY Loans to Executive	EOY Cum Loans with Interest @ 3.00%	BOY Annual Premium	BOY Non-Taxable Withdrawal	EOY Cash Accum Value	EOY Cash Surrender Value	EOY Death Benefit	Do Death Benefits Exceed Loan Balance
1	2018	46	0	78,750	81,113	78,750	0	63,005	78,750	1,747,730	Yes
2	2019	47	0	78,750	164,658	78,750	0	132,545	157,500	1,817,270	Yes
3	2020	48	0	78,750	250,711	78,750	0	206,523	236,250	1,891,247	Yes
4	2021	49	0	78,750	339,344	78,750	0	287,552	287,552	1,972,277	Yes
5	2022	50	0	78,750	430,637	78,750	0	373,687	373,687	2,058,412	Yes
16	2033	61	0	78,750	1,634,975	78,750	0	1,883,916	1,883,916	3,568,641	Yes
17	2034	62	0	78,750	1,765,137	78,750	0	2,083,277	2,083,277	3,768,002	Yes
18	2035	63	0	78,750	1,899,203	78,750	0	2,295,231	2,295,231	3,979,955	Yes
19	2036	64	0	78,750	2,037,292	78,750	0	2,520,611	2,520,611	4,205,336	Yes
20	2037	65	0	78,750	2,179,523	78,750	0	2,760,302	2,760,302	4,445,027	Yes
21	2038	66	124,922	0	2,244,909	0	167,420	2,765,402	2,765,402	3,662,642	Yes
22	2039	67	124,922	0	2,312,256	0	167,420	2,771,789	2,771,789	3,673,379	Yes
23	2040	68	124,922	0	2,381,624	0	167,420	2,779,617	2,779,617	3,684,358	Yes
24	2041	69	124,922	0	2,453,073	0	167,420	2,789,090	2,789,090	3,695,607	Yes
25	2042	70	124,922	0	2,526,665	0	167,420	2,800,295	2,800,295	3,707,013	Yes
36	2053	81	124,922	0	3,497,495	0	167,420	3,097,050	3,097,050	3,877,074	Yes
37	2054	82	124,922	0	3,602,420	0	167,420	3,138,952	3,138,952	3,937,319	Yes
38	2055	83	124,922	0	3,710,492	0	167,420	3,182,439	3,182,439	4,000,296	Yes
39	2056	84	124,922	0	3,821,807	0	167,420	3,226,880	3,226,880	4,065,419	Yes
40	2057	85	124,922	0	3,936,461	0	167,420	3,272,555	3,272,555	4,133,041	Yes
41	2058	86	0	(3,936,461)							
			2,498,446					3,348,403			
				(0)	<=NPV Cost @ 3.00%						
				471,312	<=NPV Cost @ 5.00%						

Comparison: 457(f) to Loan Regime Split Dollar

Plan Design	Funding	Benefit to Executive	Cost to Organization			
	(1)	(2)	(3)	(4)	(5)	(6)
457(f) SERP - Vest End of Yr 20	Annual Contrib	Annual After Tax Retirement Income to Executive (20 Years)	NPV @ 3.00%	Cost Reduction Versus SERP w/o Vesting	NPV @ 5.00%	Cost Reduction Versus SERP w/o Vesting
Loan Split Dollar - CompPlus	78,750	124,900	1,941,000		1,321,000	
	78,750	167,400	0	100%	471,000	64%



Issues Encountered

Are Loans to Executives Permissible?

- Some states have prohibitions against loans to key executives
 - Need to check the state regs / statutes for each particular state
 - About half the states have provisions that prohibit loans
- Special Note:
 - There are multiple examples of AG's who have opined in writing why they believe the statute in their state does not apply to Split Dollar Loans
 - Do your homework (and use competent counsel)

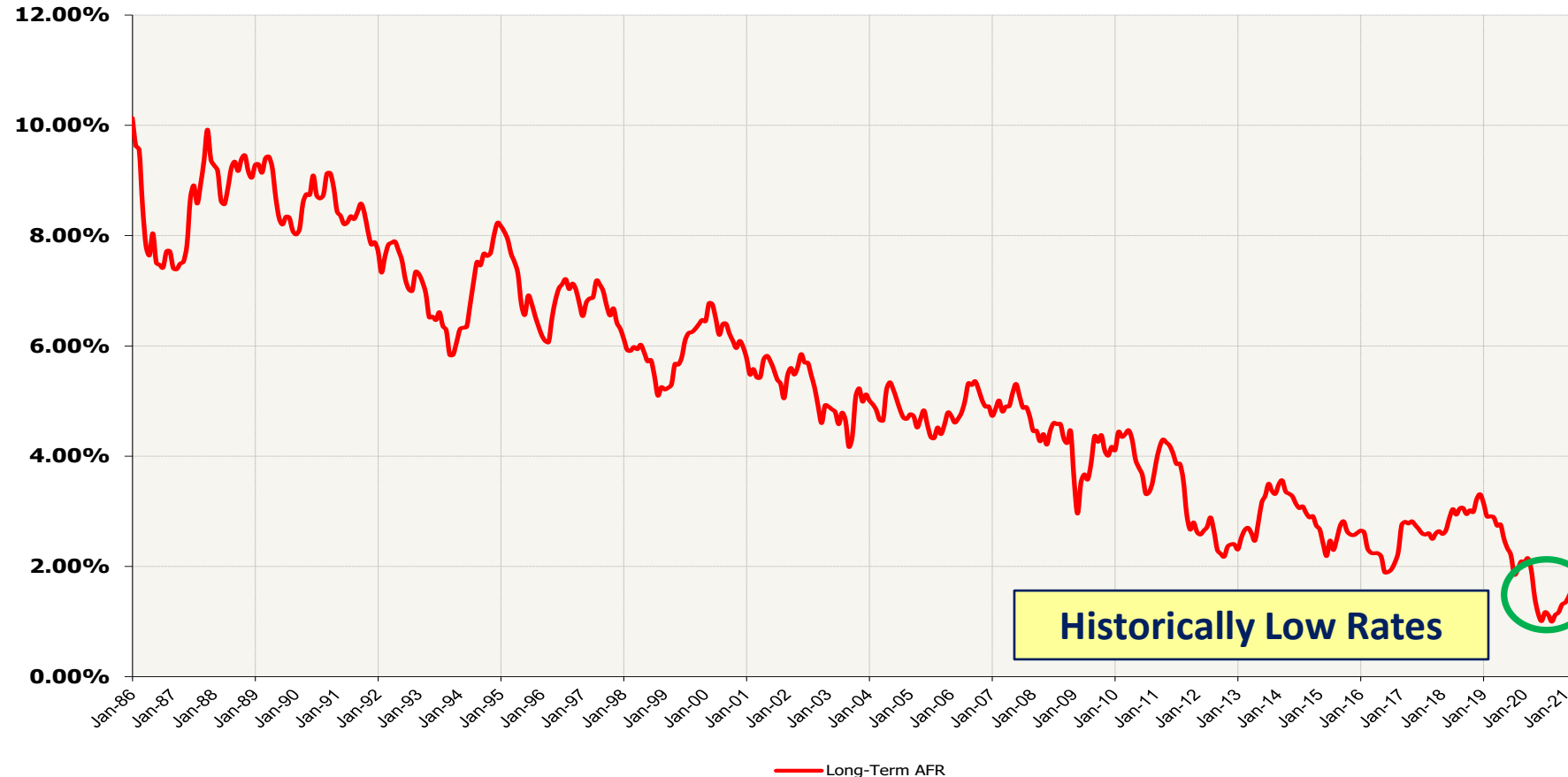
What if Loan Rates Increase?

- Loan to the Executive – Long-Term AFR:
 - Current rates are low (see historical graph next slide)
 - Future increases could stress recovery, reducing what's available for income
- Strategies to Consider:
 - Shorten the funding period
 - Fund all premiums using Single Payment to PDA
 - Issue: Locking in low rate is good for executive and the structure, but likely increases NPV cost to organization

History of Long-Term AFR

Long Term AFR Rates

Monthly Interest Rates
(January 1986 to April 2021)



How Realistic Are the Income Projections?

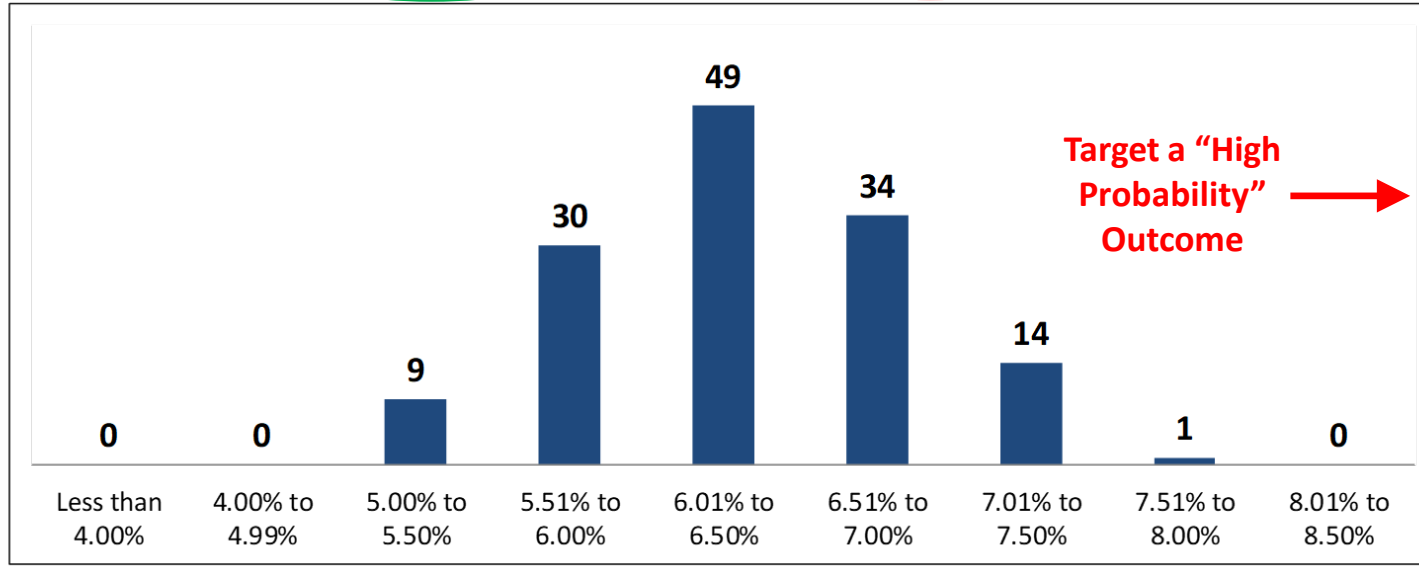
- This is really a question about the Illustration Rates:
 - Base the design on as “highly probable” outcome as possible
 - We use modeler that creates distribution of expected returns given Floor, Cap, Participation Rate, etc.
 - Set rate based on 80-90% probability (see graphic on following slide)
- Issue
 - If your objective is to use the same outlay as a 457(f), lowering the illustration rate might make it impossible to deliver same income in the Split Dollar solution, particularly at older ages
 - If so, focus on the NPV cost to the organization – Split Dollar will have lower cost because of premium recovery

Historical Returns - 20 Year Periods from 1988 to 2019:

Floor (minimum): 0.00%
 Cap (maximum): 10.00%
 Participation Rate: 100%

Start Date: 06/01/88
 End Date: 11/05/19
 # of Periods: 137

137 20-year periods beginning the 15th of each month starting June 15, 1988



Target a "High Probability" Outcome

X% of the Time Rate Exceeded	Rate
100%	5.23%
90%	5.67%
80%	5.88%
70%	6.03%
60%	6.16%
50%	6.30%
40%	6.45%
30%	6.57%
20%	6.77%
10%	7.02%
0%	7.56%

Other Potential Issues to Address:

- **Concern:** Accrued Loan becomes quite large over time
- **Solution:** Switch from accruing interest to imputing interest

- **Concern:** Proper administration of the plan and the policies
- **Solution:** Need a firm experienced and committed to administration

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Executive Benefit Solutions (EBS)

- A firm of independent consultants focused on a single core business:
- Working with clients to improve the design and cost-effectiveness of executive benefit programs
- Our approach is highly analytical and collaborative, based on detailed fact finding and listening



Disclosures

A variety of life insurance products can be used for this split dollar concept, including variable life insurance which is offered by prospectus. Securities offered through Lion Street Financial, LLC. (LSF), member FINRA & SIPC. LSF is not affiliated with EBS and neither LSF nor EBS provide legal or tax advice. Complex tax rules apply for split dollar arrangements. For complete details, consult with your tax advisor and attorney.



Thank You.

-  Executive Benefit Solutions (EBS)
-  617.904.9444
-  info@executivebenefitsolutions.com
-  www.executivebenefitsolutions.com