ADVANCED PLANNING

Life Insurance for Business At-a-Glance

FORMS OF BUSINESS ENTITIES THAT CAN USE PLAN(S):
CP *C Corp – Publicly Traded* **CC** *C Corp – Closely Held* **L** *Limited Liability Company* **P** *Partnership* **S** *S Corporation* **SP** *Sole Proprietorship*

Executive Bonus	Restricted Executive Bonus	Group Carve-Out	Death Benefit Only	Def Comp/ Supp Exec Retire Plan	Split Dollar Endorsement	Split Dollar Collateral	Key Person	Cross Purchase Buy-Sell	Entity Purchase Buy-Sell

EXECUTIVE BONUS CP, L, S, P, CC, SP

GOALS & STRATEGIES	***Plan Description*** ▸ Employer provides life insurance for key employees and owners	***Objectives*** ▸ Provide funds for personal life insurance with generally income tax-free proceeds[1] and potential for tax-favored cash accumulation ▸ Retain key employees by providing a nonqualified perk ▸ Provide life insurance protection for employees using business dollars
ADVANTAGES	***Employer Advantages*** ▸ Premiums deductible as salary expense by business ▸ Recruiting/retention tool ▸ Employer can select participants ▸ Easy to install	***Employee Advantages*** ▸ Life insurance at lower out-of-pocket cost ▸ Tax-deferred cash value accumulation can be accessed to supplement income (note that not all policies have the potential to accumulate cash value)[2] ▸ Employee controls policy
DISADVANTAGES	▸ Bonus to pay premium may put employee in higher marginal income tax bracket	
INSURANCE	***Premium Payer*** ▸ Premiums are treated as compensation to employee ▸ Employer may gross up bonus to cover employee's additional income tax costs	***Owner/Beneficiary*** ▸ Employee owns the policy and names the beneficiary
TAXES	***Income Tax Consequence*** ▸ Premiums are deductible to business if total compensation is reasonable ▸ Premiums are taxable income to employees ▸ Death proceeds are generally income tax-free[1]	***Estate Tax Consequence*** ▸ Death proceeds included in gross estate if employee retains "incidents of ownership" ▸ If structured properly, may avoid estate inclusion

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RESTRICTED EXECUTIVE BONUS CP, L, S, P, CC, SP

GOALS & STRATEGIES	***Plan Description*** ‣ Employer provides life insurance for key employees and owners maintain a golden handcuff feature	***Objectives*** ‣ Provide funds for personal life insurance with generally income tax-free proceeds[1] and potential for tax-favored cash accumulation ‣ Retain key employees by providing a nonqualified perk in combination with a restricted agreement ‣ Provide life insurance protection for employees using business dollars
ADVANTAGES	***Employer Advantages*** ‣ Golden handcuffs to attract and retain key employees ‣ Easy to establish ‣ Employer can select participants ‣ Premiums deductible by the business	***Employee Advantages*** ‣ Life insurance at lower out-of-pocket cost ‣ Tax-deferred cash value accumulation can be accessed to supplement income (note that not all policies have the potential to accumulate cash value)[2] ‣ Employee names beneficiary
DISADVANTAGES	‣ Bonus to pay premium may put employee in higher marginal income tax bracket ‣ Benefit may be perceived by employee as imperfect, due to paying taxes now but having restricted use of the asset	
INSURANCE	***Premium Payer*** ‣ Premiums are treated as compensation to employee ‣ Employer may gross up bonus to cover employee's additional income tax costs	***Owner/Beneficiary*** ‣ Employee owns the policy and names the beneficiary
TAXES	***Income Tax Consequence*** ‣ Premiums are deductible to business if total compensation is reasonable ‣ Premiums are taxable income to employees ‣ Death proceeds are generally income tax-free[1]	***Estate Tax Consequence*** ‣ Death proceeds included in gross estate if employee retains "incidents of ownership" ‣ If structured properly, may avoid estate inclusion

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GROUP CARVE-OUT L, S, P, CC, SP

GOALS & STRATEGIES	***Plan Description*** ▸ Replacement of group term life insurance (over $50,000) with individual permanent policies for selected class of employees	***Objectives*** ▸ Provide permanent insurance protection (executive bonus and split dollar arrangements commonly used)
ADVANTAGES	***Employer Advantages*** ▸ See executive bonus or split dollar, as elected	***Employee Advantages*** ▸ See executive bonus or split dollar, as elected
DISADVANTAGES	▸ See executive bonus or split dollar, as elected	
INSURANCE	***Premium Payer*** ▸ See executive bonus or split dollar, as elected	***Owner/Beneficiary*** ▸ See executive bonus or split dollar, as elected
TAXES	***Income Tax Consequence*** ▸ See executive bonus or split dollar, as elected	***Estate Tax Consequence*** ▸ See executive bonus or split dollar, as elected

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Executive Bonus | Restricted Executive Bonus | Group Carve-Out | Death Benefit Only | Def Comp/ Supp Exec Retire Plan | Split Dollar Endorsement | Split Dollar Collateral | Key Person | Cross Purchase Buy-Sell | Entity Purchase Buy-Sell

DEATH BENEFIT ONLY CP, L, S, P, CC, SP *(NOT FOR OWNER EMPLOYEES)*

GOALS & STRATEGIES	***Plan Description*** ▸ Provides death benefits only to employee's designated beneficiaries	***Objectives*** ▸ Provide a continued source of income to surviving family members upon death of a participant ▸ Use business dollars to informally fund obligations
ADVANTAGES	***Employer Advantages*** ▸ Golden handcuffs to attract and retain key employees ▸ Employer can select participants ▸ Benefit payments are deductible to the business	***Employee Advantages*** ▸ Employee cost is limited to income tax paid on benefits received ▸ Salary continuation for participant's family ▸ In very limited situations, benefits may be structured to avoid federal estate taxes
DISADVANTAGES	▸ Employer tax deduction is delayed until benefits are actually paid out ▸ Payments taxable to employee when received ▸ Risk of forfeiture	
INSURANCE	***Premium Payer*** ▸ Business	***Owner/Beneficiary*** ▸ Business entity is the policyowner and beneficiary
TAXES	***Income Tax Consequence*** ▸ Premiums are not deductible ▸ Death proceeds are generally received by the business income tax-free[1] ▸ Death benefit payments deductible to business and taxable to employee when made	***Estate Tax Consequence*** ▸ Estate exclusion is possible but requires careful planning to ensure that the executive has no policy rights, and the executive cannot be entitled to postretirement benefits under any other contractual plan

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Executive Bonus	Restricted Executive Bonus	Group Carve-Out	Death Benefit Only	Def Comp/ Supp Exec Retire Plan	Split Dollar Endorsement	Split Dollar Collateral	Key Person	Cross Purchase Buy-Sell	Entity Purchase Buy-Sell

DEFERRED COMPENSATION/SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN CP, L, S, P, CC, SP
(NOT FOR OWNER EMPLOYEES)

GOALS & STRATEGIES	***Plan Description*** • Corporation can provide selected employees with retirement benefits or allow employees to defer otherwise taxable income until retirement	***Objectives*** • Provide benefits in excess of qualified plan limitations • Use business dollars to informally fund obligations
ADVANTAGES	***Employer Advantages*** • Golden handcuffs to attract and retain key employees • Employer can select participants • No IRS approval—Notice to DOL is required • Administration less expensive than qualified plans	***Employee Advantages*** • Supplemental retirement income (note that not all policies have the potential to accumulate cash value) • If properly structured, avoids taxation until benefit is received • Can provide death benefits if death occurs prior to retirement • May be no cost to employee
DISADVANTAGES	• Employer tax deduction is delayed until benefits are actually paid out • Payments taxable to employee when received • Risk of forfeiture	
INSURANCE	***Premium Payer*** • Business entity (premium payments may include money deferred by employee)	***Owner/Beneficiary*** • Business entity is the policyowner and beneficiary
TAXES	***Income Tax Consequence*** • Premiums are not deductible • Disability, retirement, and death benefit payments are deductible to business and taxable to employee when paid[3]	***Estate Tax Consequence*** • Present value of benefits payable to designated beneficiaries included in employee's gross estate • Unlimited marital deduction could apply

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Executive Bonus | Restricted Executive Bonus | Group Carve-Out | Death Benefit Only | Def Comp/ Supp Exec Retire Plan | Split Dollar Endorsement | Split Dollar Collateral | Key Person | Cross Purchase Buy-Sell | Entity Purchase Buy-Sell

SPLIT DOLLAR ENDORSEMENT (ECONOMIC BENEFIT REGIME)[4] L, S, P, CC

GOALS & STRATEGIES	***Plan Description*** ▸ Employer and employee purchase insurance on life of participant ▸ Premiums and death benefits are shared ▸ Generally, employer owns the contract and endorses the right to name the beneficiary for a portion of the proceeds to the employee	***Objectives*** ▸ Provide life insurance protection for owners or key employees using employer dollars
ADVANTAGES	***Employer Advantages*** ▸ Plan is selective ▸ Golden handcuffs to retain key employees ▸ No IRS approval is required ▸ Easy to install and inexpensive to administer ▸ Business recovers premium expense	***Employee Advantages*** ▸ Premiums paid by business with minimal cost to employee ▸ Death proceeds generally received income tax-free by beneficiaries[1] ▸ Policy may be given to insured as a taxable bonus upon retirement
DISADVANTAGES	▸ Employee is taxed annually on the imputed insurance value (reportable economic benefit) ▸ This imputed economic benefit increases with age, becoming prohibitively costly in later years	
INSURANCE	***Premium Payer*** ▸ Business should pay all premium expense. If employee contributes to premium cost, these dollars are treated as taxable income to the business	***Owner/Beneficiary*** ▸ Business is the policyowner ▸ Business is generally the beneficiary to the extent of total policy cash value ▸ Balance paid to employee's designated beneficiaries
TAXES	***Income Tax Consequence*** ▸ Employer-paid premiums are not deductible ▸ Employee taxed on "economic benefit" if business pays all premiums, unless offset by employee contributions ▸ Proceeds generally received income tax-free by business and employee beneficiaries[1]	***Estate Tax Consequence*** ▸ Proceeds included in employee's gross estate when "incidents of ownership" are retained

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Executive Bonus | Restricted Executive Bonus | Group Carve-Out | Death Benefit Only | Def Comp/ Supp Exec Retire Plan | Split Dollar Endorsement | Split Dollar Collateral | Key Person | Cross Purchase Buy-Sell | Entity Purchase Buy-Sell

SPLIT DOLLAR COLLATERAL ASSIGNMENT (LOAN REGIME)[4] L, S, P, CC

GOALS & STRATEGIES

Plan Description

- Employer and employee purchase insurance on life of participant
- Premiums and death benefit are shared
- Insured participant or a third party owns contract with limited assignment to employer

Objectives

- Provide life insurance protection for owners or key employees using employer dollars

ADVANTAGES

Employer Advantages

- Plan is selective
- Golden handcuffs to retain key employees
- No IRS approval is required
- Business recovers premium expense (loans) from participant upon rollout or death

Employee Advantages

- Death proceeds generally received income tax-free by beneficiaries[1]
- Premiums paid by business with minimal cost to employee when interest rates are low
- Tax-favored accumulation of policy cash values (note that not all policies have the potential to accumulate cash value)

DISADVANTAGES

- Employee has interest payment, or reportable taxable income, annually
- If loan rates are high, annual cost may be prohibitive

INSURANCE

Premium Payer

- Business can pay all or part of premiums, as per written agreement
- Participant may make payments equal to loan interest due to offset income tax consequences

Owner/Beneficiary

- Employee or ILIT is policyowner
- Business usually has claim against cash value and proceeds equal to the cumulative premium contributions made
- Balance paid to employee's designated beneficiaries

TAXES

Income Tax Consequence

- Employer-paid premiums are not deductible
- Employee taxed on interest rate charged for cumulative outstanding loan balance, unless offset by employee contributions
- Proceeds generally received income tax-free by business and employee's beneficiaries[1]

Estate Tax Consequence

- Proceeds included in employee's gross estate when "incidents of ownership" are retained
- Proceeds can be excluded from estate by additional planning involving third-party ownership

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KEY PERSON CP, L, S, P, CC, SP

GOALS & STRATEGIES	***Plan Description*** ▸ Protects the business against financial loss upon death of valuable employee	***Objectives*** ▸ Provide tax-free funds to indemnify the business[1] ▸ Provide business with cash to recruit, hire, and train replacement employee
ADVANTAGES	***Employer Advantages*** ▸ Proceeds generally received income tax-free[1] ▸ Offsets financial loss ▸ Protects credit and financial integrity of business	***Employee Advantages*** ▸ Policy can be used to fund salary continuation at retirement[2]
DISADVANTAGES	▸ Premiums paid by employer with after-tax dollars	
INSURANCE	***Premium Payer*** ▸ Business entity	***Owner/Beneficiary*** ▸ Business entity is the policyowner and beneficiary
TAXES	***Income Tax Consequence*** ▸ Premium payments are not deductible by business ▸ Premiums are not taxable to employee	***Estate Tax Consequence*** ▸ Death proceeds are included as part of fair market value of business ▸ If decedent was business owner, business interest would increase taxable estate

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CROSS PURCHASE BUY-SELL L, S, P, CC

GOALS & STRATEGIES	***Plan Description*** • Each business owner purchases insurance on the other business owner(s) to buy and sell their respective business interests at an agreed-upon price at disability or death	***Objectives*** • Convert non-liquid business interest to cash • Provide surviving business owner(s) with cash to purchase business interest from deceased owner's estate
ADVANTAGES	***Employer Advantages*** • Avoids forced liquidation of business • Assures business continuity • Keeps ownership among active surviving owners	***Employee Advantages*** • Provides market for non-liquid business interest • Provides surviving owners with a step-up in cost basis in purchased interest • Creditor protection from business creditors for cash values and proceeds • Can establish a fair market value for federal estate tax purposes
DISADVANTAGES	• Business with several owners requires multiple policies • After-tax personal income required for premium payments	
INSURANCE	***Premium Payer*** • Business owners	***Owner/Beneficiary*** • Each business owner is the purchaser and beneficiary of a policy on the life of the other owner(s)
TAXES	***Income Tax Consequence*** • Premium payments made with after-tax income • Proceeds received income tax-free by owners[1] • Gain, if any, upon sale of the business interest is taxable	***Estate Tax Consequence*** • Value of business interest included in gross estate • Value of policy(ies) on surviving partner(s) or shareholder(s) included in gross estate

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ENTITY PURCHASE BUY-SELL L, S, P, CC

GOALS & STRATEGIES	***Plan Description*** ▸ Business purchases insurance on the owners to buy back their respective business interests at an agreed-upon price at disability or death	***Objectives*** ▸ Provide the business with cash to buy back decedent's interest from deceased owner's estate
ADVANTAGES	***Employer Advantages*** ▸ Cash value and proceeds are assets of business ▸ Avoids forced liquidation of business ▸ Assures business continuity ▸ Only one policy per owner	***Employee Advantages*** ▸ Provides market for non-liquid business interest ▸ Business funds are used to pay premiums ▸ Can establish a fair market value for federal estate tax purposes
DISADVANTAGES	▸ No step-up in cost basis for surviving owner(s) ▸ Family attribution rules may create problems for C corporations	
INSURANCE	***Premium Payer*** ▸ Business entity	***Owner/Beneficiary*** ▸ Business entity is the policyowner and beneficiary
TAXES	***Income Tax Consequence*** ▸ Premiums are not deductible ▸ Gain, if any, upon sale of the business interest is taxable	***Estate Tax Consequence*** ▸ Value of business interest included in gross estate ▸ Life insurance proceeds do not "balloon" estate where there is a properly structured buy-sell agreement

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RETURN TO MAIN

[1] For employer-owned life insurance policies issued after August 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. Life insurance proceeds are otherwise generally received income tax-free under IRC §101(a). The authority for tax-favored accumulation is IRC §72.

[2] Outstanding loans and withdrawals will reduce policy cash values and the death benefit and may have tax consequences.

[3] Premiums paid by an employer for disability insurance to fund a salary continuation plan for the company's employees are tax-deductible to the business, and the employees are generally not required to report such premiums as income. However, only a corporation may deduct premiums for the owner-employer without taxation to the employee.

[4] The Sarbanes-Oxley Act makes it a crime for publicly traded companies to directly or indirectly enter into a loan with certain directors and executive officers. It is unclear whether the Act applies to split dollar arrangements. Clients should contact their tax or legal advisors for the most recent development.

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