ADVANCED PLANNING

Business Strategies

Key Person & Split-Dollar Arrangement

COMBINE KEY PERSON COVERAGE WITH SPLIT DOLLAR TO PROVIDE PROTECTION FOR BOTH YOUR BUSINESS AND KEY EMPLOYEES.

When your business relies heavily on one or more key executives, having a strategy to retain them can be critical to your business' ongoing success. Sometimes, the appropriate strategy involves combining two financial strategies: one that entices key employees to stay and one that protects your business. Perhaps your business can benefit from combining key person coverage with a split-dollar agreement.

THIS STRATEGY MAY BE RIGHT FOR YOU IF YOU IDENTIFY WITH THESE STATEMENTS.

You are a business owner whose business:

- Relies on one or more key executives to generate the bulk of the business' revenue or to recruit and maintain your customer base
- Has outstanding business loans that are personally guaranteed by one or more of the business owners, placing the business at financial risk
- Has management that rests in the hands of a few key executives, and the death of one or more of these key executives would have a devastating effect on the business
- Has a key executive with a need for personal life insurance coverage
- Is able and willing to assist in the acquisition of the insurance coverage but desires to recover some or all its costs

COMBINING TWO FINANCIAL STRATEGIES: THE PURCHASE OF KEY PERSON COVERAGE AND SPLIT-DOLLAR ARRANGEMENT.

Together, these strategies offer a way to protect your business that encourages critical personnel to stay with your company.

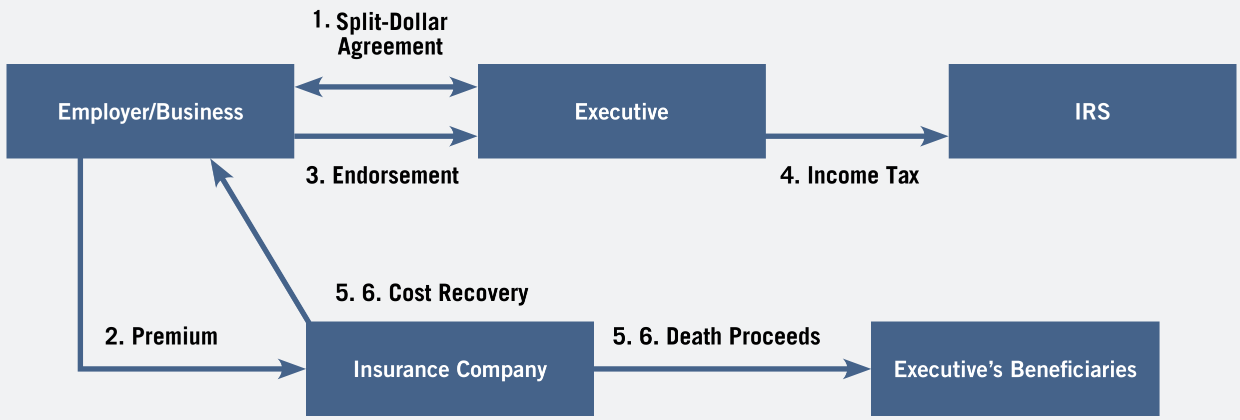
BENEFITS TO THE EMPLOYER/BUSINESS

- The death benefit helps to protect the employer against the financial loss it may suffer from the death of a key executive.
- Executive retention can be improved by using an attractive benefit backed by a binding agreement.
- The employer can selectively offer split dollar to key executives, which can increase loyalty.
- Employer costs and participant benefits may be varied, allowing for individually designed incentive programs that meet the needs of both the employer and the executive.
- A flexible benefit program is provided that, if properly structured, is not encumbered by the Employee Retirement Income Security Act of 1974 (ERISA) or nondiscrimination requirements.
- As the owner of the life insurance contract, the employer controls the cash values subject to the terms of the split-dollar agreement.
- The employer has "golden handcuffs" because the executive must sacrifice valuable benefits if they leave the employer.
- As the owner of the life insurance contract, the employer has the flexibility at the retirement or termination of the executive to:
  - Surrender the policy and receive the cash value
  - Retain the policy until the executive's death
  - Bonus or sell the policy to the executive
- The employer gains cost efficiency because one policy is used to cover two benefit needs. In addition, the arrangement can be structured to enable the potential recovery of employer outlay, resulting in lower overall long-term costs.

BENEFITS TO THE EXECUTIVE

- The executive is able to obtain the benefits of life insurance protection with little or no out-of-pocket cost during their working years.
- While the split-dollar agreement is in effect, the executive's beneficiaries receive the protection provided by the life insurance death benefit proceeds.
- If the executive requires death benefit coverage following retirement, they can purchase the policy from the employer, or the employer can bonus the policy to reward the executive for their loyalty and service to the business. The bonus would be considered additional compensation to the executive.

HOW IT WORKS
KEY PERSON & SPLIT-DOLLAR COMBINATION ARRANGEMENT



1	The employer and executive enter into a non-equity endorsement split-dollar agreement detailing the structure as well as the benefits and responsibilities of each party.
2	The employer purchases a life insurance policy insuring the key executive's life. The employer is the owner of the policy. Policy premiums are paid in accordance with the written split-dollar agreement. The notice and consent requirements under IRC §101(j) should be executed before the policies are issued in order to receive tax-favored treatment.[1]
3	The face amount of the policy is split through a policy beneficiary endorsement, with the employer receiving the amount needed for key person coverage and any excess death benefit passing to the executive's named beneficiaries.
4	The executive is taxed each year on the value of any economic benefit received less the amount the executive contributed.[2]
5	**Preretirement:** If the executive should die during employment, the employer recovers its share of the key person coverage from the death proceeds and the executive's beneficiaries receive the balance of the proceeds as provided in the split-dollar agreement.
6	**Postretirement:** At the key executive's retirement, the split-dollar agreement is generally terminated and the employer regains control of the policy cash value and death benefits. The employer may choose to either keep the policy intact and recover plan costs at the death of the executive or access cash value to reimburse the business.[3] Alternatively, the employer may bonus or sell the policy to the executive.

[1] For employer-owned life insurance policies issued after Aug. 17, 2006, IRC §101(j) provides that death proceeds will be subject to income tax; however, where specific employee notice and consent requirements are met and certain safe harbor exceptions apply, death proceeds can be received income tax-free under IRC §101(a).

[2] The current life insurance protection is calculated using either the rules in Notice 2002-8 or the rules in other IRS guidance, as applicable. This statement is true if the split-dollar arrangement is structured as a non-equity endorsement plan. If the split-dollar arrangement is structured as an equity endorsement plan, then as part of the economic benefit, the executive is also taxed on the policy cash value to the extent they are deemed to have current access and the value of any other economic benefits.

[3] Life insurance policy cash values are accessed through withdrawals and/or policy loans. Loans are at interest. Withdrawals and loans reduce cash values and death benefits, may affect any guarantee against lapse, and may have tax consequences.

TAX CONSIDERATIONS

- Premiums paid by the employer are not tax deductible.
- No IRS approval is required.
- Life insurance death proceeds are generally received income tax-free under IRC §101(a), but for so-called employer-owned contracts issued after Aug. 17, 2006, death proceeds are subject to income tax. However, death proceeds can be received income tax-free where certain exceptions apply and specific employee notice and consent requirements are met prior to policy issue.
- The tax treatment of an endorsement split-dollar arrangement between an employer and executive depends on the date the split-dollar arrangement is entered into and the structure of the agreement (equity or non-equity, contributory or noncontributory). Note: Split-dollar arrangements structured as collateral assignments have a tax treatment that is generally different from the endorsement form and are not the subject of this material.

  (If an employee has any current access to policy cash values, the arrangement is considered to be equity split dollar. In a non-equity split-dollar arrangement, the employee does not have access to policy cash values.)
- Employee is taxed on economic benefit while the endorsement split-dollar arrangement is in effect. For each year the split-dollar arrangement is in effect, the executive must report income equal to the "economic benefit" received less any amount the executive has contributed. The value of the economic benefit depends on the date the split-dollar arrangement is entered into and whether the arrangement is an equity or non-equity as follows:
  - **For non-equity endorsement split-dollar arrangements entered into after 09/17/03:** The executive is required to report as income the value of the life insurance protection as generally published by the IRS less the amount they have contributed.
  - **For equity endorsement split-dollar arrangements entered into after 09/17/03 or ones existing prior to that date that are substantially modified:** The executive is required to include in income the value of the life insurance protection as well as the cash value (equity) above the employer's recovery amount to the extent they are deemed to have current access and the value of any other economic benefit.
  - **For endorsement split-dollar arrangements entered into prior to 09/18/03:** The executive is required to report as income the value of the life insurance protection using the rules in Notice 2002-8 less the amount they have contributed. Executives are not required to report additional income for equity arrangements solely because the cash value of the policy exceeds the employer's recovery amount (policy equity).
- For arrangements entered into on or before 09/17/03, the employer is not taxed on the amount contributed by the executive. However, the employer is taxed on amounts contributed by the executive for arrangements entered into after 09/17/03.
- Your advisors may want to review Regulations §§1.61-22, 1.7872-15.
- Some forms of split-dollar arrangements may also be subject to the deferred compensation requirements of the Internal Revenue Code §409A. In addition, the Sarbanes-Oxley Act makes it a crime for publicly traded companies to directly or indirectly enter into a loan with certain directors and officers. It is unclear whether the Act applies to split-dollar arrangements. You should consult your tax and/or legal advisors for the most recent developments.

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